

GREENE COUNTY BANCSHARES INC

Form 10-Q

May 09, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

# FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2006

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-14289

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**GREENE COUNTY BANCSHARES, INC.**

(Exact name of registrant as specified in its charter)

**Tennessee**

(State or other jurisdiction of incorporation or organization)

**62-1222567**

(I.R.S. Employer Identification No.)

**100 North Main Street, Greeneville, Tennessee**

(Address of principal executive offices)

**37743-4992**

(Zip Code)

Registrant's telephone number, including area code: **(423) 639-5111**

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of May 9, 2006, the number of shares outstanding of the issuer's common stock was: 9,787,645.



**PART 1 FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

The unaudited condensed consolidated financial statements of Greene County Bancshares, Inc. and its wholly owned subsidiaries are as follows:

Condensed Consolidated Balance Sheets - March 31, 2006 and December 31, 2005.

Condensed Consolidated Statements of Income and Comprehensive Income - For the three months ended March 31, 2006 and 2005.

Condensed Consolidated Statement of Change in Shareholders' Equity - For the three months ended March 31, 2006.

Condensed Consolidated Statements of Cash Flows - For the three months ended March 31, 2006 and 2005.

Notes to Condensed Consolidated Financial Statements.

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**GREENE COUNTY BANCSHARES, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**March 31, 2006 and December 31, 2005**  
(Amounts in thousands, except share and per share data)

|  | (Unaudited)<br>March 31,<br>2006 | December 31,<br>2005* |
|--|----------------------------------|-----------------------|
| <b>Assets</b>  |                                  |                       |
| Cash and due from banks  | \$ 39,189                        | \$ 46,136             |
| Federal funds sold   | 1,341                            | 28,387                |
| Securities available for sale  | 44,311                           | 48,868                |
| Securities held to maturity (with a market value of \$3,003 and \$3,335)                           | 3,049                            | 3,379                 |
| FHLB, Bankers Bank and other stock, at cost  | 6,795                            | 6,489                 |
| Loans held for sale  | 1,957                            | 2,686                 |
| Loans, net of unearned interest  | 1,404,627                        | 1,378,642             |
| Allowance for loan losses  | (20,083)                         | (19,739)              |
| Premises and equipment, net  | 52,109                           | 49,985                |
| Goodwill and other intangible assets   | 39,352                           | 39,622                |
| Other assets   | 35,593                           | 35,534                |
| Total assets   | \$ 1,608,240                     | \$ 1,619,989          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                  |                       |
| <b>Liabilities</b>   |                                  |                       |
| Deposits   | \$ 1,285,738                     | \$ 1,295,879          |
| Repurchase agreements  | 17,966                           | 17,498                |
| FHLB advances and notes payable  | 97,052                           | 105,146               |
| Subordinated debentures  | 13,403                           | 13,403                |
| Accrued interest payable and other liabilities   | 21,764                           | 20,042                |
| Total liabilities  | 1,435,923                        | 1,451,968             |
| <b>Shareholders' equity</b>  |                                  |                       |
| Common stock: \$2 par, 15,000,000 shares authorized,<br>9,781,070 and 9,766,336 shares outstanding | 19,562                           | 19,533                |
| Additional paid-in capital   | 71,052                           | 70,700                |
| Retained earnings  | 82,080                           | 78,158                |

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|  |              |              |   |
|--|--------------|--------------|---|
| Accumulated other comprehensive loss       | (377         | ) (370       | ) |
| Total shareholders' equity                 | 172,317      | 168,021      |   |
| Total liabilities and shareholders' equity | \$ 1,608,240 | \$ 1,619,989 |   |

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\* Condensed from audited consolidated financial statements.

See accompanying notes.

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**GREENE COUNTY BANCSHARES, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
**Three Months Ended March 31, 2006 and 2005**  
**(Amounts in thousands, except share and per share data)**

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2006</b>               | <b>2005</b> |
|   | <b>(Unaudited)</b>        |             |
| Interest income                                     |                           |             |
| Interest and fees on loans                          | \$ 26,100                 | \$ 18,079   |
| Investment securities                               | 631                       | 473         |
| Federal funds sold and other                        | 36                        | 183         |
|   | 26,767                    | 18,735      |
| Interest expense                                    |                           |             |
| Deposits  | 8,042                     | 4,262       |
| Borrowings  | 1,539                     | 1,146       |
|   | 9,581                     | 5,408       |
| Net interest income                                 | 17,186                    | 13,327      |
| Provision for loan losses                           | 1,064                     | 1,622       |
| Net interest income after provision for loan losses | 16,122                    | 11,705      |
| Noninterest income                                  |                           |             |
| Service charges and fees                            | 3,231                     | 2,142       |
| Other   | 1,524                     | 1,034       |
|   | 4,755                     | 3,176       |
| Noninterest expense                                 |                           |             |
| Salaries and employee benefits                      | 6,391                     | 5,245       |
| Occupancy and furniture and equipment expense       | 2,059                     | 1,739       |
| Other   | 4,256                     | 3,291       |
|   | 12,706                    | 10,275      |
| Income before income taxes                          | 8,171                     | 4,606       |
| Provision for income taxes                          | 3,075                     | 1,671       |
| Net income  | \$ 5,096                  | \$ 2,935    |
| Comprehensive income                                | \$ 5,089                  | \$ 2,822    |
| Per share of common stock:                          |                           |             |
| Basic earnings                                      | \$ 0.52                   | \$ 0.38     |
| Diluted earnings                                    | \$ 0.52                   | \$ 0.38     |
| Dividends   | \$ 0.12                   | \$ 0.12     |
| Weighted average shares outstanding:                |                           |             |
| Basic   | 9,770,555                 | 7,649,070   |
| Diluted   | 9,870,691                 | 7,744,181   |

See accompanying notes.

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**GREENE COUNTY BANCSHARES, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY**  
**For the Three Months Ended March 31, 2006**

(Amounts in thousands, except share and per share data)

|  | Common<br>Stock<br>(Unaudited) | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Compre-<br>hensive<br>Income (Loss) | Total<br>Share-<br>holders<br>Equity |
|--|--------------------------------|----------------------------------|----------------------|---|--------------------------------------|
| <b>Balance, January 1, 2006</b>                      | \$ 19,533                      | \$ 70,700                        | \$ 78,158            | \$ (370 )   | \$ 168,021                           |
| Issuance of 14,734 shares under stock<br>option plan | 29                             | 259                              |                      |   | 288                                  |
| Effect of stock option accounting                    |                                | 93                               |                      |   | 93                                   |
| Dividends paid (\$.12 per share)                     |                                |                                  | (1,174 )             |   | (1,174 )                             |
| Comprehensive income:                                |                                |                                  |                      |   |                                      |
| Net income   |                                |                                  | 5,096                |   | 5,096                                |
| Change in unrealized losses, net oftaxes             |                                |                                  |                      | (7 )  | (7 )                                 |
| Total comprehensive income                           |                                |                                  |                      |   | 5,089                                |
| <b>Balance, March 31, 2006</b>                       | \$ 19,562                      | \$ 71,052                        | \$ 82,080            | \$ (377 )   | \$ 172,317                           |

See accompanying notes.

**GREENE COUNTY BANCSHARES, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Three Months Ended March 31, 2006 and 2005**  
**(Amounts in thousands, except share and per share data)**

|   | March 31,<br>2006<br>(Unaudited) | March 31,<br>2005 |
|---|----------------------------------|-------------------|
| <b>Cash flows from operating activities</b>   |                                  |                   |
| Net income  | \$ 5,096                         | \$ 2,935          |
| Adjustments to reconcile net income to net cash (used) provided from operating activities |                                  |                   |
| Provision for loan losses   | 1,064                            | 1,622             |
| Depreciation and amortization   | 1,036                            | 875               |
| Security amortization and accretion, net  | (6 )                             | (6 )              |
| Loss on sale of securities  | 8                                |                   |
| FHLB stock dividends  | (81 )                            | (61 )             |
| Net gain on sale of mortgage loans  | (183 )                           | (89 )             |
| Originations of mortgage loans held for sale  | (11,241 )                        | (6,968 )          |
| Proceeds from sales of mortgage loans   | 12,152                           | 6,255             |
| Increase in cash surrender value of life insurance  | (209 )                           | (153 )            |
| Net losses from sales of fixed assets   | 4                                | 20                |
| Stock compensation expense  | 93                               |                   |
| Net gain on OREO and repossessed assets   | (184 )                           | (33 )             |
| Deferred tax benefit  | (390 )                           | (489 )            |
| Net changes:  |                                  |                   |
| Other assets  | (162 )                           | (1,645 )          |
| Accrued interest payable and other liabilities  | 1,722                            | (2,497 )          |
| Net cash (used) provided from operating activities  | 8,719                            | (234 )            |
| <b>Cash flows from investing activities</b>   |                                  |                   |
| Purchase of securities available for sale   | (1,000 )                         | (14,763 )         |
| Proceeds from sale of securities available for sale                                       | 985                              |                   |
| Proceeds from maturities of securities held for sale                                      | 4,559                            | 367               |
| Proceeds from maturities of securities held to maturity                                   | 330                              | 450               |
| Purchase of life insurance  | (41 )                            | (865 )            |
| Net change in loans   | (27,185 )                        | (69,987 )         |
| Proceeds from sale of other real estate   | 1,188                            | 522               |
| Improvements to other real estate   | (1 )                             |                   |
| Proceeds from sale of fixed assets and fixed asset additions, net                         |                                  | 8                 |
| Premises and equipment expenditures   | (2,895 )                         | (714 )            |
| Net cash used in investing activities   | (24,060 )                        | (84,982 )         |
| <b>Cash flows from financing activities</b>   |                                  |                   |
| Net change in deposits  | (10,140 )                        | 76,292            |
| Net change in repurchase agreements   | 468                              | 1,249             |
| Proceeds from notes payable   | 143,200                          | 115,000           |
| Repayments of notes payable   | (151,294 )                       | (105,035 )        |
| Dividends paid  | (1,174 )                         | (918 )            |
| Proceeds from issuance of common stock  | 288                              | 47                |
| Net cash (used) provided from financing activities  | (18,652 )                        | 86,635            |
| <b>Net change in cash and cash equivalents</b>  | (33,993 )                        | 1,419             |
| Cash and cash equivalents, beginning of year  | 74,523                           | 70,648            |

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|  |           |           |
|--|-----------|-----------|
| <b>Cash and cash equivalents, end of period</b>              | \$ 40,530 | \$ 72,067 |
| <b>Supplemental disclosures cash and noncash</b>             |           |           |
| Interest paid  | \$ 9,777  | \$ 5,386  |
| Income taxes paid  | 514       | 870       |
| Loans converted to other real estate                         | 1,386     | 1,702     |
| Unrealized loss on available for sale securities, net of tax | (7 )      | (113 )    |

See accompanying notes.

**GREENE COUNTY BANCSHARES, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2006**

**Unaudited**

**(Amounts in thousands, except share and per share data)**

**NOTE 1 PRINCIPLES OF CONSOLIDATION**

The accompanying unaudited condensed consolidated financial statements of Greene County Bancshares, Inc. (the Company) and its wholly owned subsidiary, Greene County Bank (the Bank), have been prepared in accordance with accounting principles generally accepted in the United States of America for interim information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission (SEC). Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Certain amounts from prior period financial statements have been reclassified to conform to the current year's presentation.

**NOTE 2 STOCK COMPENSATION**

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS No. 123R) which was issued by the Financial Accounting Standards Board in December 2004. SFAS No. 123R revises SFAS No. 123 Accounting for Stock Based Compensation (SFAS 123), and supersedes APB No. 25, Accounting for Stock Issued to Employees, (APB No. 25) and its related interpretations. SFAS No. 123R requires recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). SFAS No. 123R also requires measurement of the cost of employee services received in exchange for an award based on the grant-date fair value of the award. SFAS No. 123R also amends SFAS No. 95 Statement of Cash Flows, to require that excess tax benefits be reported as financing cash inflows, rather than as a reduction of taxes paid, which is included within operating cash flows.

The Company adopted SFAS No. 123R using the modified prospective application as permitted under SFAS No. 123R. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Prior to the adoption of SFAS No. 123R, the Company used the intrinsic value method as prescribed by APB No. 25 and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company's common stock on the date of grant.

The Company maintains a 2004 Long-Term Incentive Plan, whereby a maximum of 500,000 shares of common stock may be issued to directors and employees of the Company and the Bank. The Plan provides for the issuance of awards in the form of stock options, stock appreciation rights, restricted shares, restricted share units, deferred share units and performance awards. Stock options granted under the Plan are typically granted at exercise prices equal to the fair market value of the Company's common stock on the date of grant and typically have terms of ten years and vest at an annual rate of 20%. At March 31, 2006, 338,511 shares remained available for future grant. The compensation cost that has been charged against income for this plan was approximately \$93,000 for the three months ended March 31, 2006.

The fair market value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. The Company granted 90,261 and 71,228 of stock options for the quarters ended March 31, 2006 and 2005, respectively, with a fair value of \$8.90 and \$7.12, respectively, for each option.



**Note 2 Stock Compensation (Continued)**

The risk-free interest rate is based upon a U.S. Treasury instrument with a life that is similar to the expected life of the option grant. Expected volatility is based upon the historical volatility of the Company's common stock based upon prior years trading history. The expected term of the options is based upon the average life of previously issued stock options. The expected dividend yield is based upon current yield on date of grant. No post-vesting restrictions exist for these options. The following table illustrates the assumptions for the Black-Scholes model used in determining the fair value of options granted to employees in the quarters presented.

|                         | <b>Quarter<br/>Ended<br/>March 31,<br/>2006</b> |   | <b>Quarter<br/>Ended<br/>March 31,<br/>2005</b> |   |
|-------------------------|---|---|---|---|
| Risk-free interest rate | 4.57  | % | 4.20  | % |
| Volatility              | 28.16   | % | 23.30   | % |
| Expected life           | 8 years   |   | 8 years   |   |
| Dividend yield          | 2.3   | % | 2.3   | % |

A summary of option activity under the stock option plan as of March 31, 2006 and changes during the three month period ended March 31, 2006 is presented below:

|                                       | <b>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|---------------------------------------|----------------|--|--|--|
| Outstanding at beginning of year      | 396,910        | \$ 21.65   |  |  |
| Granted                               | 90,261         | 28.90  |  |  |
| Exercised                             | (14,734 )      | 19.55  |  |  |
| Forfeited                             | (2,352 )       | 24.54  |  |  |
| Outstanding at March 31, 2006         | 470,085        | \$ 23.09   | 6.6 years  | \$ 2,990                                 |
| Options exercisable at March 31, 2006 | 281,259        | \$ 21.02   | 5.0 years  | \$ 2,417                                 |

The total aggregate intrinsic value of options (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) exercised during the three months ended March 31, 2006 and 2005, was \$134 and \$38, respectively. The total fair value of shares vesting during the three months ended March 31, 2006 and 2005, was \$93 and \$148, respectively. As of March 31, 2006, there was \$1,414 of total unrecognized compensation cost related to non-vested share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 2.7 years.

During the three months ended March 31, 2006, the amount of cash received from the exercise of stock options was \$288.



**NOTE 2 STOCK COMPENSATION (Continued)**

The adoption of SFAS No. 123R and its fair value compensation cost recognition provisions are different from the nonrecognition provisions under SFAS No. 123 and the intrinsic value method for compensation cost allowed by APB 25. The effect (increase/(decrease)) of the adoption of SFAS No. 123R is as follows:

|                                  | <b>Three Months Ended<br/>March 31, 2006</b> |
|----------------------------------|--|
| Income before income tax expense | \$ (93 )                                     |
| Net income                       | \$ (93 )                                     |
| Basic earnings per common share  | \$ (0.01 )                                   |
| Diluted earnings per share       | \$ (0.00 )                                   |

The following illustrates the effect on net income available to common shareholders if the Company had applied the fair value recognition provisions of SFAS No. 123 to the prior years quarter ended March 31, 2005:

|  | <b>Three Months Ended<br/>March 31, 2005</b> |
|--|--|
| <b>Net income:</b>   |  |
| As reported  | \$ 2,935                                     |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects         | 5  |
| Deduct: Total stock-based compensation expense determined under fair value-based method for all awards, net of tax | (90 )  |
| Pro forma  | \$ 2,850                                     |
| <b>Earnings per common share:</b>  |  |
| As reported  | \$ 0.38                                      |
| Pro forma  | \$ 0.37                                      |
| <b>Diluted earnings per common share:</b>  |  |
| As reported  | \$ 0.38                                      |
| Pro forma  | \$ 0.37                                      |

**NOTE 3 LOANS**

Loans at March 31, 2006 and December 31, 2005 were as follows:

|                                 | <b>March 31,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|---------------------------------|---------------------------|------------------------------|
| Commercial                      | \$ 253,935                | \$ 245,285                   |
| Commercial real estate          | 766,361                   | 729,254                      |
| Residential real estate         | 305,951                   | 319,797                      |
| Consumer                        | 86,750                    | 90,682                       |
| Other                           | 1,915                     | 3,476                        |
| Unearned interest               | (10,285 )                 | (9,852 )                     |
| Loans, net of unearned interest | \$ 1,404,627              | \$ 1,378,642                 |
| Allowance for loan losses       | \$ (20,083 )              | \$ (19,739 )                 |

Transactions in the allowance for loan losses and certain information about nonaccrual loans and loans 90 days past due but still accruing interest for the three months ended March 31, 2006 and twelve months ended December 31, 2005 were as follows:

|                                 | <b>March 31,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|---------------------------------|---------------------------|------------------------------|
| Balance at beginning of year    | \$ 19,739                 | \$ 15,721                    |
| Add (deduct):                   |                           |                              |
| Reserve acquired in acquisition |                           | 1,467                        |
| Provision                       | 1,064                     | 6,365                        |
| Loans charged off               | (1,023 )                  | (5,583 )                     |
| Recoveries of loans charged off | 303                       | 1,769                        |
| Ending balance                  | \$ 20,083                 | \$ 19,739                    |

|   | <b>March 31,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|---|---------------------------|------------------------------|
| Loans past due 90 days still on accrual | \$ 74                     | \$ 809                       |
| Nonaccrual loans                        | 4,882                     | 5,915                        |
| Total                                   | \$ 4,956                  | \$ 6,724                     |

**NOTE 4 EARNINGS PER SHARE OF COMMON STOCK**

Basic earnings per share (EPS) of common stock is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed by dividing net income by the weighted average number of common shares and potential common shares outstanding during the period. Stock options are regarded as potential common shares. Potential common shares are computed using the treasury stock method. For the three months ended March 31, 2006, 150,446 options are excluded from the effect of dilutive securities because they are anti-dilutive; 60,185 options are similarly excluded from the effect of dilutive securities for the three months ended March 31, 2005.

The following is a reconciliation of the numerators and denominators used in the basic and diluted earnings per share computations for the three months ended March 31, 2006 and 2005:

|  | <b>Three Months Ended March 31,<br/>2006</b> |                                 | <b>2005</b>                   |                                 |
|--|--|---------------------------------|-------------------------------|---------------------------------|
|  | <b>Income<br/>(Numerator)</b>                | <b>Shares<br/>(Denominator)</b> | <b>Income<br/>(Numerator)</b> | <b>Shares<br/>(Denominator)</b> |
| <b>Basic EPS</b>   |  |                                 |                               |                                 |
| Income available to common shareholders                          | \$5,096                                      | 9,770,555                       | \$2,935                       | 7,649,070                       |
| <b>Effect of dilutive securities</b>                             |  |                                 |                               |                                 |
| Stock options outstanding  |  | 100,136                         |                               | 95,111                          |
| <b>Diluted EPS</b>   |  |                                 |                               |                                 |
| Income available to common shareholders plus assumed conversions | \$5,096                                      | 9,870,691                       | \$2,935                       | 7,744,181                       |

**NOTE 5 SEGMENT INFORMATION**

The Company's operating segments include banking, mortgage banking, consumer finance, subprime automobile lending and title insurance. The reportable segments are determined by the products and services offered, and internal reporting. Loans, investments and deposits provide the revenues in the banking operation; loans and fees provide the revenues in consumer finance, mortgage banking and subprime lending; and insurance commissions provide revenues for the title insurance company. Consumer finance, subprime automobile lending and title insurance do not meet the quantitative threshold on an individual basis, and are therefore shown below in Other Segments . Mortgage banking operations are included in Bank . All operations are domestic.

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Segment performance is evaluated using net interest income and noninterest income. Income taxes are allocated based on income before income taxes, and indirect expenses (includes management fees) are allocated based on time spent for each segment. Transactions among segments are made at fair value. Information reported internally for performance assessment follows.

| <b>Three months ended March 31, 2006</b> | <b>Bank</b>         | <b>Other Segments</b> | <b>Holding Company</b> | <b>Eliminations</b> | <b>Totals</b>       |
|--|---------------------|-----------------------|------------------------|---------------------|---------------------|
| Net interest income                      | \$ 16,016           | \$ 1,429              | \$ (259 )              | \$                  | \$ 17,186           |
| Provision for loan losses                | 842                 | 222                   |                        |                     | 1,064               |
| Noninterest income                       | 4,330               | 449                   | 197                    | (221 )              | 4,755               |
| Noninterest expense                      | 11,699              | 1,111                 | 117                    | (221 )              | 12,706              |
| Income tax expense                       | 2,992               | 214                   | (131 )                 |                     | 3,075               |
| <b>Segment profit</b>                    | <b>\$ 4,813</b>     | <b>\$ 331</b>         | <b>\$ (48 )</b>        | <b>\$</b>           | <b>\$ 5,096</b>     |
| <b>Segment assets at March 31, 2006</b>  | <b>\$ 1,573,020</b> | <b>\$ 30,525</b>      | <b>\$ 4,695</b>        | <b>\$</b>           | <b>\$ 1,608,240</b> |

| <b>Three months ended March 31, 2005</b> | <b>Bank</b>         | <b>Other Segments</b> | <b>Holding Company</b> | <b>Eliminations</b> | <b>Totals</b>       |
|--|---------------------|-----------------------|------------------------|---------------------|---------------------|
| Net interest income                      | \$ 11,989           | \$ 1,477              | \$ (139 )              | \$                  | \$ 13,327           |
| Provision for loan losses                | 1,289               | 333                   |                        |                     | 1,622               |
| Noninterest income                       | 2,780               | 402                   | 183                    | (189 )              | 3,176               |
| Noninterest expense                      | 9,238               | 1,098                 | 128                    | (189 )              | 10,275              |
| Income tax expense                       | 1,577               | 176                   | (82 )                  |                     | 1,671               |
| <b>Segment profit</b>                    | <b>\$ 2,665</b>     | <b>\$ 272</b>         | <b>\$ (2 )</b>         | <b>\$</b>           | <b>\$ 2,935</b>     |
| <b>Segment assets at March 31, 2005</b>  | <b>\$ 1,287,067</b> | <b>\$ 31,193</b>      | <b>\$ 2,103</b>        | <b>\$</b>           | <b>\$ 1,320,363</b> |

**NOTE 5 SEGMENT INFORMATION (Continued)****Asset Quality Ratios**

| <b>As of and for the period ended March 31, 2006</b>                        | <b>Bank</b> | <b>Other</b> | <b>Total</b> |   |
|---|-------------|--------------|--------------|---|
| Nonperforming loans as a percentage of total loans                          | 0.33        | % 1.11       | % 0.35       | % |
| Nonperforming assets as a percentage of total assets                        | 0.46        | % 1.68       | % 0.49       | % |
| Allowance for loan losses as a percentage of total loans                    | 1.26        | % 7.94       | % 1.43       | % |
| Allowance for loan losses as a percentage of nonperforming assets           | 239.12      | % 420.17     | % 252.55     | % |
| Annualized net charge-offs to average total loans, net of unearned interest | 0.15        | % 2.59       | % 0.21       | % |

| <b>As of and for the period ended March 31, 2005</b>                        | <b>Bank</b> | <b>Other</b> | <b>Total</b> |   |
|---|-------------|--------------|--------------|---|
| Nonperforming loans as a percentage of total loans                          | 0.52        | % 2.17       | % 0.58       | % |
| Nonperforming assets as a percentage of total assets                        | 0.61        | % 2.60       | % 0.67       | % |
| Allowance for loan losses as a percentage of total loans                    | 1.27        | % 7.76       | % 1.49       | % |
| Allowance for loan losses as a percentage of nonperforming assets           | 176.73      | % 282.32     | % 187.12     | % |
| Annualized net charge-offs to average total loans, net of unearned interest | 0.16        | % 4.35       | % 0.29       | % |

| <b>As of and for the year ended December 31, 2005</b>             | <b>Bank</b> | <b>Other</b> | <b>Total</b> |   |
|---|-------------|--------------|--------------|---|
| Nonperforming loans as a percentage of total loans                | 0.45        | % 1.68       | % 0.49       | % |
| Nonperforming assets as a percentage of total assets              | 0.59        | % 2.37       | % 0.65       | % |
| Allowance for loan losses as a percentage of total loans          | 1.26        | % 7.89       | % 1.43       | % |
| Allowance for loan losses as a percentage of nonperforming assets | 180.06      | % 282.74     | % 188.58     | % |
| Net charge-offs to average total loans, net of unearned interest  | 0.21        | % 4.22       | % 0.32       | % |

**NOTE 6 REVOLVING CREDIT AGREEMENT**

On August 30, 2005, the Company entered into a revolving credit agreement with SunTrust Bank pursuant to which SunTrust agreed to loan the Company up to \$35,000, with this amount being reduced to \$15,000 after November 30, 2005. SunTrust's obligation to make advances to the Company under the credit agreement terminates on August 29, 2006, unless the loan is extended or earlier terminated. The fee for maintaining this credit agreement is 0.15% per annum on the unused portion of the commitment.

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

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements, which are based on assumptions and estimates and describe our future plans, strategies and expectations, are generally identifiable by the use of the words anticipate, will, believe, may, could, would, should, estimate, expect, intend, seek, or similar expressions. These forward-looking statements may address, among other things, the Company's business plans, objectives or goals for future operations or expansion, the Company's forecasted revenues, earnings, assets or other measures of performance, or estimates of risks and future costs and benefits. Although these statements reflect the Company's good faith belief based on current expectations, estimates and projections, they are subject to risks, uncertainties and assumptions and are not guarantees of future performance. Important factors that could cause actual results to differ materially from the forward-looking statements we make in this Quarterly Report on Form 10-Q include, but are not limited to, the following:

- the Company's potential growth, including its entrance or expansion into new markets, and the need for sufficient capital to support that growth;
- the Company's ability to successfully integrate the operations of any branches or banks acquired by it and to retain the customers of any such acquired branch or bank;
- changes in the quality or composition of the Company's loan or investment portfolios, including adverse developments in borrower industries or in the repayment ability of individual borrowers or issuers;
- an insufficient allowance for loan losses as a result of inaccurate assumptions;
- changes in interest rates, yield curves and interest rate spread relationships;
- the strength of the economies in the Company's target market areas, as well as general economic, market or business conditions;
- changes in demand for loan products and financial services;
- increased competition or market concentration;
- concentration of credit exposure;
- new state or federal legislation, regulations, or the initiation or outcome of litigation; and
- other circumstances, many of which may be beyond the Company's control.

If one or more of these risks or uncertainties materialize, or if any of the Company's underlying assumptions prove incorrect, the Company's actual results, performance or achievements may vary materially from future results, performance or achievements expressed or implied by these forward-looking statements. All forward-looking statements included in this Quarterly Report on Form 10-Q are expressly qualified in their entirety by the cautionary statements in this section and to the more detailed risk factors included in the Company's Annual Report on Form 10-K. The Company does not intend to and assumes no responsibility for updating or revising any forward-looking statements contained in or incorporated by reference into this Quarterly Report on Form 10-Q, whether as a result of new information, future events or otherwise.





## Presentation of Amounts

All dollar amounts set forth below, other than per-share amounts, are in thousands unless otherwise noted.

## General

Greene County Bancshares, Inc. (the Company) is the bank holding company for Greene County Bank (the Bank), a Tennessee-chartered commercial bank that conducts the principal business of the Company. The Company is the third largest bank holding company headquartered in Tennessee. The Bank currently maintains a main office in Greeneville, Tennessee and 49 full-service bank branches primarily in East and Middle Tennessee. In addition to its commercial banking operations, the Bank conducts separate businesses through its three wholly-owned subsidiaries: Superior Financial Services, Inc. (Superior Financial), a consumer finance company; GCB Acceptance Corporation (GCB Acceptance), a subprime automobile lending company; and Fairway Title Co., a title company formed in 1998. The Bank also operates a mortgage banking operation which has its main office in Knox County, Tennessee, and a trust and money management function doing business as Presidents Trust from an office in Wilson County, Tennessee.

On November 21, 2003, the Company entered the Middle Tennessee market by completing its acquisition of Gallatin, Tennessee-based Independent Bankshares Corporation (IBC). IBC was the bank holding company for First Independent Bank, which had four offices in Gallatin and Hendersonville, Tennessee, in Sumner County, and Rutherford Bank and Trust, with three offices in Murfreesboro and Smyrna, Tennessee in Rutherford County. First Independent Bank and Rutherford Bank and Trust were subsequently merged with the Bank, with the Bank as the surviving entity.

On November 15, 2004 the Company established banking operations in Nashville, Tennessee, with the opening of its first full-service branch of Middle Tennessee Bank & Trust, which, like all of the Bank's bank brands, operates within the Bank's structure. This new branch in Davidson County, Tennessee expanded the Company's presence in the Middle Tennessee market and helped fill in the market between Sumner and Rutherford Counties. At March 31, 2006, the Bank had three Middle Tennessee Bank & Trust branches in the Nashville area.

The Company opened a new branch in Knoxville, Tennessee in late 2003 and expects to open its second branch in that city during 2006.

On December 10, 2004 the Company purchased three full-service branches from National Bank of Commerce located in Lawrence County Tennessee. This purchase (NBC transaction) added to the Bank's presence in Middle Tennessee.

On October 7, 2005, the Company purchased five bank branches in Montgomery County, Tennessee. This purchase (the Clarksville transaction) also adds to the Bank's presence in Middle Tennessee.

## Growth and Business Strategy

The Company expects that, over the intermediate term, its growth from mergers and acquisitions, including acquisitions of both entire financial institutions and selected branches of financial institutions, will continue. De novo branching is also expected to be a method of growth, particularly in high-growth and other demographically-desirable markets.

The Company's strategic plan outlines geographic expansion within a 300-mile radius of its headquarters in Greene County, Tennessee. This could result in the Company expanding westward and eastward up to and including Nashville, Tennessee and Roanoke, Virginia, respectively, east/southeast up to and including the Piedmont area of North Carolina and western North Carolina, southward to northern Georgia and northward into eastern and central Kentucky. In particular, the Company believes the markets in and around Knoxville, Nashville and Chattanooga, Tennessee are highly desirable areas with respect to expansion and growth plans.

While the Bank operates under a single bank charter, it conducts business under 18 bank brands with a distinct community-based brand in almost every market. The Bank offers local decision making through the presence of its regional executives in each of its markets, while at the same time maintaining a cost effective organizational structure in its back office and support areas.

The Bank focuses its lending efforts predominately on individuals and small to medium-sized businesses while it generates deposits primarily from individuals in its local communities. To aid in deposit generation efforts, the Bank offers its customers extended hours of operation during the week as well as Saturday banking. The Bank also offers free online banking and in the beginning of 2005 established its High Performance Checking Program which it believes will allow it to continue to generate a significant number of core transaction accounts with significant balances.

In addition to the Company's business model, which is summarized in the paragraphs above, the Company is continuously investigating and analyzing other lines and areas of business. These include, but are not limited to, various types of insurance and real estate activities. Conversely, the Company frequently evaluates and analyzes the profitability, risk factors and viability of its various business lines and segments and, depending upon the results of these evaluations and analyses, may conclude to exit certain segments and/or business lines. Further, in conjunction with these ongoing evaluations and analyses, the Company may decide to sell, merge or close certain branch facilities.

### **Overview**

The Company's results of operations for the first quarter ended March 31, 2006, compared to the same period in 2005, reflected an increase in net interest income due primarily to organic loan growth, higher interest rates as a result of actions from the Federal Open Market Committee ( FOMC ) and the Company's continued expansion initiatives, including the Clarksville transaction in the fourth quarter of 2005. This increase in net interest income was offset, in part, by increases in noninterest expense from Company's expansion initiatives.

The Company's provision for loan losses decreased in the quarter ended March 31, 2006 as compared to the same period in 2005. The decrease is primarily the result of improved credit quality.

At March 31, 2006, the Company had total consolidated assets of approximately \$1,608,240, total consolidated deposits of approximately \$1,285,738, total consolidated loans, net of unearned interest, of approximately \$1,404,627 and total consolidated shareholders' equity of approximately \$172,317. The Company's annualized return on average shareholders' equity for the three months ended March 31, 2006 was 11.86%, and its annualized return on average total assets was 1.27%. The Company expects that its total assets, total consolidated deposits, total consolidated loans, net of unearned interest and total shareholders' equity will continue to increase over the remainder of 2006 as a result of its expansion efforts, including its branch expansions in the Middle Tennessee, Knoxville, and Clarksville markets.

### **Critical Accounting Policies and Estimates**

The Company's consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods.

Management continually evaluates the Company's accounting policies and estimates it uses to prepare the consolidated financial statements. In general, management's estimates are based on historical experience, information from regulators and third party professionals and various assumptions that are believed to be reasonable under the then existing facts and circumstances. Actual results could differ from those estimates made by management.

The Company believes its critical accounting policies and estimates include the valuation of the allowance for loan losses and the fair value of financial instruments and other accounts. Based on management's calculation, an allowance of \$20,083, or 1.43%, of total loans, net of unearned interest, was an adequate estimate of losses inherent in the loan portfolio as of March 31, 2006. This estimate resulted in a provision for loan losses on the income statement of \$1,064 during the first quarter of 2006. If the economic conditions, loan mix and amount of future charge-off

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percentages differ significantly from those assumptions used by management in making its determination, the allowance for loan losses and provision for loan losses on the income statement could be materially affected.

The consolidated financial statements include certain accounting and disclosures that require management to make estimates about fair values. Estimates of fair value are used in the accounting for securities available for sale, loans held for sale, goodwill, other intangible assets, and acquisition purchase accounting adjustments. Estimates of fair values are used in disclosures regarding securities held to maturity, stock compensation, commitments, and the fair values of financial instruments. Fair values are estimated using relevant market information and other assumptions such as interest rates, credit risk, prepayments and other factors. The fair values of financial instruments are subject to change as influenced by market conditions.

### Changes in Results of Operations

**Net Income.** Net income for the three months ended March 31, 2006 was \$5,096, as compared to \$2,935 for the same period in 2005. This increase of \$2,161, or 73.63%, resulted primarily from a \$3,859, or 28.96%, increase in net interest income reflecting a higher level of interest-earning assets arising primarily from the Company's expansion initiatives and higher interest rates as a result of actions from the FOMC. Partially offsetting this increase was a \$2,431, or 23.66%, increase in total non-interest expense from \$10,275 for the three months ended March 31, 2005 to \$12,706 for the same period of 2006. This increase was also primarily attributable to the Company's expansion initiatives.

**Net Interest Income.** The largest source of earnings for the Company is net interest income, which is the difference between interest income on interest-earning assets and interest paid on deposits and other interest-bearing liabilities. The primary factors which affect net interest income are changes in volume and yields of interest-earning assets and interest-bearing liabilities, which are affected in part by management's responses to changes in interest rates through asset/liability management. During the three months ended March 31, 2006, net interest income was \$17,186, as compared to \$13,327 for the same period in 2005, representing an increase of 28.96%.

The Company's average balance for interest-earning assets increased 24.68% from \$1,164,719 for the first quarter ended March 31, 2005 to \$1,452,221 for the first quarter ended March 31, 2006. The Company experienced a 28.98% growth in average loan balances from \$1,079,588 for the first quarter ended March 31, 2005 to \$1,392,401 for the first quarter ended March 31, 2006. The growth in loans can be attributed to the Company's expansion initiatives, including the Clarksville transaction, that occurred in the fourth quarter of 2005.

The Company's average balance for interest bearing liabilities increased 24.05% from \$1,023,929 for the first quarter ended March 31, 2005 to \$1,270,175 for the first quarter ended March 31, 2006. The company experienced a 25.62% growth in average interest bearing deposits from \$912,957 for the first quarter ended March 31, 2005 to \$1,146,868 for the first quarter ended March 31, 2006. The company's expansion initiatives, including Clarksville transaction, are the primary reasons for the growth in deposits.

The Company's yield on loans (the largest component of interest-earning assets) increase by 81 basis points from the first quarter ended March 31, 2005 to the first quarter ended March 31, 2006. The increase was primarily a result of the increases by the FOMC in the discount rate as follows:

| FMOc Meeting<br>Date | Beginning<br>Rate | Ending<br>Increase | Rate   | % |
|----------------------|-------------------|--------------------|--------|---|
| May 3, 2005          | 2.75              | % 0.25             | % 3.00 | % |
| June 30, 2005        | 3.00              | % 0.25             | % 3.25 | % |
| August 9, 2005       | 3.25              | % 0.25             | % 3.50 | % |
| September 20, 2005   | 3.50              | % 0.25             | % 3.75 | % |
| November 1, 2005     | 3.75              | % 0.25             | % 4.00 | % |
| December 13, 2005    | 4.00              | % 0.25             | % 4.25 | % |
| January 31, 2006     | 4.25              | % 0.25             | % 4.50 | % |
| March 28, 2006       | 4.50              | % 0.25             | % 4.75 | % |

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The Company's cost of interest-bearing liabilities increased by 92 basis points from the first quarter ended March 31, 2005 to the first quarter ended March 31, 2006. The cost of raising deposits and other borrowed funds are

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influenced by both local market conditions as well as FOMC actions. Management believes that these costs were prudently managed during the volatile interest rate cycle and the company was able to generally keep rates in line.

The overall effect of these rate changes plus the economic benefit of increasing noninterest bearing funding sources by almost \$25,000 was to increase the net interest margin by 16 basis points from the first quarter ended March 31, 2005 to the first quarter ended March 31, 2006.

|   | Three Months Ended<br>March 31,<br>2006 |           |                 | 2005               |           |                 |
|---|---|-----------|-----------------|--------------------|-----------|-----------------|
|   | Average<br>Balance                      | Interest  | Average<br>Rate | Average<br>Balance | Interest  | Average<br>Rate |
| <b>Interest-earning assets:</b>                                       |   |           |                 |                    |           |                 |
| Loans(1)  | \$ 1,392,401                            | \$ 26,100 | 7.60 %          | \$ 1,079,588       | \$ 18,079 | 6.79 %          |
| Investment securities   | 56,446                                  | 631       | 4.53 %          | 51,004             | 473       | 3.76 %          |
| Other short-term investments  | 3,374                                   | 36        | 4.33 %          | 34,127             | 183       | 2.17 %          |
| Total interest-earning assets   | \$ 1,452,221                            | \$ 26,767 | 7.48 %          | \$ 1,164,719       | \$ 18,735 | 6.52 %          |
| Noninterest earning assets  | 147,140                                 |           |                 | 102,563            |           |                 |
| Total assets  | \$ 1,599,361                            |           |                 | \$ 1,267,282       |           |                 |
| <b>Interest-bearing liabilities:</b>                                  |   |           |                 |                    |           |                 |
| Deposits:   |   |           |                 |                    |           |                 |
| Now accounts, money market and savings                                |   |           |                 |                    |           |                 |
|   | \$ 520,821                              | \$ 2,576  | 2.01 %          | \$ 388,983         | \$ 866    | 0.90 %          |
| Time deposits   | 626,047                                 | 5,466     | 3.54 %          | 523,974            | 3,396     | 2.63 %          |
| Total interest-bearing deposits                                       | \$ 1,146,868                            | \$ 8,042  | 2.84 %          | \$ 912,957         | \$ 4,262  | 1.89 %          |
| Securities sold under repurchase agreements and short-term borrowings |   |           |                 |                    |           |                 |
|   | 21,678                                  | 207       | 3.87 %          | 18,429             | 89        | 1.96 %          |
| Notes payable   | 88,226                                  | 1,090     | 5.01 %          | 82,233             | 918       | 4.53 %          |
| Subordinated debentures   | 13,403                                  | 242       | 7.32 %          | 10,310             | 139       | 5.48 %          |
| Total interest-bearing liabilities                                    | \$ 1,270,175                            | \$ 9,581  | 3.06 %          | \$ 1,023,929       | \$ 5,408  | 2.14 %          |
| <b>Noninterest bearing liabilities:</b>                               |   |           |                 |                    |           |                 |
| Demand deposits   | 140,044                                 |           |                 | 116,854            |           |                 |
| Other liabilities   | 17,312                                  |           |                 | 15,544             |           |                 |
| Total noninterest bearing liabilities                                 | 157,356                                 |           |                 | 132,398            |           |                 |
| Total liabilities   | 1,427,531                               |           |                 | 1,156,327          |           |                 |
| Shareholders equity   | 171,830                                 |           |                 | 110,955            |           |                 |
| Total liabilities and shareholders equity                             | \$ 1,599,361                            |           |                 | \$ 1,267,282       |           |                 |
| Net interest income   |   | \$ 17,186 |                 |                    | \$ 13,327 |                 |
| Interest rate spread  |   |           | 4.42 %          |                    |           | 4.38 %          |
| Net yield on interest-earning assets                                  |   |           | 4.80 %          |                    |           | 4.64 %          |

1 Average loan balances included nonaccrual loans. Interest income collected on nonaccrual loans has been included.

**Provision for Loan Losses.** During the three months ended March 31, 2006, loan charge-offs were \$1,023 and recoveries of charged-off loans were \$303. The Company's provision for loan losses decreased by \$558, or 34.40%, to \$1,064 for the three months ended March 31, 2006, as compared to \$1,622 for the same period in 2005. The Company's allowance for loan losses increased by \$344 to \$20,083 at March 31, 2006 from \$19,739 at December 31, 2005, while the ratio of the allowance for loan losses to total loans, net of unearned interest, was 1.43% at both March 31, 2006 and December 31, 2005, a decrease from the 1.49% at March 31, 2005. As of March 31, 2006, most indicators of

credit quality, as discussed below, have improved compared to December 31, 2005 and March 31, 2005. The ratio of allowance for loan losses to nonperforming assets was 252.55%, 188.58% and 187.12% at March 31, 2006, December 31, 2005 and March 31, 2005, respectively, and the ratio of nonperforming assets to total assets was 0.49%, 0.65% and 0.67% at March 31, 2006, December 31, 2005 and March 31, 2005, respectively. The ratio of nonperforming loans to total loans, net of unearned interest, was 0.35%, 0.49% and 0.58% at March 31, 2006, December 31, 2005 and March 31, 2005, respectively. Within the Bank, the Company's largest

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subsidiary, the ratio of nonperforming assets to total assets was 0.46%, 0.59% and 0.61% at March 31, 2006, December 31, 2005 and March 31, 2005, respectively. At Superior Financial, the ratio of nonperforming assets to total assets was 1.67%, 2.39% and 3.18% at March 31, 2006, December 31, 2005 and March 31, 2005, respectively. At GCB Acceptance, the ratio of nonperforming assets to total assets was 2.38%, 3.48% and 2.23% at March 31, 2006, December 31, 2005 and March 31, 2005, respectively.

The Company's annualized net charge-offs for the three months ended March 31, 2006 were \$2,880 compared to actual net charge-offs of \$3,814 for the year ended December 31, 2005. Annualized net charge-offs as a percentage of average loans improved from 0.29% for the three months ended March 31, 2005 to 0.21% for the three months ended March 31, 2006. Net charge-offs as a percentage of average loans were 0.32% for the year ended December 31, 2005. Within the Bank, annualized net charge-offs as a percentage of average loans decreased slightly from 0.16% for the three months ended March 31, 2005 to 0.15% for the same period in 2006. Net charge-offs within the Bank as a percentage of average loans were 0.21% for the year ended December 31, 2005. Annualized net charge-offs in Superior Financial for the three months ended March 31, 2006 were \$172 compared to actual net charge-offs of \$441 for the year ended December 31, 2005. Annualized net charge-offs in the Bank for the three months ended March 31, 2006 were \$2,080 compared to actual net charge-offs of \$2,490 for the year ended December 31, 2005. Annualized net charge-offs in GCB Acceptance for the three months ended March 31, 2006 were \$628 compared to actual net charge-offs of \$883 for the year ended December 31, 2005. At this point, management believes that total net charge-offs for 2006 within the Bank and its subsidiaries will decline slightly compared to 2005 based on an improving economy and asset quality trends.

Based on the Company's allowance for loan loss calculation and review of the loan portfolio, management believes the allowance for loan losses is adequate at March 31, 2006.

**Noninterest Income.** Income that is not related to interest-earning assets, consisting primarily of service charges, commissions and fees, has become an important supplement to the Company's traditional method of earning income through interest rate spreads.

Total noninterest income for the three months ended March 31, 2006 was \$4,755 as compared to \$3,176 for the same period in 2005. Service charges, commissions and fees remain the largest component of total noninterest income and increased \$1,089, or 50.84%, to \$3,231 for the three months ended March 31, 2006 from \$2,142 for the same period in 2005. The increase reflects an increase in fees from deposit-related products resulting primarily from the Company's success in generating new accounts from its High Performance Checking promotion and the Company's overall growth initiatives. In addition, other noninterest income increased by \$490, or 47.39%, to \$1,524 for the three months ended March 31, 2006 from \$1,034 for the same period in 2005. The increase is primarily attributable to increased fees from the sale of mutual funds and annuities, income from our check provider and a gain on the sale of foreclosed equipment.

**Noninterest Expense.** Control of noninterest expense also is an important aspect in enhancing income. Noninterest expense includes personnel, occupancy, and other expenses such as data processing, printing and supplies, legal and professional fees, postage, Federal Deposit Insurance Corporation assessment, etc. Total noninterest expense was \$12,706 for the three months ended March 31, 2006 compared to \$10,275 for the same period in 2005. The \$2,431, or 23.66%, increase in total noninterest expense for the three months ended March 31, 2006 compared to the same period of 2005 principally reflects increases in all expense categories primarily as a result of the Company's expansion initiatives.

Personnel costs are the largest component of the Company's noninterest expenses. For the three months ended March 31, 2006, salaries and benefits represented \$6,391, or 50.30%, of total non-interest expense. This was an increase of \$1,146, or 21.85%, from \$5,245 for the three months ended March 31, 2005. Including Bank offices and non-Bank office locations, the Company had 60 locations at both March 31, 2006 and December 31, 2005, as compared to 53 at March 31, 2005, and the number of full-time equivalent employees increased 7.6% from 481 at March 31, 2005 to 572 at March 31, 2006. These increases in personnel costs, number of branches and employees are primarily the result of the Company's expansion initiatives.

Effective January 1, 2006, the Company adopted SFAS No. 123R Share-Based Payment. SFAS No. 123R requires recognition of the cost of employee services received in exchange for an award of equity incentives in the financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). The Company adopted SFAS No. 123R using the modified prospective application as permitted under SFAS No. 123R. Accordingly, prior period amounts have not been restated. Under





this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. Prior to the adoption of SFAS No. 123R, the Company used the intrinsic value method as prescribed by APB No. 25 and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company's common stock on the date of grant. The compensation cost that was charged against income for our stock option plans was \$93 for the three months ended March 31, 2006. The amount of compensation cost that would have been recognized for the three months ended March 31, 2005 if SFAS No. 123R had been adopted was \$148. The total compensation cost related to nonvested awards not yet recognized at March 31, 2006 is \$1,414 which will be recognized over the weighted average period of approximately 2.7 years. See Note 2 Stock Compensation in the consolidated financial statements for further information.

The Company's efficiency ratio improved from 62.26% at March 31, 2005 to 57.55% at March 31, 2006. The improvement in the efficiency ratio is a result of the higher level of earnings generated given the current operating infrastructure in place in the quarter ended March 31, 2006 versus the higher initial start up costs incurred in the quarter ended March 31, 2005 relating to the company's High Performance Checking promotion plus the initial costs incurred in expanding the company's presence in Middle Tennessee. The efficiency ratio illustrates how much it cost the Company to generate revenue; for example, it cost the Company 57.55 cents to generate one dollar of revenue for the three months ended March 31, 2006.

**Income Taxes.** The effective income tax rate for the three months ended March 31, 2006 was 37.63% compared to 36.28% for the same period in 2005.

#### **Changes in Financial Condition Over Financial Reporting**

Total assets at March 31, 2006 were \$1,608,240, a decrease of \$11,749, or .73%, from total assets of \$1,619,989 at December 31, 2005. The decrease in assets resulted from de-leveraging the balance sheet as the seasonal impact of the year-end build-up in deposit levels subsided during the quarter.

At March 31, 2006, loans, net of unearned interest, were \$1,404,627 compared to \$1,378,642 at December 31, 2005, an increase of \$25,985, or 1.88%, from December 31, 2005. The increase in loans during the first three months of 2006 primarily reflects an increase in commercial real estate loans and commercial loans.

The Company maintains an investment portfolio to provide liquidity and earnings. Investments at March 31, 2006 with an amortized cost of \$47,968 had a market value of \$47,314. At year-end 2005, investments with an amortized cost of \$52,844 had a market value of \$52,202.

Non-performing loans include non-accrual loans and loans 90 or more days past due. All loans that are 90 days past due are considered non-accrual unless they are adequately secured and there is reasonable assurance of full collection of principal and interest. Non-accrual loans that are 120 days past due without assurance of repayment are charged off against the allowance for loan losses. Nonaccrual loans and loans past due 90 days and still accruing decreased by \$1,768, or 26.29%, during the three months ended March 31, 2006 to \$4,956. At March 31, 2006, the ratio of the Company's allowance for loan losses to non-performing assets (which include non-accrual loans) was 252.55%.

#### **Liquidity and Capital Resources**

**Liquidity.** Liquidity refers to the ability or the financial flexibility to manage future cash flows to meet the needs of depositors and borrowers and fund operations. Maintaining appropriate levels of liquidity allows the Company to have sufficient funds available for reserve requirements, customer demand for loans, withdrawal of deposit balances and maturities of deposits and other liabilities. The Company's liquid assets include cash and due from banks, federal funds sold, investment securities and loans held for sale. Including securities pledged to collateralize municipal deposits, these assets represented 6.83% of the total liquidity base at March 31, 2006, as compared to 9.49% at December 31, 2005. The liquidity base is generally defined to include deposits, repurchase agreements, notes payable and subordinated debentures. In addition, the Company maintained borrowing availability with the Federal Home Loan Bank of Cincinnati ( FHLB ) of approximately \$4,749 at March 31, 2006. The Company also maintains federal funds lines of credit totaling \$116,000 at nine correspondent banks of which



\$116,000 was available at March 31, 2006. The Company believes it has sufficient liquidity to satisfy its current operating needs.

On August 30, 2005 the Company entered into a revolving credit agreement with SunTrust Bank pursuant to which SunTrust agreed to loan the Company up to \$35,000 in connection with the Clarksville transaction with this amount being reduced to \$15,000 after November 30, 2005. SunTrust's obligation to make advances to the Company under the credit agreement terminates on August 29, 2006, unless the loan is extended or earlier terminated. The fee for maintaining this credit agreement is 0.15% per annum on the unused portion of this commitment.

For the three months ended March 31, 2006, operating activities of the Company provided \$8,719 of cash flows. Net income of \$5,096 comprised a substantial portion of the cash generated from operations. Cash flows from operating activities were also positively affected by various non-cash items, including (i) \$1,064 in provision for loan losses, (ii) \$1,036 of depreciation and amortization and (iii) \$1,722 increase in accrued interest payable and other liabilities. In addition, the cash flows provided by the proceeds from sales of mortgage loans exceeded the cash used by the originations of mortgage loans held for sale by \$728.

The Company's net increase in loans used \$27,185 in cash flows and was the primary component of the \$24,060 in net cash used in investing activities. In addition, the Company purchased \$1,000 in investment securities available for sale. Fixed asset additions used \$2,895 in cash flows. Offsetting these uses of cash was \$5,544 in proceeds from the sale and maturity of securities available for sale.

The net decrease in deposits of \$10,140 was the primary source of cash flows used in financing activities. Also providing cash from financing activities were the proceeds from notes payable of \$143,200 offset, in part, by repayments of notes payable of \$151,294. In addition, dividends paid in the amount of \$1,174 further reduced the total net cash used in financing activities.

**Capital Resources.** The Company's capital position is reflected in its shareholders' equity, subject to certain adjustments for regulatory purposes. Shareholders' equity, or capital, is a measure of the Company's net worth, soundness and viability. The Company continues to exhibit a strong capital position while consistently paying dividends to its shareholders. Further, the capital base of the Company allows it to take advantage of business opportunities while maintaining the level of resources deemed appropriate by management of the Company to address business risks inherent in the Company's daily operations.

On September 25, 2003, the Company issued \$10,310 of subordinated debentures, as part of a privately placed pool of trust preferred securities. The securities, due in 2033, bear interest at a floating rate of 2.85% above the three-month LIBOR rate, reset quarterly, and are callable in five years without penalty. The Company used the proceeds of the offering to support its acquisition of IBC, and the capital raised from the offering qualifies as Tier I capital for regulatory purposes.

On June 28, 2005, the Company issued an additional \$3,093 of subordinated debentures, as part of a privately placed pool of trust preferred securities. The securities, due in 2035, bear interest at a floating rate of 1.68% above the three-month LIBOR rate, reset quarterly, and are callable in five years from the date of issuance without penalty. The Company used the proceeds to augment its capital position in connection with its significant asset growth, and the capital raised from the offering qualifies as Tier 1 capital for regulatory purposes.

On September 28, 2005, the Company consummated the sale of 1,833,043 shares of its common stock in a public offering in which it received proceeds, after deducting the underwriting discount and the expenses of the offering, of approximately \$44,100. The Company contributed approximately \$35,000 of these net proceeds to the Bank to provide capital for the Clarksville transaction. On October 19, 2005, the underwriters in the public offering exercised their option to cover over-allotments and the Company sold an additional 274,957 shares of its common stock for net proceeds of approximately \$6,700.

Shareholders' equity on March 31, 2006 was \$172,317, an increase of \$4,296, or 2.56%, from \$168,021 on December 31, 2005. The increase in shareholders' equity primarily reflected net income for the three months ended March 31, 2006 of \$5,096 (\$0.52 per share, assuming dilution). This increase was offset by quarterly dividend payments during the three months ended March 31, 2006 totaling \$1,174 (\$0.12 per share).

On September 18, 2002, the Company announced that its Board of Directors had authorized the repurchase of up to \$2,000 of the Company's outstanding shares of common stock beginning in October 2002. The repurchase plan was renewed by the Board of Directors in September 2003. On June 4, 2004, the Company announced that its Board of Directors had approved an increase in the amount authorized to be repurchased from \$2,000 to \$5,000. The repurchase plan is dependent upon market conditions and there is no guarantee as to the exact number of shares to be repurchased by the Company. To date, the Company has purchased 25,700 shares at an aggregate cost of approximately \$538 under this program which was renewed by the Company's Board of Directors on November 14, 2005. The repurchase program will terminate on the earlier to occur of the Company's repurchase of the total authorized dollar amount of the Company's common stock or December 1, 2006.

The Company's primary source of liquidity is dividends paid by the Bank. Applicable Tennessee statutes and regulations impose restrictions on the amount of dividends that may be declared by the Bank. Further, any dividend payments are subject to the continuing ability of the Bank to maintain its compliance with minimum federal regulatory capital requirements and to retain its characterization under federal regulations as a well-capitalized institution.

Risk-based capital regulations adopted by the Board of Governors of the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (the FDIC) require bank holding companies and banks, respectively, to achieve and maintain specified ratios of capital to risk-weighted assets. The risk-based capital rules are designed to measure Tier 1 Capital and Total Capital in relation to the credit risk of both on- and off-balance sheet items. Under the guidelines, one of four risk weights is applied to the different on-balance sheet items. Off-balance sheet items, such as loan commitments, are also subject to risk-weighting after conversion to balance sheet equivalent amounts. All bank holding companies and banks must maintain a minimum total capital to total risk-weighted assets ratio of 8.00%, at least half of which must be in the form of core, or Tier 1, capital (consisting of shareholders' equity, less goodwill and other intangible assets and accumulated other comprehensive income). At March 31, 2006, the Bank and the Company each satisfied their respective minimum regulatory capital requirements, and the Bank was well-capitalized within the meaning of federal regulatory requirements.

|                           | <b>Required<br/>Minimum<br/>Ratio</b> | <b>Bank</b> | <b>Company</b> |   |
|---------------------------|---------------------------------------|-------------|----------------|---|
| Tier 1 risk-based capital | 4.00                                  | % 10.28     | % 10.36        | % |
| Total risk-based capital  | 8.00                                  | % 11.53     | % 11.61        | % |
| Leverage Ratio            | 4.00                                  | % 9.31      | % 9.38         | % |

The FRB has recently issued regulations which will allow continued inclusion of outstanding and prospective issuances of trust preferred securities as Tier 1 capital subject to stricter quantitative and qualitative limits than allowed under prior regulations. The new limits will phase in over a five-year transition period and would permit the Company's trust preferred securities to continue to be treated as Tier 1 capital.

#### Off-Balance Sheet Arrangements

At March 31, 2006, the Company had outstanding unused lines of credit and standby letters of credit totaling \$583,593 and unfunded loan commitments outstanding of \$44,943. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Company has the ability to liquidate Federal funds sold or securities available-for-sale or, on a short-term basis, to borrow any then available amounts from the FHLB and/or purchase Federal funds from other financial institutions. At March 31, 2006, the Company had accommodations with upstream correspondent banks for unsecured Federal funds lines. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within less than a month. The following table presents additional information about the Company's off-balance sheet commitments as of March 31, 2006, which by their terms have contractual maturity dates subsequent to March 31, 2006:

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|                                    | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years | Total      |
|------------------------------------|------------------|-----------|-----------|-------------------|------------|
| Commitments to make loans fixed    | \$ 6,828         | \$        | \$        | \$                | \$ 6,828   |
| Commitments to make loans variable | 38,115           |           |           |                   | 38,115     |
| Unused lines of credit             | 368,440          | 78,908    | 23,907    | 80,380            | 551,635    |
| Letters of credit                  | 15,300           | 16,658    |           |                   | 31,958     |
| Total                              | \$ 428,683       | \$ 95,566 | \$ 23,907 | \$ 80,380         | \$ 628,536 |

### Disclosure of Contractual Obligations

In the ordinary course of operations, the Company enters into certain contractual obligations. Such obligations include the funding of operations through debt issuances as well as leases for premises and equipment. The following table summarizes the Company's significant fixed and determinable contractual obligations as of March 31, 2006:

|                                    | Less than 1 Year | 1-3 Years | 3-5 Years  | More than 5 Years | Total        |
|------------------------------------|------------------|-----------|------------|-------------------|--------------|
| Deposits without a stated maturity | \$ 685,166       | \$        | \$         | \$                | \$ 685,166   |
| Certificate of deposits            | 452,149          | 91,810    | 51,282     | 5,331             | 600,572      |
| Repurchase agreements              | 17,966           |           |            |                   | 17,966       |
| FHLB advances and notes payable    | 31,187           | 3,817     | 55,368     | 6,680             | 97,052       |
| Subordinated debentures            |                  |           |            | 13,403            | 13,403       |
| Operating lease obligations        | 588              | 803       | 223        | 108               | 1,722        |
| Deferred compensation              | 509              | 1,305     |            | 966               | 2,780        |
| Purchase obligations               | 149              |           |            |                   | 149          |
| Total                              | \$ 1,187,714     | \$ 97,735 | \$ 106,873 | \$ 26,488         | \$ 1,418,810 |

Additionally, the Company routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for early termination of the contract. Management is not aware of any additional commitments or contingent liabilities which may have a material adverse impact on the liquidity or capital resources of the Company.

### Effect of New Accounting Standards

In November 2005, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) FAS 115-1 and FAS 124-1, *the Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, which amends SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. This FSP addresses the determination as to when an investment is considered impaired, whether the impairment is other than temporary, and the measurement of an impairment loss. FSP FAS 115-1 and FAS 124-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP is effective for reporting periods beginning after December 15, 2005. The adoption of FSP FAS 115-1 and FAS 124-1 did not have a material impact on the Company's financial condition or results of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. This statement replaces APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS No. 154 changes the requirements for the accounting for and reporting of a voluntary change in accounting principle. SFAS No. 154 requires retrospective application to prior periods for changes in accounting principles or error corrections, unless it is impractical to determine the period-specific effects or when a pronouncement includes specific transition provisions. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 (revised 2004) did not have a material impact on its financial condition or results of operations of the Company.



**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

A comprehensive qualitative and quantitative analysis regarding market risk was disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. No material changes in the assumptions used or results obtained from the model have occurred since December 31, 2005.

Actual results for the year ending December 31, 2006 will differ from simulated results due to timing, magnitude, and frequency of interest rate changes, as well as changes in market conditions and management strategies.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by it in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

**Changes in Internal Controls**

There were no changes in the Company's internal control over financial reporting during the Company's fiscal quarter ended March 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company and its subsidiaries are subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of these pending claims and legal proceedings will not have a material adverse effect on the Company's results of operations.

**Item 1A. Risk Factors**

Not applicable.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The Company made no repurchases of its common stock during the quarter ended March 31, 2006.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4.**            Submission of Matters to a Vote of Security Holders

None

**Item 5.**            Other Information

None.

**Item 6.**            Exhibits

(a) Exhibits

Exhibit No. 31.1 Chief Executive Officer Certification Pursuant to Rule 13a-14(a)/15d-14(a)

Exhibit No. 31.2 Chief Financial Officer Certification Pursuant to Rule 13a-14(a)/15d-14(a)

Exhibit No. 32.1 Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit No. 32.2 Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Greene County Bancshares, Inc.

Registrant

Date: May 9, 2006

By: /s/ R. Stan Puckett  
R. Stan Puckett  
Chairman of the Board and Chief Executive Officer  
(Duly authorized representative)

Date: May 9, 2006

/s/ James E. Adams  
James E. Adams  
Senior Vice President, Chief Financial  
Officer (Principal financial and accounting  
officer) and Assistant Secretary