

FIRST CITIZENS BANCSHARES INC /DE/
Form 10-Q
May 04, 2007

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

FORM 10-Q

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

For the quarterly period ended March 31, 2007

or

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

Commission File Number: 0-16471

First Citizens BancShares, Inc

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

56-1528994
(I.R.S. Employer Identification Number)

4300 Six Forks Road, Raleigh, North Carolina
(Address of principle executive offices)

27609
(Zip code)

(919) 716-7000

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve 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 ninety 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 (Check one):

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

Class A Common Stock—\$1 Par Value—8,756,778 shares

Class B Common Stock—\$1 Par Value—1,677,675 shares

(Number of shares outstanding, by class, as of May 4, 2007)

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PART I

Item 1. Financial Statements (Unaudited)

Consolidated Balance Sheets

First Citizens BancShares, Inc. and Subsidiaries

| | March 31* | December 31# | March 31* |
|---|----------------------|----------------------|----------------------|
| | 2007 | 2006 | 2006 |
| (thousands, except share data) | | | |
| Assets | | | |
| Cash and due from banks | \$ 847,202 | \$ 1,010,984 | \$ 805,757 |
| Overnight investments | 799,848 | 348,597 | 748,918 |
| Investment securities available for sale | 2,934,995 | 3,001,890 | 2,396,001 |
| Investment securities held to maturity | 96,803 | 219,158 | 500,961 |
| Loans and leases | 10,221,578 | 10,239,551 | 9,810,088 |
| Less allowance for loan and lease losses | 132,640 | 132,004 | 130,222 |
| Net loans and leases | 10,088,938 | 10,107,547 | 9,679,866 |
| Premises and equipment | 726,041 | 702,926 | 657,141 |
| Income earned not collected | 74,648 | 71,562 | 55,680 |
| Goodwill | 102,625 | 102,625 | 102,735 |
| Other intangible assets | 7,427 | 8,000 | 9,732 |
| Other assets | 175,251 | 156,408 | 138,419 |
| Total assets | \$ 15,853,778 | \$ 15,729,697 | \$ 15,095,210 |
| Liabilities | | | |
| Deposits: | | | |
| Noninterest-bearing | \$ 2,701,786 | \$ 2,682,997 | \$ 2,733,885 |
| Interest-bearing | 10,020,746 | 10,060,327 | 9,778,672 |
| Total deposits | 12,722,532 | 12,743,324 | 12,512,557 |
| Short-term borrowings | 1,245,025 | 1,150,847 | 850,566 |
| Long-term obligations | 405,356 | 401,198 | 408,954 |
| Other liabilities | 138,538 | 123,509 | 119,767 |
| Total liabilities | 14,511,451 | 14,418,878 | 13,891,844 |
| Shareholders' Equity | | | |
| Common stock: | | | |
| Class A - \$1 par value (8,756,778 shares issued for all periods) | 8,757 | 8,757 | 8,757 |
| Class B - \$1 par value (1,677,675 shares issued for all periods) | 1,678 | 1,678 | 1,678 |
| Surplus | 143,766 | 143,766 | 143,766 |
| Retained earnings | 1,175,449 | 1,148,372 | 1,054,793 |
| Accumulated other comprehensive income (loss) | 12,677 | 8,246 | (5,628) |
| Total shareholders' equity | 1,342,327 | 1,310,819 | 1,203,366 |
| Total liabilities and shareholders' equity | \$ 15,853,778 | \$ 15,729,697 | \$ 15,095,210 |

* Unaudited

Derived from the 2006 Annual Report on Form 10-K.

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Income

First Citizens BancShares, Inc. and Subsidiaries

| | Three Months Ended March 31 | |
|--|--|------------|
| | 2007 | 2006 |
| | (thousands, except share and per share data) | |
| Interest income | | |
| Loans and leases | \$ 175,024 | \$ 159,205 |
| Investment securities: | | |
| U. S. Government | 32,744 | 24,285 |
| State, county and municipal | 58 | 61 |
| Other | 774 | 711 |
| Total investment securities interest and dividend income | 33,576 | 25,057 |
| Overnight investments | 7,461 | 5,739 |
| Total interest income | 216,061 | 190,001 |
| Interest expense | | |
| Deposits | 80,011 | 57,742 |
| Short-term borrowings | 12,682 | 6,992 |
| Long-term obligations | 6,755 | 7,449 |
| Total interest expense | 99,448 | 72,183 |
| Net interest income | 116,613 | 117,818 |
| Provision for credit losses | 3,532 | 6,737 |
| Net interest income after provision for credit losses | 113,081 | 111,081 |
| Noninterest income | | |
| Cardholder and merchant services income | 22,377 | 18,428 |
| Service charges on deposit accounts | 17,157 | 18,206 |
| Commission-based income | 9,264 | 7,872 |
| Fees from processing services | 8,187 | 6,909 |
| Trust and asset management fees | 6,078 | 5,178 |
| ATM income | 1,587 | 2,532 |
| Mortgage income | 2,374 | 1,372 |
| Other service charges and fees | 3,770 | 4,123 |
| Securities losses | - | (186) |
| Other | 409 | 1,315 |
| Total noninterest income | 71,202 | 65,749 |
| Noninterest expense | | |
| Salaries and wages | 59,189 | 56,543 |
| Employee benefits | 13,177 | 13,943 |
| Occupancy expense | 13,855 | 12,875 |
| Equipment expense | 13,772 | 12,664 |
| Other | 39,197 | 35,687 |
| Total noninterest expense | 139,190 | 131,712 |
| Income before income taxes | 45,093 | 45,118 |
| Income taxes | 16,109 | 16,461 |
| Net income | \$ 28,984 | \$ 28,657 |
| Average shares outstanding | 10,434,453 | 10,434,453 |
| Net income per share | \$ 2.78 | \$ 2.75 |
| See accompanying Notes to Consolidated Financial Statements. | | |

Consolidated Statements of Changes in Shareholders' Equity

 First Citizens
 BancShares, Inc. and
 Subsidiaries

| | Class A Common Stock | Class B Common Stock | Surplus (thousands, except share data) | Retained Earnings | Accumulated Other Comprehensive Income (loss) | Total Shareholders' Equity |
|---|--------------------------------|--------------------------------|---|----------------------|---|----------------------------------|
| Balance at December 31, 2005 | \$ 8,757 | \$ 1,678 | \$ 143,766 | \$ 1,029,005 | \$ (2,147) | \$ 1,181,059 |
| Comprehensive income: | | | | | | |
| Net income | - | - | - | 28,657 | - | 28,657 |
| Unrealized securities losses arising during period, net of deferred taxes | - | - | - | - | (3,481) | (3,481) |
| Total comprehensive income | - | - | - | 28,657 | (3,481) | 25,176 |
| Cash dividends | | | | (2,869) | | (2,869) |
| Balance at March 31, 2006 | \$ 8,757 | \$ 1,678 | \$ 143,766 | \$ 1,054,793 | \$ (5,628) | \$ 1,203,366 |
| Balance at December 31, 2006 | \$ 8,757 | \$ 1,678 | \$ 143,766 | \$ 1,148,372 | \$ 8,246 | \$ 1,310,819 |
| Adjustment resulting from adoption of FASB Interpretation No. 48 | | | | 962 | | 962 |
| Comprehensive income: | | | | | | |
| Net income | - | - | - | 28,984 | - | 28,984 |
| Unrealized securities gains arising during period, net of deferred taxes | - | - | - | - | 4,722 | 4,722 |
| Change in unrecognized loss on cash flow hedge, net of deferred taxes | | | | | (291) | (291) |
| Total comprehensive income | - | - | - | 28,984 | 4,431 | 33,415 |
| Cash dividends | - | - | - | (2,869) | - | (2,869) |
| Balance at March 31, 2007 | \$ 8,757 | \$ 1,678 | \$ 143,766 | \$ 1,175,449 | \$ 12,677 | \$ 1,342,327 |

See accompanying Notes to Consolidated
Financial Statements.

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Consolidated Statements of Cash Flows

First Citizens BancShares, Inc. and Subsidiaries

| | Three months ended | |
|---|--------------------|------------|
| | 2007 | 2006 |
| | (thousands) | |
| OPERATING ACTIVITIES | | |
| Net income | \$ 28,984 | \$ 28,657 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Amortization of intangibles | 573 | 586 |
| Provision for credit losses | 3,532 | 6,737 |
| Deferred tax benefit | (2,654) | (5,104) |
| Change in current taxes payable | 15,058 | 19,172 |
| Depreciation | 12,678 | 11,603 |
| Change in accrued interest payable | (907) | 1,800 |
| Change in income earned not collected | (3,086) | (801) |
| Securities losses | - | 186 |
| Origination of loans held for sale | (118,184) | (84,096) |
| Proceeds from sale of loans | 128,448 | 123,165 |
| Gain on sale of loans | (467) | 274 |
| Net amortization of premiums and discounts | (1,208) | (1,140) |
| Net change in other assets | (19,162) | (1,697) |
| Net change in other liabilities | 1,335 | 2,335 |
| Net cash provided by operating activities | 44,940 | 101,677 |
| INVESTING ACTIVITIES | | |
| Net change in loans outstanding | 5,494 | (211,799) |
| Purchases of investment securities held to maturity | - | (1,066) |
| Purchases of investment securities available for sale | (309,431) | (161,631) |
| Proceeds from maturities of investment securities held to maturity | 122,355 | 137,741 |
| Proceeds from maturities of investment securities available for sale | 385,229 | 52,753 |
| Net change in overnight investments | (451,251) | (267,906) |
| Dispositions of premises and equipment | 505 | 2,779 |
| Additions to premises and equipment | (32,140) | (32,054) |
| Net cash used by investing activities | (279,239) | (481,183) |
| FINANCING ACTIVITIES | | |
| Net change in time deposits | (17,073) | 278,962 |
| Net change in demand and other interest-bearing deposits | (3,719) | 59,737 |
| Net change in short-term borrowings | 94,178 | 71,505 |
| Cash dividends paid | (2,869) | (2,869) |
| Net cash provided by financing activities | 70,517 | 407,335 |
| Change in cash and due from banks | (163,782) | 27,829 |
| Cash and due from banks at beginning of period | 1,010,984 | 777,928 |
| Cash and due from banks at end of period | \$ 847,202 | \$ 805,757 |
| CASH PAYMENTS FOR: | | |
| Interest | \$ 98,541 | \$ 73,982 |

| | | | | |
|--------------|--|-------|--|--------|
| Income taxes | | 3,562 | | 25,352 |
|--------------|--|-------|--|--------|

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

| | | | | |
|--------------------------------------|----|-------|----|---------|
| Unrealized securities gains (losses) | \$ | 7,695 | \$ | (5,711) |
|--------------------------------------|----|-------|----|---------|

See accompanying Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

Note A
Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements.

In the opinion of management, the consolidated financial statements contain all material adjustments necessary to present fairly the financial position of First Citizens BancShares, Inc. as of and for each of the periods presented, and all such adjustments are of a normal recurring nature. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the 2006 First Citizens BancShares, Inc. Form 10-K. Certain amounts for prior periods have been reclassified to conform with statement presentations for 2007. However, the reclassifications have no effect on shareholders' equity or net income as previously reported.

Note B
Operating Segments

BancShares conducts its banking operations through its two wholly-owned subsidiaries, First-Citizens Bank & Trust Company (FCB) and IronStone Bank (ISB). Although FCB and ISB offer similar products and services to customers, each entity operates in distinct geographic markets and each entity operates under a separate charter. The financial results and trends of ISB reflect the impact of the de novo nature of its growth.

FCB is a mature banking institution that operates under a state bank charter from its branch network in North Carolina, Virginia, West Virginia, Maryland and Tennessee. ISB began operations in 1997 and currently operates in Georgia, Florida, Texas, Arizona, California, New Mexico, Colorado, Oregon and Washington under a federal thrift charter.

In the aggregate, FCB and its consolidated subsidiaries, which are integral to its branch operation, and ISB account for more than 90 percent of consolidated assets, revenues and net income. Other includes activities of the parent company and Neuse, Incorporated, a subsidiary that owns real property used in the banking operation. For 2006, other also includes American Guaranty Insurance Corporation, a property insurance company that was sold January 1, 2007.

The adjustments in the accompanying tables represent the elimination of the impact of certain inter-company transactions. The adjustments to interest income and interest expense neutralize the earnings and cost of inter-company borrowings. The adjustments to noninterest income and noninterest expense reflect the elimination of management fees and other services fees paid by one company to another within BancShares' consolidated group.

| | March 31, 2007 | | | | | |
|---|----------------|---------------|--------------|---------------|----------------|---------------|
| | ISB | FCB | Other | Total | Adjustments | Consolidated |
| Interest income | \$ 33,808 | \$ 180,291 | \$ 9,851 | \$ 223,950 | \$ (7,889) | \$ 216,061 |
| Interest expense | 17,935 | 76,123 | 13,279 | 107,337 | (7,889) | 99,448 |
| Net interest income | 15,873 | 104,168 | (3,428) | 116,613 | - | 116,613 |
| Provision for credit losses | 318 | 3,214 | - | 3,532 | - | 3,532 |
| Net interest income after provision for credit losses | 15,555 | 100,954 | (3,428) | 113,081 | - | 113,081 |
| Noninterest income | 3,201 | 70,598 | (127) | 73,672 | (2,470) | 71,202 |
| Noninterest expense | 19,105 | 122,436 | 119 | 141,660 | (2,470) | 139,190 |
| Income (loss) before income taxes | (349) | 49,116 | (3,674) | 45,093 | - | 45,093 |
| Income taxes | (83) | 17,463 | (1,271) | 16,109 | - | 16,109 |
| Net income (loss) | \$ (266) | \$ 31,653 | \$ (2,403) | \$ 28,984 | \$ - | \$ 28,984 |
| At March 31, 2007: | | | | | | |
| Total assets | \$ 2,225,229 | \$ 13,359,371 | \$ 2,438,870 | \$ 18,023,470 | \$ (2,169,692) | \$ 15,853,778 |
| Loans and leases | 1,881,368 | 8,340,210 | - | 10,221,578 | - | 10,221,578 |
| Allowance for loan and lease losses | 22,580 | 110,060 | - | 132,640 | - | 132,640 |
| Deposits | 1,826,095 | 10,935,271 | - | 12,761,366 | (38,834) | 12,722,532 |
| | March 31, 2006 | | | | | |
| | ISB | FCB | Other | Total | Adjustments | Consolidated |
| Interest income | \$ 28,595 | \$ 161,433 | \$ 5,390 | \$ 195,418 | \$ (5,417) | \$ 190,001 |
| Interest expense | 12,347 | 55,071 | 10,182 | 77,600 | (5,417) | 72,183 |
| Net interest income | 16,248 | 106,362 | (4,792) | 117,818 | - | 117,818 |
| Provision for credit losses | 966 | 5,771 | - | 6,737 | - | 6,737 |
| Net interest income after provision for credit losses | 15,282 | 100,591 | (4,792) | 111,081 | - | 111,081 |
| Noninterest income | 2,544 | 64,612 | 543 | 67,699 | (1,950) | 65,749 |
| Noninterest expense | 17,992 | 115,115 | 555 | 133,662 | (1,950) | 131,712 |

| | | | | | | |
|---|--------------|---------------|--------------|---------------|----------------|---------------|
| Income (loss) before income taxes | (166) | 50,088 | (4,804) | 45,118 | - | 45,118 |
| Income taxes | (19) | 18,147 | (1,667) | 16,461 | - | 16,461 |
| Net income (loss) | \$ (147) | \$ 31,941 | \$ (3,137) | \$ 28,657 | \$ - | \$ 28,657 |
| At March 31, 2006: | | | | | | |
| Total assets | \$ 1,945,156 | \$ 13,003,924 | \$ 2,070,063 | \$ 17,019,143 | \$ (1,923,933) | \$ 15,095,210 |
| Loans and leases | 1,719,046 | 8,091,042 | - | 9,810,088 | - | 9,810,088 |
| Allowance for loan and lease losses | 20,268 | 109,954 | - | 130,222 | - | 130,222 |
| Deposits | 1,576,990 | 11,002,133 | - | 12,579,123 | (66,566) | 12,512,557 |

Note C
Employee Benefits

BancShares recognized pension expense totaling \$2,625 and \$3,690, respectively, in the three-month periods ended March 31, 2007 and 2006. Pension expense is included as a component of employee benefit expense.

| <u>Components of Net Periodic Benefit Cost</u> | Three month periods ended | |
|--|---------------------------|----------|
| | March 31, | |
| | 2007 | 2006 |
| Service cost | \$ 4,235 | \$ 4,128 |
| Interest cost | 5,250 | 4,885 |
| Expected return on assets | (7,442) | (6,423) |
| Amortization of prior service cost | 59 | 66 |
| Amortization of net actuarial loss | 523 | 1,034 |
| Total net periodic benefit cost | \$ 2,625 | \$ 3,690 |

The expected long-term rate of return on plan assets for 2007 is 8.50 percent, and the assumed discount rate is 5.75 percent.

Note D
Income Taxes

BancShares and its subsidiaries file a consolidated federal income tax return. BancShares and its subsidiaries each file separate state income tax returns except where unitary filing is required. BancShares and its subsidiaries are generally no longer subject to federal, state or local income tax examinations for years before 2002.

BancShares adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, BancShares recognized a decrease in the liability for uncertain tax positions of \$962, which was accounted for as an increase to the January 1, 2007 balance of retained earnings.

The total amount of uncertain tax positions at the date of adoption of FIN 48 was \$1,700. The total amount of uncertain tax positions that, if recognized, would affect the effective tax rate at the date of adoption of FIN 48 was \$500. BancShares recognizes accrued interest and penalties related to uncertain tax positions in tax expense. At the date of adoption of FIN 48, BancShares had recognized approximately \$700 for the payment of interest and penalties. BancShares is not aware of any positions for which it is reasonably possible that the total amounts of uncertain tax positions will significantly increase or decrease within the next twelve months.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

Management's discussion and analysis of earnings and related financial data are presented to assist in understanding the financial condition and results of operations of First Citizens BancShares, Inc. and Subsidiaries (BancShares). This discussion and analysis should be read in conjunction with the unaudited Consolidated Financial Statements and related notes presented within this report. Intercompany accounts and transactions have been eliminated. Although certain amounts for prior years have been reclassified to conform to statement presentations for 2007, the reclassifications have no effect on shareholders' equity or net income as previously reported.

OVERVIEW

BancShares is a financial holding company with two wholly owned banking subsidiaries: First-Citizens Bank & Trust Company (FCB), a North Carolina-chartered bank, and IronStone Bank (ISB), a federally-chartered thrift institution. FCB operates branches in North Carolina, Virginia, West Virginia, Maryland and Tennessee. ISB operates in Georgia, Florida, Texas, New Mexico, Arizona, California, Oregon, Washington and Colorado. ISB has announced plans to expand into Oklahoma City, Oklahoma; Kansas City, Missouri; Kansas City, Kansas; and Dallas, Texas.

BancShares' earnings and cash flows are derived primarily from the commercial banking activities conducted by its banking subsidiaries. These activities include commercial and consumer lending, deposit and cash management products, cardholder, merchant, wealth management services as well as various other products and services typically offered by commercial banks. FCB and ISB gather interest-bearing and noninterest-bearing deposits from retail and commercial customers. BancShares and its subsidiaries also secure funding through various non-deposit sources. We invest the liquidity generated from these funding sources in various types of interest-earning assets such as loans and leases, investment securities and overnight investments. We also invest in bank premises, furniture and equipment used to conduct the subsidiaries' commercial banking business.

Various external factors influence customer demand for our loan, lease and deposit products. In an effort to stimulate and control the rate of growth of economic activity, monetary actions by the Federal Reserve are significant to the interest rate environment in which we operate. At any point in time, both the existing level and anticipated movement of interest rates have a profound impact on customer demand for our products, our pricing of those products and on our profitability.

In addition to the interest rate environment, the general strength of the economy influences demand as well as the quality and collectibility of our loan and lease portfolio. External economic indicators such as consumer bankruptcy rates and business debt service capacity closely follow trends in the economic cycle. Demand for our deposit and cash management products is highly dependent on interest rates and, to some extent, the volatility of alternative investment markets.

Although we are unable to control the external factors that influence our business, through the utilization of various liquidity, interest rate and credit risk management tools, we seek to minimize the potentially adverse risks of unforeseen and unfavorable economic trends and take advantage of favorable economic conditions when appropriate.

Financial institutions frequently focus their strategic and operating emphasis on maximizing profitability, and therefore measure their relative success by reference to profitability measures such as return on average assets or return on average shareholders' equity. BancShares' profitability measures have historically compared unfavorably to the returns of similar-sized financial holding companies. We have historically placed significant emphasis upon asset quality, balance sheet liquidity and capital conservation, even when those priorities may be detrimental to short-term profitability.

Based on our organization's strengths and competitive position within the financial services industry, we believe opportunities for significant growth and expansion exist. We operate in diverse and growing geographic markets and believe that through competitive products and superior customer service, we can increase our business volumes and profitability. In recent years, we have focused our efforts on customers who own their own businesses, medical and other professionals and individuals who are financially active.

We seek to increase fee income in areas such as merchant processing, working capital finance, insurance, cash management, wealth management and private banking services. We also focus on opportunities to generate income by providing processing services to other banks.

We attempt to mitigate certain of the risks that can endanger our profitability and growth prospects. While we are attentive to all areas of risk, economic risk is especially problematic due to the lack of control and the potential material impact upon our financial results. Specific economic risks include recession, rapid movements in interest rates, changes in the yield curve and significant shifts in inflation expectations. Compared to our larger competitors, our relatively small asset size and limited capital resources create a level of economic risk that requires constant and focused management attention.

PERFORMANCE SUMMARY

BancShares realized an increase in earnings during the first quarter of 2007 compared to the first quarter of 2006. Consolidated net income during the first quarter of 2007 was \$29.0 million, compared to \$28.7 million earned during the corresponding period of 2006. The annualized return on average assets was 0.75 percent during the first quarter of 2007, compared to 0.79 percent during the same period of 2006. The annualized return on average equity was 8.88 percent during 2007, compared to 9.72 percent during the same period of 2006. Net income per share during the first quarter of 2007 totaled \$2.78, compared to \$2.75 during the first quarter of 2006, a 1.1 percent increase.

The \$327,000 or 1.1 percent earnings increase resulted from higher noninterest revenue, lower net charge-offs and a lower effective tax rate, partially offset by increased levels of noninterest expense and a marginal reduction in net interest income.

Financial Summary

Table 1

| | 2007 First Quarter | Fourth Quarter | 2006 Third Quarter | Second Quarter | First Quarter |
|---|--------------------------|-------------------|--------------------------|-------------------|------------------|
| Summary of Operations (thousands, except share data and ratios) | | | | | |
| Interest income | \$ 216,061 | \$ 218,102 | \$ 214,650 | \$ 202,499 | \$ 190,001 |
| Interest expense | 99,448 | 101,215 | 96,773 | 83,566 | 72,183 |
| Net interest income | 116,613 | 116,887 | 117,877 | 118,933 | 117,818 |
| Provision for credit losses | 3,532 | 7,383 | 3,813 | 2,973 | 6,737 |
| Net interest income after provision for credit losses | 113,081 | 109,504 | 114,064 | 115,960 | 111,081 |
| Noninterest income | 71,202 | 71,381 | 72,605 | 69,609 | 65,749 |
| Noninterest expense | 139,190 | 132,223 | 134,865 | 135,207 | 131,712 |
| Income before income taxes | 45,093 | 48,662 | 51,804 | 50,362 | 45,118 |
| Income taxes | 16,109 | 15,467 | 18,877 | 18,650 | 16,461 |
| Net income | \$ 28,984 | \$ 33,195 | \$ 32,927 | \$ 31,712 | \$ 28,657 |
| Net interest income-taxable equivalent | \$ 117,056 | \$ 117,394 | \$ 118,345 | \$ 119,351 | \$ 118,226 |
| Selected Quarterly Averages | | | | | |
| Total assets | \$ 15,572,613 | \$ 15,628,835 | \$ 15,477,992 | \$ 15,322,373 | \$ 14,699,290 |
| Investment securities | 3,092,261 | 3,176,845 | 3,072,113 | 2,964,308 | 2,896,711 |
| Loans and leases | 10,198,638 | 10,133,502 | 10,075,016 | 9,924,208 | 9,705,443 |
| Interest-earning assets | 13,876,402 | 13,951,134 | 13,820,610 | 13,522,235 | 13,129,313 |
| Deposits | 12,502,206 | 12,601,708 | 12,571,525 | 12,440,125 | 12,192,664 |
| Interest-bearing liabilities | 11,557,940 | 11,601,752 | 11,485,378 | 11,156,821 | 10,794,420 |
| Long-term obligations | 408,277 | 424,597 | 500,564 | 466,259 | 408,946 |
| Shareholders' equity | \$ 1,323,244 | \$ 1,292,771 | \$ 1,254,551 | \$ 1,219,835 | \$ 1,196,174 |
| Shares outstanding | 10,434,453 | 10,434,453 | 10,434,453 | 10,434,453 | 10,434,453 |
| Selected Quarter-End Balances | | | | | |
| Total assets | \$ 15,853,778 | \$ 15,729,697 | \$ 15,633,597 | \$ 15,530,846 | \$ 15,099,564 |
| Investment securities | 3,031,798 | 3,221,048 | 3,118,025 | 3,024,780 | 2,896,962 |
| Loans and leases | 10,221,578 | 10,239,551 | 10,129,423 | 10,029,045 | 9,810,088 |
| Interest-earning assets | 14,053,224 | 13,809,196 | 13,818,528 | 13,685,530 | 13,455,968 |
| Deposits | 12,722,532 | 12,743,324 | 12,681,150 | 12,717,219 | 12,512,557 |
| Interest-bearing liabilities | 11,671,127 | 11,612,372 | 11,510,073 | 11,395,473 | 11,038,192 |
| Long-term obligations | 405,356 | 401,198 | 424,351 | 527,478 | 408,954 |
| Shareholders' equity | \$ 1,342,327 | \$ 1,310,819 | \$ 1,276,608 | \$ 1,232,933 | \$ 1,207,720 |
| Shares outstanding | 10,434,453 | 10,434,453 | 10,434,453 | 10,434,453 | 10,434,453 |
| Profitability Ratios (averages) | | | | | |
| Rate of return (annualized) on: | | | | | |
| Total assets | 0.75% | 0.84% | 0.84% | 0.84% | 0.79 |
| Shareholders' equity | 8.88 | 10.19 | 10.41 | 10.43 | 9.72 |
| Dividend payout ratio | 9.89 | 8.65 | 8.70 | 9.05 | 10.00 |

| Liquidity and Capital Ratios (averages) | | | | | |
|--|---------|---------|---------|---------|---------|
| Loans and leases to deposits | 81.57% | 80.41% | 80.14% | 79.78% | 79.60 |
| Shareholders' equity to total assets | 8.50 | 8.27 | 8.11 | 7.96 | 8.14 |
| Time certificates of \$100,000 or more to total deposits | 16.60 | 16.17 | 15.74 | 15.04 | 14.44 |
| Per Share of Stock | | | | | |
| Net income | \$ 2.78 | \$ 3.18 | \$ 3.16 | \$ 3.04 | \$ 2.75 |
| Cash dividends | 0.275 | 0.275 | 0.275 | 0.275 | 0.275 |
| Book value at period end | 128.64 | 125.62 | 122.35 | 118.16 | 115.74 |
| Tangible book value at period end | 118.10 | 115.02 | 111.68 | 107.44 | 104.97 |

INTEREST-EARNING ASSETS

Interest-earning assets include loans and leases, investment securities and overnight investments, all of which reflect varying interest rates based on the risk level and maturity of the underlying asset. Riskier investments typically carry a higher interest rate, but expose the investor to potentially higher levels of default. We have historically focused on maintaining high asset quality, which results in a loan and lease portfolio subjected to strenuous underwriting and monitoring procedures. Our investment securities portfolio includes high-quality assets, primarily United States Treasury and government agency securities. Generally, the investment securities portfolio grows and shrinks based on loan, lease and deposit trends. When deposit growth exceeds loan and lease demand, we invest excess funds in the securities portfolio. Conversely, when loan and lease demand exceeds deposit growth, we use proceeds from maturing securities to fund loan and lease demand. Overnight investments are selectively made with other financial institutions that are within our risk tolerance.

During the first quarter of 2007, interest-earning assets averaged \$13.87 billion, an increase of \$747.1 million or 5.7 percent from the first quarter of 2006. This increase reflects growth in both the loan and investment securities portfolios.

Loans and Leases. At March 31, 2007 and 2006, loans and leases totaled \$10.22 billion and \$9.81 billion, respectively. The \$411.5 million or 4.2 percent growth from March 31, 2006 to March 31, 2007 resulted from growth within the commercial mortgage and commercial and industrial loan portfolios.

Commercial real estate loans totaled \$3.74 billion at March 31, 2007, representing 36.6 percent of total loans and leases. This represents an increase of \$209.7 million or 5.9 percent since March 31, 2006. Although demand for commercial real estate financing remains stable for owner-occupied medical and professional facilities, competition for this type of high-quality lending continues to be strong. A large percentage of our commercial mortgage portfolio is secured by owner-occupied facilities, rather than investment property. These loans are underwritten based primarily upon the cash flow from the operation of the business rather than the value of the real estate collateral.

Commercial and industrial loans equaled \$1.51 billion or 14.8 percent of total loans and leases outstanding. These loans have increased \$184.6 million or 13.9 percent since March 31, 2006. Healthy customer demand and franchise expansion have supported the growth of these loans.

At March 31, 2007, revolving mortgage loans totaled \$1.30 billion at March 31, 2007, representing 12.7 percent of total loans outstanding. This component of the loan and lease portfolio has declined slightly compared to March 31, 2006, reflecting continued migration of customers to closed-end fixed-rate lending alternatives. This trend results from the yield curve inversion, which has caused the short-term rate on variable mortgage products to exceed those offered on longer-term fixed-rate products.

Residential mortgage loans totaled \$1.02 billion or 10.0 percent of total loans at March 31, 2007, an increase of \$41.4 million or 4.2 percent since March 31, 2006. Growth has been caused primarily by loans within the medical customer base.

Our continuing expansion into new markets has allowed us to mitigate our historic exposure to geographic concentration in North Carolina and Virginia. As we continue to expand into new markets, we have endeavored to ensure that rigorous centralized underwriting and monitoring controls are functioning effectively. We will continue to place emphasis upon maintaining strong lending standards in new markets.

We anticipate growth in commercial mortgage and commercial and industrial loans in 2007, as our expansion into new markets translates into modestly higher levels of loan and lease demand among our business customers. Our continued expansion will likewise continue to diversify risks resulting from regional concentrations. All growth

projections are subject to change as a result of economic deterioration or improvement, competitive forces and other external factors.

Loans and Leases

Table 2

| | 2007 | | 2006 | | |
|--|------------------|-------------------|---------------------------------|-------------------|------------------|
| | First Quarter | Fourth Quarter | Third Quarter (thousands) | Second Quarter | First Quarter |
| Real estate: | | | | | |
| Construction and land development | \$ 779,718 | \$ 783,680 | \$ 833,505 | \$ 822,687 | \$ 821,477 |
| Commercial mortgage | 3,739,948 | 3,725,752 | 3,626,600 | 3,591,372 | 3,530,296 |
| Residential mortgage | 1,020,945 | 1,025,235 | 1,040,202 | 1,007,616 | 979,572 |
| Revolving mortgage | 1,301,311 | 1,326,403 | 1,331,055 | 1,368,584 | 1,359,483 |
| Other mortgage | 157,576 | 165,223 | 167,238 | 172,322 | 173,819 |
| Total real estate loans | 6,999,498 | 7,026,293 | 6,998,600 | 6,962,581 | 6,864,647 |
| Commercial and industrial | 1,510,754 | 1,493,326 | 1,448,554 | 1,417,341 | 1,326,182 |
| Consumer | 1,345,631 | 1,360,524 | 1,331,597 | 1,330,852 | 1,312,790 |
| Lease financing | 302,581 | 294,366 | 284,230 | 259,253 | 246,544 |
| Other | 63,114 | 65,042 | 66,442 | 59,018 | 59,925 |
| Total loans and leases | 10,221,578 | 10,239,551 | 10,129,423 | 10,029,045 | 9,810,088 |
| Less allowance for loan and lease losses | 132,640 | 132,004 | 131,652 | 130,532 | 130,222 |
| Net loans and leases | \$ 10,088,938 | \$ 10,107,547 | \$ 9,997,771 | \$ 9,898,513 | \$ 9,679,866 |

Investment Securities. Investment securities available for sale equaled \$2.93 billion at March 31, 2007, compared to \$2.40 billion at March 31, 2006. The \$539.0 million or 22.5 percent increase resulted from deposit and short-term borrowings growth that exceeded loan and lease demand and the reinvestment of proceeds from maturing held-to-maturity securities into newly purchased securities classified as available-for-sale. Available-for-sale securities are reported at their aggregate fair value. Investment securities held to maturity totaled \$96.8 million at March 31, 2007, compared to \$501.0 million at March 31, 2006. Securities that are classified as held-to-maturity reflect BancShares' ability and positive intent to hold those investments until maturity. Table 3 presents detailed information relating to the investment securities portfolio.

Income on Interest-Earning Assets. Interest income amounted to \$216.1 million during the first quarter of 2007, a \$26.1 million or 13.7 percent increase from the first quarter of 2006. Improved yields and growth in the volume of interest-earning assets caused the increase in interest income when compared to the same period of 2006. The taxable-equivalent yield on interest-earning assets for the first quarter of 2007 equaled 6.31 percent, compared to 5.87 percent for the corresponding period of 2006.

Loan interest income for the first quarter of 2007 was \$175.0 million, an increase of \$15.8 million or 9.9 percent from the first quarter of 2006, the combined result of balance sheet growth and higher yields. The taxable-equivalent yield on the loan portfolio was 6.96 percent during the first quarter of 2007, up 30 basis points from the same period of 2006. The higher loan yields resulted from new loans originated at current market rates and repricing of outstanding variable-rate loans. Average loans increased \$493.2 million or 5.1 percent from 2006 to 2007.

Interest income earned on the investment securities portfolio amounted to \$33.6 million during the first quarter of 2007 and \$25.1 million during the same period of 2006, an increase of \$8.5 million or 34.0 percent. This increase in income is the result of improved yields and higher average volume. The taxable-equivalent yield increased 89 basis points from 3.48 percent in the first quarter of 2006 to 4.37 percent in the first quarter of 2007 due to higher market rates. Average investment securities increased \$195.6 million from \$2.90 billion during the first quarter of 2006 to

\$3.09 billion during the first quarter of 2007. Maturing securities not needed to fund loan and lease growth were reinvested in higher-yielding securities.

Interest income from overnight investments amounted to \$7.5 million during the first quarter of 2007, an increase of \$1.7 million from the \$5.7 million earned during the first quarter of 2006, the combined result of a 75 basis point yield increase and \$58.3 million growth in average overnight investments.

Investment
Securities

Table 3

| | March 31, 2007 | | | | March 31, 2006 | | | |
|--|----------------|--------------|------------------------------|--------------------------|----------------|--------------|------------------------------|--------------------------|
| | Cost | Fair Value | Average Maturity (Yrs./Mos.) | Taxable Equivalent Yield | Cost | Fair Value | Average Maturity (Yrs./Mos.) | Taxable Equivalent Yield |
| (thousands) | | | | | | | | |
| Investment securities available for sale: | | | | | | | | |
| U. S. Government: | | | | | | | | |
| Within one year | \$ 1,522,251 | \$ 1,515,123 | 0/6 | 4.06% | \$ 1,284,299 | \$ 1,264,371 | 0/5 | 3.16% |
| One to five years | 1,267,976 | 1,268,807 | 1/7 | 4.92 | 1,009,952 | 997,206 | 1/7 | 4.10 |
| Five to ten years | 6,335 | 6,139 | 6/4 | 4.88 | 1,852 | 1,788 | 7/3 | 4.99 |
| Over ten years | 71,151 | 70,047 | 27/5 | 5.45 | 55,963 | 54,198 | 27/11 | 5.28 |
| Total | 2,867,713 | 2,860,116 | 1/0 | 5.45 | 2,352,066 | 2,317,563 | 1/7 | 3.62 |
| State, county and municipal: | | | | | | | | |
| Within one year | 871 | 870 | 0/3 | 3.02 | 1,076 | 1,074 | 0/3 | 2.37 |
| One to five years | 2,726 | 2,692 | 2/6 | 3.97 | 2,872 | 2,823 | 2/5 | 3.54 |
| Five to ten years | 470 | 476 | 5/11 | 4.90 | 1,114 | 1,104 | 6/1 | 4.65 |
| Over ten years | 211 | 211 | 24/4 | 3.46 | 145 | 145 | 26/8 | 3.01 |
| Total | 4,278 | 4,249 | 3/6 | 3.86 | 5,207 | 5,145 | 3/5 | 3.52 |
| Other | | | | | | | | |
| Over ten years | 9,566 | 10,039 | 11/2 | 10.66 | 11,740 | 11,740 | 11/8 | 11.09 |
| Total | 9,566 | 10,039 | 11/2 | 10.66 | 11,740 | 11,740 | 11/8 | 11.09 |
| Equity securities | 34,297 | 60,591 | | | 36,081 | 61,553 | | |
| Total investment securities available for sale | \$ 2,915,854 | \$ 2,934,995 | | | \$ 2,405,094 | \$ 2,396,001 | | |
| Investment securities held to maturity: | | | | | | | | |
| U. S. Government: | | | | | | | | |
| Within one year | \$ 88,294 | \$ 87,889 | 0/4 | 3.71% | \$ 398,692 | \$ 395,491 | 0/7 | 3.12% |
| One to five years | 3 | 3 | 2/11 | 8.00 | 91,589 | 90,213 | 1/4 | 3.71 |
| Five to ten years | 1,175 | 1,165 | 9/11 | 5.71 | 15 | 13 | 9/10 | 5.22 |
| Over ten years | 5,500 | 5,502 | 10/1 | 5.59 | 8,841 | 8,834 | 11/7 | 5.59 |
| Total | 94,972 | 94,559 | 1/0 | 3.85 | 499,137 | 494,551 | 0/11 | 3.27 |
| Within one year | - | - | | | - | - | | |
| One to five years | 149 | 154 | 4/1 | 5.88 | 147 | 154 | 4/1 | 5.88 |
| Over ten years | 1,432 | 1,548 | 12/1 | 6.02 | 1,427 | 1,553 | 12/1 | 6.02 |
| Total | 1,581 | 1,702 | 10/3 | 6.01 | 1,574 | 1,707 | 11/3 | 6.01 |
| Other | | | | | | | | |
| Within one year | - | - | | | - | - | | |
| One to five years | 250 | 250 | 1/4 | 3.25 | 250 | 250 | 3/4 | 7.75 |
| Five to ten years | - | - | | | - | - | | |
| Total | 250 | 250 | 1/4 | 3.25 | 250 | 250 | 3/4 | 7.75 |
| Total investment securities | | | | | | | | |

| | | | | | | | | |
|-----------------------------|--------------|--------------|-----|------|--------------|--------------|------|------|
| held to maturity | 96,803 | 96,511 | 1/0 | 3.88 | 500,961 | 496,508 | 0/11 | 3.28 |
| Total investment securities | \$ 3,012,657 | \$ 3,031,506 | | | \$ 2,906,055 | \$ 2,892,509 | | |

Average maturity assumes callable securities mature on their earliest call date; yields are based on amortized cost; yields related to securities that are exempt from federal and/or state income taxes are stated on a taxable-equivalent basis assuming statutory rates of 35% for federal income tax purposes and 6.9% for state income taxes for all periods.

INTEREST-BEARING LIABILITIES

Interest-bearing liabilities include our interest-bearing deposits as well as short-term borrowings and long-term obligations. Deposits represent our primary funding source, although we also utilize non-deposit borrowings to stabilize our liquidity base and, in some cases, to fulfill commercial customer requirements for cash management services. Certain of our long-term borrowings also provide capital strength under existing guidelines established by the Federal Reserve Bank and other banking regulators.

Deposits. At March 31, 2007, total deposits equaled \$12.72 billion, an increase of \$210.0 million or 1.7 percent over March 31, 2006. Average interest-bearing deposits were \$9.95 billion during the first quarter of 2007, an increase of \$347.6 million or 3.6 percent from the first quarter of 2006. Average time deposits increased \$427.2 million or 9.1 percent to \$5.11 billion from the first quarter of 2006 to the same period of 2007. During the first quarter of 2007, money market accounts averaged \$2.77 billion, compared to \$2.66 billion in the first quarter of 2006. Partially offsetting these increases, average balances of both Checking With Interest and savings accounts declined marginally.

We attribute the growth of time deposits to the higher interest rate environment, and expect that the mix of time deposit balances within interest-bearing deposits will continue to increase throughout much of 2007 due to generally higher market rates than those paid on existing accounts. Competition for deposit business in our market areas is extremely intense. While we have access to non-deposit borrowing sources, we prefer to fund loan and lease demand with traditional bank deposits. Therefore, generating acceptable levels of deposit growth is a critical challenge for us, particularly during periods of strong loan and lease demand.

Short-term Borrowings. At March 31, 2007, short-term borrowings totaled \$1.25 billion compared to \$850.6 million at March 31, 2006. For the quarters ended March 31, 2007 and 2006, short-term borrowings averaged \$1.20 billion and \$784.7 million, respectively. The growth in short-term borrowings was the result of significantly higher customer demand for our commercial master note and overnight repurchase obligation products, key offerings within our cash management suite of products.

Expense on Interest-Bearing Liabilities. Interest expense amounted to \$99.4 million during the first quarter of 2007, a \$27.3 million or 37.8 percent increase from the first quarter of 2006. The higher interest expense was the result of higher rates and higher average volume. The rate on average interest-bearing liabilities equaled 3.49 percent during the first quarter of 2007, a 78 basis point increase in the aggregate blended rate on interest-bearing liabilities as compared to the first quarter of 2006. Average interest-bearing liabilities increased \$763.5 million or 7.1 percent from first quarter of 2006 to the first quarter of 2007.

NET INTEREST INCOME

Net interest income totaled \$116.6 million during the first quarter of 2007, a decrease of \$1.2 million or 1.0 percent from the first quarter of 2006. The taxable-equivalent net yield on interest-earning assets equaled 3.42 percent for the first quarter of 2007, compared to the 3.65 percent achieved for the first quarter of 2006. This 23 basis point reduction primarily resulted from the unfavorable impact of the flat yield curve which has persisted since the first quarter of 2006.

Net interest income during the first quarter of 2007 was \$274,000 less than the \$116.9 million recognized during the fourth quarter of 2006. However, the taxable-equivalent net yield on interest-earning assets improved slightly from the 3.34 percent recorded during the fourth quarter of 2006.

Our asset/liability management strategy continues to focus on maintaining high levels of balance sheet liquidity and managing our interest rate risk. We maintain portfolios of interest-earning assets and interest-bearing liabilities with

maturities or repricing characteristics that will protect against wide interest rate fluctuations, thereby limiting, to the extent possible, the ultimate interest rate exposure.

Consolidated Taxable Equivalent Rate/Volume Variance Analysis - First Quarter

Table 4

| (thousands) | 2007 | | | 2006 | | | Increase (decrease) due to: | | |
|------------------------------------|-----------------|-------------------------|------------|-----------------|-------------------------|------------|-----------------------------|------------|--------------|
| | Average Balance | Interest Income/Expense | Yield/Rate | Average Balance | Interest Income/Expense | Yield/Rate | Volume | Yield/Rate | Total Change |
| Assets | | | | | | | | | |
| Loans and leases | \$ 10,198,638 | \$ 175,453 | 6.96% | \$ 9,705,443 | \$ 159,587 | 6.66% | \$ 8,393 | \$ 7,473 | \$ 15,866 |
| Investment securities: | | | | | | | | | |
| U. S. Government | 3,014,804 | 32,744 | 4.37 | 2,816,950 | 24,285 | 3.47 | 1,951 | 6,508 | 8,459 |
| State, county and municipal | 5,830 | 72 | 5.01 | 6,745 | 87 | 5.23 | (12) | (3) | (15) |
| Other | 71,627 | 774 | 4.38 | 73,016 | 711 | 3.95 | (14) | 77 | 63 |
| Total investment securities | 3,092,261 | 33,590 | 4.37 | 2,896,711 | 25,083 | 3.48 | 1,925 | 6,582 | 8,507 |
| Overnight investments | 585,503 | 7,461 | 5.17 | 527,159 | 5,739 | 4.42 | 691 | 1,031 | 1,722 |
| Total interest-earning assets | \$ 13,876,402 | \$ 216,504 | 6.31% | \$ 13,129,313 | \$ 190,409 | 5.87% | \$ 11,009 | \$ 15,086 | \$ 26,095 |
| Liabilities | | | | | | | | | |
| Interest-bearing deposits: | | | | | | | | | |
| Checking With Interest | \$ 1,475,547 | \$ 454 | 0.12% | \$ 1,561,441 | \$ 469 | 0.12% | \$ (20) | \$ 5 | \$ (15) |
| Savings | 592,804 | 311 | 0.21 | 691,093 | 362 | 0.21 | (51) | - | (51) |
| Money market accounts | 2,768,393 | 22,555 | 3.30 | 2,663,856 | 16,169 | 2.46 | 751 | 5,635 | 6,386 |
| Time deposits | 5,111,594 | 56,691 | 4.50 | 4,684,360 | 40,742 | 3.53 | 4,232 | 11,717 | 15,949 |
| Total interest-bearing deposits | 9,948,338 | 80,011 | 3.26 | 9,600,750 | 57,742 | 2.44 | 4,912 | 17,357 | 22,269 |
| Federal funds purchased | 78,535 | 1,002 | 5.17 | 47,080 | 506 | 4.36 | 370 | 126 | 496 |
| Repurchase agreements | 272,767 | 2,469 | 3.67 | 165,737 | 1,188 | 2.91 | 869 | 412 | 1,281 |
| Master notes | 774,306 | 8,295 | 4.34 | 509,145 | 4,685 | 3.73 | 2,641 | 969 | 3,610 |
| Other short-term borrowings | 75,717 | 916 | 4.91 | 62,762 | 613 | 3.96 | 141 | 162 | 303 |
| Long-term obligations | 408,277 | 6,755 | 6.62 | 408,946 | 7,449 | 7.29 | (15) | (679) | (694) |
| Total interest-bearing liabilities | \$ 11,557,940 | \$ 99,448 | 3.49% | \$ 10,794,420 | \$ 72,183 | 2.71% | \$ 8,918 | \$ 18,347 | \$ 27,265 |
| Interest rate spread | | | 2.82% | | | 3.16% | | | |

Net interest
income and net
yield
on
interest-earning
assets

| | | | | | | |
|------------|-------|------------|-------|----------|------------|------------|
| \$ 117,056 | 3.42% | \$ 118,226 | 3.65% | \$ 2,091 | \$ (3,261) | \$ (1,170) |
|------------|-------|------------|-------|----------|------------|------------|

Average loan and lease balances include nonaccrual loans and leases. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only are stated on a taxable-equivalent basis assuming a statutory federal income tax rate of 35% and state income tax rate of 6.90% for each period. The taxable-equivalent adjustment was \$443 for 2007 and \$408 for 2006.

NONINTEREST INCOME

The growth of noninterest income is essential to our ability to sustain adequate levels of profitability. The primary sources of noninterest income are cardholder and merchant services income, service charges on deposit accounts, various types of commission-based income, fees from processing services and various types of revenues derived from wealth management services.

During the first three months of 2007, noninterest income amounted to \$71.2 million, compared to \$65.7 million during the same period of 2006. The \$5.5 million or 8.3 percent increase was primarily due to improvements in cardholder and merchant services income, commission income generated by First Citizens Investor Services and the working capital finance group, mortgage income and fees from processing services.

Cardholder and merchant services generated \$22.4 million during the first quarter of 2007, an increase of \$3.9 million or 21.4 percent compared to the first quarter of 2006. This increase resulted from higher merchant discount and higher interchange income, the result of growth in transaction volumes generated by both debit and credit cardholders.

Within commission income, fees of \$5.4 million generated by broker-dealer activities increased 18.1 percent due to strong market conditions and higher referral activity generated from the branch network. The \$1.6 million of commission income generated by the working capital finance group increased 81.8 percent as receivables purchased continued to surge.

Fees from processing services totaled \$8.2 million in the first quarter of 2007 and \$6.9 million in the first quarter of 2006. The \$1.3 million or 18.5 percent increase was the combined result of increased volume and rate changes that were effective January 1, 2007.

Service charges on deposit accounts generated \$17.2 million and \$18.2 million for the first quarter of 2007 and 2006, respectively. The \$1.0 million or 5.8 percent decrease was primarily due to lower bad debt and overdraft charges. Commercial service charges also declined, the result of higher interest rates, which reduce service charge income earned on commercial analysis accounts.

NONINTEREST EXPENSE

The primary components of noninterest expense are salaries and related employee benefit costs, occupancy expenses related to branch offices and support facilities, and equipment costs related to branch offices and technology.

Noninterest expense equaled \$139.2 million for the first three months of 2007, a \$7.5 million or 5.7 percent increase over the \$131.7 million recorded during the same period of 2006. As a result of its continued growth and expansion, ISB's noninterest expense increased from \$18.0 million for the first quarter of 2006 to \$19.1 million in 2007, a \$1.1 million or 6.2 percent increase.

Salaries and wages increased \$2.6 million or 4.7 percent during the first quarter of 2007 when compared to the same period of 2006. The increase resulted from workforce expansions both as a result of new branch offices and headcount additions in various support functions and 2006 merit increases. Employee benefits expense totaled \$13.2 million for the first three months of 2007, a decrease of \$766,000. This 5.5 percent decrease resulted from reduced pension costs.

Occupancy expense amounted to \$13.9 million during the first quarter of 2007 and \$12.9 million during the first quarter of 2006. The \$980,000 or 7.6 percent increase resulted from higher building depreciation, utilities, local taxes and other costs arising from branch expansion. Equipment costs rose \$1.1 million or 8.7 percent from \$12.7 million in the first quarter of 2006 to \$13.8 million in the first quarter of 2007, primarily due to higher technology costs.

Other expenses increased \$3.5 million or 9.8 percent from the first quarter of 2006 to the first quarter of 2007. This increase includes a \$1.5 million increase in the cost of cardholder reward programs, a \$432,000 increase in card processing costs and smaller increases among advertising and losses incurred on asset sales. Partially offsetting these increases, declines were noted in sponsorships and promotions, recording fees and courier agency costs.

INCOME TAXES

BancShares continually monitors and evaluates the potential impact of current events on the estimates used to establish income tax expenses and income tax liabilities. On a periodic basis, we evaluate our income tax positions based on current tax law, positions taken by various tax auditors within the jurisdictions that BancShares is required to file income tax returns as well as potential or pending audits or assessments by such tax auditors.

Income tax expense amounted to \$16.1 million during the three months ended March 31, 2007, compared to \$16.5 million during the same period of 2006. The 2.1 percent decrease in income tax expense was primarily the result of lower blended state tax rates and changes to the deferred tax asset valuation allowance. The effective tax rates for these periods were 35.7 percent and 36.5 percent, respectively.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies uncertainty in income taxes recognized by establishing a recognition threshold and a measurement attribute for the financial statement treatment of a tax position taken or expected to be taken in a tax return. The adoption of FIN 48 resulted in a reduction in the liability for uncertain tax positions, which was offset by a \$962,000 increase in the beginning balance of retained earnings.

SHAREHOLDERS' EQUITY AND CAPITAL ADEQUACY

BancShares continues to exceed minimum regulatory capital standards, and the banking subsidiaries remain well-capitalized. At March 31, 2007 and 2006, the leverage capital ratios of BancShares were 9.60 percent and 9.26 percent, respectively, surpassing the minimum level of 3 percent. As a percentage of risk-adjusted assets, BancShares' Tier 1 capital ratios were 13.09 percent at March 31, 2007 and 12.55 percent at March 31, 2006. The minimum ratio allowed is 4 percent of risk-adjusted assets. The total risk-adjusted capital ratios were 15.52 percent at March 31, 2007 and 15.07 percent as of March 31, 2006. The minimum total capital ratio is 8 percent.

The continued de novo growth and operating losses of ISB have required BancShares to infuse significant amounts of capital into ISB to support its expanding balance sheet. BancShares infused \$5.0 million into ISB during the first quarter of 2007. Since ISB was formed in 1997, BancShares has provided \$285.0 million in capital. Losses incurred since ISB's inception total \$27.3 million. BancShares' prospective capacity to provide capital to support the growth and expansion of ISB is highly dependent upon FCB's ability to return capital through dividends to BancShares.

RISK MANAGEMENT

In the normal course of business, BancShares is exposed to various risks. To manage the major risks that are inherent in the operation of a financial holding company and to provide reasonable assurance that our long-term business objectives will be attained, various policies and risk management processes identify, monitor and manage risk within acceptable tolerances. Management continually refines and enhances its risk management policies and procedures to maintain effective risk management.

The most prominent risk exposures are credit, interest rate and liquidity risk. Credit risk is the risk of not collecting the amount of a loan, lease or investment security when it is contractually due. Interest rate risk is the potential reduction of net interest income as a result of changes in market interest rates. Liquidity risk is the possible inability to fund obligations to depositors, creditors, investors or borrowers.

Credit Risk. The maintenance of excellent asset quality is one of our key performance measures. BancShares manages and monitors extensions of credit and the quality of the loan and lease portfolio through rigorous initial underwriting processes and periodic ongoing reviews. Underwriting standards reflect credit policies and procedures, and much of the credit decision process is centralized. We maintain a credit review function that conducts independent risk reviews and analyses for the purpose of ensuring compliance with credit policies and to monitor asset quality trends. The independent risk reviews include portfolio analysis by geographic location and horizontal reviews across industry sectors within the banking subsidiaries. BancShares strives to identify potential credit problems as early as possible, to take charge-offs or write-downs as appropriate and to maintain adequate allowances for credit losses that are inherent in the loan and lease portfolio.

We maintain a well-diversified loan and lease portfolio, and seek to avoid the risk associated with large concentrations within specific geographic areas or industries. The recent expansion of our branch network has allowed us to mitigate our historic exposure to geographic risk concentration in North Carolina and Virginia.

In recent years, we have aggressively sought opportunities to provide financial services to businesses associated with and professionals within the medical community. Due to strong loan growth within this segment of our loan and lease portfolio, our loans and leases to borrowers in medical, dental or related fields totaled \$1.84 billion as of March 31, 2007, which represents 18.0 percent of total loans and leases outstanding, compared to \$1.56 billion or 15.9 percent of loans and leases at March 31, 2006. Except for this single concentration, no other industry represented more than 10 percent of total loans and leases outstanding at March 31, 2007.

Nonperforming Assets. Nonperforming assets include nonaccrual loans and leases and other real estate. Other real estate includes foreclosed property as well as branch facilities that we have closed but not sold. At March 31, 2007, BancShares' nonperforming assets amounted to \$21.2 million or 0.21 percent of loans and leases plus foreclosed properties, compared to \$21.4 million at March 31, 2006. Management views these levels of nonperforming assets as evidence of strong asset quality. Management continues to closely monitor nonperforming assets, taking necessary actions to minimize potential exposure.

Summary of Loan and Lease Loss Experience and Risk Elements

Table 5

| | 2007 | | 2006 | | |
|--|----------------------------|---------------|---------------|--------------|--------------|
| | First | Fourth | Third | Second | First |
| | Quarter | Quarter | Quarter | Quarter | Quarter |
| | (thousands, except ratios) | | | | |
| Allowance for credit losses at beginning of period | \$ 138,646 | \$ 138,246 | \$ 137,121 | \$ 137,145 | \$ 135,770 |
| Provision for credit losses | 3,532 | 7,383 | 3,813 | 2,973 | 6,737 |
| Adjustment | | - | - | - | - |
| Net charge-offs: | | | | | |
| Charge-offs | (3,980) | (8,162) | (4,189) | (4,933) | (7,053) |
| Recoveries | 1,298 | 1,179 | 1,501 | 1,936 | 1,691 |
| Net charge-offs | (2,682) | (6,983) | (2,688) | (2,997) | (5,362) |
| Allowance for credit losses at end of period | \$ 139,496 | \$ 138,646 | \$ 138,246 | \$ 137,121 | \$ 137,145 |
| Allowance for credit losses includes: | | | | | |
| Allowance for loan and lease losses | \$ 132,640 | \$ 132,004 | \$ 131,652 | \$ 130,532 | \$ 130,222 |
| Liability for unfunded credit commitments | 6,856 | 6,642 | 6,594 | 6,589 | 6,923 |
| Allowance for credit losses at end of period | \$ 139,496 | \$ 138,646 | \$ 138,246 | \$ 137,121 | \$ 137,145 |
| Historical Statistics | | | | | |
| Average loans and leases | \$ 10,198,638 | \$ 10,133,502 | \$ 10,075,016 | \$ 9,924,208 | \$ 9,705,443 |
| Loans and leases at period-end | 10,221,578 | 10,239,551 | 10,129,423 | 10,029,045 | 9,810,088 |
| Risk Elements | | | | | |
| Nonaccrual loans and leases | \$ 14,943 | \$ 14,882 | \$ 18,348 | \$ 15,573 | \$ 15,844 |
| Other real estate | 6,245 | 6,028 | 6,711 | 8,461 | 5,573 |
| Total nonperforming assets | \$ 21,188 | \$ 20,910 | \$ 25,059 | \$ 24,034 | \$ 21,417 |
| Accruing loans and leases 90 days or more past due | \$ 8,396 | \$ 5,185 | \$ 6,974 | \$ 7,534 | \$ 6,729 |
| Ratios | | | | | |
| Net charge-offs (annualized) to average total loans and leases | 0.11% | 0.27 | 0.11% | 0.12 | 0.22 |
| Percent of loans and leases at period-end: | | | | | |
| Allowance for loan and lease losses | 1.30 | 1.29 | 1.29 | 1.30 | 1.33 |
| Reserve for unfunded commitments | 0.07 | 0.06 | 0.07 | 0.07 | 0.07 |

| | | | | | |
|---|------|------|------|------|------|
| Allowance for credit losses | 1.36 | 1.35 | 1.36 | 1.37 | 1.40 |
| Nonperforming assets to total loans and leases plus other real estate | 0.21 | 0.20 | 0.25 | 0.24 | 0.22 |

Allowance for credit losses. At March 31, 2007, the allowance for credit losses totaled \$139.5 million or 1.36 percent of total loans and leases, compared to 1.40 percent at March 31, 2006. The allowance for credit losses includes the allowance for loan and lease losses and the reserve for unfunded credit commitments. We continuously analyze the growth and risk characteristics of the loan and lease portfolio under current economic conditions in order to evaluate the adequacy of the allowance. Such factors as the financial condition of borrowers, fair market value of collateral and other considerations are recognized in estimating probable credit losses.

Management considers the established allowance adequate to absorb estimated probable losses that relate to loans and leases outstanding at March 31, 2007, although future additions may be necessary based on changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for credit losses. Such agencies may require the recognition of adjustments to the allowance based on their judgments of information available to them at the time of their examination.

The provision for credit losses charged to operations during the first quarter of 2007 was \$3.5 million, compared to \$6.7 million during the first quarter of 2006. The \$3.2 million decrease in the provision for credit losses during 2007 resulted primarily from lower net charge-offs. Net charge-offs during the first quarter of 2007 equaled \$2.7 million compared to \$5.4 million during the first quarter of 2006. On an annualized basis, net charge-offs represent 0.11 percent of average loans and leases during the first quarter of 2007 compared to 0.22 percent in the first quarter of 2006. Table 5 provides details concerning the allowance and provision for credit losses during the past five quarters.

Interest Rate Risk. Interest rate risk results principally from assets and liabilities maturing or repricing at different points in time, from assets and liabilities repricing at the same point in time but in different amounts and from short-term and long-term interest rates changing in different magnitudes, an event frequently described by the resulting impact on the shape of the yield curve. External interest rates may also have a direct or indirect impact on the interest rate and repricing characteristics of loans and leases that are originated as well as the rate characteristics of our interest-bearing liabilities.

We do not typically utilize interest rate swaps, floors, collars or other derivative financial instruments to attempt to hedge our rate sensitivity and interest rate risk. However, during the second quarter of 2006, in conjunction with the issuance of \$115.0 million in trust preferred securities, we entered into an interest rate swap to synthetically convert the variable rate coupon on the securities to a fixed rate of 7.125 percent for a period of five years.

Liquidity Risk. Liquidity risk results from the mismatching of asset and liability cash flows. BancShares manages this risk by structuring its balance sheet prudently and by maintaining various borrowing resources to fund potential cash needs. BancShares has historically maintained a strong focus on liquidity, and our deposit base represents our primary liquidity source. Through our deposit pricing strategies, we have the ability to stimulate or curtail deposit growth. BancShares also maintains additional sources for borrowed funds through federal funds lines of credit and other borrowing facilities. At March 31, 2007, BancShares had access to \$525.0 million in unfunded borrowings through its correspondent bank network.

Once we have generated the needed liquidity and satisfied our loan and lease demand, residual liquidity is invested in overnight and longer-term investment products. Investment securities available for sale provide immediate liquidity as needed. In addition, investment securities held to maturity provide an ongoing liquidity source based on the scheduled maturity dates of the securities.

SEGMENT REPORTING

BancShares conducts its banking operations through its two banking subsidiaries, FCB and ISB. Although FCB and ISB offer similar products and services to customers, each entity operates in distinct geographic markets and has separate management groups. We monitor growth and financial results in these institutions separately and, within each institution, by geographic segregation.

Although FCB has grown through acquisition in certain of its markets, throughout its history the majority of its expansion has been accomplished on a de novo basis. However, because of FCB's size, market share and maturity as well as the current modest expansion of its branch network, the costs associated with de novo branching are not material to FCB's financial performance. Since it first opened in 1997, ISB has followed a similar business model for growth and expansion. Yet, due to the magnitude of the number of branch offices that have yet to attain sufficient size for profitability, the financial results and trends of ISB are significantly affected by its current and continuing growth. Each new market ISB enters creates additional operating costs that are typically not fully offset by operating revenues until the third year after initial opening. ISB's rapid growth in new markets in recent years has continued to adversely impact its financial performance.

IronStone Bank. At March 31, 2007, ISB operated 58 branches in Florida, Georgia, Texas, New Mexico, Arizona, California, Oregon, Washington and Colorado. ISB continues to focus on markets with favorable growth prospects. At the beginning of 2007, IronStone announced plans to expand into new areas, Oklahoma City, Kansas City and Dallas. Our business model for these new markets has two primary requirements. First, we recruit experienced bankers who are established in the markets we are entering and who are focused on strong asset quality and delivering high quality customer service. Second, we occupy attractive branch facilities located in areas conducive to attracting medical and professional customers. While these are costly goals, we believe that they are critical to establishing a solid foundation for future success in new markets.

ISB's total assets equaled \$2.23 billion at March 31, 2007 compared to \$1.95 billion at March 31, 2006, an increase of \$280.1 million or 14.4 percent. Net interest income decreased \$375,000 or 2.3 percent during the first quarter of 2007, the result of a lower net yield on interest-earning assets.

The provision for credit losses decreased \$648,000 during the first quarter of 2007 due to lower provision expense attributable to reduced levels of loan growth. Net charge-offs increased from \$141,000 in the first quarter of 2006 to \$219,000 in the first quarter of 2007. On an annualized basis, the ratio of current quarter net charge-offs to average loans and leases outstanding equaled 0.05 percent, compared to 0.03 percent in the prior year.

ISB's noninterest income increased \$657,000 or 25.8 percent during the first quarter of 2007 as cardholder and merchant services income increased \$307,000 and working capital finance commissions increased \$278,000.

Noninterest expense increased \$1.1 million or 6.2 percent during the first quarter of 2007, versus the same period of 2006. Personnel costs increased \$162,000 or 1.8 percent, while occupancy expense was up \$507,000 or 16.0 percent. Other expense equaled \$5.3 million during the first quarter of 2007 compared to \$4.9 million during the first quarter of 2006 caused by higher general operating expenses, such as credit card processing and service fee expense. Due to continuing branch expansions, we expect ISB's noninterest expenses will continue to grow in future periods.

ISB recorded a net loss of \$266,000 during the first quarter of 2007, compared to net loss of \$147,000 during the same period of 2006. This represents an unfavorable variance of \$119,000. ISB continues to evaluate expansion opportunities. As a result of the anticipated growth of its franchise, ISB expects to operate at a near breakeven level during 2007.

First-Citizens Bank & Trust Company. At March 31, 2007, FCB operated 339 branches in North Carolina, Virginia, West Virginia, Maryland and Tennessee.

FCB's total assets increased from \$13.00 billion at March 31, 2006 to \$13.36 billion at March 31, 2007, an increase of \$355.4 million or 2.7 percent. FCB's net interest income decreased \$2.2 million or 2.1 percent during 2007 due to a lower net yield, partially offset by slightly higher balances of interest-earning assets.

The provision for credit losses decreased \$2.6 million due to lower net charge offs, which declined by 52.8 percent. FCB's noninterest income increased \$6.0 million or 9.3 percent during the first quarter of 2007, primarily the result of higher cardholder and merchant services income, mortgage income and commission-based income. Noninterest expense increased \$7.3 million or 6.4 percent during 2007, caused principally by higher personnel, occupancy and technology related costs.

FCB recorded net income of \$31.7 million during the first quarter of 2007 compared to \$31.9 million during the same period of 2006. This represents a \$288,000 or 0.9 percent decrease in net income due to a lower net yield on interest-earning assets and higher noninterest expense.

CURRENT ACCOUNTING AND REGULATORY ISSUES

In June 2006, the FASB issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies uncertainty in income taxes recognized by establishing a recognition threshold and a measurement attribute for the financial statement treatment of a tax position taken or expected to be taken in a tax return. We adopted FIN 48 effective January 1, 2007. The adoption of FIN 48 resulted in a reduction in the liability for uncertain tax positions, which was offset by a \$962,000 adjustment to the beginning balance of retained earnings.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 "Fair Value Measurements" (Statement 157). Statement 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement 157 does not require any new fair value measurements, but clarifies and standardizes some divergent practices that have emerged since prior guidance was issued. Statement 157 will become effective for BancShares on January 1, 2008. We do not anticipate a material impact on our consolidated financial statements.

In September 2006, the FASB issued Summary of Statement No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (Statement 158). Statement 158 requires sponsors of defined benefit and other post-retirement plans to recognize the overfunded or underfunded status of that plan as an asset or liability in the sponsor's statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The recognition of the funded status of the defined benefit plan and additional disclosures outlined in Statement 158 were reflected in BancShares' December 31, 2006 consolidated financial statements. Statement 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, although that requirement is not effective until 2008.

Management is not aware of any current recommendations by regulatory authorities that, if implemented, would have or would be reasonably likely to have a material effect on liquidity, capital ratios or results of operations.

FORWARD-LOOKING STATEMENTS

Statements in this Report and exhibits relating to plans, strategies, economic performance and trends, projections of results of specific activities or investments, expectations or beliefs about future events or results, and other statements that are not descriptions of historical facts, may be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Forward-looking information is inherently subject to risks and uncertainties, and actual results could differ materially from those currently anticipated due to a number of factors, which include, but are not limited to, factors discussed in our Annual Report on Form 10-K and in other documents filed by us from time to time with the Securities and Exchange Commission.

Forward-looking statements may be identified by terms such as “may,” “will,” “should,” “could,” “expects,” “plans,” “intends,” “anticipates,” “believes,” “estimates,” “predicts,” “forecasts,” “projects,” “potential” or “continue,” or similar terms or the negation of these terms, or other statements concerning opinions or judgments of BancShares’ management about future events.

Factors that could influence the accuracy of those forward-looking statements include, but are not limited to, the financial success or changing strategies of our customers, customer acceptance of our services, products and fee structure, the competitive nature of the financial services industry, our ability to compete effectively against other financial institutions in our banking markets, actions of government regulators, the level of market interest rates and our ability to manage our interest rate risk, changes in general economic conditions particularly changes that affect our loan and lease portfolio, the abilities of our borrowers to repay their loans and leases, and the values of collateral, and other developments or changes in our business that we do not expect.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We have no obligation to update these forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the potential economic loss resulting from changes in market prices and interest rates. This risk can either result in diminished current fair values of financial instruments or reduced net interest income in future periods. As of March 31, 2007, BancShares' market risk profile has not changed significantly from December 31, 2006. Changes in fair value that result from movement in market rates cannot be predicted with any degree of certainty. Therefore, the impact that future changes in market rates will have on the fair values of financial instruments is uncertain.

Item 4. Controls and Procedures

BancShares' management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of BancShares' disclosure controls and procedures in accordance with Rule 13a-15 of the Securities Exchange Act of 1934 (Exchange Act). Based on their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, BancShares' disclosure controls and procedures were effective in enabling it to record, process, summarize and report in a timely manner the information required to be disclosed in reports it files under the Exchange Act.

No change in BancShares' internal control over financial reporting occurred during the first quarter of 2007 that had materially affected, or is reasonably likely to materially affect, BancShares' internal control over financial reporting.

PART II

Item 6. Exhibits

31.1 Certification of Chief Executive Officer

31.2 Certification of Chief Financial Officer

32 Certifications of Chief Executive Officer and Chief Financial Officer

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.

Dated: May 4, 2007

FIRST CITIZENS BANCSHARES, INC.
(Registrant)

By: /s/Kenneth A. Black
Kenneth A. Black
Vice President, Treasurer
and Chief Financial Officer