

FIRST FARMERS FINANCIAL CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012

FIRST FARMERS FINANCIAL CORPORATION
Converse, Indiana

CONSOLIDATED FINANCIAL STATEMENTS
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CONTENTS

INDEPENDENT AUDITOR'S REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS	
CONSOLIDATED BALANCE SHEETS.....	3
CONSOLIDATED STATEMENTS OF INCOME	4
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME.....	5
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY	6
CONSOLIDATED STATEMENTS OF CASH FLOWS	7
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.....	9

INDEPENDENT AUDITOR'S REPORT

Board of Directors
First Farmers Financial Corporation
Converse, Indiana

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of First Farmers Financial Corporation, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

(Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Farmers Financial Corporation as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Indianapolis, Indiana
March 19, 2014

FIRST FARMERS FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and due from financial institutions	\$ 38,884	\$ 36,645
Money market funds	<u>12,849</u>	<u>3,882</u>
Cash and cash equivalents	51,733	40,527
Securities available for sale	179,072	164,623
Securities held to maturity (fair value \$20,632 in 2013 and \$23,777 in 2012)	19,873	22,630
Restricted stock, at cost	7,790	6,193
Loans held-for-sale	3,173	25,921
Loans, net of allowance of \$12,284 and \$10,263	911,357	849,696
Premises and equipment, net	15,277	14,881
Goodwill	8,482	8,393
Core deposit and other intangibles	2,470	2,583
Bank-owned life insurance	4,622	4,492
Investments in affordable housing partnerships	10,237	10,523
Accrued interest receivable and other assets	<u>14,501</u>	<u>16,064</u>
	<u>\$ 1,228,587</u>	<u>\$ 1,166,526</u>
 LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing deposits	\$ 228,587	\$ 211,759
Interest-bearing deposits	<u>783,181</u>	<u>734,679</u>
Total deposits	1,011,768	946,438
Federal funds purchased	-	10,850
Federal Home Loan Bank (FHLB) advances	79,625	83,350
Notes payable	9,751	4,500
Subordinated debentures	18,000	18,000
Accrued interest payable and other liabilities	<u>11,199</u>	<u>15,642</u>
Total liabilities	1,130,343	1,078,780
 Stockholders' equity		
Common stock, \$1 stated value, 5,000,000 shares authorized, 3,571,812 issued and 3,562,172 outstanding in 2013; 3,572,276 issued and 3,552,120 outstanding in 2012	3,572	1,786
Additional paid-in capital	3,434	3,440
Retained earnings	92,381	81,174
Treasury Stock (9,640 shares in 2013 and 20,156 shares in 2012)	(254)	(510)
Accumulated other comprehensive income (loss)	<u>(889)</u>	<u>1,856</u>
Total stockholders' equity	<u>98,244</u>	<u>87,746</u>
	<u>\$ 1,228,587</u>	<u>\$ 1,166,526</u>

See accompanying notes.

FIRST FARMERS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

	<u>2013</u>	<u>2012</u>
Interest and dividend income		
Loans, including fees	\$ 44,414	\$ 42,404
Securities		
Taxable	2,213	1,869
Non-taxable	1,829	1,879
Other	<u>68</u>	<u>68</u>
	48,524	46,220
Interest expense		
Deposits	3,235	5,119
Short-term borrowings	33	3
Note payable and FHLB advances	1,426	1,606
Subordinated debentures	<u>478</u>	<u>807</u>
	5,172	7,535
Net interest income	43,352	38,685
Provision for loan losses	<u>3,435</u>	<u>3,750</u>
Net interest income after provision for loan losses	39,917	34,935
Other income		
Trust and investment product fees	1,001	701
Service charges on deposit accounts	2,007	2,046
Interchange income	1,672	1,403
Net gain on sale and redemption of securities	13	363
Net gain on sale of loans	3,856	4,763
Other income	<u>2,513</u>	<u>2,182</u>
	11,062	11,458
Other expenses		
Salaries and employee benefits	17,510	16,012
Occupancy and equipment expense	3,829	3,733
Amortization of intangible assets	705	779
FDIC insurance	675	650
Other operating expenses	<u>6,685</u>	<u>6,634</u>
	29,404	27,808
Income before income taxes	21,575	18,585
Provision for income taxes	<u>5,758</u>	<u>5,179</u>
Net income	<u>\$ 15,817</u>	<u>\$ 13,406</u>
Basic and diluted earnings per common share	<u>\$ 4.44</u>	<u>\$ 3.78</u>
Basic and diluted average common shares outstanding	<u>3,559,410</u>	<u>3,549,164</u>

See accompanying notes.

FIRST FARMERS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

	<u>2013</u>	<u>2012</u>
Net income	\$ 15,817	\$ 13,406
Other comprehensive income (loss):		
Change in securities available for sale:		
Unrealized holding gains/(losses) on securities available-for-sale	(4,603)	885
Reclassification adjustments for gains later recognized in income	<u>(13)</u>	<u>(363)</u>
Net unrealized gains/(losses)	(4,616)	522
Tax effect	<u>1,618</u>	<u>(177)</u>
Net of tax amount	(2,998)	345
Cash flow hedges:		
Change in fair value of derivatives used for cash flow hedges	419	50
Reclassification adjustments for (gains)/losses realized in income	<u>-</u>	<u>-</u>
Net unrealized gains	419	50
Tax effect	<u>(166)</u>	<u>(20)</u>
Net of tax amount	253	30
Other comprehensive income (loss), net of tax	<u>(2,745)</u>	<u>375</u>
Comprehensive income	<u>\$ 13,072</u>	<u>\$ 13,781</u>

See accompanying notes.

FIRST FARMERS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at January 1, 2012	\$ 1,786	\$ 3,447	\$ 70,235	\$ (720)	\$ 1,481	\$ 76,229
Net income			13,406			13,406
Other comprehensive income					375	375
Purchase of treasury stock, 184 shares				(5)		(5)
Sale of treasury stock, 3,300 shares		10		78		88
Restricted stock awards from treasury, 5,750 shares		(137)		137		0
Stock-based compensation		120				120
Dividends declared (\$0.70 per share)			(2,467)			(2,467)
Balance at December 31, 2012	1,786	3,440	81,174	(510)	1,856	87,746
Net income			15,817			15,817
Other comprehensive loss					(2,745)	(2,745)
Purchase of treasury stock, 594 shares				(18)		(18)
Sale of treasury stock, 3,596 shares		18		93		111
Retirement of treasury stock, 464 shares	-		(12)	12		-
Restricted stock awards from treasury, 7,400 shares		(178)		178		-
Stock-based compensation, net of 350 shares forfeited		154		(9)		145
Stock split	1,786		(1,786)			-
Dividends declared (\$0.79 per share)			(2,812)			(2,812)
Balance at December 31, 2013	<u>\$ 3,572</u>	<u>\$ 3,434</u>	<u>\$ 92,381</u>	<u>\$ (254)</u>	<u>\$ (889)</u>	<u>\$ 98,244</u>

See accompanying notes.

FIRST FARMERS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities		
Net income	\$ 15,817	\$ 13,406
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	1,231	1,221
Amortization of intangible assets	705	779
Net securities amortization (accretion)	683	1,807
Servicing rights amortization and impairment	548	975
Stock-based compensation	145	120
Provision for loan losses	3,435	3,750
Net gain on sale of loans	(3,856)	(4,763)
Net gain on sale and redemption of securities	(13)	(363)
Net loss on sale and write-down of premises and equipment	102	15
Net loss on sale and write-down of other real estate	22	277
Impairment of branch facility	218	-
Earnings on bank-owned life insurance	(130)	(103)
Pass thru losses in community development investments	533	220
Loans originated for resale	(70,689)	(108,932)
Proceeds from sale of loans	95,829	99,497
Changes in assets and liabilities		
Interest receivable and other assets	2,343	502
Interest payable and other liabilities	(3,327)	1,619
Net cash from operating activities	<u>43,596</u>	<u>10,027</u>
Cash flows from investing activities		
Securities available-for-sale		
Proceeds from sales	795	51,044
Purchases	(68,599)	(58,607)
Proceeds from principal payments, calls and maturities	49,603	52,843
Securities held-to-maturity		
Proceeds from principal payments, calls and maturities	2,750	5,071
Loans made to customers net of payments received	(43,342)	(81,522)
Net cash received/(disbursed) in acquisition	50,367	(3,339)
Premises and equipment expenditures	(1,201)	(804)
Proceeds from the sale of fixed assets	184	109
Investments in affordable housing partnerships	(2,213)	(4,146)
Proceeds from the sale of other real estate owned	2,336	2,457
Proceeds from redemption of restricted stock	-	622
Purchase of restricted stock	(222)	(305)
Net cash from investing activities	<u>(9,542)</u>	<u>(36,577)</u>
Cash flows from financing activities		
Net change in deposit accounts	(11,588)	36,974
Net change in short-term borrowings	(10,850)	1,905
Advances from notes payable	10,000	5,000
Payments on notes payable	(4,749)	(1,403)
Payments on FHLB advances	(32,725)	(14,975)
Proceeds from FHLB advances	29,000	20,000
Retirement of subordinated debentures	-	(2,500)
Purchase of treasury stock	(18)	(5)
Sale of treasury stock	111	88
Dividends paid	(2,029)	(3,051)
Net cash from financing activities	<u>(22,848)</u>	<u>42,033</u>
Net change in cash and cash equivalents	11,206	15,483
Cash and cash equivalents at beginning of year	<u>40,527</u>	<u>25,044</u>
Cash and cash equivalents at end of year	<u><u>\$ 51,733</u></u>	<u><u>\$ 40,527</u></u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

	<u>2013</u>	<u>2012</u>
Supplemental disclosures of cash flow information		
Cash paid during the year for:		
Interest	\$ 5,257	\$ 7,755
Income taxes	5,387	3,100
Supplemental non-cash disclosures		
Real estate acquired in satisfaction of debts previously contracted	455	822
Assets acquired	76,687	212,165
Liabilities assumed	(77,311)	(197,928)

See accompanying notes.

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Nature of Operations: The consolidated financial statements of First Farmers Financial Corporation ("Corporation") include its wholly-owned subsidiaries, First Farmers Bank & Trust ("Bank"), First Farmers Risk Management, Inc. and 46992 Holdings, LLC and the Bank's wholly-owned subsidiaries Security Capital, Inc. ("SCI"), Mark Tully Investments II, Inc. ("MTII"), Mark Tully Holdings II, Inc. ("MTHI"), and Mark Tully II, LLC ("MTL"). Security Capital Inc. originates and services leases on behalf of Midwestern financial institutions. First Farmers Risk Management, Inc. is a captive reinsurance subsidiary. MTII owns 100% of MTHI, and MTII and MTHI own 1% and 99% of MTL, which manages investment securities. All significant intercompany transactions and balances have been eliminated in consolidation.

The Corporation and Bank operate primarily in the banking industry. The Bank makes commercial, installment and mortgage loans to and receives deposits from customers through its offices located in the Indiana counties of Miami, Grant, Hamilton, Howard, Huntington, Johnson, Tipton, Madison, Cass, Marshall, Starke, Vermillion, Vigo and Wabash; and Illinois counties of Coles and Edgar. Although the overall loan portfolio is diversified, a substantial portion of its debtors' ability to honor their contracts is dependent upon the agricultural industry. The majority of the Corporation's loans are secured by specific items of collateral including business assets, consumer assets and real property.

Subsequent Events: The Corporation has evaluated subsequent events for recognition and disclosure through March 19, 2014, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. Estimates that are particularly subject to change in the near term include the allowance for loan losses and fair values of loan servicing rights and financial instruments. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Cash Flows: Cash and cash equivalents are defined as cash and deposits with other financial institutions with maturities of less than 90 days, money market funds and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, federal funds purchased and repurchase agreements.

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other than temporary impairment ("OTTI") on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Corporation has the intent to sell the security or more likely than not will be required to sell the security before its anticipated recovery in fair value.

Loans Held for Sale: The Corporation sells certain mortgage loans on the secondary market. Loans held for sale are carried at the lower of cost or estimated fair value, in aggregate. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at the principal balance outstanding, net of deferred loan fees and costs and an allowance for loan losses. Interest income on loans is accrued over the term of the loans based on the principal outstanding. Loan fees, net of certain direct loan origination costs, are deferred and recognized as an element of interest income over the term of the loan using the level yield method.

For all classes of loans, interest income is discontinued when full loan repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days. Past due status is based on the contractual terms of the loan. Loans are placed on non-accrual or charged off at an earlier date if collection of principal and interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Corporation's policy, typically after 90 days of non-payment.

For all classes of loans, all interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Certain Purchased Loans: The Corporation has purchased certain loans which have shown evidence of credit deterioration since origination. These purchased loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses will be recognized by an increase in the allowance for loan losses.

Such purchased loans are accounted for individually or aggregated into pools of loans based on loan type. The Corporation estimates the amount and timing of expected cash flows for each purchased loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance For Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Charge-offs of the commercial, agriculture, and real estate portfolio segments are recognized when the loss is confirmed and the amount of the charge-off is the difference in the recorded investment in the loan and the discounted collateral value or the discounted future cash flows, whichever is deemed to be the most likely source of repayment. Loans in the other portfolio segment are typically charged-off no later than 120 days past due. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller balance loans of similar nature such as residential mortgage, consumer, and credit card loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the weighted average of the actual loss history experienced by the Corporation over the most recent four years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment including consideration of the following: trends in delinquencies and adversely classified loans; trends and conditions in the local and national economies; and industry-specific economic trends and conditions where credit concentrations to the industry are material. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The following portfolio segments have been identified: Commercial; Agriculture; Residential Mortgage; and Other.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Each of these portfolio segments has different risk characteristics and the allowance for loan loss methodology addresses these risks as follows:

Commercial loans include those secured by pledged assets of the customer's business (such as inventories, property and equipment, or accounts receivable), those secured by mortgages or other liens on real property, and those that are unsecured. Such loans include term loans and revolving arrangements. Repayment may be structured for full, partial, or no amortization of principal. These types of loans are primarily underwritten with expected repayment to be from the cash flow from the business operations of the customer. In underwriting these types of loans, the customer's ability to repay as well as the value of any pledged assets, are considered. Repayment is dependent upon the business operations of the borrowers, which is impacted by various factors including the industry in which the customer operates and the general economy.

Agriculture loans are secured by farm real estate, farm equipment or other farm business assets such as crops or livestock. Such loans include term loans and revolving arrangements. Repayment may be structured for full, partial, or no amortization of principal. These types of loans are primarily underwritten with expected repayment to be from farm operations of the customer. In underwriting these types of loans, the customer's ability to repay as well as the value of any pledged assets, are considered. Repayment is dependent upon the farm operations of the borrowers, which can be impacted by various factors including the price of agricultural commodities, machinery, real estate, and the general economy.

Residential Mortgage loans are those that are secured by senior or junior liens on residential property. This portfolio segment includes fixed-and adjustable-rate mortgage loans that provided for the full amortization of principal and home equity lines of credit. Repayment of real estate loans is primarily dependent upon the personal income of the borrowers, which can be impacted by the economic conditions in their market area. The Corporation seeks to mitigate the risk of the uncertainty of economic conditions with its current underwriting standards, which include a required loan-to-value ratio of at least 80% of each loan originated. The losses experienced within this segment will be impacted by changes in real estate values for the collateral securing these loans.

The Other portfolio segment includes consumer installment loans and leases. Repayment of the consumer loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions such as unemployment levels. Loans to consumers are extended after a credit evaluation, including the creditworthiness of the borrower(s), the purpose of the credit, and the secondary source of repayment. Consumer loans are made at fixed and variable interest rates. The repayment of the loans in this segment is dependent upon the willingness and ability of the customers to repay any outstanding balance. Leases are generally secured by commercial or agriculture-related equipment and repayment is expected to come primarily from the business or farm operations, and secondarily from the residual value of the equipment. Management tracks the risk in this segment based on the level of past due loans and the actual net charge-offs experienced.

Direct Financing Leases: Direct financing leases are recorded at the aggregate future minimum lease payments plus estimated residual value of leased assets less unearned income. Income on direct financing leases is recognized by a method that approximates a level rate of return. Leases are included in Loans on the consolidated balance sheet.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Servicing Assets: Servicing assets are recognized separately when they are acquired through sales of loans. For sales of mortgage loans, servicing assets are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. All servicing assets are subsequently measured using the amortization method, which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing assets are \$3,100 and \$2,330 at December 31, 2013 and 2012, respectively, and are included in accrued interest receivable and other assets in the consolidated balance sheet.

Servicing assets are evaluated for impairment based upon the fair value of the assets as compared to carrying amount. Impairment is determined by stratifying assets into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Corporation later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with other income on the income statement. The fair values of servicing assets are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income which is reported on the income statement as other income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of servicing assets is netted against loan servicing fee income. Servicing fees totaled \$1,415 and \$1,124 for the years ended December 31, 2013 and 2012. Late fees and ancillary fees related to loan servicing are not material.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed. The balance of foreclosed assets was \$866 and \$2,790 at December 31, 2013 and 2012, respectively.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Premises and equipment are depreciated primarily on the straight-line method over the estimated useful lives of the assets. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Federal Reserve Bank (FRB) Stock: The Bank is a member of its regional Federal Reserve Bank. FRB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank-Owned Life Insurance: The Corporation acquired life insurance policies on certain key executives of C.B. Bankshares, Inc. during 2009 and on certain key executives of First Citizens of Paris, Inc. during 2012. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill and Other Intangible Assets: Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Corporation has selected June 30 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the balance sheet.

Core deposit intangible and other intangible assets arise from bank branch and other business acquisitions. They are initially measured at fair value and then are amortized on a straight line or accelerated method over their estimated useful lives, which range from 4 to 12 years for core deposit intangibles.

Repurchase Agreements: Substantially all repurchase agreement liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are now such matters that will have a material effect on the financial statements.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to stockholders. Additionally, the Corporation may not declare dividends if it has deferred interest payments or is in default on its subordinated debentures.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivatives: At the inception of a derivative contract, the Corporation designates the derivative as one of three types based on the Corporation's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), or (3) an instrument with no hedging designation ("stand-alone derivative"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Corporation formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Corporation also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Corporation discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

Stock Based Compensation: Compensation cost is recognized for restricted stock awards issued to employees, based on the market price of the Corporation's common stock at the date of grant. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Common Share: Basic earnings per common share is based on net income divided by the weighted-average number of common shares outstanding during the year. All outstanding unvested share-based payment awards contain rights to nonforfeitable dividends and are considered participating securities for this calculation so there is no difference between dilutive and basic earnings per share. All share and per share data are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Stock Splits: Stock splits are recorded by adjusting stated value. All share and per share data have been restated for all stock splits, including the two for one stock split in 2013.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale and unrealized gains and losses on cash flow hedges, which are also recognized as separate components of equity.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Reclassification: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or stockholders' equity.

NOTE 2 - SECURITIES

The fair value of securities available for sale and the related unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	-----2 0 1 3-----			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. treasury and government agency securities	\$ 75,351	\$ 52	\$ (1,772)	\$ 73,631
Obligations of states and political subdivisions	53,958	930	(431)	54,457
Corporate obligations	2,262	45	-	2,307
Mortgage-backed securities, residential	49,079	337	(748)	48,668
Marketable equity securities	<u>9</u>	<u>-</u>	<u>-</u>	<u>9</u>
	<u>\$ 180,659</u>	<u>\$ 1,364</u>	<u>\$ (2,951)</u>	<u>\$ 179,072</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 2 - SECURITIES (Continued)

	<u>2 0 1 2</u>			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
U.S. treasury and government agency securities	\$ 57,748	\$ 235	\$ (38)	\$ 57,945
Obligations of states and political subdivisions	52,403	1,770	(35)	54,138
Corporate obligations	2,271	33	-	2,304
Mortgage-backed securities, residential	49,163	1,052	(4)	50,211
Marketable equity securities	<u>9</u>	<u>16</u>	<u>-</u>	<u>25</u>
	<u>\$ 161,594</u>	<u>\$ 3,106</u>	<u>\$ (77)</u>	<u>\$ 164,623</u>

The carrying amount, unrecognized gains and losses, and fair value of securities held to maturity were as follows:

	<u>2 0 1 3</u>			
	<u>Carrying Amount</u>	<u>Gross Unrecognized Gains</u>	<u>Gross Unrecognized Losses</u>	<u>Fair Value</u>
Obligations of states and political subdivisions	<u>\$ 19,873</u>	<u>\$ 759</u>	<u>\$ -</u>	<u>\$ 20,632</u>

	<u>2 0 1 2</u>			
	<u>Carrying Amount</u>	<u>Gross Unrecognized Gains</u>	<u>Gross Unrecognized Losses</u>	<u>Fair Value</u>
Obligations of states and political subdivisions	<u>\$ 22,630</u>	<u>\$ 1,147</u>	<u>\$ -</u>	<u>\$ 23,777</u>

Securities with a carrying value of \$73,827 and \$63,210 were pledged to secure repurchase agreements and other borrowings at December 31, 2013 and 2012.

At December 31, 2013 and 2012, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in any amount greater than 10% of stockholders' equity.

Proceeds from sales of securities available for sale during 2013 and 2012 were \$795 and \$51,044, respectively. There were no held to maturity securities sold in 2013 and 2012. Gross gains of \$13 and \$374 and gross losses of \$0 and \$(31), were recognized on the sales of securities available for sale during 2013 and 2012, respectively. During 2013 and 2012, an additional \$0 and \$20, respectively, in gains resulted from net redemption premiums on called securities.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 2 - SECURITIES (Continued)

The amortized cost and fair value of investment securities by contractual maturity are shown below. Securities not due at a single maturity date or with no maturity date, primarily mortgage-backed and marketable equity securities are shown separately.

	-----2 0 1 3-----			
	<u>Held to Maturity</u>		<u>Available for Sale</u>	
	<u>Carrying</u> <u>Value</u>	<u>Fair</u> <u>Value</u>	<u>Amortized</u> <u>Cost</u>	<u>Fair</u> <u>Value</u>
Due in one year or less	\$ 3,786	\$ 3,836	\$ 11,535	\$ 11,568
Due after one year through five years	12,587	13,130	71,636	71,681
Due after five years through ten years	3,370	3,536	48,010	46,757
Due after ten years	130	130	390	389
Mortgage-backed securities and marketable equity securities	-	-	49,088	48,677
	<u>\$ 19,873</u>	<u>\$ 20,632</u>	<u>\$ 180,659</u>	<u>\$ 179,072</u>

Securities with unrealized losses at December 31, 2013 and 2012 are as follows, presented by length of the time the securities have been in an unrealized loss position.

<u>Description of Securities</u>	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Loss</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Loss</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Loss</u>
<u>2013</u>						
U.S. treasury and government agency	\$ 58,616	\$ (1,681)	\$ 1,911	\$ (91)	\$ 60,527	\$ (1,772)
Obligations of states and political subdivisions	15,861	(431)	120	-	15,981	(431)
Mortgage-backed securities, residential	<u>30,048</u>	<u>(748)</u>	<u>-</u>	<u>-</u>	<u>30,048</u>	<u>(748)</u>
Total temporarily impaired	<u>\$104,525</u>	<u>\$ (2,860)</u>	<u>\$ 2,031</u>	<u>\$ (91)</u>	<u>\$106,556</u>	<u>\$ (2,951)</u>
<u>Description of Securities</u>	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Loss</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Loss</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Loss</u>
<u>2012</u>						
U.S. treasury and government agency	\$ 13,952	\$ (38)	\$ -	\$ -	\$ 13,952	\$ (38)
Obligations of states and political subdivisions	4,893	(35)	-	-	4,893	(35)
Mortgage-backed securities, residential	<u>2,639</u>	<u>(4)</u>	<u>-</u>	<u>-</u>	<u>2,639</u>	<u>(4)</u>
Total temporarily impaired	<u>\$ 21,484</u>	<u>\$ (77)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 21,484</u>	<u>\$ (77)</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 2 - SECURITIES (Continued)

Unrealized losses on investments have not been recognized into income because the issuers are insured or of high credit quality, management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to market interest rates and other economic factors. The fair value is expected to recover as the investments approach their maturity date and/or market rates change.

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans are comprised of the following:

	<u>2013</u>	<u>2012</u>
Commercial		
Commercial real estate	\$ 163,271	\$ 141,352
Commercial & industrial	158,665	128,028
Construction & development	9,882	11,545
Agriculture		
Farm real estate	239,636	220,459
Other	214,872	211,494
Residential Mortgage		
Residential real estate	84,352	81,813
Other		
Leases	42,131	41,300
Consumer & other	<u>10,832</u>	<u>23,968</u>
Subtotal	923,641	859,959
Less: Allowance for loan losses	<u>(12,284)</u>	<u>(10,263)</u>
Loans, net	<u>\$ 911,357</u>	<u>\$ 849,696</u>

Lease financing consists of the following:

	<u>2013</u>	<u>2012</u>
Total minimum lease payments receivable	\$ 41,303	\$ 39,848
Total residual	7,641	7,930
Unearned income	<u>(6,813)</u>	<u>(6,478)</u>
Total lease financing	<u>\$ 42,131</u>	<u>\$ 41,300</u>

Minimum lease payments receivable are as follows:

<u>Year Ending December 31,</u>	
2014	\$ 12,116
2015	9,362
2016	6,901
2017	4,920
2018 and thereafter	<u>8,004</u>
	<u>\$ 41,303</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The Corporation has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans is as follows:

	<u>2013</u>	<u>2012</u>
Commercial	\$ 9,392	\$ 4,519
Residential Mortgage	2,719	2,885
Other	<u>-</u>	<u>42</u>
Outstanding balance	<u>\$ 12,111</u>	<u>\$ 7,446</u>
Accretable discount	(1,869)	(943)
Non-accretable discount	<u>(4,206)</u>	<u>(2,502)</u>
Carrying amount, net of allowance of \$318 and \$0	<u>\$ 6,036</u>	<u>\$ 4,001</u>

Outstanding balance includes contractual principal and interest.

Accretable yield, or income expected to be collected, is as follows:

	<u>2013</u>	<u>2012</u>
Balance at January 1	\$ 943	\$ 70
New loans purchased	1,332	946
Accretion of income	(97)	(68)
Reclassifications from non-accretable difference	311	-
Disposals	<u>(620)</u>	<u>(5)</u>
Balance at December 31	<u>\$ 1,869</u>	<u>\$ 943</u>

For those purchased credit impaired loans disclosed above, the Corporation did increase the allowance for loan losses during 2013 by \$318. The Corporation did not increase or decrease the allowance for loan losses during 2012.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Purchased credit impaired loans, for which it was probable at acquisition that all contractually required payments would not be collected, are as follows. Amounts are presented as of the acquisition dates which occurred during the years ended December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Contractually required payments receivable of loans purchased during the year:		
Commercial	\$ 5,387	\$ 9,930
Residential Mortgage	926	2,282
Other	-	4
Cash flows expected to be collected at acquisition:		
Commercial	\$ 3,738	\$ 3,295
Residential Mortgage	698	2,012
Other	-	-
Fair value of acquired loans at acquisition:		
Commercial	\$ 2,494	\$ 2,873
Residential Mortgage	610	1,300
Other	-	-
Non-Accrutable Discount	\$ 1,877	\$ 6,909

Income is not recognized on certain purchased loans if the Corporation cannot reasonably estimate cash flows expected to be collected. During the years ended December 31, 2013 and 2012 the Corporation had no such loans.

In addition to the loan purchases described above, during 2010 the Corporation also purchased for \$799 a portion of a performing loan with an outstanding principal balance of \$1,038. As contractually required payments were collected, the \$239 difference between the purchase price and contractual payments due was recorded as an accretable discount, using the level-yield method over the remaining life of the loan. The loan was paid in full during 2012 at which time the Corporation recognized the remaining \$129 discount.

Certain directors, executive officers and principal stockholders of the Corporation, including their immediate families and companies in which they are principal owners, were loan customers of the Bank. At December 31, 2013 and 2012, loans to these individuals totaled approximately \$12,933, and \$14,507.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables present the activity in the allowance for loan losses by portfolio segment for the years ending December 31, 2013 and 2012:

	<u>Commercial</u>	<u>Agriculture</u>	<u>Residential Mortgage</u>	<u>Other</u>	<u>Unallocated</u>	<u>Total</u>
<u>December 31, 2013</u>						
Allowance for loan losses						
Beginning balance	\$ 3,854	\$ 5,095	\$ 486	\$ 41	\$ 787	\$ 10,263
Provision for loan losses	71	2,023	562	350	429	3,435
Loans charged-off	(758)	(418)	(262)	(366)	-	(1,804)
Recoveries	334	9	25	22	-	390
Ending balance	<u>\$ 3,501</u>	<u>\$ 6,709</u>	<u>\$ 811</u>	<u>\$ 47</u>	<u>\$ 1,216</u>	<u>\$ 12,284</u>
<u>December 31, 2012</u>						
Allowance for loan losses						
Beginning balance	\$ 4,080	\$ 3,438	\$ 357	\$ 174	\$ 373	\$ 8,422
Provision for loan losses	1,262	1,925	217	(68)	414	3,750
Loans charged-off	(1,881)	(289)	(103)	(128)	-	(2,401)
Recoveries	393	21	15	63	-	492
Ending balance	<u>\$ 3,854</u>	<u>\$ 5,095</u>	<u>\$ 486</u>	<u>\$ 41</u>	<u>\$ 787</u>	<u>\$ 10,263</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2013 and 2012:

	<u>Commercial</u>	<u>Agriculture</u>	<u>Residential Mortgage</u>	<u>Other</u>	<u>Unallocated</u>	<u>Total</u>
<u>December 31, 2013</u>						
Allowance for loan losses						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 102	\$ 662	\$ 405	\$ -	\$ -	\$ 1,169
Collectively evaluated for impairment	<u>3,399</u>	<u>6,047</u>	<u>406</u>	<u>47</u>	<u>1,216</u>	<u>11,115</u>
Total ending allowance balance	<u>\$ 3,501</u>	<u>\$ 6,709</u>	<u>\$ 811</u>	<u>\$ 47</u>	<u>\$ 1,216</u>	<u>\$ 12,284</u>
Loans						
Loans individually evaluated for impairment	\$ 4,985	\$ 15,945	\$ 2,710	\$ -	\$ N/A	\$ 23,640
Loans collectively evaluated for impairment	<u>326,833</u>	<u>438,563</u>	<u>81,642</u>	<u>52,963</u>	<u>N/A</u>	<u>900,001</u>
Total ending loans balance	<u>\$ 331,818</u>	<u>\$ 454,508</u>	<u>\$ 84,352</u>	<u>\$ 52,963</u>	<u>\$ N/A</u>	<u>\$ 923,641</u>
<u>December 31, 2012</u>						
Allowance for loan losses						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 1,141	\$ 431	\$ 68	\$ -	\$ -	\$ 1,640
Collectively evaluated for impairment	<u>2,713</u>	<u>4,664</u>	<u>418</u>	<u>41</u>	<u>787</u>	<u>8,623</u>
Total ending allowance balance	<u>\$ 3,854</u>	<u>\$ 5,095</u>	<u>\$ 486</u>	<u>\$ 41</u>	<u>\$ 787</u>	<u>\$ 10,263</u>
Loans						
Loans individually evaluated for impairment	\$ 7,625	\$ 7,479	\$ 2,906	\$ -	\$ N/A	\$ 18,010
Loans collectively evaluated for impairment	<u>273,300</u>	<u>424,474</u>	<u>78,907</u>	<u>65,268</u>	<u>N/A</u>	<u>841,949</u>
Total ending loans balance	<u>\$ 280,925</u>	<u>\$ 431,953</u>	<u>\$ 81,813</u>	<u>\$ 65,268</u>	<u>\$ N/A</u>	<u>\$ 859,959</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents information related to impaired loans by class of loans as of and for the years ended December 31, 2013 and 2012:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
<u>December 31, 2013</u>						
With no related allowance recorded:						
Commercial						
Commercial real estate	\$ 375	\$ 375	\$ -	\$ 481	\$ 17	\$ 17
Commercial & industrial	792	774	-	2,426	56	85
Construction & development	1,507	1,507	-	2,434	-	-
Agricultural						
Farm real estate	4,267	4,266	-	4,959	226	230
Other	269	265	-	307	19	18
Residential Mortgage	1,235	1,235	-	1,833	70	72
Subtotal	<u>8,445</u>	<u>8,422</u>	<u>-</u>	<u>12,440</u>	<u>388</u>	<u>422</u>
With an allowance recorded:						
Commercial						
Commercial real estate	\$ 2,202	\$ 2,204	\$ 95	\$ 2,243	\$ 124	\$ 106
Commercial & industrial	125	125	7	129	7	7
Agricultural						
Farm real estate	10,424	10,363	622	9,443	148	187
Other	1,051	1,051	40	1,083	60	54
Residential Mortgage	1,475	1,475	405	1,501	99	101
Subtotal	<u>15,277</u>	<u>15,218</u>	<u>1,169</u>	<u>14,399</u>	<u>438</u>	<u>455</u>
Total	<u>\$ 23,722</u>	<u>\$ 23,640</u>	<u>\$ 1,169</u>	<u>\$ 26,839</u>	<u>\$ 826</u>	<u>\$ 877</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance for Loan Losses Allocated</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Interest Recognized</u>
<u>December 31, 2012</u>						
With no related allowance recorded:						
Commercial						
Commercial real estate	\$ 1,691	\$ 1,691	\$ -	\$ 1,359	\$ 39	\$ 39
Commercial & industrial	1,842	1,824	-	1,204	-	-
Construction & development	42	42	-	227	15	16
Agricultural			-			
Farm real estate	4,081	4,080	-	3,977	202	208
Other	1,281	1,278	-	725	54	82
Residential Mortgage	1,779	1,664	-	1,716	26	19
Subtotal	<u>10,716</u>	<u>10,579</u>	<u>-</u>	<u>9,208</u>	<u>336</u>	<u>364</u>
With an allowance recorded:						
Commercial						
Commercial real estate	\$ 939	\$ 939	\$ 304	\$ 1,698	\$ 32	\$ 32
Commercial & industrial	878	878	303	847	-	9
Construction & development	2,252	2,251	534	1,523	63	53
Agricultural						
Farm real estate	2,098	2,097	421	1,875	50	47
Other	23	24	10	23	-	-
Residential Mortgage	1,242	1,242	68	1,262	68	69
Subtotal	<u>7,432</u>	<u>7,431</u>	<u>1,640</u>	<u>7,228</u>	<u>213</u>	<u>210</u>
Total	<u>\$ 18,148</u>	<u>\$ 18,010</u>	<u>\$ 1,640</u>	<u>\$ 16,436</u>	<u>\$ 549</u>	<u>\$ 574</u>

The recorded investment in loans includes loan origination fees, net and purchase related discounts.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables present the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2013 and 2012:

	Nonaccrual		Loans Past Due Over 90 Days Still Accruing	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Commercial				
Commercial real estate	\$ 359	\$ 204	\$ -	\$ -
Commercial & industrial	71	223	-	-
Construction & development	1,507	2,694	-	-
Agriculture				
Farm real estate	2,440	844	1,815	-
Other	21	39	-	-
Residential Mortgage				
Residential real estate	1,509	479	35	169
Other				
Leases	55	430	-	-
Consumer & other	-	-	-	3
Total	<u>\$ 5,962</u>	<u>\$ 4,913</u>	<u>\$ 1,850</u>	<u>\$ 172</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents the aging of the recorded investment in past due loans as of December 31, 2013 and 2012 by class of loans:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
December 31, 2013						
Commercial						
Commercial real estate	\$ 480	\$ 110	\$ 249	\$ 839	\$ 162,432	\$ 163,271
Commercial & industrial	207	-	71	278	158,387	158,665
Construction & development	85	-	1,507	1,592	8,290	9,882
Agriculture						
Farm real estate	54	-	4,255	4,309	235,327	239,636
Other	-	-	21	21	214,851	214,872
Residential Mortgage						
Residential real estate	1,825	202	1,389	3,416	80,936	84,352
Other						
Leases	22	-	55	77	42,054	42,131
Consumer & Other	19	-	-	19	10,813	10,832
Total	<u>\$ 2,692</u>	<u>\$ 312</u>	<u>\$ 7,547</u>	<u>\$ 10,551</u>	<u>\$ 913,090</u>	<u>\$ 923,641</u>
December 31, 2012						
Commercial						
Commercial real estate	\$ 140	\$ -	\$ 212	\$ 352	\$ 141,000	\$ 141,352
Commercial & industrial	312	675	245	1,232	126,796	128,028
Construction & development	80	-	2,702	2,782	8,763	11,545
Agriculture						
Farm real estate	1,602	-	846	2,448	218,011	220,459
Other	21	-	44	65	211,429	211,494
Residential Mortgage						
Residential real estate	2,604	498	538	3,640	78,173	81,813
Other						
Leases	21	-	301	322	40,978	41,300
Consumer & Other	58	34	3	95	23,873	23,968
Total	<u>\$ 4,838</u>	<u>\$ 1,207</u>	<u>\$ 4,891</u>	<u>\$ 10,936</u>	<u>\$ 849,023</u>	<u>\$ 859,959</u>

Troubled Debt Restructurings:

As of December 31, 2013 and 2012, the Corporation has a recorded investment in troubled debt restructurings of \$20,554 and \$13,707, respectively. The Corporation has allocated \$921 and \$764 of specific reserves for those loans at December 31, 2013 and 2012, and has committed to lend additional amounts totaling up to \$0 and \$0.

During the years ending December 31, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 1 month to 15 years. Modifications involving an extension of the maturity date were for periods ranging from 3 months to 15 years.

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ending December 31, 2013 and 2012:

	<u>Number of of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
<u>December 31, 2013</u>			
Troubled Debt Restructurings:			
Commercial			
Commercial & industrial	2	\$ 686	\$ 686
Construction & development	1	1,184	1,184
Agriculture			
Farm real estate	6	5,567	5,567
Other	3	155	147
Residential Mortgage	<u>6</u>	<u>370</u>	<u>317</u>
Total	<u>18</u>	<u>\$ 7,962</u>	<u>\$ 7,901</u>

The troubled debt restructurings described above increased the allowance for loan losses by \$412 and resulted in charge offs of \$404 during the year ending December 31, 2013.

	<u>Number of of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
<u>December 31, 2012</u>			
Troubled Debt Restructurings:			
Commercial			
Commercial real estate	5	\$ 1,997	\$ 1,987
Commercial & industrial	1	1,715	1,715
Agriculture			
Farm real estate	1	1,218	1,191
Other	2	1,008	1,008
Residential Mortgage	<u>5</u>	<u>2,211</u>	<u>2,120</u>
Total	<u>14</u>	<u>\$ 8,149</u>	<u>\$ 8,021</u>

The troubled debt restructurings described above increased the allowance for loan losses by \$152 and resulted in charge offs of \$132 during the year ending December 31, 2012.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the years ending December 31, 2013 and 2012:

	Number of Loans	Recorded Investment
<u>December 31, 2013</u>		
Construction & development	1	\$ 1,174
Residential Mortgage	<u>2</u>	<u>1,303</u>
Total	<u>3</u>	<u>\$ 2,477</u>

The troubled debt restructurings that subsequently defaulted described above increased the allowance for loan losses by \$318 and resulted in charge offs of \$294 during the year ending December 31, 2013.

	Number of Loans	Recorded Investment
<u>December 31, 2012</u>		
Commercial real estate	-	\$ -
Total	<u>-</u>	<u>\$ -</u>

The troubled debt restructurings that subsequently defaulted described above increased the allowance for loan losses by \$0 and resulted in charge offs of \$0 during the year ending December 31, 2012.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Corporation's internal underwriting policy.

Credit Quality Indicators:

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. All loans are graded at origination. On a quarterly basis, all loans with exposure greater than \$500 or graded special mention, substandard or doubtful are reviewed for potential grade changes. Other loans outside of this scope are re-graded only as additional financial information is received or delinquency status changes. The Corporation uses the following definitions for risk ratings:

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass-rated loans.

Based on the most recent analysis performed, the risk category of loans by class of loans as of December 31, 2013 and 2012 is as follows:

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>
<u>December 31, 2013</u>				
Commercial				
Commercial real estate	\$ 152,283	\$ 9,231	\$ 1,757	\$ -
Commercial & industrial	153,043	4,802	820	-
Construction & development	8,375	-	1,507	-
Agriculture				
Farm real estate	223,392	9,799	6,445	-
Other	199,587	8,205	7,080	-
Residential Mortgage	81,158	1,326	1,868	-
Other				
Leases	40,672	1,223	236	-
Consumer & Other	<u>10,832</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 869,342</u>	<u>\$ 34,586</u>	<u>\$ 19,713</u>	<u>\$ -</u>
<u>December 31, 2012</u>				
Commercial				
Commercial real estate	\$ 138,249	\$ 1,604	\$ 1,499	\$ -
Commercial & industrial	124,596	424	3,008	-
Construction & development	8,832	-	2,713	-
Agriculture				
Farm real estate	202,953	15,434	2,072	-
Other	194,631	13,851	3,012	-
Residential Mortgage	78,051	535	3,227	-
Other				
Leases	35,895	1,191	4,214	-
Consumer & Other	<u>23,968</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 807,175</u>	<u>\$ 33,039</u>	<u>\$ 19,745</u>	<u>\$ -</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 4 - PREMISES AND EQUIPMENT

A summary of premises and equipment is detailed below as of December 31:

	<u>2013</u>	<u>2012</u>
Land	\$ 2,950	\$ 2,901
Buildings and improvements	14,226	13,734
Furniture and equipment	<u>7,974</u>	<u>7,847</u>
Total cost	25,150	24,482
Accumulated depreciation	<u>(10,325)</u>	<u>(9,658)</u>
	14,825	14,824
Buildings and equipment in process	<u>452</u>	<u>57</u>
	<u>\$ 15,277</u>	<u>\$ 14,881</u>

During 2013, the Corporation recognized an impairment charge on a branch facility of \$218.

NOTE 5 - GOODWILL AND INTANGIBLE ASSETS

Goodwill

The change in balance for goodwill during the year is as follows:

	<u>2013</u>	<u>2012</u>
Beginning of year	\$ 8,393	\$ 5,891
Measurement period adjustments to previously recorded goodwill	57	-
Acquired goodwill	<u>32</u>	<u>2,502</u>
End of year	<u>\$ 8,482</u>	<u>\$ 8,393</u>

Acquired Intangible Assets

	-----2 0 1 3-----		-----2 0 1 2-----	
	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>
Amortized intangible assets:				
Core deposit intangible	\$ 9.087	\$ 6.617	\$ 8.495	\$ 5.912

Aggregate amortization expense for 2013 and 2012 was \$705 and \$779.

Estimated amortization expense for each of the next five years:

2014	\$ 647
2015	519
2016	422
2017	332
2018	265

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 6 - SERVICING ASSETS

Loans and leases serviced for others are not reported as assets of the Corporation and total \$609,469 and \$486,072 at December 31, 2013 and 2012.

Activity for capitalized loan servicing assets (included in other assets on the consolidated balance sheet) and the related valuation allowance follow.

	<u>2013</u>	<u>2012</u>
Servicing assets		
Beginning of year	\$ 3,960	\$ 3,608
Acquired servicing rights	274	-
Additions	1,045	1,080
Direct write-downs	(394)	(173)
Amortized to expense	<u>(586)</u>	<u>(555)</u>
End of year	<u>\$ 4,299</u>	<u>\$ 3,960</u>
Valuation allowance		
Beginning of the year	\$ 1,630	\$ 1,383
Direct write-downs	(394)	(173)
Net additions/(recoveries) expensed	<u>(37)</u>	<u>420</u>
End of year	<u>\$ 1,199</u>	<u>\$ 1,630</u>
Net servicing assets	<u>\$ 3,100</u>	<u>\$ 2,330</u>

The fair value of servicing assets for 2013 and 2012 was approximately \$3,119 and \$2,333. Fair value at year-end 2013 and 2012 was primarily determined based on a valuation model that calculates the present value of estimated net servicing income. Fair value at year-end 2013 was determined using a weighted average discount rate of 7.52% and an immediate and long-term weighted average prepayment speed of 12.8% and 11.9% respectively. Fair value at year-end 2012 was determined using a weighted average discount rate of 6.77% and an immediate and long-term weighted average prepayment speed of 19.7% and 14.2% respectively.

The weighted average amortization period is 4 years. Estimated amortization expense for each of the next five years is:

2014	\$ 614
2015	525
2016	440
2017	328
2018	252

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 7 - INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following at December 31:

	<u>2013</u>	<u>2012</u>
Interest-bearing demand deposits	\$ 301,408	\$ 294,957
Savings	212,439	185,765
Time deposits over \$100,000	168,449	140,931
Other time deposits	<u>100,885</u>	<u>113,026</u>
	<u>\$ 783,181</u>	<u>\$ 734,679</u>

At December 31, 2013, stated maturities of time deposits were:

2014	\$ 120,310
2015	45,095
2016	44,661
2017	40,440
2018 and thereafter	<u>18,828</u>
	<u>\$ 269,334</u>

NOTE 8 - FEDERAL HOME LOAN BANK ADVANCES

At year-end, advances from the Federal Home Loan Bank were as follows:

	<u>2013</u>	<u>2012</u>
Maturity of June 2013, with floating rate based upon Federal Home Loan Bank Indianapolis's overnight cost of funds with a rate of 0.50% as of December 31, 2012.	\$ -	\$ 8,000
Maturity of September 2017 with a floating rate tied to 3 month LIBOR plus a spread of 0.25% capped at 2.25% with quarterly reset dates. With a current rate of 0.49% and a rate of 0.56% as of December 31, 2012.	3,000	3,000
Maturities from June 2013 through August 2015, with floating rates based upon 3-month LIBOR that may vary between 0.00% and the initial rate. Current rates, which are also the initial rates, range from 2.08% to 2.35%, with a current rate of 2.08% and a weighted average rate of 2.21% as of December 31, 2012.	5,000	10,000
Maturities from January 2013 through July 2018, with fixed rates from 0.85% to 3.23%, with a weighted average rate of 1.83%.	-	62,350
Maturities from March 2014 through August 2018, with fixed rates from 0.60% to 3.23%, with a weighted average rate of 1.51%.	66,625	-

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 8 - FEDERAL HOME LOAN BANK ADVANCES (Continued)

	<u>2013</u>	<u>2012</u>
Maturity of June 2018, with a floating rate tied to 1 month LIBOR plus a spread of 0.21% with monthly reset dates, with a current rate of 0.38%.	\$ 5,000	\$ -
Total	<u>\$ 79,625</u>	<u>\$ 83,350</u>

Maturities and scheduled principal reductions are as follows:

2014	\$ 1,875
2015	30,950
2016	12,000
2017	12,300
2018	<u>22,500</u>
	<u>\$ 79,625</u>

On February 27, 2013 the Bank entered into an interest rate swap designated as a cash flow hedge to convert the floating interest payments to a fixed rate on the \$5,000 floating rate FHLB advance tied to 1 month LIBOR for the period from June 15, 2013 to June 15, 2018. See Note 14 Derivatives and Hedging Activities for additional information on this transaction.

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances and the floating advances tied to 3 month LIBOR except for those payments made on various contractual prepayment dates. The advances were collateralized by \$133,082 and \$130,938 under a blanket lien arrangement at December 31, 2013 and 2012. At December 31, 2013, outstanding advances are secured by specific securities totaling \$35,439 and a blanket pledge of all qualifying one-to-four family real estate loans totaling \$43,397, qualifying multifamily loans totaling \$2,803, qualifying commercial real estate loans totaling \$26,370, qualifying small business loans totaling \$3,483, and qualifying small farm loans totaling \$21,590. Based on this collateral and the Corporation's holdings of FHLB stock, the Corporation is eligible to borrow up to a total of \$10,954 at December 31, 2013.

NOTE 9 - OTHER BORROWINGS

On September 5, 2013 the Corporation entered into a term loan agreement for up to \$10,000. At that time the Corporation advanced \$8,000 with a fixed rate of 3.85%. The payments for the \$8,000 loan are based on a seven year amortization schedule with quarterly payments of \$327 including principal and interest with a balloon payment of \$2,852 to be paid in full by September 5, 2018. On December 27, 2013 the Corporation exercised its option to draw the additional \$2,000 term loan with a fixed rate of 3.89%. This loan is also based on a seven year amortization schedule with quarterly payments of \$85 including principal and interest with a balloon payment of \$677 to be paid in full by September 5, 2018. The combination of the \$8,000 and \$2,000 loans were used to pay off an existing loan with a balance of \$3,765 including principal and interest while the remaining \$6,223 was invested directly into the Bank. Fees of \$12, including legal fees and commitment fees, were capitalized and are being amortized over five years. The Corporation also entered into a loan agreement for a \$5,000 revolving credit line. The loans have covenants relating to earnings, asset quality and capitalization for which the Corporation was in compliance at December 31, 2013. As of December 31, 2013 the balance on the term loans totaled \$9,751. As of December 31, 2013 the revolving line has not been drawn on.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 9 - OTHER BORROWINGS (Continued)

On May 1, 2012 in conjunction with the acquisition of First Citizens of Paris, Inc. and its wholly-owned subsidiary Citizens National Bank of Paris, the Corporation obtained a \$5,000 term loan based upon the prime rate with a floor of 4.0%. The loan amortizes over 5 years and requires quarterly payments of \$250 plus accrued interest. Loan fees of \$25 were capitalized and are being amortized over 5 years. The loan has covenants relating to earnings, asset quality and capitalization for which the Corporation was in compliance at December 31, 2012. As of December 31, 2013 this loan was paid off and the remaining capitalized fees were fully amortized. At December 31, 2012, the balance on the loan was \$4,500.

NOTE 10 - SUBORDINATED DEBENTURES

In December 2004, a trust formed by the Corporation issued \$5,000 of fixed to floating rate trust preferred securities as part of a pooled offering of such securities. The Corporation issued subordinated debentures to the trust in exchange for the proceeds of the offering, which debentures represent the sole asset of the trust. The Corporation may redeem the subordinated debentures, in whole but not in part, any time after 2009 at face value. The subordinated debentures must be redeemed no later than 2034. On December 15, 2009 the fixed rate period expired and the floating rate commenced based on 3-month LIBOR plus 2.10%. As of December 31, 2013 and 2012, the variable rates of the debentures were 2.34% and 2.41%, respectively. Interest payments are payable quarterly in arrears and the Corporation has the option to defer interest payments from time to time for a period not to exceed 20 consecutive quarters.

On January 5, 2009, the Corporation entered into an interest rate swap designated as a cash flow hedge to convert the floating rate period from December 15, 2009 to December 14, 2014 to a fixed rate. See Note 14 - Derivatives and Hedging Activities for additional information on this transaction.

In May 2007, a second trust formed by the Corporation issued \$13,000 of fixed to floating rate trust preferred securities as part of a pooled offering of such securities. The Corporation issued subordinated debentures to the trust in exchange for the proceeds of the offering, which debentures represent the sole asset of the trust. The Corporation may redeem the subordinated debentures, in whole but not in part, any time after 2012 at face value. The subordinated debentures must be redeemed no later than 2037. On June 15, 2012, the fixed rate period expired and the floating rate period commenced based on 3-month LIBOR plus 1.48%. As of December 31, 2013 and 2012 the variable rate of the debentures was 1.72% and 1.79%. Interest payments are payable quarterly in arrears and the Corporation has the option to defer interest payments from time to time for a period not to exceed 20 consecutive quarters.

On February 4, 2013, the Corporation executed an interest rate cap designated as a fair value hedge on the first \$5,000 of the \$13,000 subordinated debentures. The interest rate cap is effective from March 15, 2013 through December 15, 2019. Subsequently on February 14, 2013 the Corporation entered into an interest rate swap designated as a cash flow hedge to convert the floating interest payments to a fixed rate on the remaining \$8,000 of the \$13,000 subordinate debentures beginning March 15, 2015 until December 15, 2019. See note 14 Derivatives and Hedging Activities for additional information on these transactions.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 11 - EMPLOYEE BENEFIT PLANS

The Corporation maintains a 401(k) profit sharing plan, covering employees who have completed six months of service. Employer contributions to the plan are at the discretion of the board of directors. In addition, the plan provides for the Corporation to match employee 401(k) contributions at a percentage determined annually by the board of directors. Employer contributions charged to operations were \$855 and \$779 for 2013 and 2012.

Under employment agreements with certain executives, certain events leading to separation from the Corporation could result in cash payments equal to 2 times the average of the employee's base pay plus any cash bonuses for the last 3 complete calendar years preceding the employee's termination of employment. The President will receive 2.99 times the average base pay plus any cash bonuses.

As a result of the May 1, 2012 acquisition of First Citizens of Paris, Inc. the Corporation assumed obligations under existing employment agreements for four senior officers of Citizens National Bank of Paris. For two executives who departed during 2012, the agreements provided for a fixed payment at separation of service and health benefits continuation, if requested, for up to one year. The third executive's agreement provided for a payment of equal to 2 times the employee's annualized base pay plus cash bonuses over the prior six months and continuation of health benefits, if requested, for up to one year. This executive is being paid over a two-year period and as of December 31, 2013 and 2012 remaining accrued benefits were \$85 and \$264, respectively. A fourth executive was retained following the change in control.

As a result of the May 1, 2012 acquisition of First Citizens of Paris, Inc., the Corporation has assumed obligations under a Supplemental Executive Retirement Plan (SERP) for certain senior officers of Citizens National Bank of Paris. Under the provisions of the SERP, each participant will receive at retirement an annual benefit for a fifteen-year period as stated in the agreement. Participants who were not yet fully vested as of May 1, 2012 fully vested based on the terms of their SERP agreement. Total expense of \$22 and \$15 was recorded during 2013 and 2012, respectively. As of December 31, 2013 and 2012, accrued benefits payable totaled \$525 and \$556, respectively.

As a result of the December 4, 2009 acquisition of C.B. Bankshares, Inc., the Corporation has assumed obligations under a Supplemental Executive Retirement Plan (SERP) for certain senior officers of Central Bank. Under the provisions of the SERP, each participant will receive at retirement an annual benefit for a ten-year period as stated in the agreement. Participants fully vested upon the acquisition date. Total expense of \$44 and \$22 was recorded during 2013 and 2012, respectively. As of December 31, 2013 and 2012, accrued benefits payable totaled \$1,243 and \$1,316, respectively.

As a result of the December 4, 2009 acquisition of C.B. Bankshares, Inc., the Corporation entered five-year employment agreements with two former executives of Central Bank. In addition a seven year non-competition agreement was entered with one of the individuals.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 12 - STOCK-BASED COMPENSATION

The Corporation has adopted a Restricted Stock Plan ("RSP") which provides for the issuance of shares to officers and employees. Compensation expense is recognized over the vesting period of the shares based on the market value of the shares at issue date. The market value of the stock was determined using an independent appraisal, which is performed at least annually. Annually, the Corporation may issue up to 8,000 shares, although shares not issued during the year are not available to be granted in future periods. Prior to 2012, the Corporation could issue up to 6,000 shares annually. RSP grants cliff vest over a four year period. 7,400 and 5,750 shares were granted during 2013 and 2012 with a fair value per share of \$31.00 and \$26.75, respectively. Compensation expense of \$145 and \$120 was recorded during 2013 and 2012 for shares granted.

A summary of changes in the Corporation's nonvested shares for the year follows:

<u>Nonvested Shares</u>	<u>Shares</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Nonvested at January 1, 2013	21,500	\$ 23.20
Granted	7,400	
Vested	5,050	
Forfeited	<u>350</u>	
Nonvested at December 31, 2013	<u>23,500</u>	\$ 26.29

As of December 31, 2013, there was \$312 of total unrecognized compensation cost related to non-vested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 2.0 years.

All information related to the Plan has been restated for the two-for-one stock split that occurred on October 23, 2013.

NOTE 13 - INCOME TAXES

The provision for income taxes consists of the following:

	<u>2013</u>	<u>2012</u>
Current payable	\$ 4,959	\$ 2,674
Deferred income tax (benefit)	<u>799</u>	<u>2,505</u>
	<u>\$ 5,758</u>	<u>\$ 5,179</u>
	<u>2013</u>	<u>2012</u>
Income tax provision computed at statutory federal rate of 35%	\$ 7,551	\$ 6,505
Tax effect of:		
Income from tax exempt securities and loans	(775)	(782)
State income tax (net of federal tax effect)	832	684
Tax credits	(1,430)	(1,020)
Other	<u>(420)</u>	<u>(208)</u>
	<u>\$ 5,758</u>	<u>\$ 5,179</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 13 - INCOME TAXES (Continued)

	<u>2013</u>	<u>2012</u>
Deferred tax asset	\$ 8,470	\$ 9,006
Deferred tax liability	<u>(9,020)</u>	<u>(10,209)</u>
Net deferred tax asset (liability)	<u>\$ (550)</u>	<u>\$ (1,203)</u>

The deferred tax asset is primarily due to accumulated differences in the allowance for loan losses, SERP liabilities, other real estate write-downs, deferred loan fees, purchase accounting adjustments, fair value depreciation on securities available for sale and AMT credit carryforward. The Corporation has an AMT credit of \$531 that does not expire. The Corporation has an Illinois NOL of \$4,175 that begins to expire in 2024. The deferred tax liability is primarily due to accumulated differences in lease activity, mortgage servicing rights, amortization of intangibles and prepaid expenses.

The total amount of interest and penalties recorded in the income statement for the years ended December 31, 2013 and 2012 was \$0 and \$(5), respectively; the amount accrued for interest and penalties at December 31, 2013 and 2012 was \$0 and \$0, respectively.

The Corporation and its subsidiaries are subject to U.S. federal income tax as well as income tax of the states of Indiana and Illinois. The Corporation is no longer subject to examination by federal or state taxing authorities for years before 2010.

NOTE 14 - DERIVATIVES AND HEDGING ACTIVITIES

The Corporation uses various derivative instruments, including designated and non-designated hedge instruments. These derivative instruments may include interest rate caps, floors and swaps. The Corporation does not use derivatives for speculative purposes.

While authorized to use a variety of derivative products the Corporation primarily utilizes interest rate swaps as a means to offer borrowers credit-based products that meet their needs and may from time to time utilize interest rate swaps to manage the macro interest rate risk profile of the Corporation. The interest rate swaps are used to mitigate overall risk to changes in interest rates during the life of the swaps and are a component of the Corporation's asset liability management strategy to reduce the risk that changes in interest rates will change net interest margin.

The interest rate swap agreement establishes the basis on which interest rate payments are exchanged with counterparties, referred to as the notional amount. The notional amount of the interest rate swaps do not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the interest rate swap.

The Corporation's exposure to credit loss, in the event of nonperformance by a borrower or counterparty, is limited to the market value of the derivative instrument associated with that borrower or counterparty as provided in regulatory guidance as calculated by the Remaining Maturity Method. The Corporation monitors its derivative credit exposure to borrowers by monitoring the creditworthiness of the related loan customers through the normal credit review process the Corporation performs on all borrowers. The Corporation manages the market value credit risk of the counterparty through the Regulation F compliance review and the quarterly derivative review.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 14 - DERIVATIVES AND HEDGING ACTIVITIES (Continued)

In connection with its use of derivative instruments, the Corporation is required from time to time to post collateral with its counterparties to offset its market position. The Corporation had pledged short-term certificates of deposit, cash and securities with a carrying value of \$4,144 and \$3,698, at December 31, 2013 and 2012, respectively, in satisfaction of credit support agreements with derivative counterparties.

The following table summarizes the notional values of the derivative financial instruments utilized by the Corporation. The instruments are broken out by their designation.

				December 31, 2013					December 31, 2012						
					Weighted Average Maturity (years)	Fair Value	Weighted- Average Rate				Weighted Average Maturity (years)	Fair Value	Weighted- Average Rate		
				Notional Amount			Receive	Pay	Strike Rate	Notional Amount			Receive	Pay	Strike Rate
(Dollars in thousands)															
<u>Non-Designated Hedge Instruments</u>															
	Interest Rate Cap			\$25,000	1.60	\$ -	0.24%		4.5%	\$25,000	2.59	\$ 3	0.46%		4.5%
	Interest Rate Swaps - matched to loan prepayment			32,090	4.35	(1,524)	2.57%	5.62%		34,473	5.35	(2,705)	2.67%	5.78%	
	Prepayment penalty of matched loans					1,524						2,705			
<u>Designated as Fair Value Hedge</u>															
	Interest Rate Swaps			-	-	-	-	-		282	2	(12)	2.86%	6.50%	
<u>Designated as Cash Flow Hedge Instruments</u>															
	Interest Rate Cap - subordinated debt			5,000	5.96	303			1.80%	-	-	-			-
	Interest Rate Swap - subordinated debt			5,000	0.96	(126)	0.24%	2.79%		5,000	1.96	(242)	0.31%	2.79%	
	Interest Rate Swap - subordinated debt			8,000	5.96	159	1.92%	3.54%		-	-	-	-	-	
	Interest Rate Swap - Federal Home Loan Bank			5,000	4.46	68	0.20%	1.15%		-	-	-	-	-	
	Total			\$80,090		\$ 404				\$64,755		\$ (251)			

Non-Designated Hedge Instruments

The Corporation has one interest rate cap agreement that is considered a non-designated hedging instrument. The interest rate cap notional amount is \$25,000 and is used to mitigate the risk of increases in the interest rate which would drive up the Corporation's cost of funds. This cap is indexed to 3-month LIBOR.

The Corporation paid \$281 to enter into this transaction in 2010. For the years ended December 31, 2013 and December 31, 2012 losses relating to this freestanding derivative of \$3 and \$37 are included in other non-interest income on the Consolidated Statement of Income.

Certain interest rate swaps entered into during 2012 and prior were also classified as non-designated hedge instruments due to their offsetting matched terms with prepayment penalties on the associated loans. The offsetting changes in the fair value of these instruments are reflected in earnings. The Corporation did not enter into any new non-designated interest rate swaps during 2013 and the notional amount of these swaps as of December 31, 2013 and December 31, 2012 was \$32,090 and \$34,473.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 14 - DERIVATIVES AND HEDGING ACTIVITIES (Continued)

Fair Value Hedge Instruments

Certain Interest rate swaps, entered into during 2004 and 2005, have been designated as fair value hedges of certain commercial and agricultural loans and were determined to be fully effective during the periods presented. As such, the aggregate fair value of the swaps is recorded in other assets or other liabilities while the hedged loans are carried at fair value. Changes in fair value of both the interest rate swaps and loans are recognized in interest income. These changes directly offset each other for 2012, thus the total amount included in interest income was (\$1). Liabilities of \$12 were recorded for the interest rate swaps at December 31, 2012. The remaining swap transaction was terminated early on February 7, 2013, as the associated loan was paid off early by the Bank's customer. The notional amount of these swaps as of December 31, 2013 and December 31, 2012 was \$0 and \$282.

Cash Flow Hedge Instruments

The Corporation has one interest rate cap agreement that is designated as a cash flow hedge instrument for a portion of the Corporation's subordinated debentures. The interest rate cap notional amount is \$5,000. The Corporation's objective is to ensure that overall changes in cash flow from the hedged exposure when LIBOR is above 1.80% will be offset by overall changes in the cash flow of the hedging derivative. This should mitigate the risk of increases in the interest rate which would drive up the Corporation's cost of funds. The cap is indexed to 3-month LIBOR.

The Corporation paid \$222 to enter into this transaction in 2013. For the period ended December 31, 2013, gains relating to this derivative of \$82 are included in other non-interest income on the Consolidated Statement of Income.

Interest rate swaps with notional amounts of \$5,000 and \$8,000 were designated as cash flow hedges of the Corporation's subordinated debentures. The \$5,000 hedge commenced December 15, 2009 and was determined to be fully effective. As such, no amount of ineffectiveness has been included in the income statement. As of December 31, 2013 and December 31, 2012, the fair value of the swap was (\$126) and (\$242) with (\$67) and (\$143) reflected as other comprehensive loss, respectively. The Corporation expects the hedge to remain fully effective during the remaining term of the swap.

Interest expense recorded on the \$5,000 swap transaction was \$110 and \$119 during 2013 and 2012 and is reported as a component of interest expense on subordinated debentures. At December 31, 2013, the Corporation expected \$126 of the unrealized loss to be reclassified as an increase of interest expense during 2014.

On February 14, 2013 the Corporation executed a cash flow hedge utilizing an interest rate swap to hedge against interest rate volatility on \$8,000 of the Corporation's subordinated debentures with an effective date of December 15, 2014. The hedging strategy will ensure that changes in cash flows from the hedging derivative will be highly effective at offsetting changes in interest expense from the hedged exposure. As such, no amount of ineffectiveness has been included in the income statement. As of December 31, 2013, the fair value of the swap was \$159 with (\$96) reflected as other comprehensive loss. The Corporation expects the hedge to remain fully effective during the remaining term of the swap.

Interest expense recorded on the \$8,000 swap transaction was \$159 during 2013 and is reported as a component of interest expense on subordinated debentures. At December 31, 2013, the Corporation expected \$143 of the unrealized loss to be reclassified as an increase of interest expense during 2014.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 14 - DERIVATIVES AND HEDGING ACTIVITIES (Continued)

On February 27, 2013 the Corporation executed a cash flow hedge utilizing an interest rate swap to hedge against exposure to variability in cash flows related to changes in projected interest payments caused by changes in the underlying index. The interest rate swap with a notional amount of \$5,000 and an effective date of June 3, 2013 was designated as a cash flow hedge against the Bank's floating rate advance from the Federal Home Loan Bank. The hedge was determined to be highly effective. Cumulative ineffectiveness has been included in the income statement as of December 31, 2013. As of December 31, 2013, the fair value of the swap was \$68 with \$(41) reflected as other comprehensive loss. The Corporation expects the hedge to remain highly effective during the remaining term of the swap.

NOTE 15 - COMMITMENTS

	<u>2013</u>	<u>2012</u>
Commitments to make loans	\$ 194,984	\$ 179,427
Commercial letters of credit	2,017	2,553
Commitment to sell loans	3,173	22,893

At December 31, 2013 and 2012, the Bank was required to maintain \$1,859 and \$1,669, respectively, on deposit with the Federal Reserve or as cash on hand. These reserves earned interest at a rate of 0.25%.

During 2012 and 2010, the Corporation committed to invest \$2,500 and \$3,517, respectively, in funds that will invest the proceeds in various qualifying low-income housing projects. Subsequent to the initial investment the Corporation committed to an additional \$13 in various low-income housing projects. In accordance with current accounting guidance, the entire investment was recorded at the time the commitment was made and is reflected on the Corporation's Consolidated Balance Sheet. During 2013 and 2012, \$1,965 and \$1,484 of the commitments were funded. The remaining commitments of \$2,006 and \$3,971 were recorded with other liabilities on the Consolidated Balance Sheet at December 31, 2013 and 2012, respectively.

During 2011, the Corporation committed to invest \$3,203 in a limited liability company constructing a qualifying low-income housing development. In accordance with current accounting guidance, equity contributions toward this commitment will be recorded upon the attainment of pre-determined construction and operational benchmarks. \$234 and \$2,649 of the commitment was fulfilled during the years ended December 31, 2013 and 2012, respectively.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 16 - REGULATORY MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet various capital requirements can initiate regulatory action. Management believes as of December 31, 2013, the Corporation and Bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

At year-end 2013 and 2012, the most recent regulatory notifications categorized the Bank as well capitalized under the framework for prompt corrective action. There are no conditions or events since the notifications that management believes changed the institution's category. Actual consolidated and Bank capital levels and minimum required levels were as follows.

	<u>Actual</u>		<u>Required For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Regulations</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>2013</u>						
Total capital to risk weighted assets						
Consolidated	\$ 118,158	11.9%	\$ 79,333	8.0%	N/A	
Bank	124,895	12.6	79,292	8.0	\$ 99,115	10.0%
Tier 1 capital to risk weighted assets						
Consolidated	\$ 105,874	10.7%	\$ 39,667	4.0%	N/A	
Bank	112,611	11.4	39,646	4.0	\$ 59,469	6.0%
Tier 1 capital to average assets						
Consolidated	\$ 105,874	8.6%	\$ 49,136	4.0%	N/A	
Bank	112,611	9.2	49,051	4.0	\$ 61,313	5.0%
<u>2012</u>						
Total capital to risk weighted assets						
Consolidated	\$ 102,943	11.0%	\$ 74,857	8.0%	N/A	
Bank	105,816	11.2	75,497	8.0	\$ 94,372	10.0%
Tier 1 capital to risk weighted assets						
Consolidated	\$ 92,680	9.9%	\$ 37,428	4.0%	N/A	
Bank	95,553	10.1	37,749	4.0	\$ 56,623	6.0%
Tier 1 capital to average assets						
Consolidated	\$ 92,680	8.1%	\$ 45,791	4.0%	N/A	
Bank	95,553	8.4	45,770	4.0	\$ 57,213	5.0%

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 17 - FAIR VALUES

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods and significant assumptions to estimate the fair value of each type of asset or liability carried at fair value:

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Derivative instruments consist of interest rate swaps and interest rate caps. The Corporation obtains fair values from financial institutions that use internal models with observable market inputs to estimate the values of these instruments (Level 2 inputs).

The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. The Corporation is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 17 - FAIR VALUES (Continued)

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Corporation has elected the fair value option, are summarized below:

<u>Fair Value Measurements at December 31, 2013 Using</u>			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:			
Investment securities available-for-sale:			
U.S. treasury and government agency securities	\$ -	\$ 73,631	\$ -
Obligations of states and political subdivisions	-	54,457	-
Corporate obligations	-	2,307	-
Mortgage-backed securities, residential	-	48,668	-
Marketable equity securities	9	-	-
Total investment securities available-for-sale	<u>\$ 9</u>	<u>\$ 179,063</u>	<u>\$ -</u>
Derivatives	<u>\$ -</u>	<u>\$ 2,054</u>	<u>\$ -</u>
Financial Liabilities:			
Derivatives	<u>\$ -</u>	<u>\$ 1,650</u>	<u>\$ -</u>
<u>Fair Value Measurements at December 31, 2012 Using</u>			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:			
Investment securities available-for-sale:			
U.S. treasury and government agency securities	\$ -	\$ 57,945	\$ -
Obligations of states and political subdivisions	-	54,138	-
Corporate obligations	-	2,304	-
Mortgage-backed securities, residential	-	50,211	-
Marketable equity securities	25	-	-
Total investment securities available-for-sale	<u>\$ 25</u>	<u>\$ 164,598</u>	<u>\$ -</u>
Derivatives	<u>\$ -</u>	<u>\$ 2,708</u>	<u>\$ -</u>
Financial Liabilities:			
Derivatives	<u>\$ -</u>	<u>\$ 2,959</u>	<u>\$ -</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 17 - FAIR VALUES (Continued)

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

<u>Fair Value Measurements at December 31, 2013 Using</u>			
	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:			
Servicing rights	\$ -	\$ 2,367	\$ -
Impaired loans			
Commercial	-	-	2,225
Agriculture	-	-	10,813
Residential Mortgage	-	-	1,070
Other real estate owned			
Commercial	-	-	118
Residential	-	-	126

<u>Fair Value Measurements at December 31, 2012 Using</u>			
	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:			
Servicing rights	\$ -	\$ 1,875	\$ -
Impaired loans			
Commercial	-	-	2,928
Agriculture	-	-	1,690
Residential Mortgage	-	-	1,174
Other real estate owned			
Commercial	-	-	931
Residential	-	-	875

Appraisals or brokers-price-opinions for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Once received, a member of the Loan Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. After the review of the appraisal, the Corporation typically applies a discount for liquidation and other considerations. For collateral dependent impaired loans this discount ranges from 0-20% for Agriculture and 10%-35% for Commercial and Residential Mortgage. For other real estate owned this discount ranges from 0-25%.

The following represent impairment charges recognized during the period:

Mortgage servicing rights, which are carried at lower of cost or fair value, included a portion carried at their fair value of \$2,367 which is made up of the outstanding balance of \$3,566 net of a valuation allowance of \$1,199 at December 31, 2013, resulting in a \$37 impairment recovery for the year ending December 31, 2013. At December 31, 2012 mortgage servicing rights included a portion carried at their fair value of \$1,875, which is made up of the outstanding balance of \$3,505 net of a valuation allowance of \$1,630, resulting in a \$420 impairment charge for the year ending December 31, 2012.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 17 - FAIR VALUES (Continued)

Collateral dependent impaired loans include loans which are measured for impairment using the fair value of the collateral and loans that have been charged down to the fair value of the collateral. These loans had a carrying amount of \$9,753, with a valuation allowance of \$874 at December 31, 2013, resulting in an additional provision for loan losses of \$499 for the year ending December 31, 2013. At December 31, 2012, impaired loans had a carrying amount of \$7,148, with a valuation allowance of \$1,499, resulting in an additional provision for loan losses of \$2,110 for the year ending December 31, 2012.

Other real estate owned measured at fair value less costs to sell, had a net carrying amount of \$244, which is made up of the outstanding balance of \$385, net of a valuation allowance of \$141 at December 31, 2013, resulting in a write-down of \$69 for the year ended December 31, 2013. At December 31, 2012, other real estate owned measured at fair value less costs to sell, had a net carrying amount of \$1,806, made up of the outstanding balance of \$2,095, net of a valuation allowance of \$289, resulting in a write-down of \$289 for the year ended December 31, 2012.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2013 and 2012 are as follows:

	<u>2 0 1 3</u>		<u>2 0 1 2</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets				
Cash and cash equivalents	\$ 51,733	\$ 51,733	\$ 40,527	\$ 40,527
Securities available-for-sale	179,072	179,072	164,623	164,623
Securities held-to-maturity	19,873	20,632	22,630	23,777
Restricted stock	7,790	N/A	6,193	N/A
Loans held-for-sale	3,173	3,258	25,921	26,721
Loans, net	911,357	912,289	849,696	852,068
Accrued interest receivable	6,414	6,414	6,613	6,613
Derivatives	2,054	2,054	2,708	2,708
Financial liabilities				
Deposits	(1,011,768)	(1,014,830)	(946,438)	(950,029)
Short-term borrowings	-	-	(10,850)	(10,850)
FHLB advances	(79,625)	(80,203)	(83,350)	(85,309)
Notes payable	(9,751)	(9,751)	(4,500)	(4,500)
Subordinated debentures	(18,000)	(10,436)	(18,000)	(10,488)
Accrued interest payable	(237)	(237)	(322)	(322)
Derivatives	(1,650)	(1,650)	(2,959)	(2,959)

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, short-term borrowings, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities held to maturity is consistent with the methods for securities available for sale, which was described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of loans held for sale is based on market quotes. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of restricted stock due to restrictions placed on its transferability. The carrying value (zero) of off-balance-sheet items is considered to be a reasonable estimate of fair value of these instruments.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 18 - BUSINESS COMBINATION

On May 1, 2012, the Corporation acquired 100% of the outstanding common shares of First Citizens of Paris, Inc. and its wholly-owned subsidiary Citizens National Bank of Paris in exchange for \$16,739. Citizens National Bank of Paris' results of operations were included in the Corporation's results beginning May 1, 2012. Acquisition-related costs of \$21 and \$691 are included in other in the consolidated income statement for the years ended December 31, 2013 and 2012, respectively.

Goodwill of \$2,559 arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the operations of the companies. Goodwill arising from the acquisition was adjusted by \$57 during the measurement period and is now final as the measurement period has passed. The fair value of \$1,339 of intangible assets is related to core deposits. The following table summarizes the consideration paid for First Citizen's and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date:

Consideration	
Cash	\$ 16,739
Equity Instruments	-
Contingent Consideration	-
Fair Value of Total Consideration Transferred	<u>\$ 16,739</u>
Recognized amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	\$ 11,226
Fed funds sold	2,174
Securities	85,843
Federal Home Loan Bank stock	1,476
Loans	95,791
Premises and equipment	1,962
Core deposit intangibles	1,339
Real estate owned	3,387
Bank-owned life insurance	3,259
Other assets	<u>5,622</u>
Total assets acquired	<u>212,079</u>
Deposits	179,175
Federal Home Loan Bank advances	6,419
Repurchase Agreements	7,045
Bank loan	903
Subordinated debenture	2,500
Other liabilities	<u>1,857</u>
Total liabilities assumed	<u>197,899</u>
Total identifiable net assets	<u>14,180</u>
Goodwill	<u>2,559</u>
	<u>\$ 16,739</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 18 - BUSINESS COMBINATION (Continued)

On October 26, 2013 the Corporation acquired 4 branches of Bank of Indiana, N.A located in the communities of Bargersville, Dana, Hamlet and North Judson, Indiana through a purchase and assumption agreement. Acquisition-related costs of \$123 are included in other in the Corporation's income statement for the year ended December 31, 2013.

Under the acquisition method of accounting, the total estimated purchase price is allocated to the net tangible and intangible assets based on their current estimated fair values on the date of the acquisition. Based on management's preliminary valuation of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, the purchase price for the Bank of Indiana, N.A. branch acquisition is allocated as follows:

Cash and cash equivalents	\$ 50,367
Securities	1,525
Loans	22,075
Restricted stock	1,375
Premises and equipment	931
Accrued interest receivable	139
Other assets	<u>275</u>
Total assets acquired	76,687
Deposits	77,242
Accrued expenses and other liabilities	<u>69</u>
Total liabilities assumed	77,311
Total identifiable net liabilities assumed	<u><u>(624)</u></u>
Definite-lived intangible assets acquired	592
Goodwill	32

Definite-lived intangible assets acquired consist of core deposit intangibles.

Prior to the end of the one year measurement period for finalizing the purchase price allocation, if information becomes available which would indicate adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 19 - PARENT COMPANY CONDENSED FINANCIAL STATEMENTS

CONDENSED BALANCE SHEETS
December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Assets		
Cash	\$ 1,380	\$ 1,132
Investment in subsidiaries	124,846	109,023
Dividend receivable	1	1
Other assets	<u>833</u>	<u>1,031</u>
	<u>\$ 127,060</u>	<u>\$ 111,190</u>
Liabilities		
Notes payable	\$ 9,751	\$ 4,500
Dividend payable and other liabilities	1,065	944
Subordinate debentures payable to:		
First Farmers Statutory Trust II	5,000	5,000
First Farmers Statutory Trust III	<u>13,000</u>	<u>13,000</u>
	28,816	23,444
Shareholders' equity	<u>98,244</u>	<u>87,746</u>
	<u>\$ 127,060</u>	<u>\$ 111,190</u>

CONDENSED STATEMENTS OF INCOME
Years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Dividends from subsidiaries	\$ 4,600	\$ 19,300
Other income	51	54
Interest expense	(724)	(961)
Other operating expenses	(626)	(571)
Income tax benefit	548	531
Equity in undistributed income (excess distributions) of subsidiaries	<u>11,968</u>	<u>(4,947)</u>
Net Income	<u>\$ 15,817</u>	<u>\$ 13,406</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 19 - PARENT COMPANY CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENTS OF CASH FLOWS
Years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities		
Net income	\$ 15,817	\$ 13,406
Adjustments to reconcile net income to net cash from operating activities		
Equity in (undistributed income) excess distributions of subsidiaries	(11,968)	4,947
Share-based compensation	145	120
Change in other assets and liabilities	<u>(811)</u>	<u>400</u>
Net cash from operating activities	3,183	18,873
Cash flows from investing activities		
Investments in subsidiaries	<u>(6,250)</u>	<u>(16,896)</u>
Net cash used in investing activities	(6,250)	(16,896)
Cash flows from financing activities		
Proceeds from long-term borrowings	10,000	5,000
Repayment of long-term borrowings	(4,749)	(1,403)
Repayment of subordinated debentures	-	(2,500)
Dividends paid	(2,029)	(3,051)
Purchase of treasury stock	(18)	(5)
Sale of treasury stock	<u>111</u>	<u>88</u>
Net cash from (used in) financing activities	<u>3,315</u>	<u>(1,871)</u>
Net change in cash	248	106
Beginning cash	<u>1,132</u>	<u>1,026</u>
Ending cash	<u>\$ 1,380</u>	<u>\$ 1,132</u>

(Continued)

FIRST FARMERS FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2013 and 2012
(Dollar amounts in thousands except share and per share data)

NOTE 20 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following is changes in accumulated other comprehensive income (loss) by component, net of tax, for the year ending December 31, 2013:

	Gains and Losses on_ <u>Derivatives</u>	Unrealized Gains and Losses On Available- for-Sale <u>Securities</u>	<u>Total</u>
Beginning balance	\$ (144)	\$ 2,000	\$ 1,856
Other comprehensive income before reclassification	253	(3,006)	(2,753)
Amounts reclassified from accumulated other comprehensive income	<u>-</u>	<u>(8)</u>	<u>(8)</u>
Net current period other comprehensive income	<u>253</u>	<u>(2,998)</u>	<u>(2,745)</u>
Ending balance	<u>\$ 109</u>	<u>\$ (998)</u>	<u>\$ (889)</u>

The following is significant amounts reclassified out of each component of accumulated other comprehensive income (loss) for the year ending December 31, 2013:

<u>Details about Accumulated Other Comprehensive Income Components</u>	<u>Amount Reclassified From Accumulated Other Comprehensive Income</u>	<u>Affected Line Item in the Statement Where Net Income is Presented</u>
Unrealized gains and losses on available-for-sale securities	\$ <u>13</u>	Net gain on sale and
	13	redemption of securities
	<u>(5)</u>	Total before tax
		Tax (expense) or benefit
	<u>\$ 8</u>	Net of tax