

CITIZENS HOLDING CO /MS/
Form 10-Q
November 07, 2008
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from _____ to _____

Commission file number: 000-25221

CITIZENS HOLDING COMPANY

(Exact Name of Registrant as Specified in its Charter)

MISSISSIPPI
(State or Other Jurisdiction of
Incorporation or Organization)

64-0666512
(I. R. S. Employer
Identification Number)

521 Main Street, Philadelphia, MS
(Address of Principal Executive Offices)

39350
(Zip Code)

Registrant's Telephone Number, Including Area Code: 601-656-4692

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

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller Reporting Company

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

Number of shares outstanding of each of the issuer's classes of common stock, as of November 6, 2008:

Title	Outstanding
Common Stock, \$0.20 par value	4,856,746

Table of Contents

CITIZENS HOLDING COMPANY

THIRD QUARTER 2008 INTERIM FINANCIAL STATEMENTS

TABLE OF CONTENTS

PART I.	<u>FINANCIAL INFORMATION</u>	1
Item 1.	<u>Consolidated Financial Statements (Unaudited)</u>	1
	<u>Consolidated Statements of Condition September 30, 2008 and December 31, 2007</u>	1
	<u>Consolidated Statements of Income Three and Nine months ended September 30, 2008 and 2007</u>	2
	<u>Consolidated Statements of Comprehensive Income Three and Nine months ended September 30, 2008 and 2007</u>	3
	<u>Condensed Consolidated Statements of Cash Flows Nine months ended September 30, 2008 and 2007</u>	4
	<u>Notes to Consolidated Financial Statements</u>	5
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	21
Item 4.	<u>Controls and Procedures</u>	24
PART II.	<u>OTHER INFORMATION</u>	25
Item 1.	Legal Proceedings*	
Item 1A.	<u>Risk Factors</u>	25
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
Item 3.	Defaults Upon Senior Securities*	
Item 4.	Submission of Matters to a Vote of Security Holders*	
Item 5.	Other Information*	
Item 6.	<u>Exhibits</u>	27
*	None or Not Applicable	
	<u>SIGNATURES</u>	28

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
CITIZENS HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CONDITION

(Unaudited)

	September 30, 2008	December 31, 2007
ASSETS		
Cash and due from banks	\$ 15,670,300	\$ 18,622,058
Interest bearing deposits with other banks	1,448,896	612,938
Federal funds sold	7,400,000	900,000
Investment securities available for sale, at fair value	206,623,065	244,720,367
Loans, net of allowance for loan losses of \$4,385,771 in 2008 and \$3,967,951 in 2007	410,961,110	368,025,286
Premises and equipment, net	16,702,379	14,288,797
Other real estate owned, net	2,918,938	2,046,584
Accrued interest receivable	5,268,645	5,210,201
Cash value of life insurance	17,796,929	17,693,476
Intangible assets, net	3,826,857	4,215,070
Other assets	6,573,985	4,568,854
TOTAL ASSETS	\$ 695,191,104	\$ 680,903,631
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing demand	\$ 76,360,663	\$ 78,224,936
Interest-bearing NOW and money market accounts	168,816,742	144,302,273
Savings deposits	32,421,300	29,763,885
Certificates of deposit	225,491,364	224,941,210
Total deposits	503,090,069	477,232,304
Federal Funds Purchased		4,200,000
Accrued interest payable	1,161,819	1,915,232
Federal Home Loan Bank advances	79,400,000	49,400,000
Sweep Account Liability	37,851,007	74,963,424
Deferred compensation payable	3,182,978	2,989,940
Other liabilities	2,126,345	2,011,299
Total liabilities	626,812,218	612,712,199
STOCKHOLDERS EQUITY		
Common stock; \$.20 par value, 22,500,000 shares authorized, 4,858,146 shares outstanding at September 30, 2008 and 4,863,242 shares outstanding at December 31, 2007	971,024	972,648
Additional paid-in capital	3,778,049	3,979,717
Retained earnings	67,120,505	63,671,589
Accumulated other comprehensive loss, net of taxes of \$2,076,600 in 2008 and \$257,306 in 2007	(3,490,692)	(432,522)

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Total stockholders' equity	68,378,886	68,191,432
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 695,191,104	\$ 680,903,631

The accompanying notes are an integral part of these financial statements.

Table of Contents

CITIZENS HOLDING COMPANY
CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
INTEREST INCOME				
Loan income, including fees	\$ 7,382,418	\$ 7,281,956	\$ 21,899,227	\$ 21,621,371
Investment securities	2,494,163	2,212,508	7,262,818	5,993,173
Other interest	32,140	124,989	190,824	1,010,091
Total interest income	9,908,721	9,619,453	29,352,869	28,624,635
INTEREST EXPENSE				
Deposits	2,157,948	3,302,320	7,523,863	9,567,546
Other borrowed funds	875,832	939,099	2,934,318	2,788,336
Total interest expense	3,033,780	4,241,419	10,458,181	12,355,882
NET INTEREST INCOME	6,874,941	5,378,034	18,894,688	16,268,753
PROVISION FOR LOAN LOSSES	372,105	396,349	1,028,914	553,396
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,502,836	4,981,685	17,865,774	15,715,357
OTHER INCOME				
Service charges on deposit accounts	1,062,786	979,633	3,017,578	2,842,210
Other service charges and fees	325,696	272,401	889,234	537,025
Other income	394,944	772,673	2,405,357	2,192,450
Total other income	1,783,426	2,024,707	6,312,169	5,571,685
OTHER EXPENSES				
Salaries and employee benefits	3,019,748	2,705,828	8,974,575	7,827,309
Occupancy expense	912,118	800,095	2,704,270	2,269,964
Other operating expense	1,548,363	1,389,619	4,621,554	4,059,037
Total other expenses	5,480,229	4,895,542	16,300,399	14,156,310
INCOME BEFORE PROVISION FOR INCOME TAXES	2,806,033	2,110,850	7,877,544	7,130,732
PROVISION FOR INCOME TAXES	701,680	362,549	1,658,069	1,632,384
NET INCOME	\$ 2,104,353	\$ 1,748,301	\$ 6,219,475	\$ 5,498,348
NET INCOME PER SHARE				
-Basic	\$ 0.43	\$ 0.36	\$ 1.28	\$ 1.12
-Diluted	\$ 0.43	\$ 0.36	\$ 1.27	\$ 1.10

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DIVIDENDS PAID PER SHARE	\$	0.19	\$	0.18	\$	0.57	\$	0.54
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The accompanying notes are an integral part of these financial statements.

Table of Contents

CITIZENS HOLDING COMPANY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 2,104,353	\$ 1,748,301	\$ 6,219,475	\$ 5,498,348
Other comprehensive income (loss), net of tax				
Unrealized holding gains (losses)	(1,196,003)	1,295,326	(3,058,170)	(1,350,560)
Reclassification adjustment for losses included in net income				2,237
Total other comprehensive income (loss)	(1,196,003)	1,295,326	(3,058,170)	(1,348,323)
Comprehensive income	\$ 908,350	\$ 3,043,627	\$ 3,161,305	\$ 4,150,025

The accompanying notes are an integral part of these financial statements.

Table of Contents

CITIZENS HOLDING COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the nine months ended September 30,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Cash Provided by Operating Activities	\$ 8,225,487	\$ 6,814,181
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of securities available for sale	16,209,163	11,577,120
Proceeds from sales of securities available for sale	22,992,995	7,542,364
Purchases of investment securities available for sale	(75,935,789)	(50,918,401)
Net change in Shay Investments	69,044,931	(1,500,839)
Net change in sweep accounts	(37,112,417)	
Purchases of bank premises and equipment	(3,333,414)	(1,913,187)
Increase in interest bearing deposits with other banks	(835,958)	(111,721)
Net (increase) decrease in federal funds sold	(6,500,000)	15,200,000
Redemption of Federal Home Loan Bank Stock	544,300	869,000
Proceeds from sale of other real estate acquired by foreclosure	225,114	1,425,194
Increase in ownership of subsidiary		(2,994,671)
Net (increase) decrease in loans	(45,071,492)	15,570,500
Net Cash Used by Investing Activities	(59,772,567)	(5,254,641)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	25,857,765	6,105,059
Proceeds from exercising stock options	146,980	
Increase (Decrease) in Federal Home Loan Bank advances	30,000,000	(10,000,000)
Repurchase of Stock	(438,865)	(3,343,404)
(Increase) Decrease in federal funds purchased	(4,200,000)	9,300,000
Payment of dividends	(2,770,558)	(2,653,076)
Net Cash Provided (Used) by Financing Activities	48,595,322	(591,421)
Net Increase (Decrease) in Cash and Due from Banks	(2,951,758)	968,119
Cash and Due From Banks, beginning of period	18,622,058	15,449,434
Cash and Due from Banks, end of period	\$ 15,670,300	\$ 16,417,553

The accompanying notes are an integral part of these financial statements.

Table of Contents

CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the three and nine months ended September 30, 2008

(Unaudited)

Note 1. Summary of Significant Accounting Policies

These interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. However, these financial statements do not include all of the information and footnotes required by generally accepted accounting principles (GAAP) for complete financial statements. The interim consolidated financial statements are unaudited and reflect all adjustments and reclassifications, which, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition as of and for the interim periods presented. All adjustments and reclassifications are of a normal and recurring nature. Results for the period ended September 30, 2008 are not necessarily indicative of the results that may be expected for any other interim periods or for the year as a whole.

The interim consolidated financial statements of Citizens Holding Company include the accounts of its wholly-owned subsidiary, The Citizens Bank of Philadelphia (the Bank) and collectively with Citizens Holding Company, the Corporation. On January 2, 2007, the Bank completed a one-for-one thousand (1-for-1,000) reverse stock split with all fractional shares paid in cash. As a result of this transaction, the Corporation became the 100% owner of the Bank on January 2, 2007. All significant intercompany transactions have been eliminated in consolidation.

For additional significant accounting policies of the Corporation, see Note 1 of the Notes to Consolidated Financial Statements of Citizens Holding Company included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission on March 12, 2008.

Note 2. Commitments and Contingent Liabilities

In the ordinary course of business, the Corporation enters into commitments to extend credit to its customers. The unused portion of these commitments is not reflected in the accompanying financial statements. As of September 30, 2008, the Corporation had entered into loan commitments with certain customers with an aggregate unused balance of \$46,621,385 compared to an aggregate unused balance of \$27,293,147 at December 31, 2007. There were \$3,103,827 of letters of credit outstanding at September 30, 2008 and \$437,918 at December 31, 2007. The fair value of such contracts is not considered material because letters of credit and loan commitments often are not used in their entirety, if at all, before they expire. The balances of such letters and commitments should not be used to project actual future liquidity requirements. However, the Corporation does incorporate expectations about the level of draws under its credit-related commitments into its asset and liability management program.

The Corporation is a party to lawsuits and other claims that arise in the ordinary course of business, all of which are being vigorously contested. In the regular course of business, management evaluates estimated losses or costs related to litigation, and provision is made for anticipated losses whenever management believes that such losses are probable and can be reasonably estimated. At the present time, management believes, based on the advice of legal counsel, that the final resolution of pending legal proceedings will not have a material impact on the Corporation's consolidated financial condition or results of operations.

Note 3. Net Income per Share

Net income per share - basic, has been computed based on the weighted average number of shares outstanding during each period. Net income per share - diluted, has been computed based on the weighted

Table of Contents

average number of shares outstanding during each period plus the dilutive effect of outstanding granted stock options using the treasury stock method. Earnings per share was computed as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Basic weighted average shares outstanding	4,856,549	4,870,737	4,862,411	4,930,961
Dilutive effect of granted options	33,976	49,201	35,447	52,517
Diluted weighted average shares outstanding	4,890,525	4,919,938	4,897,858	4,983,478
Net income	\$ 2,104,353	\$ 1,748,301	\$ 6,219,475	\$ 5,498,348
Net income per share-basic	\$ 0.43	\$ 0.36	\$ 1.28	\$ 1.12
Net income per share-diluted	\$ 0.43	\$ 0.36	\$ 1.27	\$ 1.10

Note 4. Stock Option Plan

At September 30, 2008, the Corporation had two stock-based compensation plans, which are the 1999 Employees Long-Term Incentive Plan and the 1999 Directors Stock Compensation Plan. As of January 1, 2006, the Corporation began accounting for these plans under the recognition and measurement principles of fair value set forth in Statement of Financial Accounting Standards No. 123R, Share-Based Payment, (SFAS 123R) and the Securities and Exchange Commission Staff Accounting Bulletin 107 (SAB 107). SAB 107 provides guidance related to share-based payments transactions, including valuation methods (including assumptions such as expected volatility and expected term), the classification of compensation expense, non-GAAP financial measures, first time adoption of SFAS 123R in an interim period and disclosure in Management s Discussion and Analysis subsequent to the adoption of SFAS 123R.

To determine the expected term of the options granted, the Corporation chose to use the simplified method for plain vanilla options as detailed in SAB 107 for those options granted prior to December 31, 2007. The Corporation determined that those options granted comply with the requirements under SAB 107 and used this method for estimating the expected term of the options granted until December 31, 2007. Beginning with options granted after this date, the Corporation will use the methods prescribed by SFAS 123R. Volatility is determined by using the standard deviation of the differences of the closing stock price of the Corporation s common stock as quoted on the American Stock Exchange (through November 15, 2006, the date of the transfer of the listing of the Corporation s common stock to The NASDAQ Global Market) or The NASDAQ Global Market (since November 16, 2006) on or about the 15th of each month starting January 15, 2002. Stock prices prior to that date experienced volatility that is not representative of the volatility experienced since that time and therefore are not used in this calculation.

Although the option grants are not subject to an explicit vesting schedule, the Corporation recognizes that the restriction on exercising options before six months and one day after the grant date constitutes a de facto vesting schedule and must be considered when applying SFAS 123R. SFAS 123R states that a requisite service period may be explicit, implicit or derived and that an implicit service period is one that may be inferred from an analysis of the award s terms. Based on its analysis of the terms of the option awards, management concluded that the restriction on exercising options until six months and one day have passed since the date of grant constitutes a service period under SFAS 123R and the compensation costs should be amortized over this six month period.

Table of Contents

The fair value of each option granted is estimated on the date of the grant using the Black-Sholes option-pricing model.

On April 25, 2007, the members of the Board of Directors were granted a total of 13,500 options as specified in the 1999 Directors' Stock Compensation Plan. These options were granted at an exercise price of \$22.00 per option, which was the closing price of Citizens Holding Company stock on that day. These options were first exercisable on October 26, 2007 and must be exercised no later than April 25, 2017.

The following assumptions were used in estimating the fair value of the options granted to the directors in the second quarter of 2007.

Assumption	2007
Dividend Yield	3.30%
Risk-Free Interest Rate	4.76%
Expected Life	5.25 years
Expected Volatility	34.88%
Calculated Value per Option	\$6.23
Forfeitures	0.00%

Using the Black-Scholes option-pricing model with the foregoing assumptions, it was determined that the cost of options granted to directors in April 2007 was \$84,090 and should be recognized as an expense of \$14,015 per month over the six month requisite service period, beginning in April 2007. This was recorded as salary expense with a credit to paid-in capital. A deferred tax on these options was recorded in the aggregate amount of \$31,113, or \$5,186 per month, over the six month requisite service period, beginning in April 2007.

On April 23, 2008, the members of the Board of Directors were granted a total of 13,500 options as specified in the 1999 Directors' Stock Compensation Plan and 1,500 options were granted to an officer under the 1999 Employees' Stock Incentive Plan. These options were granted at an exercise price of \$18.00 per option, which was the closing price of Citizens Holding Company stock on that day. These options are first exercisable on October 24, 2008 and must be exercised no later than April 23, 2018.

The following assumptions were used in estimating the fair value of the options granted to the directors and the officer in the second quarter of 2008.

Assumption	Officer	Directors
Dividend Yield	4.10%	4.10%
Risk-Free Interest Rate	3.15%	3.15%
Expected Life	8.46 years	6.75 years
Expected Volatility	44.82%	44.82%
Calculated Value per Option	\$5.92	\$5.76
Forfeitures	0.00%	0.00%

Using the Black-Scholes option-pricing model with the foregoing assumptions, it was determined that the cost of options granted to directors in April 2008 was \$79,952 and should be recognized as an expense of \$13,325 per month over the six month requisite service period, beginning in April 2008. This was recorded as salary expense with a credit to paid-in capital. A deferred tax on these options was recorded in the aggregate amount of \$29,582, or \$4,930 per month, over the six month requisite service period, beginning in April 2008.

Table of Contents

Using the assumptions in the previous table, it was also determined that the cost of options granted to the officer was \$8,462 and should be recognized as an expense of \$1,440 over the six month requisite service period, beginning in April 2008. This was recorded as salary expense with a credit paid-in capital. No deferred taxes were recorded on this option grant.

The following table below is a summary of the stock option activity for the nine months ended September 30, 2008.

	Directors Plan		Employees Plan	
	Number	Weighted	Number	Weighted
	of	Average	of	Average
	Shares	Exercise	Shares	Exercise
		Price		Price
Outstanding at December 31, 2007	100,650	\$ 16.76	192,300	\$ 18.60
Granted	13,500	18.00	1,500	18.00
Exercised	(16,800)	11.22	(7,500)	13.73
Expired	(3,000)	22.98	(9,500)	21.72
Outstanding at September 30, 2008	94,350	\$ 17.73	176,800	\$ 18.63

The intrinsic value of options granted under the Directors Plan at September 30, 2008 was \$136,931 and the intrinsic value of options granted under the Employees Plan at September 30, 2008 was \$173,250 for a total intrinsic value at September 30, 2008 of \$310,181.

Note 5. Income Taxes

FASB Interpretation 48, Accounting for Income Tax Uncertainties (FIN 48), was issued in June 2006 and defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. FIN 48 also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, and includes guidance concerning accounting for income tax uncertainties in interim periods. The Corporation adopted the provisions of FIN 48, on January 1, 2007, and determined there was no need to make an adjustment to retained earnings upon adoption of FIN 48. As of January 1, 2007, the Corporation had no unrecognized tax benefits related to federal and state income tax matters. Therefore, the Corporation does not anticipate any material increase in the effective tax rate during 2008 relative to any tax positions taken prior to January 1, 2007. It is the Corporation's policy to recognize interest and/or penalties related to income tax matters in income tax expense.

The Corporation and its subsidiaries file a consolidated U. S. federal income tax return. The Corporation is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending December 31, 2004 through 2007. The Corporation and its subsidiaries state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2004 through 2007.

Note 6. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157), which establishes a hierarchy to be used in performing measurements of fair value. SFAS No. 157 emphasizes that fair value should be determined from the perspective of a market participant while also indicating that valuation methodologies should first reference available market data

Table of Contents

before using internally developed assumptions. Additionally, SFAS No. 157 provides expanded disclosure requirements regarding the effects of fair value measurements on the financial statements. This statement applies whenever other standards require or permit assets and liabilities to be measured at fair value. This statement does not mandate the use of fair value in any circumstance. The Corporation adopted SFAS No. 157 on January 1, 2008. The adoption of SFAS No. 157 did not have a material impact on the financial position or results of operations of the Corporation. See Note 7, Fair Value of Financial Instruments, for further disclosures in regards to the Corporation's adoption of SFAS No. 157.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (an amendment of FASB Statements No. 87, 88, 106, and 132R) (SFAS No. 158), which requires an employer to: (1) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status; (2) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions); and (3) recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income. The requirement by SFAS No. 158 to recognize the funded status of a benefit plan and the disclosure requirements of SFAS No. 158 are effective as of the end of the first fiscal year ending after December 15, 2006 for entities with publicly traded equity securities. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Corporation does not expect the adoption of SFAS No. 158 to have a material effect on the Corporation's financial condition or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159), which allows an irrevocable election to measure certain financial assets and financial liabilities at fair value on an instrument-by-instrument basis, with unrealized gains and losses recognized currently in earnings. Under SFAS No. 159, the fair value option may only be elected at the time of initial recognition of a financial asset or financial liability or upon the occurrence of certain specified events. SFAS No. 159 requires that assets and liabilities which are measured at fair value be reported in the financial statements in a manner that separates those fair values from the carrying amounts of similar assets and liabilities which are measured using another measurement attribute. SFAS No. 159 also provides expanded disclosure requirements regarding the effects of electing the fair value option on the financial statements. The Corporation adopted SFAS No. 159 on January 1, 2008. The adoption of SFAS No. 159 did not have an impact on the financial position or results of operations of the Corporation.

In December 2007, the FASB issued Statement No. 141(R), Business Combinations (Statement 141R), which replaces Statement No. 141, Business Combinations (Statement 141). Statement 141R retains the fundamental requirements in Statement 141 that the acquisition method of accounting (formerly referred to as purchase method) be used for all business combinations and that an acquirer be identified for each business combination. Statement 141R defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as of the date that the acquirer achieves control. Statement 141R requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values. Statement 141R requires the acquirer to account for acquisition related costs and restructuring costs separately from the business combination as period expense. Statement 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of Statement 141R is not expected to have a material impact on the financial position or results of operations of the Corporation.

In December 2007, the FASB issued Statement No. 160, Noncontrolling Interest in Consolidated Financial Statements - an Amendment to ARB No. 51 (Statement 160). Statement 160 establishes new accounting and reporting standards that require the ownership interests in the subsidiaries held by parties other than the parent be clearly identified, labeled and presented in the consolidated statement of financial position within equity, but separate from the parent's equity. Statement 160 also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the

Table of Contents

face of the consolidated statement of income. In addition, when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary shall be initially measured at fair value, with the gain or loss on the deconsolidation of the subsidiary measured using the fair value of any noncontrolling equity investment rather than the carrying amount of that retained investment. Statement 160 also clarifies that changes in a parent's ownership in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. Statement 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. Statement 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Early adoption is prohibited. The Corporation is currently in the process of evaluating the impact of adopting Statement 160 on its financial statements.

In May 2008, the FASB issued SFAS 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendment to AU 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The Corporation does not expect the implementation of SFAS 162 to have a material impact on its consolidated financial statements.

Note 7. Fair Value of Financial Instruments

FASB Statement 157, "Fair Value Measurements" (SFAS No. 157) establishes a framework for measuring the fair value of assets and liabilities. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The Corporation estimates the fair values of financial assets and liabilities on a recurring basis using the following methods and assumptions:

Securities available for sale: Fair values for securities are based on quoted market prices, where available. If quoted prices are not available, fair values are based on quoted market prices of similar instruments. Level 2 securities include debt securities including obligations of U. S. Government agencies and corporations, mortgage-backed securities, state, county and municipal bonds and preferred stock.

The following table presents assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2008:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Totals
Securities available for sale	\$	\$ 206,623,065	\$	\$ 206,623,065

The Corporation recorded no gains or losses in earnings for the period that were attributable to the change in unrealized gains or losses relating to assets still held at the reporting date.

Table of Contents

CITIZENS HOLDING COMPANY

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

Management's discussion and analysis is written to provide greater insight into the results of operations and the financial condition of Citizens Holding Company and its wholly owned subsidiary, The Citizens Bank of Philadelphia (the Bank, and collectively with Citizens Holding Company, the Corporation).

LIQUIDITY

The Corporation has an asset and liability management program that assists management in maintaining net interest margins during times of both rising and falling interest rates and in maintaining sufficient liquidity. A measurement of liquidity is the ratio of net deposits and short-term liabilities divided by net cash, short-term investments and marketable assets. This measurement for liquidity of the Corporation at September 30, 2008 was 35.01% and at December 31, 2007 was 48.50%. Management believes it maintains adequate liquidity for the Corporation's current needs.

The Corporation's primary source of liquidity is customer deposits, which were \$503,090,069 at September 30, 2008 and \$477,232,304 at December 31, 2007. Other sources of liquidity include investment securities, the Corporation's line of credit with the Federal Home Loan Bank (FHLB) and federal funds lines with correspondent banks. The Corporation had \$206,623,065 invested in investment securities at September 30, 2008 and \$244,720,367 at December 31, 2007. The Corporation had secured and unsecured federal funds lines with correspondent banks in the amount of \$40,500,000 at September 30, 2008 and \$17,500,000 at December 31, 2007. In addition, the Corporation has the ability to draw on its line of credit with the FHLB. At September 30, 2008, the Corporation had unused and available \$104,138,353 of its line of credit with the FHLB and at December 31, 2007, the Corporation had unused and available \$72,441,868 of its line of credit with the FHLB. The decrease in the amount available under the Corporation's line of credit with the FHLB from the end of 2007 to September 30, 2008 resulted from the Corporation securing advances as an alternative to higher cost deposits.

At September 30, 2008, the Corporation had \$7,400,000 in federal funds sold compared to \$900,000 at December 31, 2007. The Corporation invests its excess liquidity in federal funds sold on a daily basis. The amount of increase in federal funds sold from December 31, 2007 to September 30, 2008 was the excess of the increase in deposits that were not utilized to fund loans or invested in investment securities.

When the Corporation has more funds than it needs for its reserve requirements or short-term liquidity needs, the Corporation increases its investment portfolio or sells federal funds. It is management's policy to maintain an adequate portion of its portfolio of assets and liabilities on a short-term basis to insure rate flexibility and to meet loan funding and liquidity needs. When deposits decline or do not grow sufficiently to fund loan demand, management will seek funding either through federal funds purchased or advances from the FHLB.

CAPITAL RESOURCES

The Corporation's equity capital was \$68,378,886 at September 30, 2008 as compared to \$68,191,432 at December 31, 2007. The main reason for the increase in equity capital was net earnings in excess of dividends paid. Equity capital was negatively impacted by the FASB 115 adjustment due to a decrease in the market value of the Corporation's investment portfolio. This market value decrease was due to general market conditions, specifically the increase in short term interest rates, which caused a decrease in the market price of the investment portfolio.

Certain employees and directors exercised stock options for 3,200 shares of stock in 2007. These option exercises brought the number of shares outstanding to 4,863,242 at December 31, 2007. In the first nine months of 2008, four directors exercised stock options for 16,800 shares of stock. Commencing March 1,

Table of Contents

2007, the Corporation implemented a stock repurchase program under which the Corporation may repurchase up to 250,000 shares of its stock on the open market. At the end of the program, February 29, 2008, the Corporation had purchased 160,186 shares at an average price of \$21.66.

Commencing May 1, 2008 the Corporation implemented a stock repurchase program under which the Corporation may repurchase up to 250,000 shares of the Company's common stock on the open market. The Plan is effective as of May 1, 2008 and will terminate no later than April 30, 2009. At September 30, 2008, the Corporation had purchased 20,984 shares at an average price of \$20.43. This reduced the number of shares outstanding at September 30, 2008 to 4,858,146.

Cash dividends in the amount of \$2,770,558, or \$0.57 per share, have been paid in 2008 as of the end of the third quarter.

Quantitative measures established by federal regulations to ensure capital adequacy require the Corporation to maintain minimum amounts and ratios of Total and Tier 1 capital (primarily common stock and retained earnings, less goodwill) to risk weighted assets, and of Tier 1 capital to average assets. Management believes that as of September 30, 2008 the Corporation meets all capital adequacy requirements to which it is subject.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Actions Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2008						
Total Capital (to Risk-Weighted Assets)	\$ 72,428,491	16.24%	\$ 35,677,592	>8.00%	\$ 44,596,990	>10.00%
Tier 1 Capital (to Risk-Weighted Assets)	\$ 68,042,720	15.26%	\$ 17,838,796	>4.00%	\$ 26,758,194	>6.00%
Tier 1 Capital (to Average Assets)	\$ 68,042,720	10.04%	\$ 27,095,681	>4.00%	\$ 33,869,601	>5.00%
The Corporation is currently in the process of constructing a new \$1.4 million branch facility in Carthage, Mississippi with an estimated completion date in November 2008.						

Table of Contents

RESULTS OF OPERATIONS

The following table sets forth for the periods indicated, certain items in the consolidated statements of income of the Corporation and the related changes between those periods:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Interest Income, including fees	\$ 9,908,721	\$ 9,619,453	\$ 29,352,869	\$ 28,624,635
Interest Expense	3,033,780	4,241,419	10,458,181	12,355,882
Net Interest Income	6,874,941	5,378,034	18,894,688	16,268,753
Provision for Loan Losses	372,105	396,349	1,028,914	553,396
Net Interest Income after Provision for Loan Losses	6,502,836	4,981,685	17,865,774	15,715,357
Other Income	1,783,426	2,024,707	6,312,169	5,571,685
Other Expense	5,480,229	4,895,542	16,300,399	14,156,310
Income before Provision For Income Taxes	2,806,033	2,110,850	7,877,544	7,130,732
Provision for Income Taxes	701,680	362,549	1,658,069	1,632,384
Net Income	\$ 2,104,353	\$ 1,748,301	\$ 6,219,475	\$ 5,498,348
Net Income Per share Basic	\$ 0.43	\$ 0.36	\$ 1.28	\$ 1.12
Net Income Per Share-Diluted	\$ 0.43	\$ 0.36	\$ 1.27	\$ 1.10

See Note 3 to the Corporation's Consolidated Financial Statements for an explanation regarding the Corporation's calculation of Net Income Per Share - basic and - diluted.

Annualized return on average equity (ROE) was 12.04% for the three months ended September 30, 2008 and 10.61% for the corresponding period in 2007. The increase in ROE was caused by the increase in net income for the first nine months of 2008 while the average equity increased. For the nine months ended September 30, 2008, ROE was 11.84% compared to 10.88% for the nine months ended June 30, 2007.

The book value per share increased to \$14.08 at September 30, 2008 compared to \$14.02 at December 31, 2007. The increase in book value per share reflects the increase in equity due to the amount of earnings in excess of dividends and the increase in the FASB 115 adjustment. Average assets for the nine months ended September 30, 2008 were \$693,190,191 compared to \$639,304,724 for the year ended December 31, 2007.

NET INTEREST INCOME / NET INTEREST MARGIN

One component of the Corporation's earnings is net interest income, which is the difference between the interest and fees earned on loans and investments and the interest paid for deposits and borrowed funds. The net interest margin is net interest income expressed as a percentage of average earning assets.

Table of Contents

The annualized net interest margin was 4.61% for the third quarter of 2008 compared to 4.39% for the corresponding period of 2007. For the nine months ended September 30, 2008 annualized net interest margin was 4.46% as compared to 4.34% for the nine months ended September 30, 2007. The increase in net interest margin from 2007 to 2008 is the result of slower decrease in yields on earning assets compared to the decrease in rates paid on deposits and borrowed funds, as detailed below. Earning assets averaged \$612,906,175 for the three months ended September 30, 2008. This represents an increase of \$41,937,752, or 7.35%, over average earning assets of \$570,968,423 for the three month period ended September 30, 2007. Earning assets averaged \$626,710,668 for the nine months ended September 30, 2008. This represents an increase of \$54,460,456, or 9.52% over average earning assets of \$572,250,212 for the nine months ended September 30, 2007. The increase in earning assets for the three and nine months ended September 30, 2008 is the result of the normal growth pattern of the Corporation and not due to any special investments or acquisitions.

Interest bearing deposits averaged \$410,359,677 for the three months ended September 30, 2008. This represents an increase of \$8,786,635, or 2.19%, over the average of interest bearing deposits of \$401,573,042 for the three month period ended September 30, 2007. This was due to an increase in interest bearing deposits offset by a decrease in certificates of deposit outstanding. Other borrowed funds averaged \$119,968,017 for the three months ended September 30, 2008. This represents an increase of \$38,675,441, or 47.58%, over the other borrowed funds of \$81,292,576 for the three month period ended September 30, 2007. This increase in other borrowed funds was due to a \$28,979,391 decrease in the Sweep Account Liability, a \$37,749,141 increase in the Commercial Repo Liability, a \$236,700 decrease in the ABE Loan Liability, a \$183,696 decrease in Federal Funds Purchased and an increase in the Federal Home Loan Bank advances of \$30,326,087 for the three month period ended September 30, 2008 when compared to the three month period ended September 30, 2007. Interest bearing deposits averaged \$408,717,092 for the nine months ended September 30, 2008. This represents an increase of \$4,732,646, or 1.17%, over the average of interest bearing deposits of \$403,984,446 for the nine month period ended September 30, 2007. The net increase was due to an increase in interest bearing deposits and certificates of deposit offset by a decrease in savings accounts. Other borrowed funds averaged \$129,336,070 for the nine months ended September 30, 2008. This represents an increase of \$49,206,026, or 61.41%, over the other borrowed funds of \$80,130,044 for the nine month period ended September 30, 2007. The increase in other borrowed funds was due to a \$106,484 increase in the Sweep Account Liability, a \$19,100,047 increase in the Commercial Repo Liability, a \$2,935,678 increase in Federal Funds Purchased and an increase in the Federal Home Loan Bank advances of \$27,303,074 for the nine month period ended September 30, 2008 when compared to the nine month period ended September 30, 2007.

Net interest income was \$6,874,941 for the three month period ended September 30, 2008, an increase of \$1,496,907 from the \$5,378,034 for the three month period ended September 30, 2007, primarily due to changes in both volume and rate. The changes in volume in earning assets and in deposits and in borrowed funds are discussed above. As to changes in rate, in the three month period ended September 30, 2008, the rates paid on deposits and borrowed funds decreased faster than the yield on earning assets as compared to the changes in rates and yields in the same period in 2007. The yield on all interest bearing assets decreased 61 basis points to 6.64% in the third quarter of 2008 from 7.25% for the same period in 2007. At the same time, the rate paid on all interest bearing liabilities for the third quarter of 2008 decreased by 118 basis points to 2.28% from 3.46% in the same period of 2007. Net interest income was \$18,894,688 for the nine months ended September 30, 2008, an increase of \$2,625,935 from the \$16,268,753 for the nine month period ended September 30, 2007, primarily due to changes in both volume and rate. The changes in volume in earning assets and in deposits and in borrowed funds are discussed above. As to changes in rate, in the nine month period ended September 30, 2008, the rates paid on deposits and borrowed funds decreased faster than the yield on earning assets as compared to the changes in rates and yields in the same period in 2007. The yield on all interest bearing assets decreased 47 basis points to 6.67% in the first nine months of 2008 from 7.14% for the same period in 2007. At the same time, the rate paid on all interest bearing liabilities for the first nine months of 2008 decreased 58 basis points to 2.59% from 3.17% in the same period of 2007. As longer term interest bearing assets and liabilities mature and reprice, management believes that the yields on interest bearing assets and rates on interest bearing liabilities will both decrease.

Table of Contents

The following table shows the interest and fees and corresponding yields for loans only.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Interest and Fees	\$ 7,382,418	\$ 7,281,956	\$ 21,899,227	\$ 21,621,371
Average Loans	401,647,346	355,677,162	391,112,280	357,549,332
Annualized Yield	7.35%	8.19%	7.47%	8.06%

The decrease in interest rates in the three and nine month period ended September 30, 2008 reflects the decrease in all loan interest rates for both new and refinanced loans in the period.

CREDIT LOSS EXPERIENCE

As a natural corollary to the Corporation's lending activities, some loan losses are to be expected. The risk of loss varies with the type of loan being made and the creditworthiness of the borrower over the term of the loan. The degree of perceived risk is taken into account in establishing the structure of, and interest rates and security for, specific loans and for various types of loans. The Corporation attempts to minimize its credit risk exposure by use of thorough loan application and approval procedures.

The Corporation maintains a program of systematic review of its existing loans. Loans are graded for their overall quality. Those loans, which the Corporation's management determines require further monitoring and supervision, are segregated and reviewed on a periodic basis. Significant problem loans are reviewed on a monthly basis by the Corporation's Board of Directors.

The Corporation charges off that portion of any loan that management has determined to be a loss. A loan is generally considered by management to represent a loss in whole or in part when exposure beyond the collateral value is apparent, servicing of the unsecured portion has been discontinued or collection is not anticipated based on the borrower's financial condition. The general economic conditions in the borrower's industry influence this determination. The principal amount of any loan which is declared a loss is charged against the Corporation's allowance for loan losses.

The Corporation's allowance for loan losses is designed to provide for loan losses, that can be reasonably anticipated. The allowance for loan losses is established through charges to operating expenses in the form of provisions for loan losses. Actual loan losses or recoveries are charged or credited to the allowance for loan losses. Management of the Corporation determines the amount of the allowance. Among the factors considered in determining the allowance for loan losses are the current financial condition of the Corporation's borrowers and the value of security, if any, for their loans. Estimates of future economic conditions and their impact on various industries and individual borrowers are also taken into consideration, as are the Corporation's historical loan loss experience and reports of banking regulatory authorities. As these estimates, factors and evaluations are primarily judgmental, no assurance can be given as to whether or not the Corporation will sustain loan losses in excess or below its allowance or that subsequent evaluation of the loan portfolio may not require material increases or decreases in such allowance.

Table of Contents

The following table summarizes the Corporation's allowance for loan losses for the dates indicated:

	Quarter Ended September 30, 2008	Year to Date December 31, 2007	Amount of Increase (Decrease)	Percent of Increase (Decrease)
BALANCES:				
Gross Loans	\$ 415,735,924	\$ 372,493,878	\$ 43,242,046	11.61%
Allowance for Loan Losses	4,385,771	3,967,951	417,820	10.53%
Nonaccrual Loans	1,899,286	1,441,251	458,035	31.78%
Ratios:				
Allowance for loan losses to gross loans	1.05%	1.07%		
Net loans charged off to allowance for loan losses				