

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:

<b>Title</b>	<b>Outstanding</b>
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
<b>ASSETS</b>		
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
<b>TOTAL ASSETS</b>	<b>\$ 695,191,104</b>	<b>\$ 680,903,631</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
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
<b>Total deposits</b>	<b>503,090,069</b>	<b>477,232,304</b>
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
<b>Total liabilities</b>	<b>626,812,218</b>	<b>612,712,199</b>
<b>STOCKHOLDERS' EQUITY</b>		
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)

Edgar Filing: CITIZENS HOLDING CO /MS/ - Form 10-Q

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
<b>INTEREST INCOME</b>				
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
<b>Total interest income</b>	<b>9,908,721</b>	<b>9,619,453</b>	<b>29,352,869</b>	<b>28,624,635</b>
<b>INTEREST EXPENSE</b>				
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
<b>Total interest expense</b>	<b>3,033,780</b>	<b>4,241,419</b>	<b>10,458,181</b>	<b>12,355,882</b>
<b>NET INTEREST INCOME</b>	<b>6,874,941</b>	<b>5,378,034</b>	<b>18,894,688</b>	<b>16,268,753</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>372,105</b>	<b>396,349</b>	<b>1,028,914</b>	<b>553,396</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>6,502,836</b>	<b>4,981,685</b>	<b>17,865,774</b>	<b>15,715,357</b>
<b>OTHER INCOME</b>				
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
<b>Total other income</b>	<b>1,783,426</b>	<b>2,024,707</b>	<b>6,312,169</b>	<b>5,571,685</b>
<b>OTHER EXPENSES</b>				
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
<b>Total other expenses</b>	<b>5,480,229</b>	<b>4,895,542</b>	<b>16,300,399</b>	<b>14,156,310</b>
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>2,806,033</b>	<b>2,110,850</b>	<b>7,877,544</b>	<b>7,130,732</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>701,680</b>	<b>362,549</b>	<b>1,658,069</b>	<b>1,632,384</b>
<b>NET INCOME</b>	<b>\$ 2,104,353</b>	<b>\$ 1,748,301</b>	<b>\$ 6,219,475</b>	<b>\$ 5,498,348</b>
<b>NET INCOME PER SHARE</b>				
-Basic	\$ 0.43	\$ 0.36	\$ 1.28	\$ 1.12
-Diluted	\$ 0.43	\$ 0.36	\$ 1.27	\$ 1.10

Edgar Filing: CITIZENS HOLDING CO /MS/ - Form 10-Q

DIVIDENDS PAID PER SHARE	\$	0.19	\$	0.18	\$	0.57	\$	0.54
--------------------------	----	------	----	------	----	------	----	------

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)

	<b>For the nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Cash Provided by Operating Activities	\$ 8,225,487	\$ 6,814,181
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
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)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
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 15<sup>th</sup> 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.

<b>Assumption</b>	<b>2007</b>
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.

<b>Assumption</b>	<b>Officer</b>	<b>Directors</b>
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)
<b>BALANCES:</b>				
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%
<b>Ratios:</b>				
Allowance for loan losses to gross loans	1.05%	1.07%		
Net loans charged off to allowance for loan losses	3.90%	13.32%		

The provision for loan losses for the three months ended September 30, 2008 was \$372,105, a decrease of \$24,244 from the \$396,349 provision for the same period in 2007. The provision for loan losses was \$1,028,914 for the nine months ended September 30, 2008 compared to a provision of \$553,396 for the nine months ended September 30, 2007. The increase in our loan loss provisions is a result of slightly higher loan losses and a substantial increase in loans outstanding. The Corporation's model used to calculate the provision is based on the percentage of historical charge-offs applied to the current loan balances by loan segment. Therefore, an increase in the historical charge-off percentage combined with an increase in loans outstanding has caused the loan loss provision increase. The provision in the three month period ended September 30, 2008 reflects an increase in the amount of loans outstanding and the need to replenish the allowance for loans charged-off in the third quarter of 2008.

For the three months ended September 30, 2008, net loan losses charged to the allowance for loan losses totaled \$226,600, a decrease of \$113,365 from the \$339,965 charged off in the same period in 2007. For the nine months ended September 30, 2008, net loan losses charged to the allowance for loan losses totaled \$611,094, an increase of \$93,588 over the \$517,506 charged off in the same period in 2007.

Management of the Corporation reviews with the Board of Directors the adequacy of the allowance for loan losses on a quarterly basis. The loan loss provision is adjusted when specific items reflect a need for such an adjustment. Management believes that there were no material loan losses during the first nine months of 2008 that have not been charged off. Management also believes that the Corporation's allowance will be adequate to absorb probable losses inherent in the Corporation's loan portfolio. However, in light of overall economic conditions in the Corporation's geographic area and the nation as a whole, it is possible that additional provisions for loan loss may be required.

**NON-INTEREST INCOME**

Non-interest income includes service charges on deposit accounts, wire transfer fees, safe deposit box rentals and other revenue not derived from interest on earning assets. Non-interest income for the three months ended September 30, 2008 was \$1,783,426, a decrease of \$241,281, or 11.92%, over the same period in 2007. Service charges on deposit accounts increased by \$83,153, or 8.49%, to \$1,062,786 in the three months ended September 30, 2008 compared to \$979,633 for the same period in 2007. Other service charges and fees increased by \$53,295, or 19.56%, in the three months ended September 30, 2008 compared to the same period in 2007. The difference in fee income was the result of fluctuations in volume and not a direct result of fee changes.

**Table of Contents**

Non-interest income for the nine months ended September 30, 2008 was \$6,312,169, an increase of \$740,484, or 13.29%, over the same period in 2007. Service charges on deposit accounts increased by \$175,368, or 6.17%, to \$3,017,578 in the nine months ended September 30, 2008 compared to \$2,842,210 for the same period in 2007. Other service charges and fees increased by \$352,209, or 65.59%, in the nine months ended September 30, 2008 compared to the same period in 2007. The difference in fee income was the result of an increase in volume and not a direct result of fee changes.

During the second quarter of 2008, the Bank received proceeds from bank owned life insurance that insured the life of one of its officers. These net proceeds resulted in an additional \$772,771 in other income for the second quarter and year to date.

The following is a detail of the other major income classifications that are included in Other Income under Non-Interest Income on the income statement.

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>Other Income</b>				
BOLI Insurance	\$ 180,773	\$ 222,783	\$ 539,526	\$ 510,960
Mortgage Loan Origination Income	87,890	70,599	214,942	234,404
Shay Investments Income		342,878	441,588	831,651
Other Income	126,281	136,413	1,209,301	615,435
<b>Total Other Income</b>	<b>\$ 394,944</b>	<b>\$ 772,673</b>	<b>\$ 2,405,357</b>	<b>\$ 2,192,450</b>

**NON-INTEREST EXPENSE**

Non-interest expenses include salaries and employee benefits, occupancy and equipment, and other operating expenses. Aggregate non-interest expenses for the three month period ended September 30, 2008 and 2007 were \$5,480,229 and \$4,895,542, respectively, an increase of \$584,687, or 11.94%, from 2007 to 2008. Salaries and benefits increased to \$3,019,748 for the three months ended September 30, 2008 from \$2,705,828 for the same period in 2007. This represents an increase of \$313,920, or 11.60%. This increase was the result of an increase in the number of officers of the Corporation to staff the five new branches added since the first half of 2007. Occupancy expense increased by \$112,023, or 14.00%, to \$912,118 in the three months ended September 30, 2008 when compared to the same period of 2007. This also reflects the increase in expenses due to the adding of five new branches.

Total non-interest expenses for the nine month period ended September 30, 2008 and 2007 were \$16,300,399 and \$14,156,310, respectively, an increase of \$2,144,089, or 15.14%, from 2007 to 2008. Salaries and benefits increased to \$8,974,575 for the nine months ended September 30, 2008 from \$7,827,309 for the same period in 2007. This represents an increase of \$1,147,266, or 14.66%. This increase was the result of an increase in the number of officers of the Corporation to staff the five new branches added since the first half of 2007. Occupancy expense increased \$434,306, or 19.13%, to \$2,704,270 in the nine months ended September 30, 2008 when compared to the same period of 2007. This also reflects the increase in expenses due to the adding of five new branches.

During the second quarter of 2008, benefits were paid out to the beneficiary of an officer of the bank under the Bank's Supplemental Executive Retirement Plan in the amount of \$259,945. This amount is reflected in the increase of the nine months' other non-interest expense.

**Table of Contents**

The following is a detail of the major expense classifications that make up the other operating expense line item in the income statement.

<b>Other Operating Expense</b>	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Intangible Amortization	\$ 119,462	\$ 134,376	\$ 388,213	\$ 403,127
Advertising	197,418	126,220	573,526	381,542
Office Supplies	130,018	154,552	446,040	402,766
Legal and Audit Fees	95,155	75,804	286,669	280,339
Telephone expense	151,967	105,070	367,885	305,186
Postage and Freight	78,589	96,790	250,899	221,166
Loan Collection Expense	55,619	16,283	114,287	127,864
Other Losses	148,510	173,133	228,323	393,290
Other expenses	571,625	507,391	1,965,712	1,543,757
<b>Total Other Expense</b>	<b>\$ 1,548,363</b>	<b>\$ 1,389,619</b>	<b>\$ 4,621,554</b>	<b>\$ 4,059,037</b>

The Corporation's efficiency ratio for the three months ended September 30, 2008 was 61.33% compared to the 63.76% for the same period in 2007. For the nine months ended June 30, 2008 and 2007, the Corporation's efficiency ratio was 62.62% and 62.50%, respectively. The efficiency ratio is the ratio of non-interest expenses divided by the sum of net interest income (on a fully tax equivalent basis) and non-interest income.

**BALANCE SHEET ANALYSIS**

	<b>September 30, 2008</b>	<b>December 31, 2007</b>	<b>Amount of Increase (Decrease)</b>	<b>Percent of Increase (Decrease)</b>
Cash and Due From Banks	\$ 15,670,300	\$ 18,622,058	\$ (2,951,758)	-15.85%
Investment Securities	206,623,065	244,720,367	(38,097,302)	-15.57%
Loans, net	410,961,110	368,025,286	42,935,824	11.67%
Total Assets	695,191,104	680,903,631	14,287,473	2.10%
Total Deposits	503,090,069	477,232,304	25,857,765	5.42%
Total Stockholders' Equity	68,378,886	68,191,432	187,454	0.27%
<b>CASH AND CASH EQUIVALENTS</b>				

Cash and cash equivalents are made up of cash, balances at correspondent banks and items in process of collection. The balance at September 30, 2008 was \$15,670,300, a decrease of \$2,951,758 from the balance of \$18,622,058 at December 31, 2007 due to an increase in the availability of cash letters sent for collection on the last day of the period.

**Table of Contents****PREMISES AND EQUIPMENT**

During the nine month period ended September 30, 2008, premises and equipment increased by \$2,413,582, or 16.89%, to \$16,702,379, when compared to \$14,288,797 at December 31, 2007. The increase was due to the addition of new branches. The Bank is currently in the process of constructing a new full service branch in Carthage, Mississippi, which is scheduled to be completed in November 2008.

**INVESTMENT SECURITIES**

The investment securities portfolio is made up of U. S. Treasury Notes, U. S. Agency debentures, mortgage-backed securities, obligations of states, counties and municipal governments and FHLB stock. Investments at September 30, 2008 decreased \$38,097,302, or 15.57%, to \$206,623,065 from the balance at December 31, 2007. This decline is primarily due to the discontinuance of the sweep investments provided by Shay Financial Service which was replaced by instituting a security repurchase agreement program with select large commercial customers.

**LOANS**

The loan balance increased by \$42,935,824 during the nine month period ended September 30, 2008 to \$410,961,110 from \$368,025,286 at December 31, 2007. Residential housing loans continue to be in demand along with commercial and industrial loans. No material changes were made to the loan products offered by the Corporation during this period.

**DEPOSITS**

The following table shows the balance and percentage change in the various deposits:

	September 30, 2008	December 31, 2007	Amount of Increase (Decrease)	Percent of Increase (Decrease)
Noninterest-bearing Deposits	\$ 76,360,663	\$ 78,224,936	\$ (1,864,273)	-2.38%
Interest-bearing Deposits	168,816,742	144,302,273	24,514,469	16.99%
Savings	32,421,300	29,763,885	2,657,415	8.93%
Certificates of Deposit	225,491,364	224,941,210	550,154	0.24%
<b>Total Deposits</b>	<b>\$ 503,090,069</b>	<b>\$ 477,232,304</b>	<b>\$ 25,857,765</b>	<b>5.42%</b>

All classifications of deposits, with the exception of non interest-bearing deposits, increased during the nine months ended September 30, 2008. The Corporation increased its rates paid on interest bearing deposits to compete more aggressively with the other banks in its market area. Higher rates paid on deposits could further compress future net interest rate margins if market pressures do not allow the Corporation to increase loan rates at the same pace. Management continually monitors the interest rates on loan and deposit products to ensure that the Corporation is in line with the rates dictated by the market.

**OFF-BALANCE SHEET ARRANGEMENTS**

Refer to Note 2 in the notes to the consolidated financial statements included in this report for a discussion of the nature and extent of the Corporation's off-balance sheet arrangements, which consist of commitments to fund loans and letters of credit.



**Table of Contents**

**CONTRACTUAL OBLIGATIONS**

There have been no material changes outside of the ordinary course of the Corporation's business to the contractual obligations set forth in Note 12 to the Corporation's financial statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2007.

**FORWARD LOOKING STATEMENTS**

In addition to historical information, this report contains statements which constitute forward-looking statements and information within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are based on management's beliefs, plans, expectations and assumptions and on information currently available to management. The words "may," "should," "expect," "anticipate," "intend," "plan," "continue," "believe," "seek," "estimate," and similar expressions used in this report that do not relate to historical facts are intended to identify forward-looking statements. These statements appear in a number of places in this report, including, but not limited to, statements found in Item 1, "Notes to Consolidated Financial Statements" and in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations." The Corporation notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of the Corporation's business include, but are not limited to, the following: (a) the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Corporation operates; (b) changes in the legislative and regulatory environment that negatively impact the Corporation through increased operating expenses; (c) increased competition from other financial institutions; (d) the impact of technological advances; (e) expectations about the movement of interest rates, including actions that may be taken by the Federal Reserve Board in response to changing economic conditions; (f) changes in asset quality and loan demand; (g) expectations about overall economic strength and the performance of the economies in the Corporation's market area and (h) other risks detailed from time to time in the Corporation's filings with the Securities and Exchange Commission. The Corporation does not undertake any obligation to update or revise any forward-looking statements subsequent to the date on which they are made.

## Table of Contents

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

This item outlines specific risks that could affect the Corporation's ability to compete, change the Corporation's risk profile, or eventually impact the Corporation's financial results. The risks the Corporation faces generally are similar to those experienced, to varying degrees, by all financial services companies.

Our strategies and management's ability to react to changing competitive and economic environments have enabled us historically to compete effectively and manage risks to acceptable levels. The Corporation has outlined potential risk factors below that we presently believe could be important; however, other risks may prove to be important in the future. New risks may emerge at any time and the Corporation cannot predict with certainty all potential developments which could affect the Corporation's financial performance. The following discussion highlights potential risks which could intensify over time or shift dynamically in a way that might change the Corporation's risk profile.

#### Competition Risks

The market in which the Corporation competes is saturated with community banks seeking to provide a service oriented banking experience to individuals and businesses compared with what the Corporation believes, is the more rigid and less friendly environment found in large banks. This requires us to offer most, if not all, of the products and conveniences that are offered by the larger banks with a service differentiation. In doing so, it is imperative that the Corporation identify the lines of business that the Corporation can excel in, prudently utilize the Corporation's available capital to acquire the people and platforms required thereof and execute on the strategy.

#### Credit Risks

Like all lenders, the Corporation faces the risk that the Corporation's customers may not repay their loans and that the realizable value of collateral may be insufficient to avoid a loss of principal. In the Corporation's business, some level of credit loss is unavoidable and overall levels of credit loss can vary over time. Our ability to manage credit risks depends primarily upon the Corporation's ability to assess the creditworthiness of customers and the value of collateral, including real estate. We control credit risk by diversifying the Corporation's loan portfolio and managing its composition, and by recording and managing an allowance for expected loan losses in accordance with applicable accounting rules. At the end of September 2008, the Corporation had \$4.39 million of available reserves to cover such losses. The models and approaches the Corporation uses to originate and manage loans are regularly updated to take into account changes in the competitive environment, in real estate prices and other collateral values, and in the economy, among other things based on the Corporation's experience originating loans and servicing loan portfolios.

#### Financing, Funding and Liquidity Risks

One of the most important aspects of management's efforts to sustain long-term profitability for the Corporation is the management of interest rate risk. Management's goal is to maximize net interest income within acceptable levels of interest-rate risk and liquidity.

The Corporation's assets and liabilities are principally financial in nature and the resulting earnings thereon are subject to significant variability due to the timing and extent to which the Corporation can reprice the yields on interest-earning assets and the costs of interest bearing liabilities as a result of changes in market interest rates. Interest rates in the financial markets affect the Corporation's decisions on pricing its assets and liabilities which impacts net interest income, an important cash flow stream for the Corporation. As a result, a substantial part of the Corporation's risk-management activities are devoted to managing interest-rate risk. There is also focus on managing the risks associated with the volatility of fair value in both mortgage loan servicing rights and mortgage banking assets. Currently, the Corporation does not have any

## Table of Contents

significant risks related to foreign exchange, commodities or equity risk exposures.

### Interest Rate and Yield Curve Risks

A significant portion of the Corporation's business involves borrowing and lending money. Accordingly, changes in interest rates directly impact the Corporation's revenues and expenses, and potentially could compress the Corporation's net interest margin. The Corporation actively manages its balance sheet to control the risks of a reduction in net interest margin brought about by ordinary fluctuations in rates.

The Corporation's mortgage lending and servicing businesses also are affected by changes in interest rates. Generally, when rates increase demand for mortgage loans decreases (and the Corporation's revenues from new originations fall), and when rates decrease, demand increases (and the Corporation's origination revenues increase). In a contrary fashion, when interest rates increase the value of mortgage servicing rights (MSR) that the Corporation retain generally increases, and when rates decline the value of MSR declines. Within the Corporation's mortgage businesses, therefore, there is a partial natural hedge against ordinary interest rate changes.

Like all financial services companies, the Corporation faces the risks of abnormalities in the yield curve. The yield curve simply shows the interest rates applicable to short and long term debt. The curve is steep when short-term rates are much lower than long-term rates: it is flat when short-term rates are equal, or nearly equal, to long-term rates; and it is inverted when short-term rates exceed long-term rates. Historically, the yield curve is positively sloped. However, during much of 2006 the yield curve was inverted and the degree of inversion generally worsened as the year progressed. A flat or inverted yield curve tends to decrease net interest margin, as funding costs increase relative to the yield on assets.

### Regulatory and Legal Risks

We operate in a heavily regulated industry and therefore are subject to many banking, deposit, and consumer lending regulations in addition to the rules applicable to all companies publicly traded in the U.S. securities markets. Failure to comply with applicable regulations could result in financial, structural, and operational penalties. In addition, efforts to comply with applicable regulations may increase the Corporation's costs and, or limit the Corporation's ability to pursue certain business opportunities. Federal and state regulations significantly limit the types of activities in which the Corporation, as a financial institution, may engage. In addition, the Corporation is subject to a wide array of other regulations that govern other aspects of how the Corporation conducts the Corporation's business, such as in the areas of employment and intellectual property. Federal and state legislative and regulatory authorities occasionally consider changing these regulations or adopting new ones. Such actions could limit the amount of interest or fees the Corporation can charge, could restrict the Corporation's ability to collect loans or realize on collateral, or could materially affect us in other ways. Additional federal and state consumer protection regulations also could expand the privacy protections afforded to customers of financial institutions, restricting the Corporation's ability to share or receive customer information and increasing the Corporation's costs. In addition, changes in accounting rules can significantly affect how the Corporation records and reports assets, liabilities, revenues, expenses, and earnings.

We also face litigation risks from customers (singly or in class actions) and from federal or state regulators. Litigation is an unavoidable part of doing business, and the Corporation manages those risks through internal controls, personnel training, insurance, litigation management, the Corporation's compliance and ethics processes and other means. However, the commencement, outcome, and magnitude of litigation cannot be predicted or controlled with certainty.

### Accounting Estimate Risks

The preparation of the Corporation's consolidated financial statements in conformity with U.S generally accepted accounting principles requires management to make significant estimates that affect the financial

**Table of Contents**

statements. Two of the Corporation's most critical estimates are the level of the allowance for credit losses and the valuation of mortgage servicing rights. However, other estimates occasionally become highly significant, especially in volatile situations such as litigation and other loss contingency matters. Estimates are made at specific points in time; as actual events unfold, estimates are adjusted accordingly. Due to the inherent nature of these estimates, it is possible that, at some time in the future, the Corporation may significantly increase the allowance for credit losses and/or sustain credit losses that are significantly higher than the provided allowance, or the Corporation may recognize a significant provision for impairment of the Corporation's mortgage servicing rights, or the Corporation may make some other adjustment that will differ materially from the estimates that the Corporation make today.

**Expense Control**

Expenses and other costs directly affect the Corporation's earnings. Our ability to successfully manage expenses is important to the Corporation's long-term profitability. Many factors can influence the amount of the Corporation's expenses, as well as how quickly they grow. As the Corporation's businesses change or expand, additional expenses can arise from asset purchases, structural reorganization evolving business strategies, and changing regulations, among other things. The Corporation manages expense growth and risk through a variety of means, including actual versus budget management, imposition of expense authorization, and procurement coordination and processes.

**Table of Contents**

ITEM 4. CONTROLS AND PROCEDURES

The management of the Corporation, with the participation of our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures in ensuring that the information required to be disclosed in our filings under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, including ensuring that such information is accumulated and communicated to the Corporation's management as appropriate to allow timely decision regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that such disclosure controls and procedures were effective as of September 30, 2008 (the end of the period covered by this Quarterly Report on Form 10-Q).

There were no changes to the Corporation's internal control over financial reporting that occurred in the three months ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Table of Contents**

PART II. - OTHER INFORMATION

ITEM 1A. RISK FACTORS.

Information regarding risk factors appears in Part I, Item 1A, Risk Factors, of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2007. Other than as set forth below, there have been no material changes in the risk factors previously disclosed in such Annual Report on Form 10-K.

Deposit run-off risks

The corporation relies significantly upon deposits for liquidity and to fund business operations. Generally deposits are a relatively stable and cost-effective source of funding for banks due to many factors, including FDIC deposit insurance. Changes in deposit levels can be influenced substantially by many factors, including customer satisfaction and the interest rates offered to deposit customers. Those rates, in turn, generally reflect prevailing market conditions. During 2008, the media has highlighted the risk of an extreme form of deposit run-off, sometimes referred to as a "run on the bank". More moderate levels of run-off can adversely affect banks but are less dramatic and have been significantly less reported. The increased level of public concern created by the current adverse business environment, punctuated by media reports of potential or actual bank failures, have increased the risk of some level of deposit run-off for all depository institutions at the present time. That increased run-off risk applies both generally and in relation to deposits that exceed FDIC insurance coverage. To manage this risk, the Corporation maintains cash reserves and access to other liquidity sources to accommodate normal and, to a degree, unusual withdrawal activity, and the Corporation strives to respond promptly and accurately to any customer concerns that might arise.

The can be no assurance that the recently enacted Emergency Economic Stabilization Act of 2008 will help stabilize the U.S. financial system.

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (the "EESA"). The legislation was the result of a proposal by Treasury Secretary Henry Paulson to the U.S. Congress on September 20, 2008 in response to the financial crisis affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions. The U.S. Treasury and banking regulators are implementing a number of programs under this legislation to address capital and liquidity issues in the banking system. There can be no assurance, however, as to the actual impact that the EESA will have on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of the EESA to help stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect the Corporation's business, financial condition, results of operations, access to credit or the trading price of its common stock.

**Table of Contents**

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

Repurchases of Securities

The following table summarizes the Corporation's purchases of its own securities for the three-month period ended September 30, 2008:

Period	( a ) Total Number of Shares Purchased (1)	( b ) Average Price Paid per Share	( c ) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) (2)	( d ) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (2)
July 1 to July 31	4,200	20.82	4,200	
August 1 to August 31	200	20.59	200	
September 1 to September 30	200	18.65	200	229,016
Total	4,600	\$ 20.72	4,600	229,016

(1) All shares were purchased through the Corporation's publicly announced share buy-back plan.

(2) On April 30, 2008, the Corporation's board of directors adopted a stock repurchase program which authorizes the Corporation to repurchase up to 250,000 shares of its outstanding common stock. The plan is effective May 1, 2008 and will terminate no later than April 30, 2009. As of September 30, 2008, 20,984 shares of the Corporation's common stock had been purchased and 229,016 shares under the plan were not purchased. All share purchases during 2007 and 2008 were made pursuant to open market transactions.

**Table of Contents**

ITEM 6. EXHIBITS.  
Exhibits

- 31(a) Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
- 31(b) Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).
- 32(a) Certification of the Chief Executive Officer pursuant to 18 U.S.C. § 1350.
- 32(b) Certification of the Chief Financial Officer pursuant to 18 U.S.C. § 1350.



**Table of Contents**

SIGNATURES

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

CITIZENS HOLDING COMPANY

BY: /s/ Greg L. McKee  
Greg L. McKee  
President and Chief Executive Officer

BY: /s/ Robert T. Smith  
Robert T. Smith  
Treasurer and Chief Financial Officer

DATE: November 6, 2008

DATE: November 6, 2008

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
31(a)	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)
31(b)	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)
32(a)	Certification of the Chief Executive Officer pursuant to 18 U.S.C. §1350.
32(b)	Certification of the Chief Financial Officer pursuant to 18 U.S.C. §1350.