

CITIZENS HOLDING CO /MS/  
Form 10-Q  
August 09, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 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 June 30, 2012

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: 001-15375

**CITIZENS HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

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

**MISSISSIPPI**  
(State or other jurisdiction of  
incorporation or organization)

**64-0666512**  
(IRS Employer  
Identification No.)

**521 Main Street, Philadelphia, MS**  
(Address of principal executive offices)

**39350**  
(Zip Code)

**601-656-4692**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).  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 large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) 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 August 8, 2012:

Title	Outstanding
Common Stock, \$0.20 par value	4,861,411

---

**Table of Contents**

CITIZENS HOLDING COMPANY

INTERIM FINANCIAL STATEMENTS FOR QUARTER ENDED JUNE 30, 2012

TABLE OF CONTENTS

<b><u>PART I. FINANCIAL INFORMATION</u></b>	1
<b><u>Item 1. Consolidated Financial Statements (Unaudited).</u></b>	1
<u>Consolidated Statements of Condition June 30, 2012 and December 31, 2011</u>	1
<u>Consolidated Statements of Income Three and six months ended June 30, 2012 and 2011</u>	2
<u>Consolidated Statements of Comprehensive Income Three and six months ended June 30, 2012 and 2011</u>	3
<u>Condensed Consolidated Statements of Cash Flows Six months ended June 30, 2012 and 2011</u>	4
<u>Notes to Consolidated Financial Statements</u>	5
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.</u></b>	24
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk.</u></b>	35
<b><u>Item 4. Controls and Procedures.</u></b>	38
<b><u>PART II. OTHER INFORMATION</u></b>	39
<b><u>Item 1. Legal Proceedings.*</u></b>	
<u>Item 1A. Risk Factors.</u>	39
<b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.*</u></b>	
<b><u>Item 3. Defaults Upon Senior Securities.*</u></b>	
<b><u>Item 4. Mine Safety Disclosures.*</u></b>	
<b><u>Item 5. Other Information.*</u></b>	
<b><u>Item 6. Exhibits.</u></b>	40
* None or Not Applicable	
<b><u>SIGNATURES</u></b>	41

**Table of Contents**

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (Unaudited).

## CITIZENS HOLDING COMPANY

## CONSOLIDATED STATEMENTS OF CONDITION (Unaudited)

	June 30 , 2012	December 31, 2011
<b>ASSETS</b>		
Cash and due from banks	\$ 44,363,414	\$ 35,407,715
Interest bearing deposits with other banks	67,957,333	3,990,521
Investment securities available for sale, at fair value	299,928,467	374,507,805
Loans, net of allowance for loan losses of \$7,210,717 in 2012 and \$6,681,412 in 2011	377,012,459	382,580,529
Premises and equipment, net	19,737,642	20,278,443
Other real estate owned, net	4,461,177	4,868,653
Accrued interest receivable	3,920,561	4,445,384
Cash value of life insurance	20,745,332	20,382,063
Intangible assets, net	3,149,657	3,226,612
Other assets	3,412,985	4,257,729
<b>TOTAL ASSETS</b>	<b>\$ 844,689,027</b>	<b>\$ 853,945,454</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand	\$ 114,043,397	\$ 116,894,676
Interest-bearing NOW and money market accounts	180,465,762	172,585,498
Savings deposits	45,297,712	41,876,977
Certificates of deposit	251,765,014	240,980,984
<b>Total deposits</b>	<b>591,571,885</b>	<b>572,338,135</b>
Securities sold under agreement to repurchase	79,103,790	120,220,433
Federal Home Loan Bank advances	78,500,000	68,500,000
Accrued interest payable	351,756	372,374
Deferred compensation payable	5,560,842	5,085,935
Other liabilities	1,204,088	1,349,360
<b>Total liabilities</b>	<b>756,292,361</b>	<b>767,866,237</b>
<b>STOCKHOLDERS EQUITY</b>		
Common stock; \$.20 par value, 22,500,000 shares authorized, 4,861,411 shares outstanding at June 30, 2012 and 4,843,911 shares outstanding at December 31, 2011	972,282	968,782
Additional paid-in capital	3,561,050	3,247,208
Retained earnings	78,697,821	77,420,318
Accumulated other comprehensive income, net of applicable taxes of \$3,072,945 in 2012 and \$2,643,070 in 2011	5,165,513	4,442,909
<b>Total stockholders equity</b>	<b>88,396,666</b>	<b>86,079,217</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 844,689,027</b>	<b>\$ 853,945,454</b>

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

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		For the Six Months	
	Ended June 30, 2012	2011	Ended June 30, 2012	2011
<b>INTEREST INCOME</b>				
Loans, including fees	\$ 6,038,190	\$ 6,398,678	\$ 12,010,427	\$ 12,947,609
Investment securities	2,956,655	3,038,701	5,874,050	5,823,247
Other interest	8,323	6,472	17,681	18,267
<b>Total interest income</b>	<b>9,003,168</b>	<b>9,443,851</b>	<b>17,902,158</b>	<b>18,789,123</b>
<b>INTEREST EXPENSE</b>				
Deposits	703,728	802,618	1,428,434	1,689,617
Other borrowed funds	753,525	879,750	1,539,408	1,759,704
<b>Total interest expense</b>	<b>1,457,253</b>	<b>1,682,368</b>	<b>2,967,842</b>	<b>3,449,321</b>
<b>NET INTEREST INCOME</b>	<b>7,545,915</b>	<b>7,761,483</b>	<b>14,934,316</b>	<b>15,339,802</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>330,097</b>	<b>682,773</b>	<b>865,777</b>	<b>926,834</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>7,215,818</b>	<b>7,078,710</b>	<b>14,068,539</b>	<b>14,412,968</b>
<b>OTHER INCOME</b>				
Service charges on deposit accounts	897,920	855,986	1,745,570	1,730,383
Other service charges and fees	437,473	415,174	866,069	829,133
Other income	301,763	245,306	635,116	541,345
<b>Total other income</b>	<b>1,637,156</b>	<b>1,516,466</b>	<b>3,246,755</b>	<b>3,100,861</b>
<b>OTHER EXPENSES</b>				
Salaries and employee benefits	3,473,956	3,524,103	7,033,660	7,043,712
Occupancy expense	1,097,856	1,018,542	2,129,165	2,107,489
Other operating expense	2,102,189	1,703,394	3,921,443	3,495,119
<b>Total other expenses</b>	<b>6,674,001</b>	<b>6,246,039</b>	<b>13,084,268</b>	<b>12,646,320</b>
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>2,178,973</b>	<b>2,349,137</b>	<b>4,231,026</b>	<b>4,867,509</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>427,375</b>	<b>494,865</b>	<b>816,262</b>	<b>1,058,351</b>
<b>NET INCOME</b>	<b>\$ 1,751,598</b>	<b>\$ 1,854,272</b>	<b>\$ 3,414,764</b>	<b>\$ 3,809,158</b>
<b>NET INCOME PER SHARE</b>				
-Basic	\$ 0.36	\$ 0.38	\$ 0.70	\$ 0.79
-Diluted	\$ 0.36	\$ 0.38	\$ 0.70	\$ 0.79
<b>DIVIDENDS PAID PER SHARE</b>	<b>\$ 0.22</b>	<b>\$ 0.22</b>	<b>\$ 0.44</b>	<b>\$ 0.44</b>

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 June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	\$ 1,751,598	\$ 1,854,272	\$ 3,414,764	\$ 3,809,158
Other comprehensive income				
Unrealized holding gains	4,631,065	5,816,380	1,190,231	8,351,093
Income tax effect	(1,727,387)	(2,169,510)	(443,956)	(3,114,958)
	2,903,678	3,646,870	746,275	5,236,135
Reclassification adjustment for gains included in net income	(9,061)	(5,357)	(37,753)	(5,789)
Income tax effect	3,380	1,998	14,082	2,159
	(5,681)	(3,359)	(23,671)	(3,630)
Total other comprehensive income	2,897,997	3,643,511	722,604	5,232,505
Comprehensive income	\$ 4,649,595	\$ 5,497,783	\$ 4,137,368	\$ 9,041,663

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 Six Months Ended June 30,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net cash provided by operating activities	\$ 6,065,086	\$ 5,419,819
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from maturities and calls of securities available for sale	190,899,754	73,203,384
Purchases of investment securities available for sale	(115,075,780)	(88,813,259)
Purchases of bank premises and equipment	(30,889)	(1,035,486)
Increase in interest bearing deposits with other banks	(63,966,812)	(10,466,534)
Purchase of Federal Home Loan Bank Stock	(282,700)	(108,000)
Proceeds from sale of other real estate	1,235,367	338,080
Net decrease in loans	3,874,402	8,072,260
Net cash provided by (used by) investing activities	16,653,342	(18,809,555)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	19,233,750	9,720,050
Net change in securities sold under agreement to repurchase	(41,116,643)	3,572,364
Proceeds from exercising stock options	257,425	63,385
Increase in Federal Home Loan Bank advances	10,000,000	10,000,000
Decrease in federal funds purchased		(2,500,000)
Payment of dividends	(2,137,261)	(2,130,331)
Net cash provided by financing activities	(13,762,729)	18,725,468
Net increase in cash and due from banks	8,955,699	5,335,732
Cash and due from banks, beginning of period	35,407,715	16,963,393
Cash and due from banks, end of period	\$ 44,363,414	\$ 22,299,125

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 six months ended June 30, 2012

(Unaudited)

**Note 1. Basis of Presentation**

These interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). However, these financial statements do not include all of the information and footnotes required by 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 June 30, 2012, 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). All significant intercompany transactions have been eliminated in consolidation.

For further information and significant accounting policies of the Corporation, see 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, 2011, filed with the Securities and Exchange Commission on March 14, 2012.

**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 June 30, 2012, the Corporation had entered into loan commitments with certain customers with an aggregate unused balance of \$34,798,961 compared to an aggregate unused balance of \$37,703,387 at December 31, 2011. There were \$2,956,725 of letters of credit outstanding at June 30, 2012 and \$3,113,225 at December 31, 2011. 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 provisions are 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.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Basic weighted average shares outstanding	4,859,125	4,841,438	4,854,145	4,840,770
Dilutive effect of granted options	6,881	12,799	8,654	9,056
<b>Diluted weighted average shares outstanding</b>	<b>4,866,006</b>	<b>4,854,237</b>	<b>4,862,799</b>	<b>4,849,826</b>
Net income	\$ 1,751,598	\$ 1,854,272	\$ 3,414,764	\$ 3,809,158
Net income per share-basic	\$ 0.36	\$ 0.38	\$ 0.70	\$ 0.79
Net income per share-diluted	\$ 0.36	\$ 0.38	\$ 0.70	\$ 0.79

**Note 4. Stock Option Plan**

At June 30, 2012, the Corporation had one stock-based compensation plan, which is the 1999 Directors Stock Compensation Plan (the Directors Plan ). Prior to its expiration, the Corporation also had the 1999 Employees Long-Term Incentive Plan, or the Employees Plan.

On April 25, 2012, the non-management members of the Board of Directors were granted a total of 13,500 options as specified in the Directors Plan. These options were granted at an exercise price of \$18.76 per option, which was the closing price of Citizens Holding Company stock on that day. These options are first exercisable on October 26, 2012, and must be exercised no later than April 25, 2022.

The fair value of each option granted is estimated on the date of the grant using the Black-Scholes option-pricing model. The following assumptions were used in estimating the fair value of the options granted to the directors in the second quarter of 2012:

**Table of Contents**

Assumption	Directors
Dividend Yield	4.70%
Risk-Free Interest Rate	0.78%
Expected Life	8.2 years
Expected Volatility	78.29%
Calculated Value per Option	\$ 8.88
Forfeitures	0.00%

Using the Black-Scholes option-pricing model with the foregoing assumptions, it was determined that the cost of options granted under the Directors Plan on April 25, 2012 was \$119,834 and should be recognized as an expense of \$19,972 per month over the six-month requisite service period, beginning on April 25, 2012. 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 \$44,698, or \$7,450 per month, over the six-month requisite service period, beginning on April 25, 2012.

The following table below is a summary of the stock option activity for the six months ended June 30, 2012.

	Directors Plan Number of Shares	Plan Weighted Average Exercise Price	Employees Plan Number of Shares	Plan Weighted Average Exercise Price
Outstanding at December 31, 2011	102,000	\$ 21.00	135,500	\$ 19.96
Granted	13,500	18.76		
Exercised	(3,000)	15.00	(14,500)	14.65
Expired	(1,500)	15.00	(13,000)	18.09
Outstanding at June 30, 2012	111,000	\$ 20.97	108,000	\$ 20.90

The intrinsic value of options granted under the Directors Plan at June 30, 2012, was \$60,000 and the intrinsic value of options granted under the Employees Plan at June 30, 2012, was \$107,160 for a total intrinsic value at June 30, 2012, of \$167,160.

**Note 5. Income Taxes**

The income tax topic of the ASC 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. This topic 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. As of June 30, 2012, the Corporation had no unrecognized tax benefits related to federal and state income tax matters. Therefore, the Corporation does not anticipate any material increase or decrease in the effective tax rate during 2012 relative to any tax positions taken. It is the Corporation's policy to recognize interest and/or penalties related to income tax matters in income tax expense.

**Table of Contents**

The Corporation files a consolidated United States federal income tax return. The Corporation is currently open to audit under the statute of limitations by the Internal Revenue Service for all tax years after 2009. The Corporation consolidated state income tax returns are also open to audit under the statute of limitations for the same period.

**Note 6. Loans**

The composition of net loans at June 30, 2012 and December 31, 2011 is as follows:

	June 30, 2012	December 31, 2011
	(In Thousands)	
<b>Real Estate:</b>		
Land Development and Construction	\$ 11,394	\$ 13,480
Farmland	34,204	35,912
1-4 Family Mortgages	122,119	133,987
Commercial Real Estate	136,010	129,387
<b>Total Real Estate Loans</b>	<b>303,727</b>	<b>312,766</b>
<b>Business Loans:</b>		
Commercial and Industrial Loans	47,101	36,581
Farm Production and Other Farm Loans	1,537	1,579
<b>Total Business Loans</b>	<b>48,638</b>	<b>38,160</b>
<b>Consumer Loans:</b>		
Credit Cards	971	995
Other Consumer Loans	31,163	37,545
<b>Total Consumer Loans</b>	<b>32,134</b>	<b>38,540</b>
<b>Total Gross Loans</b>	<b>384,499</b>	<b>389,466</b>
Unearned income	(276)	(204)
Allowance for loan losses	(7,211)	(6,681)
<b>Loans, net</b>	<b>\$ 377,012</b>	<b>\$ 382,581</b>

Loans are considered to be past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status, when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether such loans are considered past due. When interest accruals are discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Table of Contents**

Period-end non-accrual loans, segregated by class of loans, were as follows:

	June 30, 2012	December 31, 2011
	(in thousands)	
<b>Real Estate:</b>		
Land Development and Construction	\$ 252	\$ 1,134
Farmland	469	641
1-4 Family Mortgages	2,151	1,966
Commercial Real Estate	7,251	6,818
<b>Total Real Estate Loans</b>	<b>10,123</b>	<b>10,559</b>
<b>Business Loans:</b>		
Commercial and Industrial Loans	218	284
Farm Production and Other Farm Loans	10	21
<b>Total Business Loans</b>	<b>228</b>	<b>305</b>
<b>Consumer Loans:</b>		
Credit Cards		
Other Consumer Loans	281	435
<b>Total Consumer Loans</b>	<b>281</b>	<b>435</b>
<b>Total Non-Accrual Loans</b>	<b>\$ 10,632</b>	<b>\$ 11,299</b>

**Table of Contents**

An aging analysis of past due loans, segregated by class of loans, as of June 30, 2012, was as follows (in thousands):

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
<b>Real Estate:</b>						
Land Development and Construction	\$ 176	\$	\$ 176	\$ 11,218	\$ 11,394	\$
Farmland	786		786	33,418	34,204	
1-4 Family Mortgages	5,620	994	6,614	115,505	122,119	536
Commercial Real Estate	6,882	1,089	7,971	128,039	136,010	
<b>Total Real Estate Loans</b>	<b>13,464</b>	<b>2,083</b>	<b>15,547</b>	<b>288,180</b>	<b>303,727</b>	<b>536</b>
<b>Business Loans:</b>						
Commercial and Industrial Loans	704	19	723	46,378	47,101	
Farm Production and Other Farm Loans	16		16	1,521	1,537	
<b>Total Business Loans</b>	<b>720</b>	<b>19</b>	<b>739</b>	<b>47,899</b>	<b>48,638</b>	
<b>Consumer Loans:</b>						
Credit Cards	16	13	29	942	971	13
Other Consumer Loans	1,386	26	1,412	29,751	31,163	3
<b>Total Consumer Loans</b>	<b>1,402</b>	<b>39</b>	<b>1,441</b>	<b>30,693</b>	<b>32,134</b>	<b>16</b>
<b>Total Loans</b>	<b>\$ 15,586</b>	<b>\$ 2,141</b>	<b>\$ 17,727</b>	<b>\$ 366,772</b>	<b>\$ 384,499</b>	<b>\$ 552</b>

**Table of Contents**

An aging analysis of past due loans, segregated by class of loans, as of December 31, 2011 was as follows (in thousands):

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
<b>Real Estate:</b>						
Land Development and Construction	\$ 30	\$ 562	\$ 592	\$ 12,888	\$ 13,480	\$ 39
Farmland	1,061	139	1,200	34,712	35,912	
1-4 Family Mortgages	5,774	822	6,596	127,391	133,987	80
Commercial Real Estate	4,941	4,855	9,796	119,591	129,387	109
<b>Total Real Estate Loans</b>	<b>11,806</b>	<b>6,378</b>	<b>18,184</b>	<b>294,582</b>	<b>312,766</b>	<b>228</b>
<b>Business Loans:</b>						
Commercial and Industrial Loans	294	99	393	36,188	36,581	
Farm Production and Other Farm Loans	13	6	19	1,560	1,579	
<b>Total Business Loans</b>	<b>307</b>	<b>105</b>	<b>412</b>	<b>37,748</b>	<b>38,160</b>	
<b>Consumer Loans:</b>						
Credit Cards	20	17	37	958	995	17
Other Consumer Loans	1,858	252	2,110	35,435	37,545	24
<b>Total Consumer Loans</b>	<b>1,878</b>	<b>269</b>	<b>2,147</b>	<b>36,393</b>	<b>38,540</b>	<b>41</b>
<b>Total Loans</b>	<b>\$ 13,991</b>	<b>\$ 6,752</b>	<b>\$ 20,743</b>	<b>\$ 368,723</b>	<b>\$ 389,466</b>	<b>\$ 269</b>

Loans are considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all the amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. In determining which loans to evaluate for impairment, management looks at past due loans, bankruptcy filing and any situation that might lend itself to cause a borrower to be unable to repay the loan according to the original contract terms. If a loan is determined to be impaired and the collateral is deemed to be insufficient to fully repay the loan, a specific reserve will be established. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans or portions thereof, are charged-off when deemed uncollectible.

**Table of Contents**

Impaired loans as of June 30, 2012 and December 31, 2011, by class of loans, are as follows (in thousands):

June 30, 2012	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
<b>Real Estate:</b>						
Land Development and Construction	\$ 252	\$ 120	\$ 132	\$ 252	\$ 117	\$ 479
Farmland	469	324	145	469	24	557
1-4 Family Mortgages	2,251	1,482	769	2,251	202	2,419
Commercial Real Estate	7,251	1,432	5,819	7,251	1,205	7,032
<b>Total Real Estate Loans</b>	<b>10,223</b>	<b>3,358</b>	<b>6,865</b>	<b>10,223</b>	<b>1,548</b>	<b>10,487</b>
<b>Business Loans:</b>						
Commercial and Industrial Loans	218	114	104	218	57	241
Farm Production and Other Farm Loans	10	10		10		13
<b>Total Business Loans</b>	<b>228</b>	<b>124</b>	<b>104</b>	<b>228</b>	<b>57</b>	<b>254</b>
<b>Consumer Loans:</b>						
Other Consumer Loans	281	281		281		307
<b>Total Consumer Loans</b>	<b>281</b>	<b>281</b>		<b>281</b>		<b>307</b>
<b>Total Loans</b>	<b>\$ 10,732</b>	<b>\$ 3,763</b>	<b>\$ 6,969</b>	<b>\$ 10,732</b>	<b>\$ 1,605</b>	<b>\$ 11,048</b>

**Table of Contents**

December 31, 2011	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
<b>Real Estate:</b>						
Land Development and Construction	\$ 1,134	\$ 992	\$ 142	\$ 1,134	\$ 134	\$ 883
Farmland	641	492	149	641	24	588
1-4 Family Mortgages	2,066	1,297	769	2,066	216	1,933
Commercial Real Estate	6,818	5,042	1,776	6,818	736	6,896
<b>Total Real Estate Loans</b>	<b>10,659</b>	<b>7,823</b>	<b>2,836</b>	<b>10,659</b>	<b>1,110</b>	<b>10,300</b>
<b>Business Loans:</b>						
Commercial and Industrial Loans	284	163	121	284	57	860
Farm Production and Other Farm Loans	21	21		21		19
<b>Total Business Loans</b>	<b>305</b>	<b>184</b>	<b>121</b>	<b>305</b>	<b>57</b>	<b>879</b>
<b>Consumer Loans:</b>						
Other Consumer Loans	435	430	5	435		321
<b>Total Consumer Loans</b>	<b>435</b>	<b>430</b>	<b>5</b>	<b>435</b>		<b>321</b>
<b>Total Loans</b>	<b>\$ 11,399</b>	<b>\$ 8,437</b>	<b>\$ 2,962</b>	<b>\$ 11,399</b>	<b>\$ 1,167</b>	<b>\$ 11,500</b>

The Corporation utilizes a risk grading matrix to assign a risk grade to each of its loans when originated and is updated as factors related to the strength of the loan changes. Loans are graded on a scale of 1 to 9. A description of the general characteristics of the 9 risk grades is as follows.

**Grade 1. MINIMAL RISK** - These loans are without loss exposure to the Corporation. This classification is reserved for only the best, well secured loans to borrowers with significant capital strength, low leverage, stable earnings and growth and other readily available financing alternatives. This type of loan would also include loans secured by a program of the government.

**Grade 2. MODEST RISK** - These loans include borrowers with solid credit quality and moderate risk of loss. These loans may be fully secured by certificates of deposit with another reputable financial institution, or secured by readily marketable securities with acceptable margins.

**Grade 3. AVERAGE RISK** - This is the rating assigned to most of the loans held by the Corporation. This includes loans with average loss exposure and average overall quality. These loans should liquidate through possessing adequate collateral and adequate earnings of the borrower. In addition, these loans are properly documented and are in accordance with all aspects of the current loan policy.

**Table of Contents**

Grade 4. ACCEPTABLE RISK - Borrower generates sufficient cash flow to fund debt service but most working asset and capital expansion needs are provided from external sources. Profitability and key balance sheet ratios are usually close to peers but one or more may be higher than peers.

Grade 5. MANAGEMENT ATTENTION - Borrower has significant weaknesses resulting from performance trends or management concerns. The financial condition of the borrower has taken a negative turn and may be temporarily strained. Cash flow is weak but cash reserves remain adequate to meet debt service. Management weakness is evident.

Grade 6. OTHER LOANS ESPECIALLY MENTIONED (OLEM) - Loans in this category are fundamentally sound but possess some weaknesses. OLEM loans have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the bank's credit position at some future date. These loans have an identifiable weakness in credit, collateral, or repayment ability but there is no expectation of loss.

Grade 7. SUBSTANDARD ASSETS - Assets classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets classified as substandard must have a well-defined weakness based upon objective evidence. Assets classified as substandard are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. The possibility that liquidation would not be timely requires a substandard classification even if there is little likelihood of total loss.

Grade 8. DOUBTFUL - A loan classified as doubtful has all the weaknesses of a substandard classification and the added characteristic that the weakness makes collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable or improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined. A doubtful classification could reflect the fact that the primary source of repayment is gone and serious doubt exists as to the quality of a secondary source of repayment.

Grade 9. LOSS - Loans classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may occur in the future. Also included in this classification is the defined loss portion of loans rated substandard assets and doubtful assets.

These internally assigned grades are updated on a continual basis throughout the course of the year and represent management's most updated judgment regarding grades at June 30, 2012.

**Table of Contents**

The following table details the amount of gross loans by loan grade and class as of June 30, 2012 (in thousands):

	Grades	Satisfactory 1, 2, 3, 4	Special Mention 5, 6	Substandard 7	Doubtful 8	Loss 9	Total Loans
<b>Real Estate:</b>							
Land Development and Construction		\$ 8,978	\$ 1,974	\$ 442	\$	\$	\$ 11,394
Farmland		30,066	2,786	1,352			34,204
1-4 Family Mortgages		103,767	5,852	12,473	27		122,119
Commercial Real Estate		110,646	6,762	18,602			136,010
<b>Total Real Estate Loans</b>		<b>253,457</b>	<b>17,374</b>	<b>32,869</b>	<b>27</b>		<b>303,727</b>
<b>Business Loans:</b>							
Commercial and Industrial Loans		39,248	7,057	764	32		47,101
Farm Production and Other Farm Loans		1,470	7	60			1,537
<b>Total Business Loans</b>		<b>40,718</b>	<b>7,064</b>	<b>824</b>	<b>32</b>		<b>48,638</b>
<b>Consumer Loans:</b>							
Credit Cards		958		13			971
Other Consumer Loans		29,736	216	1,181	30		31,163
<b>Total Consumer Loans</b>		<b>30,694</b>	<b>216</b>	<b>1,194</b>	<b>30</b>		<b>32,134</b>
<b>Total Loans</b>		<b>\$ 324,869</b>	<b>\$ 24,654</b>	<b>\$ 34,887</b>	<b>\$ 89</b>	<b>\$</b>	<b>\$ 384,499</b>

**Table of Contents**

The following table details the amount of gross loans by loan grade and class as of December 31, 2011:

	Grades	Satisfactory 1, 2, 3, 4	Mention 5, 6	Substandard 7	Doubtful 8	Loss 9	Total Loans
<b>Real Estate:</b>							
Land Development and Construction		\$ 9,647	\$ 2,290	\$ 1,481	\$	\$ 62	\$ 13,480
Farmland		31,405	3,043	1,464			35,912
1-4 Family Mortgages		115,365	5,784	12,811	27		133,987
Commercial Real Estate		108,347	7,188	13,852			129,387
<b>Total Real Estate Loans</b>		<b>264,764</b>	<b>18,305</b>	<b>29,608</b>	<b>27</b>	<b>62</b>	<b>312,766</b>
<b>Business Loans:</b>							
Commercial and Industrial Loans		27,970	7,712	863	36		36,581
Farm Production and Other Farm Loans		1,481	8	90			1,579
<b>Total Business Loans</b>		<b>29,451</b>	<b>7,720</b>	<b>953</b>	<b>36</b>		<b>38,160</b>
<b>Consumer Loans:</b>							
Credit Cards		978		17			995
Other Consumer Loans		35,859	325	1,304	53	4	37,545
<b>Total Consumer Loans</b>		<b>36,837</b>	<b>325</b>	<b>1,321</b>	<b>53</b>	<b>4</b>	<b>38,540</b>
<b>Total Loans</b>		<b>\$ 331,052</b>	<b>\$ 26,350</b>	<b>\$ 31,882</b>	<b>\$ 116</b>	<b>\$ 66</b>	<b>\$ 389,466</b>

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio.

The allowance on the majority of the loan portfolio is calculated using a historical chargeoff percentage applied to the current loan balances by loan segment. This historical period is the average of the previous 5 years with the most current years weighted to show the effect of the most recent chargeoff activity. This percentage is also adjusted for economic factors such as local unemployment and general business conditions, both local and nationwide.

The group of loans that are considered to be impaired are individually evaluated for possible loss and a specific reserve is established to cover any loss contingency. Loans that are determined to be a loss with no benefit of remaining in the portfolio are charged off to the allowance. These specific reserves are reviewed periodically for continued impairment and adequacy of the specific reserve and adjusted when necessary.

**Table of Contents**

The following table details activity in the allowance for possible loan losses by portfolio segment for the six months ended June 30, 2012:

June 30, 2012	Real Estate	Business Loans	Consumer	Total
Beginning Balance, January 1, 2012	\$ 4,176,475	\$ 1,672,467	\$ 832,470	\$ 6,681,412
Provision for possible loan losses	817,494	(160,894)	209,177	865,777
Chargeoffs	280,703	28,759	158,865	468,327
Recoveries	28,459	39,553	63,843	131,855
Net Chargeoffs	252,244	(10,794)	95,022	336,472
Ending Balance	\$ 4,741,725	\$ 1,522,367	\$ 946,625	\$ 7,210,717
Period end allowance allocated to:				
Loans individually evaluated for impairment	\$ 1,548,065	\$ 57,325	\$	\$ 1,605,390
Loans collectively evaluated for impairment	3,193,660	1,465,042	946,625	5,605,327
Ending Balance, June 30, 2012	\$ 4,741,725	\$ 1,522,367	\$ 946,625	\$ 7,210,717

Activity in the allowance for possible loan losses for the six months ended June 30, 2011 was as follows:

	June 30, 2011
Balance, beginning of period	\$ 6,379,070
Provision for loan losses	926,834
Loans charged off	(1,017,099)
Recoveries of loans previously charged off	70,797
Balance, end of period	\$ 6,359,602

**Table of Contents**

The Corporation's recorded investment in loans as of June 30, 2012 and December 31, 2011 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Corporation's impairment methodology was as follows (in thousands):

<b>June 30, 2012</b>	Real Estate	Business Loans	Consumer	Total
Loans individually evaluated for specific impairment	\$ 10,224	\$ 227	\$ 281	\$ 10,732
Loans collectively evaluated for general impairment	293,503	48,411	31,853	373,767
	\$ 303,727	\$ 48,638	\$ 32,134	\$ 384,499

<b>December 31, 2011</b>	Real Estate	Business Loans	Consumer	Total
Loans individually evaluated for specific impairment	\$ 10,659	\$ 305	\$ 435	\$ 11,399
Loans collectively evaluated for general impairment	302,107	37,855	38,105	378,067
	\$ 312,766	\$ 38,160	\$ 38,540	\$ 389,466

**Note 7. Recent Accounting Pronouncements**

In September 2011, FASB issued an update to ASC Topic 350 to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. This update is effective for annual and interim impairment tests beginning after December 15, 2011, and is not expected to have a significant impact on the Corporation's financial statements as it related to disclosures made herein.

**Table of Contents****Note 8. Fair Value of Financial Instruments**

The fair value topic of the ASC establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. This topic clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. This topic also requires disclosure about how fair value was determined for assets and liabilities and establishes a hierarchy for which these assets and liabilities must be grouped, based on significant levels of inputs as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities;
- Level 2 Quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability; or
- Level 3 Unobservable inputs, such as discounted cash flow models or valuations.

The determination of where assets and liabilities fall within this hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following table presents assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2012:

	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 Obligations of U. S. Government Agencies	\$	\$ 151,509,731	\$	\$ 151,509,731
Mortgage-backed Securities		30,550,393		30,550,393
State, county and municipal obligations		110,949,942		110,949,942
Other investments			2,746,801	2,746,801
<b>Total</b>	<b>\$</b>	<b>\$ 293,010,066</b>	<b>\$ 2,746,801</b>	<b>\$ 295,756,867</b>

**Table of Contents**

The following table presents assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2011:

	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 Obligations of U. S. Government Agencies	\$	\$ 234,938,488	\$	\$ 234,938,488
Mortgage-backed Securities		35,117,858		35,117,858
State, county and municipal obligations		102,422,164		102,422,164
Other investments			2,029,295	2,029,295
<b>Total</b>	<b>\$</b>	<b>\$ 372,478,510</b>	<b>\$ 2,029,295</b>	<b>\$ 374,507,805</b>

The following table reports the activity for 2012 in assets measured at fair value on a recurring basis using significant unobservable inputs.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Structured Financial Product
Balance at January 1, 2012	\$ 2,029,295
Unrealized gains included in other comprehensive income	717,506
<b>Balance at June 30, 2012</b>	<b>\$ 2,746,801</b>

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**

For assets measured at fair value on a nonrecurring basis during 2012 that were still held in the balance sheet at June 30, 2012, the following table provides the hierarchy level and the fair value of the related assets:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Totals
Impaired loans	\$	\$	\$ 4,100,152	\$ 4,100,152
Other real estate owned			688,091	688,091
<b>Total</b>	<b>\$</b>	<b>\$</b>	<b>\$ 4,788,243</b>	<b>\$ 4,788,243</b>

For assets measured at fair value on a nonrecurring basis during 2011 that were still held in the balance sheet at December 31, 2011, the following table provides the hierarchy level and the fair value of the related assets:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Totals
Impaired loans	\$	\$	\$ 505,585	\$ 505,585
Other real estate owned			3,056,902	3,056,902
<b>Total</b>	<b>\$</b>	<b>\$</b>	<b>\$ 3,562,487</b>	<b>\$ 3,562,487</b>

Impaired loans with a carrying value of \$4,828,328 and \$682,517 had an allocated allowance for loan losses of \$728,176 and \$176,932 at June 30, 2012 and December 31, 2011, respectively. The allocated allowance is based on the carrying value of the impaired loan and the fair value of the underlying collateral less estimated costs to sell.

Other real estate owned ( OREO ) acquired during the six-month period ended June 30, 2012, and recorded at fair value, less costs to sell, was \$827,891, of which \$139,800 was acquired and sold during this period. There have been no writedowns during the period on OREO previously acquired and still held. OREO acquired during 2011 and recorded at fair value, less costs to sell, was \$2,503,659. Additional writedowns during 2011 on OREO acquired in previous years was \$216,000 on 10 properties valued at \$553,243.

**Table of Contents**

The financial instruments topic of the ASC requires disclosure of financial instruments' fair values, as well as the methodology and significant assumptions used in estimating fair values. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. The financial instruments topic of the ASC excludes certain financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Corporation and may not be indicative of amounts that might ultimately be realized upon disposition or settlement of those assets and liabilities.

The following represents the carrying value and estimated fair value of the Corporation's financial instruments at June 30, 2012, and December 31, 2011:

	June 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets</b>				
Cash and due from banks	\$ 44,363,414	\$ 44,363,414	\$ 35,407,715	\$ 35,407,715
Interest bearing deposits with banks	67,957,333	67,957,333	3,990,521	3,990,521
Securities available-for-sale	299,928,467	299,928,467	374,507,805	374,507,805
Net loans	377,012,459	376,439,588	382,580,529	382,174,094
<b>Financial liabilities</b>				
Deposits	\$ 591,571,885	\$ 591,904,539	\$ 572,338,135	\$ 572,388,706
Federal Home Loan Bank advances	78,500,000	81,527,818	68,500,000	71,950,022
Securities Sold under agreement to repurchase	79,103,790	79,103,790	120,220,433	120,220,433

The fair value estimates, methods and assumptions used by the Corporation in estimating its fair value disclosures for financial statements were as follows:

**Cash and Due from Banks and Interest Bearing Deposits with Banks**

The carrying amounts reported in the balance sheet for these instruments approximate fair value because of their immediate and shorter-term maturities, which are considered to be three months or less when purchased.

**Securities Available-for-Sale**

Fair values for investment securities are based on quoted market prices, when available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. When neither quoted prices nor comparable instruments are available, unobservable inputs are needed to form an expected future cash flow analysis to establish fair values. Level 2 securities include debt securities such as obligations of United States government agencies and corporations, mortgage-backed securities and state, county and municipal bonds. Level 3 securities consist of a pooled trust preferred security.

## Table of Contents

### Net Loans

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (i.e., commercial real estate and rental property mortgage loans, commercial and industrial loans, financial institution loans, and agricultural loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

### Deposits

The fair values for demand deposits, NOW and money market accounts and savings accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts for variable-rate, fixed-term money market accounts and time deposits approximate their fair values at the reporting date. Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

### Securities Sold Under Agreement to Repurchase

Due to the short term nature of these instruments, which is considered to be three months or less, the carrying amount is equal to the fair value.

### Federal Home Loan Bank (FHLB) Borrowings

The fair value of FHLB advances is based on discounted cash flow analysis.

### Off-Balance Sheet Instruments

The fair value of commitments to extend credit and letters of credit are estimated using fees currently charged to enter into similar agreements. The fees associated with these financial instruments are not material.

**Table of Contents**

CITIZENS HOLDING COMPANY

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

Management's discussion and analysis is intended 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). The following discussion should be read in conjunction with the consolidated financial statements and notes appearing elsewhere in this report.

### **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 the sum of net cash, short-term investments and marketable assets. This measurement for liquidity of the Corporation at June 30, 2012, was 43.10% and at December 31, 2011, was 29.32%. Liquidity increased due to the amount of investment securities that were called and not reinvested at June 30, 2012. Management believes it maintains adequate liquidity for the Corporation's current needs.

The Corporation's primary source of liquidity is customer deposits, which were \$591,571,885 at June 30, 2012, and \$572,338,135 at December 31, 2011. 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 \$299,928,467 invested in investment securities at June 30, 2012, and \$374,507,805 at December 31, 2011. The Corporation also had \$67,957,333 in interest bearing deposits at other banks at June 30, 2012 and \$3,990,521 at December 31, 2011. The Corporation had secured and unsecured federal funds lines with correspondent banks in the amount of \$37,500,000 at June 30, 2012 and December 31, 2011. In addition, the Corporation has the ability to draw on its line of credit with the FHLB. At June 30, 2012, the Corporation had unused and available \$93,598,381 of its line of credit with the FHLB and at December 31, 2011, the Corporation had unused and available \$126,473,758 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 2011 to June 30, 2012, was the result of an increase in advances outstanding of \$10 million and a reduction in the amount of loans eligible for the collateral pool. The Corporation had no federal funds purchased as of June 30, 2012 and December 31, 2011. The Corporation usually purchases funds from correspondent banks on a temporary basis to meet short term funding needs.

When the Corporation has more funds than it needs for its reserve requirements or short-term liquidity needs, the Corporation increases its investment portfolio, increases the balances in interest bearing due from accounts 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.

**Table of Contents**

## CAPITAL RESOURCES

The total stockholders' equity was \$88,396,666 at June 30, 2012, as compared to \$86,079,217 at December 31, 2011. The reason for the increase in stockholders' equity was net earnings in excess of dividends paid and the increase in the investment securities market value adjustment due to an increase in the market value of the Corporation's investment portfolio. This market value increase was due to general market conditions, specifically the increase in medium term interest rates, which caused an increase in the market price of the investment portfolio.

Cash dividends in the amount of \$2,137,261, or \$0.44 per share, have been paid in 2012 as of the end of the second quarter 2012.

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 June 30, 2012, the Corporation meets all capital adequacy requirements to which it is subject.

	Actual		Adequacy Purposes		Actions Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2012						
Total Capital (to Risk-Weighted Assets)	\$ 86,092,530	17.95%	\$ 38,374,642	>8.00%	\$ 47,968,303	>10.00%
Tier 1 Capital (to Risk-Weighted Assets)	80,081,496	16.69%	19,187,321	>4.00%	28,780,982	>6.00%
Tier 1 Capital ( to Average Assets)	80,081,496	9.62%	33,281,182	>4.00%	41,601,478	>5.00%

**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		For the Six Months	
	Ended June 30,		Ended June 30,	
	2012	2011	2012	2011
Interest Income, including fees	\$ 9,003,168	\$ 9,443,851	\$ 17,902,158	\$ 18,789,123
Interest Expense	1,457,253	1,682,368	2,967,842	3,449,321
<b>Net Interest Income</b>	<b>7,545,915</b>	<b>7,761,483</b>	<b>14,934,316</b>	<b>15,339,802</b>
Provision for Loan Losses	330,097	682,773	865,777	926,834
<b>Net Interest Income after Provision for Loan Losses</b>	<b>7,215,818</b>	<b>7,078,710</b>	<b>14,068,539</b>	<b>14,412,968</b>
<b>Other Income</b>	<b>1,637,156</b>	<b>1,516,466</b>	<b>3,246,755</b>	<b>3,100,861</b>
Other Expense	6,674,001	6,246,039	13,084,268	12,646,320
<b>Income Before Provision For Income Taxes</b>	<b>2,178,973</b>	<b>2,349,137</b>	<b>4,231,026</b>	<b>4,867,509</b>
Provision for Income Taxes	427,375	494,865	816,262	1,058,351
<b>Net Income</b>	<b>\$ 1,751,598</b>	<b>\$ 1,854,272</b>	<b>\$ 3,414,764</b>	<b>\$ 3,809,158</b>
<b>Net Income Per share - Basic</b>	<b>\$ 0.36</b>	<b>\$ 0.38</b>	<b>\$ 0.70</b>	<b>\$ 0.79</b>
<b>Net Income Per Share - Diluted</b>	<b>\$ 0.36</b>	<b>\$ 0.38</b>	<b>\$ 0.70</b>	<b>\$ 0.79</b>

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 7.79% for the three months ended June 30, 2012, and 9.19% for the corresponding period in 2011. For the six months ended June 30, 2012, ROE was 7.74% compared to 9.60% for the six months ended June 30, 2011. In both instances, the decrease in ROE was caused by an increase in average equity along with a decrease in net income for the three and six months of 2012.

The book value per share increased to \$18.21 at June 30, 2012, compared to \$17.77 at December 31, 2011. The increase in book value per share reflects the increase in other comprehensive income due to the increase in market value of the Corporation's investment securities and by the amount of earnings in excess of dividends. Average assets for the six months ended June 30, 2012, were \$834,621,887 compared to \$829,177,021 for the year ended December 31, 2011.

---

**Table of Contents**

**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.

The annualized net interest margin was 4.16% for the second quarter of 2012 compared to 4.29% for the corresponding period of 2011. For the six months ended June 30, 2012, annualized net interest margin was 4.13% compared to 4.28% for the six months ended June 30, 2011. The decrease in net interest margin from 2011 to 2012 is the result of a decrease in yields on earning assets compared to the decrease in rates paid on deposits and borrowed funds, offset partially by an increase in average earning assets, as detailed below. Earning assets averaged \$774,095,199 for the three months ended June 30, 2012. This represents an increase of \$22,590,525, or 3.0%, over average earning assets of \$751,504,674 for the three month period ended June 30, 2011. Earning assets averaged \$765,801,458 for the six months ended June 30, 2012. This represents an increase of \$17,358,127, or 2.3% over average earning assets of \$748,443,331 for the six months ended June 30, 2011. The increase in earning assets for the three and six months ended June 30, 2012, is the result of an increase in investment securities offset partially by a decrease in loans due to the declining loan demand due to current local, national and international economic conditions.

Interest bearing deposits averaged \$470,496,017 for the three months ended June 30, 2012. This represents an increase of \$24,400,460, or 5.6%, from the average of interest bearing deposits of \$438,381,788 for the three-month period ended June 30, 2011. This was due, in large part, to an increase in certificates of deposit and interest-bearing NOW and money market accounts.

Other borrowed funds averaged \$163,988,201 for the three months ended June 30, 2012. This represents a decrease of \$42,086,599, or 20.4%, over the other borrowed funds of \$206,074,800 for the three-month period ended June 30, 2011. This decrease in other borrowed funds was due to a \$35,007,634 decrease in the Commercial Repo Liability, a \$62,086 decrease in the ABE Loan Liability, a \$2,591,141 increase in Federal Funds Purchased and a decrease in the FHLB advances of \$9,608,020 for the three-month period ended June 30, 2012, when compared to the three-month period ended June 30, 2011.

Interest bearing deposits averaged \$467,043,764 for the six months ended June 30, 2012. This represents an increase of \$24,400,460, or 5.6%, from the average of interest bearing deposits of \$438,784,184 for the six-month period ended June 30, 2011.

Other borrowed funds averaged \$168,840,833 for the six months ended June 30, 2012. This represents a decrease of \$36,797,910, or 17.9%, over the other borrowed funds of \$205,638,743 for the six-month period ended June 30, 2011. This decrease in other borrowed funds was due to a \$27,666,358 decrease in the Commercial Repo Liability, a \$96,155 decrease in the ABE Loan Liability, a \$1,872,769 increase in Federal Funds Purchased and a decrease in the FHLB advances of \$10,908,166 for the six-month period ended June 30, 2012, when compared to the six-month period ended June 30, 2011.

**Table of Contents**

Net interest income was \$7,545,915 for the three-month period ended June 30, 2012, an increase of \$215,568 from \$7,761,483 for the three-month period ended June 30, 2011, primarily due to changes in 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 June 30, 2012, the yield on earning assets decreased more than the rates paid on deposits and borrowed funds decreased from the same period in 2011. The yield on all interest bearing assets decreased 25 basis points to 4.93% in the second quarter of 2012 from 5.18% for the same period in 2011. At the same time, the rate paid on all interest bearing liabilities for the second quarter of 2012 decreased by 13 basis points to 0.92% from 1.05% in the same period of 2011. 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.

Net interest income was \$14,934,316 for the six months ended June 30, 2012, a decrease of \$405,486 from the \$15,339,802 for the six-months ended June 30, 2011, primarily due to changes in both rate and volume. The changes in volume in earning assets and in deposits and in borrowed funds are discussed above. As to changes in rate in the six-month period ended June 30, 2012, the yield on earning assets decreased more than the rates paid on deposits and borrowed funds as compared to the changes in rates and yields in the same period of 2011. The yield on all interest bearing assets decreased 28 basis points to 4.92% in the first six months of 2012 from 5.20% for the same period in 2011. At the same time, the rate paid on all interest bearing liabilities for the first six months of 2012 decreased 14 basis points to 0.93% from 1.07% in the same period in 2011. 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.

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

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2012	2011	2012	2011
Interest and Fees	\$ 6,038,190	\$ 6,398,678	\$ 12,010,427	\$ 12,947,609
Average Loans	386,667,016	412,887,296	387,733,738	415,451,123
Annualized Yield	6.25%	6.20%	6.20%	6.23%

The decrease in interest rates in the six-month period ended June 30, 2012, 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 overall 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.

**Table of Contents**

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 regular 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 that 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 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 June 30, 2012	Year Ended December 31, 2011	Amount of Increase (Decrease)	Percent of Increase (Decrease)
<b>BALANCES:</b>				
Gross Loans	\$ 384,499,320	\$ 389,466,242	\$ (4,966,922)	-1.28%
Allowance for Loan Losses	7,210,717	6,681,412	529,305	7.92%
Nonaccrual Loans	10,632,129	11,299,060	(666,931)	-5.90%
<b>Ratios:</b>				
Allowance for loan losses to gross loans	1.88%	1.72%		
Net loans charged off to allowance for loan losses	4.67%	40.31%		

The provision for loan losses for the three months ended June 30, 2012, was \$330,097, a decrease of \$352,676 from the \$682,773 provision for the same period in 2011. The provision for loan losses was \$865,777 for the six month period ended June 30, 2012, compared to a provision of \$926,834 for the six months ended June 30, 2011. The decrease in our loan loss provisions for the three and six month periods is a result of a decrease in loan losses recorded for the respective periods and management's assessment of inherent loss in the loan portfolio, including the impact caused by current local, national and global economic conditions. 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 and specific reserves applied to certain impaired loans. Nonaccrual loans decreased during this period due to payments received in excess of the amount of new loans being added to the list.

For the three months ended June 30, 2012, net loan losses charged to the allowance for loan losses totaled \$191,330, an increase of \$656,059 from the \$847,389 charged off in the same period in 2011. For the six months ended June 30, 2012, net loan losses charged to the allowance for loan losses totaled \$336,472, a decrease of \$609,830 from the \$946,302 charged off in the same period in 2011. This decrease was due to an overall decrease in the number of charge offs in 2012 when compared to the same period in 2011 and not the result of any one loan segment.

Management 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 six months of 2012 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, the nation and internationally, as a whole, it is possible that additional provisions for loan loss may be required.

**Table of Contents****OTHER INCOME**

Other income includes service charges on deposit accounts, wire transfer fees, safe deposit box rentals and other revenue not derived from interest on earning assets. Other income for the three months ended June 30, 2012, was \$1,637,156, an increase of \$120,690, or 8.0%, from the same period in 2011. Service charges on deposit accounts increased by \$41,934, or 4.9%, to \$897,920 in the three months ended June 30, 2012, compared to \$855,986 for the same period in 2011. Other service charges and fees increased by \$22,299, or 5.4%, in the three months ended June 30, 2012, compared to the same period in 2011. The difference in fee income was the result of fluctuations in volume and not a direct result of fee changes.

Other income for the six months ended June 30, 2012, was \$3,246,755, an increase of \$145,894, or 4.7%, from the same period in 2011. Service charges on deposit accounts increased by \$15,187, or 0.9%, to \$1,745,570 in the six months ended June 30, 2012, compared to \$1,730,383 for the same period in 2011. Other service charges and fees increased by \$36,936, or 5.4%, in the six months ended June 30, 2012, compared to the same period in 2011. The difference in fee income was the result of fluctuations in volume and not a direct result of fee changes. The following is a detail of the other major income classifications that are included in Other Income on the income statement:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Other Income				
BOLI Insurance	\$ 120,000	\$ 121,924	\$ 240,000	\$ 237,309
Mortgage Loan Origination Income	100,783	69,993	217,012	168,493
Income from Security Sales, net	9,061	5,357	37,753	5,789
Other Income	71,919	48,032	140,351	129,754
<b>Total Other Income</b>	<b>\$ 301,763</b>	<b>\$ 245,306</b>	<b>\$ 635,116</b>	<b>\$ 541,345</b>

**OTHER EXPENSES**

Other expenses include salaries and employee benefits, occupancy and equipment, and other operating expenses. Aggregate non-interest expenses for the three-month period ended June 30, 2012 and 2011 were \$6,674,001 and \$6,246,039, respectively, an increase of \$427,962, or 6.9%, from 2011 to 2012. Salaries and benefits decreased to \$3,473,956 for the three months ended June 30, 2012, from \$3,524,103 for the same period in 2011. This represents a decrease of \$50,147, or 1.4%. This decrease was the result of decreases in the cost of employee benefits paid by the Corporation and a reduction in the number of employees. Occupancy expense increased by \$79,314, or 7.8%, to \$1,097,856 for the three months ended June 30, 2012, when compared to the same period of 2011. This increase is due in part to an increase in office and equipment rental and service costs. Other operating expenses increased by \$398,795 from 2011 to 2012. A detail of the major expense classifications is set forth below.

**Table of Contents**

Total non-interest expenses for the six-month period ended June 30, 2012 and 2011 were \$13,084,268 and \$12,646,320, respectively, an increase of \$437,948, or 3.5%, from 2011 to 2012. Salaries and benefits decreased to \$7,033,660 for the six months ended June 30, 2012, from \$7,043,712 for the same period in 2011. This represents a decrease of \$10,052, or 0.1%. This decrease was the result of a reduction in the number of employees. Occupancy expense increased \$21,676, or 1.0%, to \$2,129,165 in the six months ended June 2012 when compared to the same period in 2011. Other operating expenses increased by \$426,324 from 2011 to 2012. A detail of the major expense classifications is set forth below.

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

	Three months ended		Six months ended	
	June 30,		June 30,	
Other Operating Expense	2012	2011	2012	2011
Intangible Amortization	\$ 30,782	\$ 46,172	\$ 76,955	\$ 92,345
Advertising	171,044	180,900	333,654	351,662
Office Supplies	94,650	123,474	208,708	303,250
Legal and Audit Fees	121,954	116,254	226,779	237,160
Telephone expense	92,626	117,770	211,666	214,152
Postage and Freight	93,350	100,224	230,033	192,874
Loan Collection Expense	126,323	(31,323)	229,498	42,051
Other Losses	16,675	(1,818)	29,398	11,502
FDIC and State Assessment	316,966	267,801	628,416	532,870
Debit Card/ATM expense	205,522	203,983	397,584	385,361
Travel and Convention	52,648	75,578	105,211	138,779
Other expenses	779,649	504,379	1,243,541	993,113
<b>Total Other Expense</b>	<b>\$ 2,102,189</b>	<b>\$ 1,703,394</b>	<b>\$ 3,921,443</b>	<b>\$ 3,495,119</b>

The Corporation's efficiency ratio for the three months ended June 30, 2012, was 70.16% compared to the 65.11% for the same period in 2011. For the six months ended June 30, 2012 and 2011, the Corporation's efficiency ratio was 69.54% and 66.31%, 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.

**Table of Contents**

## BALANCE SHEET ANALYSIS

	June 30, 2012	December 31, 2011	Amount of Increase (Decrease)	Percent of Increase (Decrease)
Cash and Due From Banks	\$ 44,363,414	\$ 35,407,715	\$ 8,955,699	25.29%
Interest Bearing deposits with Other Banks	67,957,333	3,990,521	63,966,812	1602.97%
Investment Securities	299,928,467	374,507,805	(74,579,338)	-19.91%
Loans, net	377,012,459	382,580,529	(5,568,070)	-1.46%
Total Assets	844,689,027	853,945,454	(9,256,427)	-1.08%
Total Deposits	591,571,885	572,338,135	19,233,750	3.36%
Total Stockholders Equity	88,396,666	86,079,217	2,317,449	2.69%

## CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash, balances at correspondent banks, interest bearing deposits with other banks and items in process of collection. The balance at June 30, 2012, was \$112,320,747, an increase of \$72,922,511 from the balance of \$39,398,236 at December 31, 2011, due to an increase in the balances of correspondent banks due to an increase in the amount of the month ending cash letter and by an increase in the balances of interest bearing deposits with other banks.

## PREMISES AND EQUIPMENT

During the quarter ended June 30, 2012, premises and equipment decreased by \$540,801, or 2.7%, to \$19,737,642 when compared to \$20,278,443 at December 31, 2011. The decrease was due to the amount of depreciation exceeding the addition of property and equipment in the normal course of business.

## INVESTMENT SECURITIES

The investment securities portfolio consists of United States agency debentures, mortgage-backed securities, obligations of states, counties and municipal governments and FHLB stock and FNBB stock. Investments at June 30, 2012, decreased \$74,579,338, or 19.9%, to \$299,928,467 from the balance at December 31, 2011. This decrease is due to the maturity and calls of investment securities that were not reinvested by the end of the reporting period.

## LOANS

The loan balance decreased by \$5,568,070 during the six months ended June 30, 2012, to \$377,012,459 from \$382,580,529 at December 31, 2011. Loan demand, especially in the commercial and industrial loan and consumer categories, was weak during the first six months of 2012. No material changes were made to the loan products offered by the Corporation during this period.

**Table of Contents**

## DEPOSITS

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

	June 30, 2012	December 31, 2011	Amount of Increase (Decrease)	Percent of Increase (Decrease)
Noninterest-Bearing Deposits	\$ 114,043,397	\$ 116,894,676	\$ (2,851,279)	-2.44%
Interest-Bearing Deposits	180,465,762	172,585,498	7,880,264	4.57%
Savings Deposits	45,297,712	41,876,977	3,420,735	8.17%
Certificates of Deposit	251,765,014	240,980,984	10,784,030	4.48%
<b>Total Deposits</b>	<b>\$ 591,571,885</b>	<b>\$ 572,338,135</b>	<b>\$ 19,233,750</b>	<b>3.36%</b>

Interest-bearing deposits, certificates of deposit and savings increased while noninterest-bearing deposits decreased during the three months ended June 30, 2012. 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 and our asset and liability management. These rate adjustments impact deposit balances.

## OFF-BALANCE SHEET ARRANGEMENTS

Refer to Note 2 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.

## 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, 2011.

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

The following discussion 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.

## Table of Contents

The Corporation's strategies and its management's ability to react to changing competitive and economic environments have historically enabled the Corporation to compete effectively and manage risks to acceptable levels. The Corporation has outlined potential risk factors below that it 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 the Corporation 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. The Corporation controls 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 June 30, 2012, the Corporation had \$7.211 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. Currently, the Corporation does not have any significant risks related to foreign exchange, commodities or equity risk exposures.

## **Table of Contents**

### **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.

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. A flat or inverted yield curve tends to decrease net interest margin, as funding costs increase relative to the yield on assets. Currently, the yield curve is positively sloped.

### **Regulatory and Legal Risks**

The Corporation operates in a heavily regulated industry and therefore is 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 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.

The Corporation also faces litigation risks from customers (individually 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.

## Table of Contents

### Accounting Estimate Risks

The preparation of the Corporation's consolidated financial statements in conformity with United States generally accepted accounting principles requires management to make significant estimates that affect the financial statements. The Corporation's most critical estimate is the level of the allowance for credit losses. 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 or sustain credit losses that are significantly higher than the provided allowance, or the Corporation may make some other adjustment that will differ materially from the estimates that the Corporation makes today.

### Expense Control

Expenses and other costs directly affect the Corporation's earnings. The Corporation's ability to successfully manage expenses is important to its 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.

### ITEM 4. CONTROLS AND PROCEDURES.

The management of the Corporation, with the participation of our principal executive officer and principal financial officer, 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 officer and principal financial officer have concluded that such disclosure controls and procedures were effective as of June 30, 2012 (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 June 30, 2012, 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.

The Corporation is supplementing the risk factors that appear in Part I, Item 1A., Risk Factors, of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011, to include the following.

**Changes in interest rates could make it difficult to maintain our current interest income spread and could result in reduced earnings.**

Our earnings are largely derived from net interest income, which is interest income and fees earned on loans and investments, less interest paid on deposits and other borrowings. Interest rates are highly sensitive to many factors that are beyond the control of our management, such as general economic conditions and the policies of various governmental and regulatory authorities. An unanticipated rapid decrease or increase in interest rates could have an adverse effect on the spreads between the interest rates earned on assets and the rates of interest paid on liabilities, and therefore on the level of net interest income. Further, substantially higher interest rates generally reduce loan demand and may result in slower loan growth than previously experienced. Due to concerns regarding the federal debt ceiling, one credit rating agency has downgraded the credit rating of the federal government, and others may as well, which could result in increased interest rates generally. For the reasons set forth above, an increase in interest rates generally as a result of such a credit rating downgrade could adversely affect our net interest income levels, thereby resulting in reduced earnings, and reduce loan demand.

**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.
- 101 The following financial information from Citizens Holding Company's Quarterly Report on Form 10-Q for the period ended June 30, 2012, filed with the SEC on August 9, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Condition as of June 30, 2012 (Unaudited) and December 31, 2011; (ii) the Consolidated Statements of Income for the three and six months ended June 30, 2012 (Unaudited) and 2011 (Unaudited); (iii) the Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2012 (Unaudited) and 2011 (Unaudited); (iv) the Consolidated Statements of Cash Flows for the six months ended June 30, 2012 (Unaudited) and 2011 (Unaudited); and (v) Notes to Consolidated Financial Statements, tagged as blocks of text (Unaudited).\*

\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.

**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  
(Principal Executive Officer)

BY: /s/ Robert T. Smith  
Robert T. Smith  
Treasurer and Chief Financial Officer  
(Principal Financial Officer and Chief Accounting  
Officer)

DATE: August 8, 2012

**Table of Contents**

**EXHIBIT INDEX**

Exhibit Number	Description of Exhibit
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.
101	The following financial information from Citizens Holding Company's Quarterly Report on Form 10-Q for the period ended June 30, 2012, filed with the SEC on August 9, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Condition as of June 30, 2012 (Unaudited) and December 31, 2011; (ii) the Consolidated Statements of Income for the three and six months ended June 30, 2012 (Unaudited) and 2011 (Unaudited); (iii) the Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2012 (Unaudited) and 2011 (Unaudited); (iv) the Consolidated Statements of Cash Flows for the six months ended June 30, 2012 (Unaudited) and 2011 (Unaudited); and (v) Notes to Consolidated Financial Statements, tagged as blocks of text (Unaudited).*

\* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.