CITIZENS HOLDING CO /MS/
Form 10-Q
November 08, 2010
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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 September 30, 2010

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)

MISSISSIPPI	**64-0666512**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
521 Main Street, Philadelphia, MS	**39350**
(Address of principal executive offices)	**(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. x 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	x
Non-accelerated filer	¨	Smaller Reporting Company	¨

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

Number of shares outstanding of each of the issuer s classes of common stock, as of November 5, 2010:

Title	**Outstanding**
Common Stock, $0.20 par value	**4,838,411**

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CITIZENS HOLDING COMPANY

THIRD QUARTER 2010 INTERIM FINANCIAL STATEMENTS

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (Unaudited).

CITIZENS HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CONDITION

(Unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Cash and due from banks	$ 21,346,850	$ 15,365,612
Interest bearing deposits with other banks	22,168,769	5,232,723
Investment securities available for sale, at fair value	318,356,411	318,403,999
Loans, net of allowance for loan losses of $6,295,579 in 2010 and $5,525,903 in 2009	423,268,923	441,694,562
Premises and equipment, net	19,532,682	18,124,109
Other real estate owned, net	3,011,376	3,229,180
Accrued interest receivable	5,521,248	6,048,718
Cash value of life insurance	19,260,457	18,783,333
Intangible assets, net	3,457,475	3,595,994
Other assets	6,909,675	9,525,598
TOTAL ASSETS	$ 842,833,866	$ 840,003,828
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$ 90,424,866	$ 87,116,776
Interest-bearing NOW and money market accounts	170,189,911	183,971,551
Savings deposits	38,397,679	34,466,029
Certificates of deposit	259,455,374	264,248,229
Total deposits	558,467,830	569,802,585
Securities sold under agreement to repurchase	111,492,563	114,753,010
Federal Home Loan Bank advances	84,400,000	74,400,000
Accrued interest payable	751,397	778,989
Deferred compensation payable	4,217,068	3,870,344
Other liabilities	2,121,435	1,801,436
Total liabilities	761,450,293	765,406,364
STOCKHOLDERS EQUITY		
Common stock; $.20 par value, 22,500,000 shares authorized, 4,838,411 shares outstanding at September 30, 2010 and 4,838,187 shares outstanding at December 31, 2009	967,682	967,637
Additional paid-in capital	3,061,221	3,087,738

Retained earnings	73,819,252	71,412,383
Accumulated other comprehensive income (loss), net of tax expense (benefit) of $2,103,207 in 2010 and ($517,734) in 2009	3,535,418	(870,294)
Total stockholders equity	81,383,573	74,597,464
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 842,833,866	$ 840,003,828

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

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CITIZENS HOLDING COMPANY

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	For the Three Months Ended September 30, 2010	2009	For the Nine Months Ended September 30, 2010	2009
INTEREST INCOME				
Loan income, including fees	$ 6,982,131	$ 7,368,838	$ 21,247,055	$ 22,007,962
Investment securities	2,459,128	3,100,773	7,487,294	8,702,289
Other interest	20,962	5,454	54,924	18,929
Total interest income	9,462,221	10,475,065	28,789,273	30,729,180
INTEREST EXPENSE				
Deposits	1,274,676	1,796,697	4,061,406	6,270,269
Other borrowed funds	906,420	854,059	2,670,169	2,492,463
Total interest expense	2,181,096	2,650,756	6,731,575	8,762,732
NET INTEREST INCOME	7,281,125	7,824,309	22,057,698	21,966,448
PROVISION FOR LOAN LOSSES	397,200	1,123,297	1,717,411	2,263,642
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,883,925	6,701,012	20,340,287	19,702,806
OTHER INCOME				
Service charges on deposit accounts	991,121	1,081,059	2,976,894	3,009,826
Other service charges and fees	400,299	395,370	1,146,696	1,064,555
Other income	329,216	604,398	985,869	1,447,587
Total other income	1,720,636	2,080,827	5,109,459	5,521,968
OTHER EXPENSES				
Salaries and employee benefits	3,465,713	3,281,090	10,314,413	9,646,435
Occupancy expense	1,017,538	1,099,080	2,955,888	3,061,057
Other operating expense	1,886,498	2,229,742	5,291,809	5,624,037
Total other expenses	6,369,749	6,609,912	18,562,110	18,331,529
INCOME BEFORE PROVISION FOR INCOME TAXES	2,234,812	2,171,927	6,887,636	6,893,245
PROVISION FOR INCOME TAXES	453,263	434,506	1,434,426	1,457,133
NET INCOME	$ 1,781,549	$ 1,737,421	$ 5,453,210	$ 5,436,112

NET INCOME PER SHARE								
-Basic	$	0.37	$	0.36	$	1.13	$	1.12
-Diluted	$	0.37	$	0.35	$	1.12	$	1.11
DIVIDENDS PAID PER SHARE	$	0.21	$	0.20	$	0.63	$	0.60

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

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CITIZENS HOLDING COMPANY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
Net income	$ 1,781,549	$ 1,737,421	$ 5,453,210	$ 5,436,112
Other comprehensive income, net of tax				
Unrealized holding gains (losses)	1,864,923	(1,253,730)	3,770,253	(3,325,903)
Reclassification adjustment for gains included in net income	17,446	308,765	635,459	527,828
Total other comprehensive income (loss)	1,882,369	(944,965)	4,405,712	(2,798,075)
Comprehensive income	$ 3,663,918	$ 792,456	$ 9,858,922	$ 2,638,037

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

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CITIZENS HOLDING COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Nine Months Ended September 30, 2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net cash provided by operating activities	$ 11,672,663	$ 9,298,253
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of securities available for sale	156,278,394	91,333,533
Proceeds from sales of securities available for sale	30,089,646	20,872,131
Purchases of investment securities available for sale	(180,842,931)	(148,170,397)
Net change in securities sold under agreement to repurchase	(3,260,447)	56,284,037
Purchases of bank premises and equipment	(2,363,088)	(2,360,698)
Increase in interest bearing deposits with other banks	(16,936,046)	(4,836,738)
Purchase of Federal Home Loan Bank Stock	(529,300)	(435,100)
Proceeds from sale of other real estate acquired by foreclosure	1,096,609	432,430
Net decrease (increase) in loans	15,334,054	(20,414,396)
Net cash used by investing activities	(1,133,109)	(7,295,198)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (decrease) increase in deposits	(11,334,755)	14,642,645
Proceeds from exercising stock options	189,161	485,748
Increase (decrease) in Federal Home Loan Bank advances	10,000,000	(5,000,000)
Repurchase of stock	(366,381)	(339,449)
Decrease in federal funds purchased		(18,200,000)
Payment of dividends	(3,046,341)	(2,914,986)
Net cash used by financing activities	(4,558,316)	(11,326,042)
Net increase (decrease) in cash and due from banks	5,981,238	(9,322,987)
Cash and due from banks, beginning of period	15,365,612	28,844,221
Cash and due from banks, end of period	$ 21,346,850	$ 19,521,234

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

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the nine months ended September 30, 2010

(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 September 30, 2010, 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, 2009, filed with the Securities and Exchange Commission on March 15, 2010.

Note 2. Commitments and Contingent Liabilities

In the ordinary course of business, the Corporation enters into commitments to extend credit to its customers. The unused portion of these commitments is not reflected in the accompanying financial statements. As of September 30, 2010, the Corporation had entered into loan commitments with certain customers with an aggregate unused balance of $39,567,607 compared to an aggregate unused balance of $35,605,204 at December 31, 2009. There were $3,171,959 of letters of credit outstanding at September 30, 2010, and $8,592,050 at December 31, 2009. 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.

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

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 September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
Basic weighted average shares outstanding	4,838,411	4,862,784	4,834,657	4,855,028
Dilutive effect of granted options	12,633	76,336	27,903	61,659
Diluted weighted average shares outstanding	4,851,044	4,939,120	4,862,560	4,916,687
Net income	$ 1,781,549	$ 1,737,421	$ 5,453,210	$ 5,436,112
Net income per share-basic	$ 0.37	$ 0.36	$ 1.13	$ 1.12
Net income per share-diluted	$ 0.37	$ 0.35	$ 1.12	$ 1.11

Note 4. Stock Option Plan

At September 30, 2010, 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 . The Corporation accounts for these plans under the stock compensation topic of the FASB Accounting Standards Codification (ASC). This topic provides guidance related to share-based payment transactions, including valuation methods (including assumptions such as expected volatility and expected term), the classification of compensation expense, non-GAAP financial measures, first-time adoption in an interim period and disclosure in Management s Discussion and Analysis subsequent to adoption.

To determine the expected term of the options granted, the Corporation chose to use the simplified method for plain vanilla options as detailed in the stock compensation topic of the ASC for those options granted prior to December 31, 2007. Beginning with options granted after that date, the Corporation uses the Black-Scholes option pricing model. Volatility is determined by using the standard deviation of the differences of the closing stock price of the Corporation s common stock as quoted on the American Stock Exchange (through November 15, 2006, the date of the transfer of the listing of the Corporation s common stock to The NASDAQ Global Market) or The NASDAQ Global Market (since November 16, 2006) on or about the 15th of each month starting January 15, 2002. Stock prices prior to that date experienced volatility that is not representative of the volatility experienced since that time and therefore are not used in this calculation.

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

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

On April 28, 2010, the 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 $25.72 per option, which was the closing price of Citizens Holding Company stock on that day. These options are first exercisable on October 29, 2010, and must be exercised no later than April 28, 2020. No options were granted to officers during 2010.

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 2010.

Assumption	Directors
Dividend Yield	4.86%
Risk-Free Interest Rate	2.24%
Expected Life	7.9 years
Expected Volatility	69.40%
Calculated Value per Option	$ 11.17
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 in April 2010 was $150,748 and should be recognized as an expense of $25,124 per month over the six-month requisite service period, beginning in April 2010. 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 $51,254, or $8,542 per month, over the six-month requisite service period, beginning in April 2010.

On April 29, 2009, the 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 $21.75 per option, which was the closing price of Citizens Holding Company stock on that day. These options were first exercisable on October 30, 2009, and must be exercised no later than April 29, 2019. No options were granted to officers during 2009.

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 2009.

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

Assumption	Directors
Dividend Yield	3.70%
Risk-Free Interest Rate	2.23%
Expected Life	7.8 years
Expected Volatility	64.24%
Calculated Value per Option	$ 9.96
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 in April 2009 was $134,952 and should be recognized as an expense of $22,492 per month over the six-month requisite service period, beginning in April 2009. 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 $49,932, or $8,322 per month, over the six-month requisite service period, beginning in April 2009.

The following table below is a summary of the stock option activity for the nine months ended September 30, 2010.

	Directors Plan		Employees Plan	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2009	88,500	$ 18.96	151,650	$ 19.63
Granted	13,500	25.72		
Exercised	(9,000)	11.64	(7,350)	11.49
Expired				
Outstanding at September 30, 2010	93,000	$ 20.65	144,300	$ 20.04

The intrinsic value of options granted under the Directors Plan at September 30, 2010, was $80,370 and the intrinsic value of options granted under the Employees Plan at September 30, 2010, was $164,410 for a total intrinsic value at September 30, 2010, of $244,780.

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 September 30, 2010, 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 2010 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.

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

The Corporation and its subsidiaries file 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 the years ending December 31, 2007 through 2009. The Corporation and its subsidiaries state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2007 through 2009.

Note 6. Recent Accounting Pronouncements

In December 2008, the FASB issued FAS FSP No. 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* (FSP 132-1), codified in the Compensation-Retirement Benefits Topic of the ASC. FSP 132-1 requires further disclosures about the fair value measurements of an employer s benefit plan assets, including disclosures about the following: how investment allocation decisions are made, including the factors material to an understanding of investment policies and strategies; major categories of plan assets; information about inputs and valuation techniques, including the fair value hierarchy classifications, as defined by Fair Value Topic of the ASC, of the major categories of plan assets; the effect of fair value measurements using significant unobservable inputs (Level 3 inputs) on changes in plan assets; and significant concentrations of risk within plan assets. FSP 132-1 is effective for fiscal years beginning on or after December 15, 2009, with early adoption permitted. The Corporation does not believe that the adoption of FSP 132-1 will have a material impact on its financial statements.

In June 2009, the FASB issued SFAS 166, *Accounting for Transfers of Financial Assets-an Amendment of FAS 140*, (SFAS 166), codified in the Transfers and Servicing Topic of the ASC. The objective of this standard is to provide implementation guidance on accounting for a transfer of a financial asset and repurchase financing. The amendment presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS 166. However, if certain criteria are met, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall not be evaluated under SFAS 166. SFAS 166 was effective for fiscal years beginning after November 15, 2009, and its adoption did not have a material effect on its financial position or results of operations.

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05, *Fair Value Measurements and Disclosures*, *(Topic 820): Measuring Liabilities at Fair Value* (ASU 2009-05) which provides additional guidance on the measurement of liabilities at fair value. Specifically, when a quoted price in an active market for the identical liability is not available, ASU 2009-05 requires that the fair value of a liability be measured using one or more of the valuation techniques that should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. In addition, an entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of a liability. The Corporation adopted ASU 2009-05 effective October 1, 2009, and the adoption did not have a material impact on its consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurement and Disclosures*, *(Topic 820): Improving Disclosures about Fair Value Measurements* (ASU 2010-06) which

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

requires the addition of new disclosures and clarifies existing disclosure requirements already included in the guidance for fair value measurements. The new disclosures related to significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers, as well as the clarifications of existing disclosures are effective for interim or annual reporting periods beginning after December 15, 2009. The new disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements are effective for interim or annual reporting periods beginning after December 15, 2010. ASU 2010-06 clarifies and increases the disclosure requirements for fair value measurements. Management does not anticipate that ASU 2010-06 will have a material effect on the Corporation s financial position, results of operations or stockholders equity.

In July 2010, the FASB issued ASU 2010-20, *Receivables (Topic 310): Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20). ASU 2010-20 requires additional disclosures that facilitate financial statement users evaluation of the nature of credit risk inherent in the entity s portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses and the changes and reasons for those changes in the allowance for credit losses. ASU 2010-20 makes changes to existing disclosure requirements and includes additional disclosure requirements about financing receivables, including credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables, the aging of past due financing receivables at the end of the reporting period by class of financing receivables, and the nature and extent of troubled debt restructurings that occurred during the period by class of financing receivables and their effect on the allowance for credit losses. These disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. We do not expect ASU 2010-20 to have a material effect on our consolidated financial statements other than the new required disclosures.

Note 7. Fair Value of Financial Instruments

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.

CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

The Fair Value Topic of the ASC establishes a framework for measuring fair value and required 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 established 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 fair value estimates, methods and assumptions used by the Corporation in estimating its fair value disclosures for financial instruments were:

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.

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.

The following table presents assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2010:

	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	$	$ 316,222,579	$ 2,133,832	$ 318,356,411

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

The following table presents assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2009:

	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	$	$ 316,258,603	$ 2,145,396	$ 318,403,999

The following table reports the activity for 2010 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, 2010	$ 2,145,396
Total gains or losses (realized or unrealized)	
Other-than-temporary impairment included in earnings	
Other-than-temporary impairment included in other comprehensive income	
Other gains/losses included in other comprehensive income	(11,564)
Purchases, issuances and settlements	
Transfers in and/or out of Level 3	
Balance at September 30, 2010	$ 2,133,832
The amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at reporting date	$

As of September 30, 2010, management determined, based on the current credit ratings, known defaults and deferrals by the underlying banks and the degree to which future defaults and deferrals would be required to occur before the cash flow for the Corporation s tranche is negatively impacted, that no other than temporary impairment exists.

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.

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CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the nine months ended September 30, 2010

(Unaudited)

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. The carrying amount of accrued interest receivable approximates its fair value.

Impaired Loans

Loans considered impaired, as defined in the Receivables topic of the ASC, are reserved for at the time the loan is identified as impaired taking into account the fair value of the collateral less estimated selling costs. Collateral may be real estate and/or business assets including but not limited to, equipment, inventory and accounts receivable. The fair value of real estate is determined based on appraisals by qualified licensed appraisers. The fair value of the business assets is generally based on amounts reported on the business financial statements. Appraised and reported values may be adjusted based on management s historical knowledge, changes in market conditions from the time of valuation and management s knowledge of the client and the client s business. Since not all valuation inputs are observable, these nonrecurring fair value determinations are classified Level 3. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors previously identified.

Other real estate owned

Other real estate owned (OREO) is comprised of commercial and residential real estate obtained in partial and total satisfaction of loan obligations. OREO acquired in settlement of indebtedness is recorded at fair value of the real estate, less costs to sell. Subsequently, it may be necessary to record nonrecurring fair value adjustments for decline in fair value. Fair value, when recorded, is determined based on appraisals by qualified licensed appraisers and adjusted for management s estimates of costs to sell. As such, values for OREO are classified as Level 3.

For assets measured at fair value on a nonrecurring basis during 2010 that were still held in the balance sheet at September 30, 2010, 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	$	$	$ 12,146,370	$ 12,146,370
Other real estate owned			3,011,376	3,011,376