



Dear Valued Stockholder:

On behalf of your Board of Directors, I am pleased to present to you the 2018 Annual Report of The Citizens Bank. Within these numbers is the continuing story of your bank's progress and growth; and by virtually any standard our performance this past year was very good. Not only does The Citizens Bank remain a leader in the State of Mississippi, but is also in the good company of the strongest, most secure banks in the nation.

First and foremost, let me provide two key measures of our bank's growth in 2018: Deposits increased by \$35.5 million, or 4.9% while Loans increased by \$23.8 million or 5.9%. These numbers reflect continued confidence in the deposit services we offer and indicates a pleasing uptick in lending activity that has been somewhat suppressed in recent years. The question we pose to ourselves...every year...is to define what it is that sets us apart and allows us to have prosperity beyond our peer banks.

We believe our customers, both consumer and commercial, want to do business with bankers who are knowledgeable, attentive and sincere in their efforts. Our wealth of good employees meet these criteria with singular purpose and a common thread of commitment to helping our customers reach lifetime goals. These employees conduct themselves under the premise of the Golden Rule: treating our customers as they would like to be treated.

Quality service is perhaps the most over-promised and under-delivered dynamic in business. The Citizens Bank, however, takes service seriously as we know that is what sets us apart. By working diligently to provide relationship-based, service-driven banking, our customers are truly being well served. Our C2C Service Standards define the commitment our employees share.

The Citizens Bank continues its sense of corporate citizenship and, in 2018, fulfilled commitments to support the communities in which we operate. Individually and collectively, we understand our role as an independent bank demands that we embrace the needs of the community in civic, charitable, educational, youth and economic development organizations. Our bankers often assume leadership roles in these organizations



GREG MCKEE, President and CEO

and our employees are generous with their time and resources to enhance the quality of life we share with friends and neighbors.

In recent years, identity theft and phishing have become far too common, threatening the financial well-being of virtually everyone in America. The Citizens Bank has invested in technologies that can help detect and deter phishing efforts and, through other technologies, we are reducing the opportunity for identity theft.

Of course, our core business of banking requires us to consistently address our existing products and financial services, and to introduce new services that enhance the banking experience of our customers and makes life a little easier. And, while personal service remains the signature of The Citizens Bank, we will continue to view, create and introduce technologies that accomplish those goals.

I thank you for your continuing support of The Citizens Bank. It is an honor to serve you and I look forward to a successful 2019.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Greg McKee', written in a cursive style.

Greg McKee  
President and CEO





**TREAT  
PEOPLE**



**TO BE  
TREATED.**



**We believe that customers want to do business with bankers who are knowledgeable, attentive and concerned. We are committed to providing professionals who are genuine and who have industry experience that will lead to achieving lifetime goals for our customers.**

The employees at The Citizens Bank live by the Golden Rule of treating people the way they want to be treated every time they report to work. Without exception, we share a common thread of commitment to be the financial resource our customers need to enhance their families' needs or to grow a business. We strive to have every member of our staff endlessly pursuing meeting the needs of our customers by:

- Developing personal relationships that create an exceptional customer experience.
- Building customer loyalty by providing innovative and technologically advanced products and services.
- Building trust by being transparent and accountable in all aspects of our banking activities.
- Going the extra mile for our customers; connecting with each through traditional face to face and digital banking solutions.
- Providing safe and secure banking in an era where identity theft has become the fastest-growing crime in the U.S.

In 2018 the bank implemented a formal customer service policy C2C Service Standards to ensure that customer service protocol is adhered to across all customer service touch points of the bank. C2C Service Standards is excellent customer service made simple. Banking is a customer service industry. Without customers, The Citizens Bank would not exist. Each point of contact with a customer forms a lasting impression, whether created by face-to-face contact, by phone, in writing, or through digital means.

## **To the customer, each employee is the bank. As employees, we must provide excellent service that exceeds the customer's expectations.**

Our employees interact with customers every day and it is imperative that we provide them with the tools and resources to answer questions and provide solutions to customer issues as they arise. We are committed to reinvesting in our employees by providing educational opportunities that foster personal and professional growth. Banking seminars, that guide our employees through the ever-changing regulatory environment, internal and external training programs, that enhance banking knowledge and skills, and job specific certifications, that recognize mastery in focused areas, are just a few of the ways we ensure our employees drive the success of our great company.

We continue to provide our employees with opportunities to plan for their financial health by offering an employee 401(k) plan. Other benefits include medical, dental, vision, disability and life insurance, along with many other quality add-ons they can choose from.

The bank continues to offer an employee Healthy You program. It provides employees with onsite and web-based information throughout the year on how to maintain a healthier life style.

Qualified health professionals provide information on age and gender specific health screening that include immunizations, cholesterol, blood pressure, blood sugar and BMI (weight) that helps gives them a clear picture of their overall health.





**OUR  
MANAGEMENT  
TEAM**



**REALIZES  
THAT  
THE  
BANK'S**



**MOST  
VALUABLE  
ASSET**



**IS ITS  
EMPLOYEES.**



## BOARD OF DIRECTORS

### Don Fulton

Retired  
W. G. Yates and Sons  
Construction Company

### Donald L. Kilgore

Special Assistant Attorney  
General, State of Mississippi

### David A. King

Proprietor,  
Philadelphia Motor Company

### Herbert A. King

Chairman,  
Civil Engineer, King  
Engineering Associates, Inc.

### Adam Mars

Business Manager,  
Mars, Mars, Mars & Chalmers

### Craig Dungan, MD

Physician,  
Meridian Gastroenterology  
PLLC

### Greg L. McKee

President & Chief Executive  
Officer,  
Citizens Holding Company  
and The Citizens Bank

### David P. Webb

Attorney,  
Baker, Donelson, Bearman,  
Caldwell & Berkowitz, PC

### A.T. Williams

Certified Public Accountant,  
A.T. Williams, CPA

### Terrell E. Winstead

Chief Financial Officer,  
Molpus Woodlands Group

## BANK OFFICERS

### Greg McKee

President  
& Chief Executive Officer

### Robert T. Smith

Senior Vice President  
& Chief Financial Officer

### Mark Taylor

Senior Vice President  
& Chief Operating Officer

### Ray Stone

Senior Vice President  
& Chief Credit Officer

### Liz Owen

Senior Vice President  
HR & Chief Risk Officer

### Ledale Reynolds

Senior Vice President  
& Chief Information Officer

### Erdis Chaney

Vice President  
& Senior Deposit Officer

### Jackie Hester

Vice President  
& Marketing Officer

### Jean Fulton

Vice President  
& Internal Auditor

### Darrel Bates

Vice President  
& Collections Manager

### Mark Majure

Vice President  
& Loan Review Officer

### Bob Posey

Vice President  
& Loan Officer

### Vicki Brown

Vice President  
& BSA Officer

### Stacy Arnold

Vice President  
& Compliance Officer

### Joshua Sullivan

Vice President  
& Senior Credit Analyst

### Ashley Peebles

Vice President  
& Director of Deposit Services

### Phillip Branch

Vice President

### Jamie Shotts

Vice President  
Appraisal Review Officer

### Beth Branning

Assistant Vice President  
& Purchasing Officer

### Sommer Vick

Assistant Vice President  
& Accounting Officer

### Mitch Peden

Assistant Vice President  
& Information Services  
Manager

### Scott Lewis

Assistant Vice President  
& Information Security Officer

### Sam Mars

Assistant Vice President  
& Loan Officer

### Pat Stokes

Assistant Vice President  
& Operations Officer

### Son Kirkland

Assistant Vice President  
& Security Officer/Facilities  
Manager

### Charles Wilkerson

Assistant Vice President  
& Loan Operations Officer

### Sandra Curtis

Assistant Cashier  
& Teller Administrator

### Temika Triplett

Assistant Cashier  
& Electronic Services Officer

### Greg Jackson

Accounting Officer

### Tammy Pope

Accounting Officer

### Deborah Ladd

Item Processing Officer

### Craig Stevens

Deposit Operations Manager

### Westside Branch

#### Mike Chandler

Vice President & Loan Officer

### Eastside Branch

#### Brad Copeland

Vice President  
& Branch Manager

### Carthage Branch

#### Mike Brooks

President

### Billy Cook

Vice President & Loan Officer

### Sue Fisher

Assistant Vice President  
& Deposit Operations Officer

### Sebastopol Branch

#### Connie Comans

President

### DeKalb & Scooba Branch

#### Reginald Moore

Assistant Vice President  
& Branch Manager

### Jan White

Branch Operations Officer

### Decatur Branch

#### Susan Brown

Deposit Operations Officer

### Kosciusko Branch

#### Teresa Patterson

Vice President  
& Branch Manager

### Meridian Eastgate Branch

#### James V. Hines

Vice President  
& Loan Officer

### Vikki Gunter

Assistant Vice President  
& Branch Operations Officer

### Annette Brooks

Assistant Cashier

### Forest Branch

#### Richard Latham

Vice President & Loan Officer

### Lawanda McCaughn

Deposit Operations Officer

### Louisville, Industrial &

#### Noxapater Branch

#### Bruce Lee

President



**Lynn Graham**  
Assistant Vice President  
& Branch Operations Officer

**Collinsville Branch**  
**Mike Shelby**  
Vice President  
& Branch Manager

**Starkville Branch**  
**Rhonda Edmonson**  
Assistant Vice President  
& Branch Operations Officer

**Hattiesburg Branch**  
**Chad Hill**  
Vice President  
& Branch Manager

**Tammy McAlpin**  
Commercial Loan Portfolio  
Manager

**Biloxi Cedar Lake**  
**Travis Moore**  
Regional President  
South Mississippi

**Brandon Sherwood**  
President Gulf Coast Region

**Katie Hancock**  
Vice President  
& Branch Manager

**Mortgage Loan  
Department**  
**David Blair**  
Vice President  
& Mortgage Loan Officer  
Kosciusko Branch

**Tammy Warren**  
Assistant Vice President  
& Mortgage Loan Officer  
Biloxi Lemoyne Branch

**Charlene DeWeese**  
Assistant Vice President  
& Mortgage Loan Officer  
Philadelphia Annex

**Oxford Loan Production  
Office**  
**Marion Boyd**  
Vice President  
& Regional Commercial  
Lender

## **BANKING LOCATIONS**

**Philadelphia Main Office**  
521 Main Street  
Philadelphia, MS 39350  
601.656.4692

**Westside Branch**  
912 West Beacon Street  
Philadelphia, MS 39350  
601.656.4978

**Northside Branch**  
802 Pecan Avenue  
Philadelphia, MS 39350  
601.656.4977

**Eastside Branch**  
599 East Main Street  
Philadelphia, MS 39350  
601.656.4976

**Union Branch**  
502 Bank Street  
Union, MS 39365  
601.774.9231

**Carthage Branch**  
301 West Main Street  
Carthage, MS 39051  
601.267.4525

**Sebastopol Branch**  
24 Pine Street  
Sebastopol, MS 39359  
601.625.7447

**Dekalb Branch**  
176 Main Avenue  
Dekalb, MS 39328  
601.743.2115

**Kosciusko Branch**  
775 North Jackson Street  
Kosciusko, MS 39090  
662.289.4356

**Scooba Branch**  
27597 Hwy 16 East  
Scooba, MS 39358  
662.476.8431

**Meridian Eastgate Branch**  
1825 Hwy 39 North  
Meridian, MS 39301  
601.693.8367

**Meridian Broadmoor Branch**  
5015 Hwy 493  
Meridian, MS 39305  
601.581.1541

**Decatur Branch**  
15330 Hwy 15 South  
Decatur, MS 39327  
601.635.2321

**Forest Branch**  
247 Woodland Drive North  
Forest, MS 39074  
601.469.3424

**Louisville Main**  
100 East Main Street  
Louisville, MS 39339  
662.773.6261

**Louisville Industrial Branch**  
803 South Church Street  
Louisville, MS 39339  
662.773.6261

**Noxapater Branch**  
45 East Main Street  
Noxapater, MS 39346  
662.724.4261

**Collinsville Branch**  
9065 Collinsville Road  
Collinsville, MS 39325  
601.626.7608

**Starkville Branch**  
201 Hwy 12 West  
Starkville, MS 39759  
662.323.1420

**Flowood Branch**  
5419 Hwy 25 North, Suite Q  
Flowood, MS 39232  
601.992.7688

**Hattiesburg Branch**  
6222 Highway 98  
Hattiesburg, MS 39402  
601.264.4425

**Biloxi Cedar Lake Branch**  
1830 Popp's Ferry RD  
Biloxi, MS 39532  
228.594.6913

**Lemoyne Blvd. Branch**  
15309 Lemoyne Boulevard  
Biloxi, MS 39532  
228.207.2343

**Oxford Loan Production  
Office**  
304 Enterprise Drive, Suite A  
Oxford, MS 38655  
662.550.4029



**As a community bank we strive to help our friends and neighbors fulfill their financial dreams. We also believe in working with communities to make lives better for its citizens and we value the financial needs of each person gracing our doorway.**

We make commitments each year to support our communities through financial contributions, along with employee volunteers, investing countless hours taking an active role working with civic organizations in the communities where they live and work. Employees participate in community health fairs, fall fun day programs for disabled children, blood drives, and Senior Citizens Day in local communities. Our bankers take leadership roles, and make monetary donations, and work many volunteer hours to support community organizations.

Organizations that our employees are active in include; Main Street Associations, The Salvation Army, American Cancer Society "Relay for Life", Kiwanis, Rotary, Boys and Girls Club, Diamond Dreams, little league sports programs, Boy Scouts, Girl Scouts, Lions Clubs, For the Children, volunteer fire departments, Open Arms, God's Closet, and Dolly Parton's Imagination Library, along with many other non-profits.



**WE BELIEVE IN  
WORKING WITH  
COMMUNITIES**



**TO MAKE  
LIVES BETTER  
FOR ITS  
CITIZENS.**







WE  
BELIEVE



IS IN  
THE  
CLASSROOM.





## **In 2018 we awarded a total of 14 Reward A's scholarships to Junior and Senior high school students and their schools totaling \$21,000.**

We continue to give back to local high schools through our School Stash debit card program. This past year customers who used their school's debit card as a credit transaction generated a total of \$38,000. Over 31 schools throughout Mississippi received funds from this program to help with school projects and programs.

During Teacher Appreciation Week we continued to provide lunches to teachers and employees in local school districts to show our appreciation for what they do to help prepare our youth for college or enter the workforce when they graduate.

Bank employees throughout the state participate annually in the Mississippi Scholars Initiative education program. This course path gives students a boost - not just for college but for life. The initiative pairs trained local business leaders with classes of 8th grade students. Travis Moore, Veronica Holmes, Lawanda McCaughn along with many other bankers participated in the Mississippi Bankers "A Banker in Every Classroom", presenting programs on budgeting and savings to students at Popp's Ferry Elementary, Philadelphia Elementary, and Forest Municipal Schools to name a few.

Bank employees attend high school career day events in their community's school districts to provide information on scholarships that the bank offers to high school juniors and seniors. During these events employees discuss banking options with students that can enhance their time management skills by taking advantage of online banking, mobile banking, C2C people pay, and mobile deposit on their smart phones.

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**"Thank you to the Citizens Bank for your School Stash Debit Card Program! Our community raised big \$\$\$\$...were able to purchase more Chromebooks to help teachers and students."**

SEBASTOPOL HIGH SCHOOL

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## **The Bank has implemented an artificial intelligence (AI) engine that learns unique communication patterns to identify and block real-time spear phishing attempts.**

The engine also helps to protect against domain spoofing and brand hijacking by collecting and analyzing DMARC data. The system also leverages the insights from its AI platform to identify and train high-risk individuals within the Bank through the use of simulated spear phishing attacks.

Hardware authentication devices that support one-time passwords, public-key encryption and authentication, and the Universal 2nd Factor protocol developed by the FIDO Alliance are now being used by key users throughout the Bank for multi-factor authentication. This technology allows users to securely log into their accounts by emitting one-time passwords or using a FIDO-based public/private key pair generated by the hardware device.

A greater emphasis has been placed on higher risk and key individuals throughout the Bank in Identity Management. Expanded controls have been put in place to protect the accounts of these individuals.

The Bank's Information Security Officer has been named the Mississippi Financial Services Sector Chief for InfraGard. InfraGard is a non-profit organization serving as a public-private partnership between U.S. businesses and the Federal Bureau of Investigation.



## IDENTIFYING AND BLOCKING



## REAL TIME PHISHING ATTACKS.





**OUR  
LENDERS**



**ALWAYS  
TAKE  
THE TIME**



**TO  
LISTEN  
TO THE**



**CUSTOMER'S  
NEEDS.**





## **Our mortgage lenders were busy assisting customers in the home buying process in 2018. Our mortgage lenders provide step-by-step instructions and information for potential homebuyers.**

Many times, customers who come in or call to inquire about a mortgage loan are first time home buyers. Our lenders always take the time to listen to the customer's needs and walk the buyer through the different types of mortgage loan options that are available to them.

The Citizens Bank has expanded the TCB ITM's (Interactive Teller Machines) to six additional branch locations. The addition of ITM's provide our customers an opportunity to move from traditional in-branch banking to banking from their automobile. Customers may drive up to an ATM and touch a screen to activate service. Our TCB Live Tellers are available for extended banking hours from 7:00 AM to 5:30 PM Monday - Friday.

C2C People Pay usage has continued to grow with our millennial customers as well with all age groups across our market. A survey conducted by Nerdwallet concluded that over 50% of people say they do not carry cash with them anymore, making C2C a very valuable tool that helps our customers pay others for yard work, lunch or sending their college student gas money.

As we continue to look for new and improved ways to serve the needs of our customers, and as technology evolves we will continue to stay abreast of new banking trends that will be of value to our customers. We are aware that technology will always be a changing force in the financial industry, but customer service will always be the driving source of our success. We will forever honor our customer service commitments and we will strive to under-promise and over-deliver, being thankful for every customer who walks through our doors.



**CITIZENS HOLDING COMPANY**

Philadelphia, Mississippi

Consolidated Financial Statements

As of December 31, 2018 and 2017 and for the  
Years Ended December 31, 2018, 2017 and 2016

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Citizens Holding Company

### Opinion on Financial Statement

We have audited the accompanying consolidated statements of financial condition of Citizens Holding Company and subsidiary (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive (loss) income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes to the consolidated financial statements (collectively, referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, are in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (the "PCAOB"), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in the *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 15, 2019, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

### Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 1998.

*Horne LLP*

Memphis, Tennessee  
March 15, 2019



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Citizens Holding Company

### Opinion on the Internal Control Over Financial Reporting

We have audited Citizens Holding Company and subsidiary's (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in the *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria for effective internal control over financial reporting described in the *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (the "PCAOB"), the consolidated financial statements of the Company as of December 31, 2018 and our report dated March 15, 2019 expressed an unqualified opinion.

### Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying Report on Management's Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*HORNE LLP*

Memphis, Tennessee

March 15, 2019



## Citizens Holding Company<sup>SM</sup>

### **Report on Management's Assessment of Internal Control over Financial Reporting**

Citizens Holding Company (the "Company") is responsible for the preparation, integrity and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with accounting principles generally accepted in the United States and necessarily include some amounts that are based on management's best estimates and judgments.

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. The Company's internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

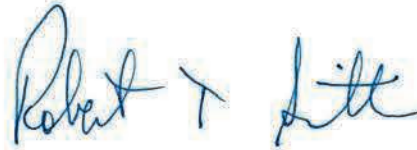
The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden, and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.



Management, with the participation of the Company's principal executive officer and principal financial officer, conducted an assessment of the effectiveness of the Company's system of internal control over financial reporting as of December 31, 2018, based on criteria for effective internal control over financial reporting described in the "Internal Control – Integrated Framework," (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management has concluded that, as of December 31, 2018, the Company's system of internal control over financial reporting is effective and meets the criteria of the "Internal Control – Integrated Framework". HORNE LLP, the Company's independent registered public accounting firm that has audited the Company's financial statements included in this annual report, has issued an attestation report on the Company's internal control over financial reporting which is included herein.



Greg L. McKee  
President and Chief Executive Officer



Robert T. Smith  
Treasurer and Chief Financial Officer

March 15, 2019

**CITIZENS HOLDING COMPANY**  
Consolidated Statements of Financial Condition  
December 31, 2018 and 2017

<b>ASSETS</b>	<b>2018</b>	<b>2017</b>
Cash and due from banks	\$ 12,592,130	\$ 17,962,990
Interest bearing deposits with other banks	8,079,742	1,532,420
Securities available for sale, at fair value (amortized cost of \$464,699,289 in 2018 and \$516,006,296 in 2017)	444,746,454	505,046,377
Loans, net of allowance for loan losses of \$3,371,695 in 2018 and \$3,019,228 in 2017	425,905,093	402,390,574
Bank premises, furniture, fixtures and equipment, net	19,717,305	20,571,551
Other real estate owned, net	3,440,148	3,980,127
Accrued interest receivable	4,165,783	4,450,723
Cash surrender value of life insurance	25,383,931	24,612,779
Deferred tax assets	6,633,539	5,362,750
Other assets	7,965,952	7,185,537
Total assets	\$ 958,630,077	\$ 993,095,828
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits		
Non-interest bearing deposits	\$ 170,029,729	\$ 159,291,356
Interest bearing deposits	586,191,781	561,394,143
Total deposits	756,221,510	720,685,499
Securities sold under agreement to repurchase	107,965,505	142,497,938
Federal Funds Purchased	-	1,500,000
Federal Home Loan Bank advances	-	30,000,000
Accrued interest payable	470,710	198,183
Deferred compensation payable	9,052,972	8,620,890
Other liabilities	1,053,063	1,142,278
Total liabilities	874,763,760	904,644,788
Shareholders' equity		
Common stock, \$.20 par value, authorized 22,500,000 shares; 4,904,530 shares issued and outstanding at December 31, 2018 and 4,894,705 shares issued and outstanding at December 31, 2017	980,906	978,941
Additional paid-in capital	4,298,499	4,103,139
Accumulated other comprehensive loss, net of tax benefit of (\$4,978,232) in 2018 and (\$2,734,500) in 2017	(14,974,603)	(8,225,419)
Retained earnings	93,561,515	91,594,379
Total shareholders' equity	83,866,317	88,451,040
Total liabilities and shareholders' equity	\$ 958,630,077	\$ 993,095,828

The accompanying notes are an integral part of these statements.

**CITIZENS HOLDING COMPANY**  
Consolidated Statements of Income  
Years Ended December 31, 2018, 2017, and 2016

	2018	2017	2016
Interest income			
Interest and fees on loans	\$ 20,241,255	\$ 18,733,676	\$ 19,012,157
Interest on securities			
Taxable	8,344,788	8,178,526	7,589,532
Non-taxable	2,579,431	3,319,234	3,382,064
Other interest	193,258	273,379	185,188
Total interest income	31,358,732	30,504,815	30,168,941
Interest expense			
Deposits	2,810,968	1,921,904	1,843,983
Other borrowed funds	1,647,724	1,420,635	1,253,574
Total interest expense	4,458,692	3,342,539	3,097,557
Net interest income	26,900,040	27,162,276	27,071,384
(Provision for) reversal of loan losses	(333,990)	543,138	65,056
Net interest income after (provision for) reversal of loan losses	26,566,050	27,705,414	27,136,440
Non-interest income			
Service charges on deposit accounts	4,562,293	4,238,525	3,788,984
Other service charges and fees	2,878,865	2,637,947	2,440,819
Net gains on sales of securities	11,047	104,708	112,881
Other income	1,147,561	1,314,964	1,348,916
Total non-interest income	8,599,766	8,296,144	7,691,600
Non-interest expense			
Salaries and employee benefits	14,530,499	14,772,438	13,696,985
Occupancy expense	2,016,758	2,174,839	2,079,529
Equipment expense	3,713,073	3,209,677	3,028,654
Other expense	7,404,629	8,070,465	7,674,483
Total non-interest expense	27,664,959	28,227,419	26,479,651
Income before income taxes	7,500,857	7,774,139	8,348,389
Income tax expense	827,730	4,070,591	1,611,735
Net income	\$ 6,673,127	\$ 3,703,548	\$ 6,736,654
Net income per share – basic	\$ 1.36	\$ 0.76	\$ 1.38
Net income per share – diluted	\$ 1.36	\$ 0.76	\$ 1.38
Average shares outstanding			
Basic	4,889,420	4,878,691	4,865,968
Diluted	4,899,218	4,895,848	4,875,638

The accompanying notes are an integral part of these statements.

**CITIZENS HOLDING COMPANY**  
Consolidated Statements of Comprehensive (Loss) Income  
Years Ended December 31, 2018, 2017, and 2016

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net income	\$ 6,673,127	\$ 3,703,548	\$ 6,736,654
Other comprehensive (loss) income			
Unrealized holding (losses) gains on available-for-sale securities	(8,981,869)	6,240,505	(16,938,482)
Income tax effect	2,240,976	(2,080,129)	6,318,053
Net unrealized (losses) gains	<u>(6,740,893)</u>	<u>4,160,376</u>	<u>(10,620,429)</u>
Unrealized losses on securities transferred from available-for-sale to held-to-maturity	-	-	-
Amortization of net unrealized losses transferred during the period	-	-	11,305,439
Income tax effect	-	-	(4,216,929)
	<u>-</u>	<u>-</u>	<u>7,088,510</u>
Reclassification adjustment for gains included in net income	(11,047)	(104,708)	(112,881)
Income tax effect	2,756	26,125	42,105
Net gains included in net income	<u>(8,291)</u>	<u>(78,583)</u>	<u>(70,776)</u>
Total other comprehensive (loss) income	<u>(6,749,184)</u>	<u>4,081,793</u>	<u>(3,602,695)</u>
Comprehensive (loss) income	<u>\$ (76,057)</u>	<u>\$ 7,785,341</u>	<u>\$ 3,133,959</u>

The accompanying notes are an integral part of these statements.

**CITIZENS HOLDING COMPANY**  
Consolidated Statements of Changes in Shareholders' Equity  
Years Ended December 31, 2018, 2017, and 2016

	<b>Number of Shares Issued</b>	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Accumulated Other</b>			<b>Total</b>
				<b>Comprehensive Income (Loss)</b>	<b>Retained Earnings</b>		
Balance, January 1, 2016	4,875,079	\$ 975,016	\$ 3,617,279	\$ (7,116,319)	\$ 88,949,360	\$	86,425,336
Net income	-	-	-	-	6,736,654		6,736,654
Dividends paid (\$0.93 per share)	-	-	-	-	(4,686,325)		(4,686,325)
Restricted stock granted	7,500	1,500	(1,500)	-	-		-
Stock compensation expense	-	-	186,425	-	-		186,425
Other comprehensive income, net	-	-	-	(3,602,695)	-		(3,602,695)
Balance, December 31, 2016	4,882,579	976,516	3,802,204	(10,719,014)	90,999,689		85,059,395
Net income	-	-	-	-	3,703,548		3,703,548
Dividends paid (\$0.96 per share)	-	-	-	-	(4,697,056)		(4,697,056)
Options exercised	4,626	925	91,700	-	-		92,625
Restricted stock granted	7,500	1,500	(1,500)	-	-		-
Stock compensation expense	-	-	210,735	-	-		210,735
AOCI reclassification	-	-	-	(1,588,198)	1,588,198		-
Other comprehensive income, net	-	-	-	4,081,793	-		4,081,793
Balance, December 31, 2017	4,894,705	978,941	4,103,139	(8,225,419)	91,594,379		88,451,040
Net income	-	-	-	-	6,673,127		6,673,127
Dividends paid (\$0.96 per share)	-	-	-	-	(4,705,991)		(4,705,991)
Options exercised	2,325	465	26,535	-	-		27,000
Restricted stock granted	7,500	1,500	(1,500)	-	-		-
Stock compensation expense	-	-	170,325	-	-		170,325
Other comprehensive income, net	-	-	-	(6,749,184)	-		(6,749,184)
Balance, December 31, 2018	4,904,530	\$ 980,906	\$ 4,298,499	\$ (14,974,603)	\$ 93,561,515	\$	83,866,317

The accompanying notes are an integral part of these statements.



**CITIZENS HOLDING COMPANY**  
Consolidated Statements of Cash Flows  
Years Ended December 31, 2018, 2017, and 2016

	2018	2017	2016
Cash flows from operating activities			
Net income	\$ 6,673,127	\$ 3,703,548	\$ 6,736,654
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	936,632	1,003,381	980,514
Amortization of premiums and accretion of discounts on investment securities, net	3,282,985	3,316,537	2,536,692
Stock compensation expense	170,325	210,735	186,425
Provision for (reversal of) loan losses	333,990	(543,138)	(65,056)
Gain on sale of securities	(11,047)	(104,707)	(112,881)
Federal Home Loan Bank stock dividends	(37,000)	(22,000)	(13,000)
Deferred income tax expense	972,944	3,885,194	673,977
Net writedown on other real estate owned	-	413,740	226,828
Decrease (increase) in accrued interest receivable	284,940	269,466	(792,128)
Increase in cash surrender value life insurance	(771,152)	(722,446)	(756,689)
Increase (decrease) in accrued interest payable	272,527	(1,185)	19,373
Increase in deferred compensation liability	432,082	411,463	490,803
Net change in other operating assets and liabilities	(368,550)	(1,200,936)	(32,599)
Net cash provided by operating activities	12,171,803	10,619,652	10,078,913
Cash flows from investing activities			
Proceeds from calls, paydowns and maturities of securities available-for-sale	40,964,130	42,390,364	130,181,028
Proceeds from calls of securities held-to-maturity	-	-	172,359,945
Proceeds from sales of securities available-for-sale	17,620,939	114,060,844	764,023
Purchases of investment securities available-for-sale	(10,550,000)	(162,449,043)	(379,291,499)
Purchases of bank premises, furniture, fixtures and equipment	(346,386)	(2,910,848)	(988,907)
Proceeds from sales of bank premises, furniture, fixtures and equipment	264,000	-	-
Proceeds from sale of other real estate owned	811,957	137,722	1,090,031
Net (increase) decrease in interest bearing deposits with other banks	(6,547,322)	47,070,762	(6,335,405)
Purchases of Federal Home Loan Bank Stock	(476,200)	(498,700)	(3,600)
Net (increase) decrease in loans	(24,108,368)	(11,787,672)	30,837,979
Net cash provided by (used by) investing activities	17,632,750	26,013,429	(51,386,405)

**CITIZENS HOLDING COMPANY**  
Consolidated Statements of Cash Flows  
Years Ended December 31, 2018, 2017, and 2016  
2 of 2

	2018	2017	2016
Cash flows from financing activities			
Net increase (decrease) in deposits	\$ 35,536,011	\$ (39,469,242)	\$ 6,749,953
Net (decrease) increase in federal funds purchased	(1,500,000)	1,500,000	-
Net (decrease) increase in securities sold under agreement to repurchase	(34,532,433)	(7,784,975)	45,984,731
Proceeds from exercise of stock options	27,000	92,625	-
Dividends paid to shareholders	(4,705,991)	(4,697,056)	(4,686,325)
Net (decrease) increase in Federal Home Loan Bank advances	(30,000,000)	10,000,000	-
Net cash (used in) provided by financing activities	(35,175,413)	(40,358,648)	48,048,359
Net (decrease) increase in cash and due from banks	(5,370,860)	(3,725,567)	6,740,867
Cash and due from banks, beginning of year	17,962,990	21,688,557	14,947,690
Cash and due from banks, end of year	<u>\$ 12,592,130</u>	<u>\$ 17,962,990</u>	<u>\$ 21,688,557</u>
Supplemental disclosures of cash flow information			
Cash paid for Interest	<u>\$ 4,186,165</u>	<u>\$ 3,343,724</u>	<u>\$ 3,078,184</u>
Income taxes	<u>\$ 410,000</u>	<u>\$ 1,781,790</u>	<u>\$ 1,692,201</u>
Noncash disclosures			
Real estate acquired by foreclosure	<u>\$ 259,859</u>	<u>\$ 88,579</u>	<u>\$ 2,187,125</u>

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

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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### **Note 1. Summary of Significant Accounting Policies**

#### Nature of Business

Citizens Holding Company (referred to herein as the “Company”) owns and operates The Citizens Bank of Philadelphia (the “Bank”). In addition to full service commercial banking, the Bank offers title insurance services through its subsidiary, Title Services LLC. As a state bank, the Bank is subject to regulations of the Mississippi Department of Banking and Consumer Finance and the Federal Deposit Insurance Company. The Company is also subject to the regulations of the Federal Reserve. The area served by the Bank is east central, several southern and northern counties of Mississippi and the surrounding areas. Services are provided at multiple branch offices.

#### Basis of Financial Statement Presentation

The accounting policies of the Company and its subsidiary conform to generally accepted accounting principles (“GAAP”) in the United States of America and to general practices within the banking industry. The consolidated financial statements of the Company include the accounts of the Bank and its subsidiary (collectively, the “Company”). All significant intercompany transactions have been eliminated in consolidation.

#### Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for loan losses and valuation of foreclosed real estate, management obtains independent appraisals for significant properties.

While management uses available information to recognize losses on loans and to value foreclosed real estate, future additions to the allowance or adjustments to the valuation may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses and valuations of foreclosed real estate. Such agencies may require the Company to recognize additions to the allowance or to make adjustments to the valuation based on their judgments about information available to them at the time of their examination. Due to these factors, it is reasonably possible that the allowance for loan losses and valuation of foreclosed real estate may change materially in the near term.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

Cash, Due from Banks and Interest Bearing Deposits with Other Banks

For the purpose of reporting cash flows, cash and due from banks includes cash on hand and demand deposits. Cash flows from loans originated by the Company, deposits, and federal funds purchased and sold are reported net in the statement of cash flows. The Company is required to maintain average reserve balances with the Federal Reserve Bank based on a percentage of deposits.

Interest-bearing deposits with other banks mature within one year and are carried at cost.

Investment Securities

In accordance with the investments topic of the Accounting Standards Codification (“ASC”), securities are classified as “available-for-sale,” “held-to-maturity” or “trading”. Fair values for securities are based on quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. Gains or losses on the sale of securities are determined using the specific identification method. Currently, the Company has no trading securities.

Securities Available-for-Sale

Securities that are held for indefinite periods of time or used as part of the Company’s asset/liability management strategy and that may be sold in response to interest rate changes, changes in prepayment risk, the need to increase regulatory capital and other similar factors are classified as available-for-sale (“AFS”). Securities available-for-sale are reported at fair value, with unrealized gains and losses reported, net of related income tax effect, as a separate component of shareholders’ equity.

Securities Held to Maturity

Securities that are held-to-maturity (“HTM”) are those securities that the Company has the positive intent and ability to hold until maturity. These securities cannot be sold in response to the risk factors discussed above for available for sale securities. These securities are reported at book value. As of December 31, 2018 and 2017, there were no securities classified as HTM.



**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings. The amortization of premiums and accretion of discounts are recognized in interest income.

The Company periodically reviews its securities for impairment based upon a number of factors, including but not limited to, length of time and extent to which the fair value has been less than cost, the likelihood of the security's ability to recover any decline in its fair value, financial condition of the underlying issuer, ability of the issuer to meet contractual obligations and ability to retain the security for a period of time sufficient to allow for recovery in fair value. Impairments on securities are recognized when management, based on its analysis, deems the impairment to be other-than-temporary. Disclosures about unrealized losses in the Company's securities portfolio that have not been recognized as other-than-temporary impairments are provided in Note 2.

Loans and Allowance for Loan Losses

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amount outstanding, net of unearned income and an allowance for loan losses. The Company has no loans held-for-sale.

Unearned income includes deferred fees net of deferred direct incremental loan origination cost. Unearned income attributable to loans held with a maturity of more than one year is recognized as income or expense over the life of the loan.

Unearned discounts on installment loans are recognized as income over the terms of the loans by a method that approximates the interest method. Unearned income and interest on commercial loans are recognized based on the principal amount outstanding. For all other loans, interest is accrued daily on the outstanding balances. For impaired loans, interest is discontinued on a loan when management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Cash collections on impaired loans are credited to the loan receivable balance, and no interest income is recognized on those loans until the principal balance has been collected. The Company generally discontinues the accrual of interest income when a loan becomes 90 days past due as to principal or interest; however, management may elect to continue the accrual when the estimated net realizable value of collateral is sufficient to cover the principal balance and the accrued interest. Interest income on other nonaccrual loans is recognized only to the extent of interest payments. Upon discontinuance of the accrual of interest on a loan, any previously accrued but unpaid interest is reversed against interest income.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

A loan is impaired when management determines that it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses.

Troubled debt restructurings ("TDR") are those for which concessions have been granted to the borrower due to a deterioration of the borrower's financial condition. Such concessions may include reduction in interest rates or deferral of interest or principal payments. In evaluating whether to restructure a loan, management analyzes the long-term financial condition of the borrower, including guarantor and collateral support, to determine whether the proposed concessions will increase the likelihood of repayment of principal and interest. TDR are classified as performing, unless they are on nonaccrual status of 90 days or more delinquent, in which case they are considered nonperforming.

The allowance for loan losses is established through a provision for loan losses charged against net income. Loans determined to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. The allowance represents an amount, which, in management's judgment, will be adequate to absorb estimated probable losses on existing loans that may become uncollectible. In order to determine an adequate level of allowance, management utilizes a model that calculates the allowance for loan loss by applying an average historical charge-off percentage by loan segment and over a 20 quarter period of time with the most current quarters weighted to show the effect of the most recent chargeoff activity to the current loan balances in the corresponding loan segment. Additionally, for loan balances over \$100,000, specific reserves on an individual loan basis may be applied in addition to the allowance calculated using the model. This specific reserve is determined by an extensive review of the borrower's credit history, capacity to pay, adequacy of collateral and general economic conditions related to the respective loan. This specific reserve will stay in place until such time that the borrower's obligation is satisfied or the loan is greatly improved.

Large groups of small-balance homogenous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

Bank Premises, Furniture, Fixtures and Equipment

The Company's premises, furniture, fixtures and equipment are stated at cost less accumulated depreciation computed by straight-line methods over the estimated useful lives of the assets, which range from three to forty years. Costs of major additions and improvements are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred.

Other Real Estate Owned

Other real estate owned ("OREO") consists of properties repossessed by the Company on foreclosed loans. These assets are stated at fair value at the date acquired less estimated costs to sell. Losses arising from the acquisition of such property are charged against the allowance for loan losses. Declines in value resulting from subsequent revaluation of the property or losses resulting from disposition of such property are expensed as incurred. Revenue and expenses from operations of other real estate owned are reflected as other income (expense).

Cash Surrender Value of Life Insurance

The Company has purchased life insurance contracts on certain employees and directors. Certain of such policies were acquired to fund deferred compensation arrangements with employees and directors. The cash surrender value of the Company owned policies is carried at the actual cash surrender value of the policy at the balance sheet date. Changes in the value of the policies are classified in non-interest income.

Intangible Assets

Intangible assets include core deposits purchased and goodwill. Core deposit intangibles are amortized on a straight-line basis over their estimated economic lives ranging from 5 to 10 years. At December 31, 2018, all core deposit intangibles had been fully amortized. Goodwill and other intangible assets with indefinite lives are not amortized but are tested at least annually for impairment. Fair values are determined based on market valuation multiples for the Company and comparable businesses based on the assets and cash flow of the Bank, the Company's only reportable segment. If impairment has occurred, the goodwill or other intangible asset is reduced to its estimated fair value through a charge to expense. At December 31, 2018 and 2017, the Company had \$3,149,657 in goodwill included in other assets.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

Trust Assets

Assets held by the trust department of the Company in its fiduciary or agency capacities are not assets of the Company and are not included in the consolidated financial statements.

Income Taxes

Provisions for income taxes are based on taxes payable or refundable for the current year and the changes in deferred tax assets and liabilities, excluding components of other comprehensive income. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Comprehensive (Loss) Income

Comprehensive (loss) income includes net earnings reported in the consolidated statements of income and changes in unrealized gain (loss) on securities available-for-sale reported as a component of shareholders' equity. Unrealized gain (loss) on securities available-for-sale, net of related income taxes, was the only component of accumulated other comprehensive income for the Company.



**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

Net Income Per Share

Net income per share-basic is computed by dividing net income by the weighted average number of common shares outstanding during the year. Net income per share-diluted is based on the weighted average number of shares of common stock outstanding for the periods, including the dilutive effect of the Company's outstanding stock options and restricted stock grants. The effect of the dilutive shares for the years 2018, 2017 and 2016 is illustrated in the following table.

	2018	2017	2016
Basic weighted average shares outstanding	4,889,420	4,878,691	4,865,968
Dilutive effect of stock options	9,798	17,157	9,670
Dilutive weighted average shares outstanding	4,899,218	4,895,848	4,875,638
Net income	\$6,673,127	\$3,703,548	\$6,736,654
Net income per share-basic	\$1.36	\$0.76	\$1.38
Net income per share-diluted	\$1.36	\$0.76	\$1.38

Advertising Costs

Advertising costs are charged to expense when incurred. Advertising expense was \$639,684, \$649,612 and \$783,303 for the years ended December 31, 2018, 2017 and 2016, respectively.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase are accounted for as collateralized financing transactions and are recorded at the amounts at which the securities were sold. Securities, generally United States Government, federal agency and state county municipal securities, pledged as collateral under these financing arrangements cannot be sold or re-pledged by the secured party.

Reclassifications

Certain information for 2016 and 2017 has been reclassified to conform to the financial presentation for 2018. Such reclassifications had no effect on net income or shareholders' equity.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

Stock-Based Compensation

At December 31, 2018, the Company had outstanding grants under two stock-based compensation plans, which are the 1999 Directors' Stock Compensation Plan and the 2013 Incentive Compensation Plan. Compensation expense for option grants and restricted stock awards is determined based on the estimated fair value of the stock options and restricted stock on the applicable grant or award date. The Company has elected to account for forfeitures in compensation cost when they occur as permitted under the guidance in ASC 718, "Compensation - Stock Compensation" ("ASC 718"). Expense associated with the Company's stock-based compensation is included under the line item "Salaries and benefits" on the Consolidated Statements of Income. The Company recognizes compensation expense for all share-based payments to employees in accordance with ASC 718, "Compensation – Stock Compensation." See Note 17 for further details regarding the Company's stock-based compensation.

Subsequent Events

The Company has evaluated, for consideration of recognition or disclosure, subsequent events that have occurred through the date of issuance of its financial statements, and has determined that no significant events occurred after December 31, 2018 but prior to the issuance of these financial statements that would have a material impact on its Consolidated Financial Statements.

Adoption of New Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "*Revenue from Contracts with Customers*" ("ASU 2014-09"), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Company on January 1, 2018. Adoption of ASU 2014-09 did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Company's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of OREO, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption however, periods prior to the date of adoption will not be retrospectively revised as the impact of the ASU on uncompleted contracts at the date of adoption was not material.

In January 2016, the FASB issued ASU No. 2016-01, "*Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*" ("ASU 2016-01"). The guidance affects the accounting for equity investments, financial liabilities under the fair

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

value option and the presentation and disclosure requirements of financial instruments. ASU 2016-01 was effective for the Company on January 1, 2018 and did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company does not hold any equity securities that are within the scope of ASU 2016-01. ASU 2016-01 also eliminates the disclosure of assumptions used to estimate fair value for financial instruments measured at amortized cost and requires disclosure of an exit price notion in determining the fair value of certain financial instruments prior to its changing to the exit price upon adoption of this standard in the first quarter of 2018. This ASU did not have any other implications to the Company at the time of adoption.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* ("ASU 2016-15"). ASU 2016-15 is intended to reduce the diversity in practice in how certain cash receipts and cash payments are presented and classified in the Consolidated Statement of Cash Flows, including (1) debt prepayment or debt extinguishment costs, (2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (3) contingent consideration payments made after a business combination, (4) proceeds from the settlement of insurance claims, (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (6) distributions received from equity method investees, (7) beneficial interests in securitization transactions and (8) separately identifiable cash flows and application of the predominance principle. The ASU was effective for the Company on January 1, 2018 and only impacts the presentation of specific items within the Consolidated Statement of Cash Flows and did not have a material impact to the Company.

In January 2017, FASB issued ASU 2017-01, *Business Combinations (Topic 805), Clarifying the Definition of a Business* ("ASU 2017-01"), that changes the definition of a business when evaluating whether transactions should be accounted for as the acquisition of assets or the acquisition of a business. ASU 2017-01 requires an entity to evaluate if substantially all of the fair value of the assets acquired are concentrated in a single asset or a group of similar identifiable assets; if so, the acquired assets or group of similar identifiable assets is not considered a business. In addition, the guidance requires that, to be considered a business, the acquired assets must include an input and a substantive process that together significantly contribute to the ability to create output. The ASU removes the evaluation of whether a market participant could replace any of the missing elements. ASU 2017-01 was effective for the Company on January 1, 2018 and is to be applied under a prospective approach. The Company expects the adoption of this new guidance to impact the determination of whether future acquisitions are considered business combinations.

In February 2018, FASB issued ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220)* ("ASU 2018-02"). The amendments in ASU 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings to eliminate the stranded tax effects in accumulated other comprehensive income resulting from the Tax Cuts

**CITIZENS HOLDING COMPANY**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

and Jobs Act. ASU 2018-02 will be effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period, for public companies for reporting periods for which financial statements have not yet been issued. The Company early adopted ASU 2018-02 as of December 31, 2017 and, as a result, reclassified \$1,588,198 from accumulated other comprehensive income to retained earnings as of December 31, 2017. The reclassification impacted the Consolidated Statements of Financial Condition and the Consolidated Statements of Changes in Shareholders' Equity as of and for the twelve months ended December 31, 2017.

Newly Issued, But Not Yet Effective Accounting Standards

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). The FASB issued this ASU to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current U.S. GAAP and disclosing key information about leasing arrangements. The new standard was adopted by the Company on January 1, 2019. ASU 2016-02 provides for a modified retrospective transition approach requiring lessees to recognize and measure leases on the balance sheet at the beginning of either the earliest period presented or as of the beginning of the period of adoption. The Company has elected to apply ASU 2016-02 as of the beginning of the period of adoption (January 1, 2019) and will not restate comparative periods. The Company expects that the adoption of ASU 2016-02 will result in the recognition of lease liabilities totaling \$700,000 to \$900,000 and the recognition of right-of-use assets totaling \$700,000 to \$900,000, which results in a 2- to 3-basis point decrease in the tier 1 capital to risk weighted assets ratio as of the date of adoption. The initial balance sheet gross up upon adoption is primarily related to operating leases of certain pieces of equipment. The Company has no material leasing arrangements for which it is the lessor of property or equipment. The Company has made an accounting policy election to not apply the recognition requirements in the new standard to short-term leases. The Company has elected to apply the package of practical expedients allowed by the new standard under which the Company need not reassess whether any expired or existing contracts are or contain leases, the Company need not reassess the lease classification for any expired or existing lease, and the Company need not reassess initial direct costs for any existing leases. The Company has also elected to use the practical expedient to make an accounting policy election for leases of certain underlying assets to include both lease and nonlease components as a single component and account for it as a lease. Adoption of ASU 2016-02 is not expected to materially change the Company's recognition of lease expense in future periods.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"). ASU 2016-13 makes significant changes to the accounting for credit losses on financial instruments and disclosures about them. The new current expected credit loss (CECL) impairment model will require an estimate of expected credit losses, measured over the contractual life of an instrument, which considers reasonable and supportable forecasts of future economic conditions in addition



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1. Continued**

to information about past events and current conditions. The standard provides significant flexibility and requires a high degree of judgment with regards to pooling financial assets with similar risk characteristics, determining the contractual terms of said financial assets and adjusting the relevant historical loss information in order to develop an estimate of expected lifetime losses. In addition, ASU 2016-13 amends the accounting for credit losses on debt securities and purchased financial assets with credit deterioration. The amendments in ASU 2016-13 are effective for fiscal years beginning after December 31, 2019, and interim periods within those years for public business entities that are SEC filers. The Company will adopt ASU 2016-13 on January 1, 2020. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018, however, the Company does not currently plan to early adopt the ASU. ASU 2016-13 permits the use of estimation techniques that are practical and relevant to the Company's circumstances, as long as they are applied consistently over time and faithfully estimate expected credit losses in accordance with the standard. The ASU lists several common credit loss methods that are acceptable such as a discounted cash flow method, loss-rate method and probability of default/loss given default (PD/LGD) method. Depending on the nature of each identified pool of financial assets with similar risk characteristics, the Company currently plans on implementing a PD/LGD method or a loss-rate method to estimate expected credit losses. The Company expects ASU 2016-13 to have a significant impact on the Company's accounting policies, internal controls over financial reporting and footnote disclosures. The Company has assessed its data and system needs and has begun designing its financial models to estimate expected credit losses in accordance with the standard. Further development, testing and evaluation of said models is required to determine the impact that adoption of this standard will have on the financial condition and results of operations of the Company.

In March 2017, FASB issued ASU 2017-08, *"Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities"* ("ASU 2017-08"). ASU 2017-08 requires the amortization period for certain callable debt securities held at a premium to be the earliest call date. ASU 2017-08 will be effective for interim and annual periods beginning after December 15, 2018. The Company is evaluating the effect that ASU 2017-08 will have on its financial position and results of operations and its financial statement disclosures.

In August 2018, FASB issued ASU 2018-13, *"Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement"* ("ASU 2018-13"). ASU 2018-13 is intended to improve the disclosures on fair value measurements by eliminating, amending and adding certain disclosure requirements. These changes are intended to reduce costs for preparers while providing more useful information for financial statement users. ASU 2018-13 will be effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the effect that ASU 2018-13 will have on its financial position and results of operations and its financial statement disclosures.

**CITIZENS HOLDING COMPANY**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 2. Investment Securities**

The amortized cost and estimated fair value of securities available-for-sale and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income at December 31, 2018 and 2017 were as follows:

<b>2018</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
Securities available-for-sale				
Obligations of U.S.				
Government agencies	\$ 99,365,930	\$ -	\$ 3,388,147	\$ 95,977,783
Mortgage-backed securities	259,742,501	4,921	12,373,269	247,374,153
State, County, Municipals	105,590,858	67,888	4,264,228	101,394,518
Total	<u>\$ 464,699,289</u>	<u>\$ 72,809</u>	<u>\$ 20,025,644</u>	<u>\$ 444,746,454</u>

<b>2017</b>	<b>Amortized Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
Securities available-for-sale				
Obligations of U.S.				
Government agencies	\$ 180,647,580	\$ -	\$ 4,199,022	\$ 176,448,558
Mortgage-backed securities	213,707,125	43,197	5,327,265	208,423,057
State, County, Municipals	118,786,297	849,364	2,535,126	117,100,535
Other investments	2,865,294	208,933	-	3,074,227
Total	<u>\$ 516,006,296</u>	<u>\$ 1,101,494</u>	<u>\$ 12,061,413</u>	<u>\$ 505,046,377</u>

During the 2<sup>nd</sup> quarter of 2018, management reclassified Small Business Administration Pools (“SBAP”) that are backed by mortgages from the Obligation of U.S. Government agencies portfolio to the Mortgage backed securities portfolio. This resulted in a reclassification of \$76,518,180 in securities and did not have an impact on shareholders’ equity or net income.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 2. Continued**

The following tables show the gross unrealized losses and fair value of the Company's investments classified as AFS investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2018 and 2017.

A summary of unrealized loss information for AFS securities, categorized by security type follows (in thousands):

December 31, 2018		Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	Unrealized	
		Losses		Losses		Losses	
Obligations of U.S.							
Government agencies	\$ -	-	\$ 95,977,783	3,388,147	\$ 95,977,783	3,388,147	
Mortgage backed securities	12,257,636	179,281	234,928,705	12,193,988	247,186,341	12,373,269	
State, County, Municipal	12,623,964	285,275	76,535,741	3,978,953	89,159,705	4,264,228	
Total	\$ 24,881,600	464,556	\$ 407,442,229	19,561,088	\$ 432,323,829	20,025,644	

December 31, 2017		Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	Unrealized	
		Losses		Losses		Losses	
Obligations of U.S.							
Government agencies	\$ 15,681,866	223,535	\$ 160,766,691	3,975,487	\$ 176,448,557	4,199,022	
Mortgage backed securities	88,499,852	1,613,091	116,753,236	3,714,175	205,253,088	5,327,266	
State, County, Municipal	7,117,600	59,041	66,973,174	2,476,084	74,090,774	2,535,125	
Total	\$ 111,299,318	1,895,667	\$ 344,493,101	10,165,746	\$ 455,792,419	12,061,413	

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 2. Continued**

**Investment Securities.**

The Company's unrealized losses on its Obligations of United States Government agencies, Mortgage backed securities and State, County and Municipal bonds are the result of an upward trend in interest rates, mainly in the mid-term sector. The Company does not intend to sell any of the securities in an unrealized loss position, and it is not more likely than not that the Company will be required to sell any such security prior to the recovery of its amortized cost basis, which may be at maturity. Furthermore, even though a number of these securities have been in a continuous unrealized loss position for a period greater than twelve months, the Company is collecting principal and interest from the respective issuers as scheduled. None of the unrealized losses disclosed in the previous table are related to credit deterioration. As such, the Company did not record any other-than-temporary impairment for the years ended December 31, 2018 or 2017.

**Other Investments.**

The Company, at December 31, 2017, owned an investment in a pooled trust preferred security. During 2018, the Company sold the pooled trust preferred security and no longer has any of these type of investments in its portfolio. The impact of the transaction is further detailed in Note 16.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 2. Continued**

The amortized cost and estimated fair value of securities at December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>Amortized Cost</b>	<b>Fair Value</b>
Securities AFS		
Due in one year or less	\$ 1,875,288	\$ 1,877,665
Due after one year through five years	91,948,838	89,121,194
Due after five years through ten years	32,801,788	31,718,293
Due after ten years	78,330,873	74,655,149
Residential mortgage backed securities	187,776,954	179,235,806
Commercial mortgage backed securities	71,965,548	68,138,347
	<u>\$ 464,699,289</u>	<u>\$ 444,746,454</u>
Total	<u>\$ 464,699,289</u>	<u>\$ 444,746,454</u>

Investment securities with fair values of \$357,231,440 and \$373,956,804 at December 31, 2018 and December 31, 2017, respectively, were pledged as collateral for public deposits and securities sold under agreement to repurchase.

Gross realized gains and losses are included in net gains on sales of securities. Total gross realized gains and gross realized losses from the sale of investment securities for each of the years ended December 31 were:

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Gross realized gains	\$ 171,376	\$ 633,244	\$ 112,881
Gross realized losses	160,329	528,536	-
	<u>\$ 11,047</u>	<u>\$ 104,708</u>	<u>\$ 112,881</u>
Net realized gains	<u>\$ 11,047</u>	<u>\$ 104,708</u>	<u>\$ 112,881</u>



**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 3. Federal Home Loan Bank Stock**

The Company, as a member of the Federal Home Loan Bank of Dallas (“FHLB”) system, owns stock in the organization. No ready market exists for the stock, and it has no quoted market value. The Company’s investment in the FHLB is carried at cost of \$2,253,400 and \$1,740,200 at December 31, 2018 and December 31, 2017, respectively, and is included in other assets. The Company purchased stock in 2018 and 2017 at the par value of \$100 per share.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Loans**

The composition of loans, net at December 31, 2018 and 2017 is as follows (in thousands):

	2018	2017
Real Estate:		
Land Development and Construction	\$ 41,134	\$ 25,923
Farmland	14,498	16,905
1-4 Family Mortgages	88,747	95,925
Commercial Real Estate	203,595	191,736
Total Real Estate Loans	347,974	330,489
Business Loans:		
Commercial and Industrial Loans	66,421	58,204
Farm Production and Other Farm Loans	907	922
Total Business Loans	67,328	59,126
Consumer Loans:		
Credit Cards	1,648	1,310
Other Consumer Loans	12,372	14,680
Total Consumer Loans	14,020	15,990
Total Gross Loans	429,322	405,605
Unearned Income	(45)	(195)
Allowance for Loan Losses	(3,372)	(3,019)
Loans, net	\$ 425,905	\$ 402,391

The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews these policies and procedures and submits them to the Company's Board of Directors for its approval when needed, but no less frequently than annually. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 4. Continued**

The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of this review are presented to management with quarterly reports made to the board of directors. The loan review process complements and reinforces the risk identification and assessment decisions made by the lenders and credit personnel, as well as the Company's policies and procedures.

Loans are made principally to customers in the Company's market. The Company's lending policy provides that loans collateralized by real estate are normally made with loan-to-value ("LTV") ratios of 80 percent or less. Commercial loans are typically collateralized by property, equipment, inventories or receivables with LTV ratios from 50 percent to 80 percent. Real estate mortgage loans are collateralized by personal residences with LTV ratios of 80 percent or less. Consumer loans are typically collateralized by real estate, vehicles and other consumer durable goods. Approximately \$67.5 million and \$48.7 million of the loans outstanding at December 31, 2018 and December 31, 2017, respectively, were variable rate loans.

In the ordinary course of business, the Company has granted loans to certain directors and their affiliates (collectively referred to as "related parties"). These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other unaffiliated persons and do not involve more than normal risk of collectability. Activity in related party loans during 2018 is presented in the following table.

Balance outstanding at December 31, 2017	\$ 3,117,526
Principal additions	518,154
Principal reductions	<u>(567,729)</u>
Balance outstanding at December 31, 2018	<u><u>\$ 3,067,951</u></u>

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.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 4. Continued**

Year-end non-accrual loans, segregated by class of loans, were as follows (in thousands):

	2018	2017
Real Estate:		
Land Development and Construction	\$ -	\$ -
Farmland	200	366
1-4 Family Mortgages	1,831	2,131
Commercial Real Estate	7,612	4,891
Total Real Estate Loans	<u>9,643</u>	<u>7,388</u>
Business Loans:		
Commercial and Industrial Loans	76	78
Farm Production and Other Farm Loans	31	32
Total Business Loans	<u>107</u>	<u>110</u>
Consumer Loans:		
Other Consumer Loans	89	84
Total Consumer Loans	<u>89</u>	<u>84</u>
 Total Nonaccrual Loans	 <u><u>\$ 9,839</u></u>	 <u><u>\$ 7,582</u></u>

In the event that non-accrual loans had performed in accordance with their original terms, the Company would have recognized additional interest income of approximately \$428,644, \$412,915 and \$651,560 in 2018, 2017 and 2016, respectively.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

An age analysis of past due loans, segregated by class of loans, as of December 31, 2018 is as follows (in thousands):

	Loans			Accruing Loans		
	Loans 30-89 Days Past Due	90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	90 or more Days Past Due
Real Estate:						
Land Development and Construction	\$ 1,494	\$ 54	\$ 1,548	\$ 39,586	\$ 41,134	\$ 54
Farmland	779	29	808	13,690	14,498	-
1-4 Family Mortgages	3,456	330	3,786	84,961	88,747	-
Commercial Real Estate	1,059	2,981	4,040	199,555	203,595	-
Total Real Estate Loans	6,788	3,394	10,182	337,792	347,974	54
Business Loans:						
Commercial and Industrial Loans	1,672	21	1,693	64,728	66,421	-
Farm Production and Other Farm Loans	9	-	9	898	907	-
Total Business Loans	1,681	21	1,702	65,626	67,328	-
Consumer Loans:						
Credit Cards	16	4	20	1,628	1,648	4
Other Consumer Loans	212	33	245	12,127	12,372	15
Total Consumer Loans	228	37	265	13,755	14,020	19
Total Loans	\$ 8,697	\$ 3,452	\$ 12,149	\$ 417,173	\$ 429,322	\$ 73



**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

An age analysis of past due loans, segregated by class of loans, as of December 31, 2017 is 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
Real Estate:						
Land Development and Construction	\$ 281	\$ -	\$ 281	\$ 25,642	\$ 25,923	\$ -
Farmland	93	-	93	16,812	16,905	-
1-4 Family Mortgages	2,657	-	2,657	93,268	95,925	-
Commercial Real Estate	2,585	862	3,447	188,289	191,736	807
Total Real Estate Loans	5,616	862	6,478	324,011	330,489	807
Business Loans:						
Commercial and Industrial Loans	32	-	32	58,172	58,204	-
Farm Production and Other Farm Loans	19	-	19	903	922	-
Total Business Loans	51	-	51	59,075	59,126	-
Consumer Loans:						
Credit Cards	25	6	31	1,279	1,310	6
Other Consumer Loans	422	-	422	14,258	14,680	-
Total Consumer Loans	447	6	453	15,537	15,990	6
Total Loans	\$ 6,114	\$ 868	\$ 6,982	\$ 398,623	\$405,605	\$ 813

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

Loans are considered impaired when, based on current information and events, it is probable the Company 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 filings and any situation that might lend itself to cause a borrower to be unable to repay the loan according to the original contract terms on those loans in excess of \$100,000. 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.

Impaired loans as of December 31, by class of loans, are as follows (in thousands):

		Unpaid	Recorded	Recorded	Total		Average
		Principal	Investment	Investment	Recorded	Related	Recorded
		Balance	With No	With	Investment	Allowance	Investment
	2018		Allowance	Allowance			
Real Estate:							
Land Development and Construction		\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Farmland		269	269	-	269	-	135
1-4 Family Mortgages		1,153	1,062	91	1,153	27	728
Commercial Real Estate		10,601	5,209	3,675	8,884	374	6,489
Total Real Estate Loans		12,023	6,540	3,766	10,306	401	7,352
Total Loans		\$ 12,023	\$ 6,540	\$ 3,766	\$ 10,306	\$ 401	\$ 7,352

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

			Recorded	Recorded			
	Unpaid	Investment	Investment	Total	Related	Average	
	Principal	With No	With	Recorded	Allowance	Recorded	
2017	Balance	Allowance	Allowance	Investment		Investment	
Real Estate:							
Land Development and Construction	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	
Farmland	-	-	-	-	-	62	
1-4 Family Mortgages	303	-	303	303	46	875	
Commercial Real Estate	5,616	-	4,093	4,093	397	4,710	
Total Real Estate Loans	5,919	-	4,396	4,396	443	5,647	
Total Loans	\$ 5,919	\$ -	\$ 4,396	\$ 4,396	\$ 443	\$ 5,647	

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

The following table presents troubled debt restructurings segregated by class (in thousands, except number of loans):

		Pre-Modification	Post-Modification
	Number of	Outstanding	Outstanding
	Loans	Recorded	Recorded
		Investment	Investment
December 31, 2018			
Commercial real estate	3	\$ 4,871	\$ 2,782
Total	3	\$ 4,871	\$ 2,782
December 31, 2017			
Commercial real estate	3	\$ 4,871	\$ 3,047
Total	3	\$ 4,871	\$ 3,047

Changes in the Company's troubled debt restructurings are set forth in the table below:

	Number of Loans	Recorded Investment
Total at January 1, 2016	3	\$ 3,858
Reductions due to:		
Principal paydowns		(570)
Total at January 1, 2017	3	3,288
Reductions due to:		
Principal paydowns		(241)
Total at January 1, 2018	3	3,047
Reductions due to:		
Principal paydowns		(265)
Total at December 31, 2018	3	\$ 2,782

The allocated allowance for loan losses attributable to restructured loans was \$174,274 at December 31, 2018 and 2017.

The Company had no remaining availability under commitments to lend additional funds on these troubled debt restructurings at December 31, 2018.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 4. Continued**

The Company 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 Company. 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 Company. 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.

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



**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 4. Continued**

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 that 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 December 31, 2018.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

The following table details the amount of gross loans by loan grade and class for the year ended December 31, 2018 (in thousands):

	Satisfactory 1,2,3,4	Mention 5,6	Substandard 7	Doubtful 8	Loss 9	Total Loans
Real Estate:						
Land Development and Construction	\$ 39,726	\$ 840	\$ 568	\$ -	\$ -	\$ 41,134
Farmland	13,248	339	911	-	-	14,498
1-4 Family Mortgages	79,659	1,751	7,337	-	-	88,747
Commercial Real Estate	172,217	17,938	13,440	-	-	203,595
Total Real Estate Loans	304,850	20,868	22,256	-	-	347,974
Business Loans:						
Commercial and Industrial Loans	63,994	81	2,346	-	-	66,421
Farm Production and Other Farm Loans	876	-	31	-	-	907
Total Business Loans	64,870	81	2,377	-	-	67,328
Consumer Loans:						
Credit Cards	1,628	-	20	-	-	1,648
Other Consumer Loans	12,181	65	71	55	-	12,372
Total Consumer Loans	13,809	65	91	55	-	14,020
Total Loans	\$ 383,529	\$ 21,014	\$ 24,724	\$ 55	\$ -	\$ 429,322

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

The following table details the amount of gross loans by loan grade and class for the year ended December 31, 2017 (in thousands):

	Satisfactory 1,2,3,4	Mention 5,6	Substandard 7	Doubtful 8	Loss 9	Total Loans
Real Estate:						
Land Development and Construction	\$ 23,720	\$ 2,116	\$ 87	\$ -	\$ -	\$ 25,923
Farmland	15,496	377	1,032	-	-	16,905
1-4 Family Mortgages	82,227	5,615	8,083	-	-	95,925
Commercial Real Estate	143,271	41,833	6,632	-	-	191,736
Total Real Estate Loans	264,714	49,941	15,834	-	-	330,489
Business Loans:						
Commercial and Industrial Loans	55,081	2,990	133	-	-	58,204
Farm Production and Other Farm Loans	853	9	60	-	-	922
Total Business Loans	55,934	2,999	193	-	-	59,126
Consumer Loans:						
Credit Cards	1,304	-	6	-	-	1,310
Other Consumer Loans	14,414	71	137	58	-	14,680
Total Consumer Loans	15,718	71	143	58	-	15,990
Total Loans	\$ 336,366	\$ 53,011	\$ 16,170	\$ 58	\$ -	\$ 405,605

The allowance for loan losses is a reserve established through a provision for possible loan losses charged to expense, which represents management's best estimate of probable losses that will occur 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 five 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 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.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 4. Continued**

Net chargeoffs (recoveries), segregated by class of loans, were as follows:

	2018	2017	2016
Real Estate:			
Land Development and Construction	\$ 55,908	\$ 97,685	\$ (17,677)
Farmland	2,702	-	(934)
1-4 Family Mortgages	51,303	40,682	154,387
Commercial Real Estate	(197,839)	-	2,387,956
Total Real Estate Loans	<u>(87,926)</u>	<u>138,367</u>	<u>2,523,732</u>
Business Loans:			
Commercial and Industrial Loans	<u>11,683</u>	<u>164,191</u>	<u>(8,230)</u>
Total Business Loans	<u>11,683</u>	<u>164,191</u>	<u>(8,230)</u>
Consumer Loans:			
Credit Cards	36,494	(6,654)	9,285
Other Consumer Loans	<u>21,272</u>	<u>44,526</u>	<u>(18,936)</u>
Total Consumer Loans	<u>57,766</u>	<u>37,872</u>	<u>(9,651)</u>
Total Net Chargeoffs	<u>\$ (18,477)</u>	<u>\$ 340,430</u>	<u>\$ 2,505,851</u>

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

The following table details activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2018, 2017 and 2016:

	Real Estate	Business Loans	Consumer	Total
<b>2018</b>				
Beginning Balance	\$ 2,151,715	\$ 346,781	\$ 520,732	\$ 3,019,228
Provision for (reversal of) loan losses	605,040	(113,257)	(157,793)	333,990
Chargeoffs	223,403	18,963	145,943	388,309
Recoveries	311,329	7,280	88,177	406,786
Net chargeoffs	(87,926)	11,683	57,766	(18,477)
Ending Balance	\$ 2,844,681	\$ 221,841	\$ 305,173	\$ 3,371,695

Period end allowance allocated to:

Loans individually evaluated for impairment	\$ 401,347	\$ -	\$ -	\$ 401,347
Loans collectively evaluated for impairment	2,443,334	221,841	305,173	2,970,348
Ending Balance	\$ 2,844,681	\$ 221,841	\$ 305,173	\$ 3,371,695

	Real Estate	Business Loans	Consumer	Total
<b>2017</b>				
Beginning Balance	\$ 3,117,134	\$ 257,554	\$ 528,108	\$ 3,902,796
(Reversal of) provision for loan losses	(827,052)	253,418	30,496	(543,138)
Chargeoffs	168,841	165,685	102,567	437,093
Recoveries	30,474	1,494	64,695	96,663
Net chargeoffs	138,367	164,191	37,872	340,430
Ending Balance	\$ 2,151,715	\$ 346,781	\$ 520,732	\$ 3,019,228

Period end allowance allocated to:

Loans individually evaluated for impairment	\$ 442,589	\$ -	\$ -	\$ 442,589
Loans collectively evaluated for impairment	1,709,126	346,781	520,732	2,576,639
Ending Balance	\$ 2,151,715	\$ 346,781	\$ 520,732	\$ 3,019,228



**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

	Real Estate	Business Loans	Consumer	Total
<b>2016</b>				
Beginning Balance	\$ 5,238,895	\$ 643,248	\$ 591,560	\$ 6,473,703
Provision for (reversal of) loan losses	401,971	(393,924)	(73,103)	(65,056)
Chargeoffs	2,567,499	8,035	65,311	2,640,845
Recoveries	43,767	16,265	74,962	134,994
Net chargeoffs	2,523,732	(8,230)	(9,651)	2,505,851
Ending Balance	\$ 3,117,134	\$ 257,554	\$ 528,108	\$ 3,902,796

Period end allowance allocated to:

Loans individually evaluated for impairment	\$ 749,090	\$ 37,803	\$ -	\$ 786,893
Loans collectively evaluated for impairment	2,368,044	219,751	528,108	3,115,903
Ending Balance	\$ 3,117,134	\$ 257,554	\$ 528,108	\$ 3,902,796

The Company's recorded investment in loans as of December 31, 2018 and 2017 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology was as follows (in thousands):

	Real Estate	Business Loans	Consumer	Total
<b>2018</b>				
Loans individually evaluated for impairment	\$ 10,306	\$ -	\$ -	\$ 10,306
Loans collectively evaluated for impairment	337,668	67,328	14,020	419,016
	\$ 347,974	\$ 67,328	\$ 14,020	\$ 429,322

	Real Estate	Business Loans	Consumer	Total
<b>2017</b>				
Loans individually evaluated for impairment	\$ 4,396	\$ -	\$ -	\$ 4,396
Loans collectively evaluated for impairment	326,093	59,126	15,990	401,209
	\$ 330,489	\$ 59,126	\$ 15,990	\$ 405,605

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 5. Bank Premises, Furniture, Fixtures and Equipment**

Bank premises, furniture, fixtures and equipment consist of the following at December 31, 2018 and December 31, 2017:

	<b>2018</b>	<b>2017</b>
Land and buildings	\$ 27,051,942	\$ 27,610,855
Furniture, fixtures and equipment	6,012,214	15,954,422
	33,064,156	43,565,277
Less accumulated depreciation	13,346,851	22,993,726
Total	<u>\$ 19,717,305</u>	<u>\$ 20,571,551</u>

Certain items within furniture, fixtures and equipment were deemed to be fully depreciated and no longer in use and were purged from furniture, fixtures and equipment during 2018.

Depreciation expense for the years ended December 31, 2018, 2017 and 2016, respectively, was \$936,632, \$1,003,381, and \$980,514.

**Note 6. Deposits**

The composition of deposits as of December 31, 2018 and December 31, 2017 is as follows:

	<b>2018</b>	<b>2017</b>
Non-interest bearing	\$ 170,029,729	\$ 159,291,356
NOW and money market accounts	298,220,430	306,047,053
Savings deposits	76,735,710	77,784,876
Time deposits, \$250,000 or more	65,406,835	36,237,241
Other time deposits	145,828,806	141,324,973
Total	<u>\$ 756,221,510</u>	<u>\$ 720,685,499</u>

The scheduled maturities of time deposits at December 31, 2018 are as follows:

<b>Year Ending December 31,</b>	<b>Amount</b>
2019	\$ 128,490,421
2020	36,889,571
2021	28,375,850
2022	2,865,242
2023	14,614,557
	<u>\$ 211,235,641</u>

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 7. Federal Home Loan Bank Advances**

Pursuant to collateral agreements with the FHLB, advances are collateralized by all of the Bank's FHLB stock (\$2,253,400 included in other assets at December 31, 2018) and qualifying first mortgages and other loans. As of December 31, 2018, the balance in qualifying first mortgages and other loans was \$171,252,131. At December 31, 2018 and December 31, 2017, advances from the FHLB, along with their rate and maturity date, consist of the following:

<b>Advance Amount at December 31,</b>		<b>Interest Rate</b>	<b>Final Maturity</b>
<b>2018</b>	<b>2017</b>		
\$ -	20,000,000	2.53	January 9, 2018
-	10,000,000	1.60	January 5, 2018

The scheduled payments for the next five years are as follows:

<b>Year Due</b>	<b>Payment</b>
2019	\$ -
2020	-
2021	-
2022	-
2023	-

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 8. Other Income and Other Expense**

The following is a detail of the major income classifications that are included in other income under non-interest income on the income statement for the year ended December 31:

Other Income	2018	2017	2016
BOLI Insurance	\$ 495,290	\$ 528,425	\$ 511,854
Mortgage Loan Origination Income	362,712	340,395	451,476
Other Income	289,559	446,144	385,586
Total Other Income	<u>\$ 1,147,561</u>	<u>\$ 1,314,964</u>	<u>\$ 1,348,916</u>

The following is a detail of the major expense classifications that comprise the other expense line item in the income statement for the years ended December 31:

Other Operating Expense	2018	2017	2016
Advertising	\$ 639,684	\$ 649,612	\$ 783,303
Office Supplies	975,428	1,008,541	702,705
Legal and Audit Fees	560,594	515,273	497,986
FDIC and State Assessment	350,502	417,047	702,705
Telephone Expense	520,081	529,747	446,628
Postage and Freight	566,723	544,722	499,611
Loan Collection Expense	287,921	471,779	380,093
Other Losses	243,461	463,415	445,792
Debit Card/ATM expense	470,606	413,058	378,748
Travel and Convention	207,007	254,594	254,229
Other expenses	2,582,622	2,802,677	2,582,683
Total Other Expense	<u>\$ 7,404,629</u>	<u>\$ 8,070,465</u>	<u>\$ 7,674,483</u>

Other losses in 2018, 2017 and 2016 include the write-down on OREO in the amount of \$-0-, \$234,042 and \$220,419, respectively.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 9. Income Taxes**

The consolidated provision for income taxes consists of the following:

	2018	2017	2016
Current (benefit) payable			
Federal	\$ (180,733)	\$ 257,886	\$ 884,743
State	35,519	(72,489)	53,015
	(145,214)	185,397	937,758
Deferred tax expense	972,944	3,885,194	673,977
Income tax expense	\$ 827,730	\$ 4,070,591	\$ 1,611,735

The differences between income taxes calculated at the federal statutory rate and income tax expense were as follows:

	2018	2017	2016
Federal taxes based on statutory rate	\$ 1,575,180	\$ 2,643,207	\$ 2,838,452
State income taxes, net of federal benefit	133,013	(47,843)	46,972
Tax-exempt investment interest	(486,893)	(1,074,443)	(1,133,970)
Revaluation of net deferred tax assets as a result of the Tax Cuts and Jobs Act	-	2,558,859	-
Other, net	(393,570)	(9,189)	(139,719)
Income tax expense	\$ 827,730	\$ 4,070,591	\$ 1,611,735

The Tax Cuts and Jobs Act (the “Tax Act”), enacted on December 22, 2017, among other things, permanently lowered the statutory federal corporate tax rate from 35% to 21%, effective for tax years including or beginning January 1, 2018. Under the guidance of ASC 740, “Income Taxes” (“ASC 740”), the Company revalued its net deferred tax assets on the date of enactment based on the reduction in the overall future tax benefit expected to be realized at the lower tax rate implemented by the new legislation. After reviewing the Company's inventory of deferred tax assets and liabilities on the date of enactment and giving consideration to the future impact of the lower corporate tax rates and other provisions of the new legislation, the Company's revaluation of its net deferred tax assets was \$2,558,859, which was included in “Income tax expense” in the Consolidated Statements of Income for the year ended December 31, 2017.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 9. Continued**

At December 31, 2018 and December 31, 2017, net deferred tax assets consist of the following:

	<b>2018</b>	<b>2017</b>
Deferred tax assets		
Allowance for loan losses	\$ 841,238	\$ 753,297
Deferred compensation liability	2,418,290	2,150,913
Alternative minimum tax credit	-	667,280
Unrealized loss on securities available-for-sale	4,978,232	2,734,500
Other	435,102	608,913
Total	8,672,862	6,914,903
Deferred tax liabilities		
Premises and equipment	1,856,404	1,358,165
Other	182,919	193,988
Total	2,039,323	1,552,153
Net deferred tax asset	\$ 6,633,539	\$ 5,362,750

The net deferred tax asset was \$6,633,539 and \$5,362,750 at December 31, 2018 and 2017, respectively. The Company has evaluated the need for a valuation allowance related to the above deferred tax assets and, based on the weight of the available evidence, has determined that it is more likely than not that all deferred tax assets will be realized.

As of December 31, 2018, the Company has no unrecognized tax benefits related to federal and state income tax matters. As of December 31, 2018, the Company has not accrued for interest and penalties related to uncertain tax positions. It is the Company's policy to recognize interest or penalties related to income tax matters in income tax expense.

The Company and the Bank file a consolidated United States federal income tax return. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2015 through 2017. The Company and Bank's state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2015 through 2017.



**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 10. Summarized Financial Information of Citizens Holding Company**

Summarized financial information of Citizens Holding Company, excluding the Bank, at December 31, 2018 and December 31, 2017, and for the years ended December 31, 2018, 2017 and 2016, is as follows:

**Balance Sheets**  
December 31, 2018 and 2017

	2018	2017
Assets		
Cash <sup>(1)</sup>	\$ 1,595,939	\$ 2,369,429
Investment in bank subsidiary <sup>(1)</sup>	82,002,089	85,729,466
Other assets <sup>(1)</sup>	268,289	352,145
Total assets	<u>\$ 83,866,317</u>	<u>\$ 88,451,040</u>
Liabilities		
Other liabilities	\$ -	\$ -
Shareholders' equity	83,866,317	88,451,040
Total liabilities and shareholders' equity	<u>\$ 83,866,317</u>	<u>\$ 88,451,040</u>

<sup>(1)</sup> Fully or partially eliminates in consolidation.

**Income Statements**  
Years Ended December 31, 2018, 2017 and 2016

	2018	2017	2016
Interest income <sup>(1)</sup>	\$ 2,255	\$ 1,902	\$ 2,379
Other income			
Dividends from bank subsidiary <sup>(1)</sup>	3,990,000	5,472,000	4,104,001
Equity in undistributed earnings (loss) of bank subsidiary <sup>(1)</sup>	3,021,807	(1,348,757)	2,845,152
Other income	-	-	-
Total other income	<u>7,014,062</u>	<u>4,123,243</u>	<u>6,951,532</u>
Other expense	<u>445,938</u>	<u>459,935</u>	<u>355,256</u>
Income before income taxes	6,568,124	3,665,210	6,596,276
Income tax benefit	<u>(105,003)</u>	<u>(38,338)</u>	<u>(140,378)</u>
Net income	<u>\$ 6,673,127</u>	<u>\$ 3,703,548</u>	<u>\$ 6,736,654</u>

<sup>(1)</sup> Eliminates in consolidation.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 10. Continued**

**Statements of Cash Flows**  
Years Ended December 31, 2018, 2017 and 2016

	2018	2017	2016
Cash flows from operating activities			
Net income	\$ 6,673,127	\$ 3,703,548	\$ 6,736,654
Adjustments to reconcile net income to net cash provided by operating activities			
Equity in undistributed (earnings) loss of the Bank	(3,021,807)	1,348,757	(2,845,152)
Stock compensation expense	170,325	210,735	186,425
Increase (decrease) in other assets	83,856	265,925	(143,602)
Net cash provided by operating activities	3,905,501	5,528,965	3,934,325
Cash flows from financing activities			
Dividends paid to shareholders	\$ (4,705,991)	\$ (4,697,056)	\$ (4,686,325)
Proceeds from stock option exercises	27,000	92,625	-
Net cash used in financing activities	(4,678,991)	(4,604,431)	(4,686,325)
Net (decrease) increase in cash	(773,490)	924,534	(752,000)
Cash, beginning of year	2,369,429	1,444,895	2,196,895
Cash, end of year	\$ 1,595,939	\$ 2,369,429	\$ 1,444,895

The Bank is required to obtain approval from state regulators before paying dividends.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 11. Related Party Transactions**

The Company had, and may have in the future, banking transactions in the ordinary course of business with directors, significant shareholders, principal officers, their immediate families, and affiliated companies in which they are principal shareholders (commonly referred to as related parties). In management's opinion, such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties, and do not involve more than the normal risk of collectability at the time of the transaction.

Activity in related party loans is detailed in tabular form in Note 4 of the notes to the Financial Statements.

Deposits from related parties at December 31, 2018 and December 31, 2017 approximated \$5,605,733 and \$6,553,975, respectively.

**Note 12. Off-Balance Sheet Financial Instruments, Commitments and Contingencies and Concentrations of Risks**

Commitments to Extend Credit

In the ordinary course of business, the Company makes various commitments and incurs certain contingent liabilities to fulfill the financing needs of its customers. These commitments and contingent liabilities include commitments to extend credit and issue standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. At December 31, 2018 and December 31, 2017, commitments related to unused lines of credit were \$58,835,208 and \$46,405,869, respectively, and standby letters of credit were \$2,516,810 and \$2,842,010, respectively. The fair value of such commitments is not materially different than stated values. As some of these commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Company applies the same credit policies and standards as it does in the lending process when making these commitments. The collateral obtained is based upon the assessed credit worthiness of the borrower. Collateral held varies, but may include accounts receivable, crops, livestock, inventory, property and equipment, residential real estate and income-producing commercial properties.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 12. Continued**

Interest Rate Risk

The Company is principally engaged in providing short-term and medium-term installment, commercial and agricultural loans with interest rates that are fixed or fluctuate with the prime lending rate. These assets are primarily funded through short-term demand deposits and long-term certificates of deposit with variable and fixed rates. Accordingly, the Company is exposed to interest rate risk because in changing interest rate environments interest rate adjustments on assets and liabilities may not occur at the same time or in the same amount. The Company manages the overall rate sensitivity and mix of its asset and liability portfolio and attempts to minimize the effects that interest rate fluctuations will have on its net interest margin.

Legal Proceedings

We are a party to various legal proceedings such as claims and lawsuits arising in the course of our normal business activities. Although the ultimate outcome of all claims and lawsuits outstanding as of December 31, 2018 cannot be ascertained at this time, it is the opinion of management that these matters, when resolved, will not have a material adverse effect on our business, results of operations or financial condition.

Concentration of Risk

The Company makes agricultural, agribusiness, commercial, residential and consumer loans primarily in eastern central and southern Mississippi. A substantial portion of the customers' abilities to honor their contracts is dependent on their business and the agricultural economy in the area.

Although the Company's loan portfolio is diversified, there is a relationship in this region between the agricultural economy and the economic performance of loans made to nonagricultural customers. The Company's lending policies for agricultural and nonagricultural customers require loans to be well-collateralized and supported by cash flows. Collateral for agricultural loans includes equipment, crops, livestock, and land. Credit losses from loans related to the agricultural economy are consistent with credit losses experienced in the portfolio as a whole. The concentration of credit in the regional agricultural economy is taken into consideration by management in determining the allowance for loan losses. See Note 4 for a summary of loans by type.

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 13. Lease Commitment and Total Rental Expense**

The Company has operating leases under non-cancellable operating lease agreements for banking facilities and equipment. Future minimum rental payments due under the leases are as follows:

<b>Years Ending December 31,</b>	<b>Amounts</b>
2019	\$ 291,676
2020	216,528
2021	216,528
2022	216,528
2023	47,508
	<u>\$ 988,768</u>

The total rental expense included in the income statements for the years ended December 31, 2018, 2017 and 2016 is \$76,096, \$107,418 and \$118,805, respectively.

**Note 14. Benefit Plans**

The Company provides its employees with a profit sharing and savings plan, which allows employees to direct a percentage of their compensation into a tax deferred retirement account, subject to statutory limitations. To encourage participation, the Company provides a 50 percent matching contribution for up to a maximum of 3 percent of each participant's compensation, plus discretionary non-matching contributions. Employees are eligible after one year of service. For 2018, 2017 and 2016, the Company's contributions were \$590,002, \$538,495 and \$520,488, respectively.

Deferred Compensation Plans

The Company provides a deferred compensation plan covering its directors. Participants in the deferred compensation plan can defer a portion of their compensation for payment after attaining age 70. Life insurance contracts have been purchased which may be used to fund payments under the plan. Expenses related to this plan were \$194,146, \$189,966 and \$183,824 for the plan years ended December 31, 2018, 2017 and 2016, respectively.

The Company has also entered into deferred compensation arrangements with certain officers that provide for payments to such officers or their survivors after retirement. Life insurance policies have been purchased that may be used to fund all or a portion of the payments under these arrangements. The obligations of the Company under both the directors and officers deferred compensation arrangements are expensed on a systematic basis over the remaining expected service period of the individual directors and officers. Expenses related to this plan were \$535,489, \$521,991 and \$584,319 for the plan years ended December 31, 2018, 2017 and 2016, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 15. Regulatory Matters**

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on the Company.

Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines involving quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total capital and Tier I capital to risk-weighted assets (as defined in the regulations) and Tier I capital to average assets (as defined in the regulations). Management believes, as of December 31, 2018, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

The FRB, FDIC and other federal banking agencies have established risk-based capital adequacy guidelines. These guidelines are intended to provide a measure of a bank's capital adequacy that reflects the degree of risk associated with a bank's operations.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance sheet items. Since December 31, 1992, the federal banking agencies have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance sheet items of 4%.

The Dodd-Frank Act requires the FRB, the Office of the Comptroller of the Currency ("OCC") and the FDIC to adopt regulations imposing a continuing "floor" on the risk based capital requirements. In December 2010, the Basel Committee released a final framework for a strengthened set of capital requirements, known as "Basel III". In July 2013, each of the U.S. federal banking agencies adopted final rules relevant to us: (1) the Basel III regulatory capital reforms; and (2) the "standardized approach of Basel II for non-core banks and bank holding companies, such as the Bank and the Company. The capital framework under Basel III will replace the existing regulatory capital rules for all banks, savings associations and U.S. bank holding companies with greater than \$500 million in total assets, and all savings and loan holding companies.



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 15. Continued**

Beginning January 1, 2015, the Bank began to comply with the Basel III rules, which became effective on January 1, 2019. Among other things, the Basel III rules impact regulatory capital ratios of banking organizations in the following manner:

- Create a new requirement to maintain a ratio of common equity Tier 1 capital to total risk-weighted assets of not less than 4.5%;
- Increase the minimum leverage ratio to 4% for all banking organizations (currently 3% for certain banking organizations);
- Increase the minimum Tier 1 risk-based capital ratio from 4% to 6%; and
- Maintain the minimum total risk-based capital ratio at 8%.

In addition, the Basel III rules will subject a banking organization to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization did not maintain a capital conservation buffer of common equity Tier 1 capital in an amount greater than 2.5% of its total risk-weighted assets. The capital conservation buffer increases the minimum common equity Tier 1 capital ratio to 7%, the minimum Tier 1 risk-based capital ratio to 8.5% and the minimum total risk-based capital ratio to 10.5% for banking organizations seeking to avoid the limitations on capital distributions and discretionary bonus payments to executive officers.

The Basel III rules also changed the capital categories for insured depository institutions for purposes of prompt corrective action. Under the rules, to be well capitalized, an insured depository institution must maintain a minimum common equity Tier 1 capital ratio of at least 6.5%, a Tier 1 risk-based capital ratio of at least 8%, a total risk-based capital ratio of at least 10.0%, and a leverage capital ratio of at least 5%. In addition, the Basel III rules established more conservative standards for including an instrument in regulatory capital and imposed certain deductions from and adjustments to the measure of common equity Tier 1 capital.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 15. Continued**

As of December 31, 2018 and 2017, the most recent regulatory notification categorized the Bank as well capitalized. There have been no conditions or events that would cause changes to the capital structure of the Company since this notification. To continue to be categorized as well capitalized under the regulatory framework for prompt corrective action, the Company would have to maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as disclosed below, in comparison with actual capital amounts and ratios (amounts in thousands):

	Actual		Minimum Capital Requirement to be Well Capitalized		Minimum Capital Requirement to be Adequately Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2018</b>						
Citizens Holding Company						
Tier 1 leverage ratio	\$ 95,691	9.93%	\$ 48,191	5.00%	\$ 38,553	4.00%
Common Equity tier 1 capital ratio	95,691	9.93%	62,648	6.50%	43,372	4.50%
Tier 1 risk-based capital ratio	95,691	17.41%	43,966	8.00%	32,974	6.00%
Total risk-based capital ratio	99,063	18.03%	54,957	10.00%	43,966	8.00%
The Citizens Bank of Philadelphia						
Tier 1 leverage ratio	\$ 93,827	9.74%	\$ 48,178	5.00%	\$ 38,542	4.00%
Common Equity tier 1 capital ratio	93,827	9.74%	62,631	6.50%	43,360	4.50%
Tier 1 risk-based capital ratio	93,827	17.08%	43,944	8.00%	32,958	6.00%
Total risk-based capital ratio	97,199	17.69%	54,930	10.00%	43,944	8.00%
<b>December 31, 2017</b>						
Citizens Holding Company						
Tier 1 leverage ratio	\$ 93,527	9.17%	\$ 51,005	5.00%	\$ 40,804	4.00%
Common Equity tier 1 capital ratio	93,527	9.17%	66,307	6.50%	45,905	4.50%
Tier 1 risk-based capital ratio	93,527	17.93%	41,737	8.00%	31,303	6.00%
Total risk-based capital ratio	96,546	18.51%	52,171	10.00%	41,737	8.00%
The Citizens Bank of Philadelphia						
Tier 1 leverage ratio	\$ 89,243	8.75%	\$ 50,978	5.00%	\$ 40,782	4.00%
Common Equity tier 1 capital ratio	89,243	8.75%	66,271	6.50%	45,880	4.50%
Tier 1 risk-based capital ratio	89,243	17.12%	41,708	8.00%	31,281	6.00%
Total risk-based capital ratio	92,262	17.70%	52,136	10.00%	41,708	8.00%

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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### **Note 16. Fair Values of Financial Instruments**

Under the authoritative guidance on fair value measurements, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the three following categories:

- |         |  |
|---------|--|
| 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 Company used the following methods and assumptions to estimate the fair value of financial instruments that are measured at fair value on a recurring basis:

#### Investment Securities

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

As of December 31, 2017, the Company owned certain beneficial interests in one collateralized debt obligation secured by community bank trust preferred securities. These interests do not trade in a liquid market, and therefore, market quotes are not a reliable indicator of their ultimate realizability. The Company utilized a discounted cash flow model using inputs of (1) market yields of trust-preferred securities as the discount rate and (2) expected cash flows which are estimated using assumptions related to defaults, deferrals and prepayments to determine the fair values of these beneficial interests. Many of the factors that adjust the timing and extent of cash flows are based on judgment and not directly observable in the markets. Therefore, these fair

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 16. Continued**

values were classified as Level 3 valuations for accounting and disclosure purposes. Since observable transactions in these securities are extremely rare, the Company used assumptions that a market participant would use in valuing these instruments. These assumptions primarily include cash flow estimates and market discount rates. The cash flow estimates are sensitive to the assumptions related to the ability of the issuers to pay the underlying trust preferred securities according to their terms. The market discount rates depend on transactions, which are rare given the lack of interest of investors in these types of beneficial interests.

The following table presents investment securities that are measured at fair value on a recurring basis as of December 31, 2018:

	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	\$ -	\$ 95,977,783	\$ -	\$ 95,977,783
Mortgage-backed securities	-	247,374,153	-	247,374,153
State, County, Municipals	-	101,394,518	-	101,394,518
	<u>\$ -</u>	<u>\$ 444,746,454</u>	<u>\$ -</u>	<u>\$ 444,746,454</u>

The following table presents investment securities that are measured at fair value on a recurring basis as of December 31, 2017:

	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	\$ -	\$ 176,448,558	\$ -	\$ 176,448,558
Mortgage-backed securities	-	208,423,057	-	208,423,057
State, County, Municipals	-	117,100,535	-	117,100,535
Other Investments	-	-	3,074,227	3,074,227
	<u>\$ -</u>	<u>\$ 501,972,150</u>	<u>\$ 3,074,227</u>	<u>\$ 505,046,377</u>

**CITIZENS HOLDING COMPANY**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 16. Continued**

The following table reports the activity in assets measured at fair value on a recurring basis using significant unobservable inputs, during the years ended December 31, 2018 and December 31, 2017.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	2018	2017
Balance at January 1	\$ 3,074,227	\$ 2,971,106
Sales	\$ (2,865,294)	
Principal payments received	-	(4,466)
Unrealized loss included in other comprehensive income	(208,933)	107,587
Balance at December 31	\$ -	\$ 3,074,227

The Company recorded no gains or losses in earnings for the period ended December 31, 2018 and 2017 that were attributable to the change in unrealized gains or losses relating to assets still held at the reporting date.

**Impaired Loans**

Loans considered impaired 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's 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 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. The unobservable inputs may vary depending on the individual assets with the fair value of real estate based on appraised value being the predominant approach. The Company reviews the certified appraisals for appropriateness and adjusts the value downward to consider selling, closing and liquidation costs, which typically approximates 25% of the appraised value. 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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 16. Continued**

Other real estate owned

OREO is primarily comprised of real estate acquired in partial or full satisfaction of loans. OREO is recorded at its estimated fair value less estimated selling and closing costs at the date of transfer, with any excess of the related loan balance over the fair value less expected selling costs charged to the ALLL. Subsequent changes in fair value are reported as adjustments to the carrying amount and are recorded against earnings. The Company outsources the valuation of OREO with material balances to third party appraisers. The Company reviews the third-party appraisal for appropriateness and adjusts the value downward to consider selling and closing costs, which typically approximate 25% of the appraised value.

The following table presents assets measured at fair value on a nonrecurring basis during December 31, 2018 and 2017 and were still held at those respective dates:

	in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Totals
<u>December 31, 2018</u>				
Impaired loans	\$ -	\$ -	\$ 3,364,538	\$ 3,364,538
Other real estate owned	-	-	188,609	188,609
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,553,147</u>	<u>\$ 3,553,147</u>
<u>December 31, 2017</u>				
Impaired loans	\$ -	\$ -	\$ 544,502	\$ 544,502
Other real estate owned	-	-	1,307,250	1,307,250
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,851,752</u>	<u>\$ 1,851,752</u>

Impaired loans with a carrying value of \$3,364,538 and \$544,502 had an allocated allowance for loan losses of \$401,347 and \$442,589 at December 31, 2018 and December 31, 2017, 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.

After monitoring the carrying amounts for subsequent declines or impairment after foreclosure, management determined that a fair value adjustment to OREO in the amount of \$-0- and \$234,042 was necessary and was recorded during the year ended December 31, 2018 and December 31, 2017, respectively.



**CITIZENS HOLDING COMPANY**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 16. Continued**

The following represents the carrying value and estimated fair value of the Company's financial instruments at December 31, 2018 and December 31, 2017:

		Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
	Carrying Value						
<u>2018</u>							
Financial assets							
Cash and due from banks	\$ 12,592,130	\$ 12,592,130	\$ -	\$ -	\$ -	\$ -	\$ 12,592,130
Interest bearing deposits with banks	8,079,742	8,079,742	-	-	-	-	8,079,742
Securities available-for-sale	444,746,454	-	444,746,454	-	-	-	444,746,454
Net loans	425,905,093	-	-	420,992,074	-	-	420,992,074
Financial liabilities							
Deposits	\$ 756,221,510	\$ 544,985,869	\$ 210,477,092	\$ -	\$ -	\$ -	\$ 755,462,961
Securities Sold under Agreement to Repurchase	107,965,505	107,965,505	-	-	-	-	107,965,505
		Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
	Carrying Value						
<u>2017</u>							
Financial assets							
Cash and due from banks	\$ 17,962,990	\$ 17,962,990	\$ -	\$ -	\$ -	\$ -	\$ 17,962,990
Interest bearing deposits with banks	1,532,420	1,532,420	-	-	-	-	1,532,420
Securities available-for-sale	505,046,377	-	501,972,150	3,074,227	-	-	505,046,377
Net loans	402,390,574	-	-	401,706,081	-	-	401,706,081
Financial liabilities							
Deposits	\$ 720,685,499	\$ 543,123,284	\$ 177,698,280	\$ -	\$ -	\$ -	\$ 720,821,564
Federal Home Loan Bank advances	30,000,000	30,005,541	-	-	-	-	30,005,541
Securities Sold under Agreement to Repurchase	142,497,938	142,497,938	-	-	-	-	142,497,938

**CITIZENS HOLDING COMPANY**  
Years Ended December 31, 2018, 2017 and 2016

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 17. Stock Based Compensation**

The Company has a directors' stock compensation plan and had an employees' long-term incentive plan. Under the directors' plan, the Company may grant options for up to 210,000 shares of common stock. The price of each option is equal to the market price determined as of the option grant date. Options granted are exercisable after six months and expire after 10 years. The employee plan expired on April 13, 2009, no options have been granted since this date and all previously granted options either expired or were exercised as of December 31, 2018. The options previously granted under the employee plan expire 10 years from the grant date. The exercise price is equal to the market price of the Company's stock on the date of grant.

The fair value of each option granted is estimated on the date of the grant using the Black-Sholes option-pricing model. No options were granted in 2018 or 2017, therefore no calculations were required in 2018 or 2017 to determine fair values.

The Company has adopted the 2013 Incentive Compensation Plan (the "2013 Plan"), which the Company has used for all equity grants after the adoption and approval of the 2013 Plan.

During 2018, the Company's directors received restricted stock grants totaling 7,500 shares of common stock at a then market value of \$22.05 per share and in 2017 received 7,500 shares of common stock at a then market value of \$24.03 per share. These grants vest over a one-year period during which time the recipients have rights to vote the shares and to receive dividends. The grant date fair value of these shares granted in 2018 was \$165,375 and will be recognized over the one-year restriction period at a cost of \$13,781 per month less deferred taxes of \$3,439 per month. The grant date fair value of the shares granted in 2017 was \$180,225 and was recognized over the one-year restriction period at a cost of \$15,019 per month less deferred taxes of \$3,748 per month.

During 2015, 7,500 shares of restricted stock was granted to the Chief Executive Officer (CEO) that would vest according to a stock performance schedule over the next five years. The stock performance for the Company met the goal for 2016 and the CEO became vested in 20%, or 1,500 shares of the restricted stock at an expense of \$31,725. Again in 2017, the Company met 20% of its goal and the CEO became vested in an additional 1,500 shares of the restricted stock at an expense of \$36,810. The stock performance for the Company did not meet the goal in 2018 and no corresponding expense was recorded.

During 2018 and 2017, the Company recorded expense of \$170,325 and \$210,735 and recorded deferred taxes in the amounts of \$42,496 and \$43,395, respectively, related to all of the restricted shares.

At December 31, 2018, there were 12,000 shares non-vested with \$55,125 in unrecognized stock-based compensation expense related to the 2013 Plan.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 17. Continued**

Following is a summary of the status of the stock options remaining under the plans for the years ending December 31, 2018, 2017 and 2016:

	<b>Directors' Plan</b>		<b>Employees' Plan</b>	
	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding at January 1, 2016	87,000	\$ 21.35	23,000	\$ 23.46
Granted	-	-	-	-
Exercised	-	-	-	-
Expired	(9,000)	23.70	(23,000)	23.46
Outstanding at December 31, 2016	78,000	\$ 21.08	-	\$ -
Granted	-	-	-	-
Exercised	(6,000)	20.94	-	-
Expired	(9,000)	22.00	-	-
Outstanding at December 31, 2017	63,000	\$ 20.96	-	\$ -
Granted	-	-	-	-
Exercised	(6,000)	18.00	-	-
Expired	(4,500)	18.00	-	-
Outstanding at December 31, 2018	52,500	\$ 21.55	-	\$ -
Options exercisable at: December 31, 2018	52,500	\$ 21.55	-	\$ -

**CITIZENS HOLDING COMPANY**  
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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 17. Continued**

The following table presents the outstanding stock options granted in relation to the option price and the weighted average maturity.

Range of Exercise Prices	Options Outstanding	Weighted Average Price	Weighted Average Life Remaining
\$15.01 to \$20.00	13,500	18.76	3 years, 4 months
\$20.01 to \$22.50	25,500	20.83	1 year, 5 months
\$22.51 and above	13,500	25.72	1 year, 4 months
Total	52,500	\$21.55	1 years, 11 months

The intrinsic value of options outstanding under the Directors' Plan at December 31, 2018 was \$43,470. Additionally, the total intrinsic value of options exercised during 2018 and 2017 was \$24,300 and \$18,825, respectively.

There were no options granted during 2018 under the 2013 Plan.

**Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**as of December 31, 2018, 2017 and 2016**

**OVERVIEW**

The following information discusses the financial condition and results of operations of Citizens Holding Company (the "Company") as of December 31, 2018, 2017 and 2016. In this discussion, all references to the activities, operations or financial performance of the Company reflect the Company's activities, operations and financial performance through its wholly-owned subsidiary, The Citizens Bank of Philadelphia, Mississippi (the "Bank"), unless otherwise specifically noted. The Company's financial statements and accompanying notes should be read in conjunction with this Management's Discussion and Analysis.

Over the past three years, the Company has experienced growth in total loans as management has capitalized on opportunities for organic growth within the Company's market area and the addition of a loan production office in 2016. Total loans increased over the three-year period by \$35.8 million or 9.2%. In the three-year period, net income decreased by \$100 thousand or 0.9%. As competition for deposits has increased, the cost of deposits has also increased. The yield on earning assets hasn't increased at the same rate as interest bearing liabilities. Management continues to focus on growing non-interest income while containing costs to the extent possible to help offset shrinking margins. Due to the loan growth over the period, management has increased the provision for loan losses to help manage risks. All of these factors are driving the net income results and continue to be a focus of management moving forward.

During 2018 as compared to 2017, the Company's total assets decreased by \$34,465,750, or 3.5%, loans increased by \$23,514,519, or 5.8%, and total deposits increased by \$35,536,011, or 4.9%. Loans increased in 2018 due to an increased focus on loan production in the Company's service area, including the loan production office in North Mississippi. Certificates of deposit ended 2018 at \$211,235,641, or 19.0% higher than 2017. Demand, NOW, savings and money market accounts increased \$1,862,584, or 0.3% from December 31, 2017 to \$544,985,869 at December 31, 2018.

During 2017 as compared to 2016, the Company's total assets decreased by \$32,116,079, or 3.1%, loans increased by \$12,242,231, or 3.1%, and total deposits decreased by \$39,466,841, or 5.2%. Loans increased in 2017 due to the addition of a loan production office in North Mississippi and the addition of additional loan officers in the Company's service area. Certificates of deposit ended 2017 at \$177,562,214, or 9.7% lower than 2016. Demand, NOW, savings and money market accounts increased \$20,314,947, or 3.6% from December 31, 2016 to \$543,123,285 at December 31, 2017.

In 2018, the Company's net income after taxes increased to \$6,673,127, an increase of \$2,929,803 from 2017. The bulk of this increase was from the Tax Cuts and Jobs Act of 2017 that was signed into law on December 22, 2017 that negatively impacted 2017 earnings. This resulted in an increase in the income tax expense related to this in the amount of \$2,588,859 in 2017. Net interest income after the provision for loan losses decreased in 2018 primarily due to an increase in interest expense on interest bearing liabilities and an increase in the provision for

loan losses. An increase in non-interest income coupled with the decrease in non-interest expense helped offset the decrease in net interest income. Net income for 2018 produced, on a fully diluted basis, earnings per share of \$1.36 compared to \$0.76, after the deferred tax adjustment, for 2017.

In 2017, the Company's net income after taxes decreased to \$3,703,548, a decrease of \$3,033,106 from 2016. The bulk of this decline was an increase in income taxes that resulted from the Tax Cuts and Jobs Act of 2017 that was signed into law on December 22, 2017. This change in the corporate tax rate required the Company to revalue its net deferred tax assets at the new rate of 21% and to adjust those taxes through the income tax expense on the income statement. This resulted in an increase in the income tax expense related to this in the amount of \$2,588,859. Net interest income increased in 2017 primarily due to an increase in interest income on interest earning assets and a decrease in the provision for loan losses. An increase in non-interest income partially offset the increase in non-interest expense which contributed to the decrease in net income for 2017. Net income for 2017 produced, on a fully diluted basis after the deferred tax asset adjustment, earnings per share of \$0.76 compared to \$0.76 in 2017 and \$1.38 for 2016.

The Company's return on average assets ("ROA") was 0.69% in 2018, compared to 0.37% in 2017 and 0.86% in 2016. The Company's return on average equity ("ROE") was 7.95% in 2018, 4.10% in 2017 and 7.34% in 2016. During these periods, leverage capital ratios (the ratio of equity to average total assets) decreased from 9.22% in 2016 to 9.17% in 2017 and increased to 9.74% in 2018. The ROE in 2018, 2017 and 2016 is a function of the level of net income and equity balances during those years. The changes in ROA were also a result of the Company's net income in those years and also affected by the decrease in total assets during these time periods. The Company set the annual dividend payout rate to approximately 70.59% of 2018 earnings per share, as compared to 126.32% in 2016 and 69.57% in 2016. The leverage capital ratio of 9.74% in 2018 remains above the regulatory requirement of 5% to be considered "well capitalized" under applicable Federal Deposit Insurance Corporation (the "FDIC") guidelines for the Bank.

The Company's net interest income, non-interest income and income from continuing operations are not directly affected by inflation and changing prices although these factors could influence our customers' ability to repay loans or cause them to withdraw deposits. The impact of a slowdown in loan repayments could be felt in both liquidity and income. It could affect liquidity by reducing the amount of cash available for new loans and income by increasing the amount of the provision for loan loss expense due to loans that are charged off.

Liquidity is discussed in more detail beginning on page 90 of this report under the heading, *Liquidity and Rate Sensitivity*. The Company did not have any commitments at December 31, 2018 that would require a material expenditure of capital resources.

The Company is not aware of any developments that would have material impact on its revenues or net income. Interest rate increases being projected for 2019 are unknown at this time but it is difficult to know the frequency and size of interest rate movements. A measured increase in interest rates could have the effect of increasing revenues and net income.



## CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Allowance for Loan Losses

The accounting policy most important to the presentation of the Company's financial statements relates to the allowance for loan loss and the related provision for loan losses. The allowance for loan losses is available to absorb probable credit losses inherent in the entire loan portfolio. The appropriate level of the allowance is based on a monthly analysis of the loan portfolio and represents an amount that management deems adequate to provide for inherent losses, including collective impairment as recognized under ASC Subtopic 450-20, *Loss Contingencies*. The collective impairment is calculated based on loans grouped by similar risk characteristics. Another component of the allowance is losses on loans assessed as impaired under ASC Subtopic 310-10, *Loan Impairments*. The balance of these loans determined to be impaired under ASC Subtopic 310-10 and their related allowance is included in management's estimation and analysis of the allowance for loan losses. For a discussion of other considerations in establishing the allowance for loan losses and the Company's and the Bank's loan policies and procedures for addressing credit risk, please refer to the disclosures in this Item under the heading "Provision for Loan Losses and Asset Quality."

### Other Than Temporary Impairment

The Company currently classifies a portion of its debt securities as AFS as they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income (loss), net of tax. Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement; and 2) OTTI related to other factors, which is recognized in other comprehensive

income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

### Other Real Estate

Real estate acquired through foreclosure on a loan or by surrender of the real estate in lieu of foreclosure is called “OREO”. OREO is initially recorded at the fair value of the property less estimated costs to sell, which establishes a new cost basis. OREO is subsequently accounted for at the lower of cost or fair value of the property less estimated costs. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Valuation adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Valuation adjustments are also required when the listing price to sell an OREO has had to be reduced below the current carrying value. If there is a decrease in the fair value of the property from the last valuation, the decrease in value is charged to noninterest expense. All income produced from, changes in fair values in, and gains and losses on OREOs is also included in noninterest expense. During the time the property is held, all related operating and maintenance costs are expensed as incurred.

### Intangible Assets

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the estimated fair value of the net assets acquired. Goodwill and intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized, but instead reviewed for impairment when there is evidence to suggest that the estimated fair value of the net assets is lower than the carrying value, or at a minimum of once a year. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill was the only intangible asset with an indefinite life on the Company’s balance sheet. Other intangible assets consisted of core deposit and acquired customer relationship intangible assets arising from the Company’s acquisition of the Citizens Bank and Trust Company of Louisville, Mississippi. These assets are initially measured at fair value and then are amortized on an accelerated method over their estimated useful lives, which were determined to be 15 years.

### Stock Based Compensation

The Company recognizes stock compensation expenses in accordance with ASC 718, “Compensation - Stock Compensation” (“ASC 718”). The Company sponsors stock plans which most commonly include restricted stock and stock options. The Company accounts for stock based compensation under the fair value recognition provisions whereby compensation cost is measure based on the fair value of the award at the grant date and is recognized in the consolidated financial statements on a straight-line basis over the requisite service period. The fair value of restructured stock is determined based on the closing price of the Company’s common stock on the date of grant. The fair value of stock options is estimated at the date of grant using a Black-Scholes option pricing model. For more information on the Company’s

stock options and the assumptions used to calculate the expense of such options, please refer to Note 1, “Summary of Significant Accounting Policies,” and Note 17, “Stock Based Compensation” to the Company’s Consolidated Financial Statements included in this Annual Report.

### Income Taxes

The Company uses the asset and liability method, which recognizes the future tax consequences attributable to an event or a liability or asset that has been recognized in the consolidated financial statements. Due to tax regulations, several items of income and expense are recognized in different periods for tax return purposes than for financial reporting purposes. These items represent “temporary differences.” Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. Deferred tax assets represent future deductions in the Company’s income tax return, while deferred tax liabilities represent future payments to tax authorities. Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Please refer to Note 1, “Summary of Significant Accounting Policies,” to the Consolidated Financial Statements of the Company included in this Annual Report for a detailed discussion of other significant accounting policies affecting the Company.

## DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

In addition to historical information, this report contains statements that constitute forward-looking statements 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, that are based on management's beliefs, plans, expectations, assumptions and on information currently available to management. The words "may," "should," "expect," "anticipate," "intend," "plan," "continue," "believe," "seek," "estimate" and similar expressions used in this report that do not relate to historical facts are intended to identify forward-looking statements. These statements appear in a number of places in this report, including, but not limited to, statements found in Item 1, "Business," and in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." Citizens Holding Company (the "Company") notes that a variety of factors could cause its 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 business of the Company and the Company's wholly-owned subsidiary, The Citizens Bank of Philadelphia, Mississippi (the "Bank"), include, but are not limited to, the following:

- expectations about the movement of interest rates, including actions that may be taken by the Federal Reserve Board in response to changing economic conditions;
- adverse changes in asset quality and loan demand, the potential insufficiency of the allowance for loan losses and our ability to foreclose on delinquent mortgages;
- the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Company operates;
- extensive regulation, changes in the legislative and regulatory environment that negatively impact the Company and the Bank through increased operating expenses and the potential for regulatory enforcement actions, claims or litigation;
- increased competition from other financial institutions and the risk of failure to achieve our business strategies;
- events affecting our business operations, including the effectiveness of our risk management framework, the accuracy of our estimates, our reliance on third party vendors, the risk of security breaches and potential fraud, and the impact of technological advances;
- our ability to maintain sufficient capital and to raise additional capital when needed;
- our ability to maintain adequate liquidity to conduct business and meet our obligations;
- events affecting our ability to compete effectively and achieve our strategies, such as the risk of failure to achieve the revenue increases expected to result from our acquisitions, branch additions and in new product and service offerings, our ability to control expenses and our ability to attract and retain skilled people;
- events that adversely affect our reputation, and the resulting potential adverse impact on our business operations;
- risks arising from owning our common stock, such as the volatility and trading volume, our ability to pay dividends, the regulatory limitations on stock ownership, and provisions in our governing documents that may make it more difficult for another party to obtain control of us; and

- other risks detailed from time-to-time in the Company's filings with the Securities and Exchange Commission.

The Company undertakes no obligation to update or revise any forward-looking statements subsequent to the date on which they are made.

## **SELECTED FINANCIAL DATA**

The following selected financial data has been taken from the Company's Consolidated Financial Statements and related notes included in this Annual Report and should be read in conjunction with such consolidated financial statements and related notes. Dollar references in all of the following tables are in thousands except for per share data.

The major components of the Company's operating results for the past five years are summarized in Table 1 - Five Year Financial Summary of Consolidated Statements and Related Statistics.

TABLE 1 - FIVE YEAR SUMMARY OF CONSOLIDATED STATEMENTS AND RELATED STATISTICS (in thousands, except per share and ratio amounts)

	2018	2017	2016	2015	2014
<b><u>Summary of Earnings</u></b>					
Total Interest Income	\$ 31,359	\$ 30,505	\$ 30,169	\$ 30,965	\$ 31,380
Total Interest Expense	4,459	3,343	3,098	3,077	3,018
Provision for loan losses	334	(543)	(65)	556	923
Non-interest income	8,599	8,296	7,692	8,327	8,163
Non-interest expense	27,665	28,227	26,480	25,591	26,324
Income tax expense	828	4,070	1,612	2,479	1,828
Net Income	6,673	3,704	6,737	7,589	7,450
<b><u>Per Share Data</u></b>					
Earnings-basic	\$ 1.36	\$ 0.76	\$ 1.38	\$ 1.56	\$ 1.53
Earnings-diluted	1.36	0.76	1.38	1.56	1.53
Cash dividends	0.96	0.96	0.96	0.93	0.89
Book value at year end	17.09	18.07	17.42	17.73	16.78
<b><u>Selected Year End Actual Balances</u></b>					
Loans, net of unearned income	\$ 429,277	\$ 406,605	\$ 394,051	\$ 429,582	\$ 390,960
Allowance for loan losses	3,372	3,019	3,903	6,474	6,542
Investment Securities	444,746	505,046	496,125	428,308	386,562
Earning assets	885,416	910,283	935,957	894,765	833,845
Total assets	958,630	993,096	1,025,212	973,505	921,061
Deposits	756,222	720,685	760,152	753,405	696,094
Long term borrowings	15	20,000	20,000	20,000	20,000
Shareholders' equity	83,866	88,451	85,059	86,425	81,858
<b><u>Selected Year End Average Balances</u></b>					
Loans, net of unearned income	\$ 418,136	\$ 395,217	\$ 409,367	\$ 412,161	\$ 389,720
Allowance for loan losses	3,002	3,586	5,051	6,637	7,902
Investment securities	484,298	511,133	475,714	421,729	396,806
Earning assets	911,175	929,260	917,366	863,830	798,432
Total assets	971,893	1,013,177	996,266	945,270	884,688
Deposits	760,992	762,983	766,264	725,116	682,444
Long term borrowings	19	20,000	20,042	20,056	35,593
Shareholders' equity	83,907	90,230	91,766	84,250	73,219



	2018	2017	2016	2015	2014
<b><u>Selected Ratios</u></b>					
Return on average assets	0.69%	0.37%	0.68%	0.80%	0.84%
Return on average equity	7.95%	4.10%	7.34%	9.01%	10.17%
Dividend payout ratio	70.59%	126.32%	69.57%	59.62%	58.17%
Equity to year end assets	8.75%	8.91%	8.30%	8.88%	8.89%
Total risk-based capital to risk-adjusted assets	17.69%	18.51%	18.67%	17.54%	17.84%
Leverage capital ratio	9.74%	9.17%	9.22%	9.26%	9.60%
Efficiency ratio	75.99%	76.35%	71.49%	68.69%	70.09%

## NET INCOME

Net income for 2018 increased by 0.9% to \$6,673,127 or \$1.36 per share-basic and -diluted, from \$3,703,548 or \$0.76 per share-basic and -diluted for 2017. The provision for loan losses for 2018 was a positive \$333,990 as compared to negative \$543,138 in 2017. The increase in the loan loss provision for 2018 was mainly due to the increase in the balance of loans outstanding coupled with management's assessment of inherent losses in the loan portfolio, including the impact caused by current local and national economic conditions. Non-interest income increased by \$303,189, or 3.7%, and non-interest expense decreased by \$562,460 or 2.0%, in 2018. Non-interest income for 2018 increased primarily due to an increase in service charges on deposit accounts and other service charges and fees offset by a decrease in other income. Non-interest expense decreased due to a decrease in salaries and benefits, loan collection expense, other losses and a reduction in other expenses.

Net income for 2017 decreased by 45.0% to \$3,703,548 or \$0.76 per share-basic and -diluted, from \$6,736,654 or \$1.38 per share-basic and -diluted for 2016. The provision for loan losses for 2017 was a negative \$543,138 as compared to negative \$65,056 in 2016. The increase in the negative loan loss provision for 2017 was mainly due to management's assessment of inherent losses in the loan portfolio, including the impact caused by current local and national economic conditions and low level of prior years' loan losses offset by the increase in the balance of loans outstanding. Non-interest income increased by \$604,544, or 7.9%, and non-interest expense increased by \$1,747,768 or 6.6%, in 2017. Non-interest income for 2017 increased primarily due to an increase in other service charges and fees. Non-interest expense increased due to an increase in salaries and benefits, loan collection expense and office supplies.

Net income for 2016 decreased by 11.2% to \$6,736,654 or \$1.38 per share-basic and -diluted, from \$7,588,901 or \$1.56 per share-basic and -diluted for 2015. The provision for loan losses for 2016 was a negative \$65,056 as compared to positive \$556,687 in 2015. The decrease in the loan loss provision for 2016 was mainly due to management's assessment of inherent losses in the loan portfolio, including the impact caused by current local and national economic conditions and the decrease in the balance of loans outstanding. Non-interest income decreased by \$636,109, or 7.6%, and non-interest expense increased by \$888,684 or 3.5%, in 2016. Non-interest income for 2016 decreased primarily due to a decrease in gains from the sale of repossessed assets offset partially by an increase in other service charges and fees. Non-interest expense increased due to an increase in salaries and benefits, writedowns on other real estate, loan collection expense and office supplies.

## NET INTEREST INCOME

Net interest income is the most significant component of the Company's earnings. Net interest income is the difference between interest and fees realized on earning assets, primarily loans and securities, and interest paid on deposits and other borrowed funds. The net interest margin is this difference expressed as a percentage of average earning assets. Net interest income is affected by several factors, including the volume of earning assets and liabilities, the mix of earning assets and liabilities, and interest rates. The discussion below is presented on a tax equivalent basis which management believes to be the best way to analyze net interest income.

Net interest income on a tax equivalent basis was \$27,806,000, \$28,339,000 and \$28,270,000 for the years 2018, 2017 and 2016, respectively. Net interest margin was 3.05%, 3.01% and 3.07% for the same periods. During 2018, the yields on interest earning assets and the rates paid on interest bearing deposits increased. In 2018 as compared to 2017, interest-bearing assets decreased by \$24.9 million, or 2.7% and interest-bearing liabilities decreased by \$41.2 million, or 5.6%. For the year ended December 31, 2018, the average yield on earnings assets was 3.54%, an increase of 18 basis points compared to the average yield at December 31, 2017. The average rate paid on interest-bearing liabilities was 0.62%, an increase of 18 basis points compared to the average rate at December 31, 2017.

During 2017, the yields on interest earning assets declined and the rates paid on interest bearing deposits increased slightly. In 2017 as compared to 2016, interest-bearing assets increased by \$21.9 million, or 2.4% and interest-bearing liabilities increased by \$13.1 million, or 1.7%. For the year ended December 31, 2017, the average yield on earnings assets was 3.36%, a decrease of 4 basis points compared to the average yield at December 31, 2016. The average rate paid on interest-bearing liabilities was 0.44%, an increase of 3 basis points compared to the average rate at December 31, 2016.

During this three-year period, loans outstanding decreased in 2016 and increased in 2017 and 2018. Loans generally provide the Company with yields that are greater than the yields on typical investment securities.

Table 2 – Average Balance Sheets and Interest Rates sets forth average balance sheet data, including all major categories of interest-earning assets and interest-bearing liabilities, together with the interest earned or interest paid and the average yield or average rate paid on each such category for the fiscal years ended December 31, 2018, 2017 and 2016.

TABLE 2 – AVERAGE BALANCE SHEETS AND INTEREST RATES

(in thousands)									
	Average Balance			Income/Expense			Average Yield/Rate		
	2018	2017	2016	2018	2017	2016	2018	2017	2016
Loans:									
Loans, net of unearned <sup>(1)</sup>	\$417,624	\$394,684	\$408,922	\$20,287	\$18,782	\$19,012	4.86%	4.76%	4.65%
Investment Securities									
Taxable	376,392	392,626	353,794	8,345	8,178	7,590	2.22%	2.08%	2.15%
Tax-exempt	107,906	129,709	121,358	3,445	4,448	4,581	3.19%	3.43%	3.77%
Total Investment Securities	484,298	522,335	475,152	11,790	12,626	12,171	2.43%	2.42%	2.56%
Federal Funds Sold and Other	9,253	24,999	36,071	157	274	185	1.70%	1.09%	0.51%
Total Interest Earning Assets <sup>(1)(2)</sup>	911,175	942,018	920,145	32,234	31,682	31,368	3.54%	3.36%	3.40%
Non-Earning Assets	69,971	71,159	76,121						
Total Assets	\$981,146	\$1,013,177	\$996,266						
Deposits:									
Interest-bearing Demand									
Deposits <sup>(3)</sup>	\$325,192	\$347,260	\$345,438	\$1,131	\$806	\$730	0.35%	0.23%	0.21%
Savings	79,281	74,923	72,127	113	133	122	0.14%	0.14%	0.12%
Time	191,836	189,359	202,261	1,536	983	992	0.80%	0.52%	0.49%
Total Deposits	596,309	611,542	619,826	2,780	1,922	1,844	0.47%	0.31%	0.30%
Borrowed Funds									
Short-term Borrowings	116,787	130,248	108,884	1,648	907	740	1.41%	0.70%	0.68%
Long-term Borrowings	-	20,000	20,000	-	514	514	0.00%	2.53%	2.53%
Total Borrowed Funds	116,787	150,248	128,884	1,648	1,421	1,254	1.41%	0.95%	0.97%
Total Interest-Bearing Liabilities <sup>(3)</sup>	713,096	761,790	748,710	4,428	3,343	3,098	0.62%	0.44%	0.41%
Non-Interest Bearing Liabilities									
Demand Deposits	164,682	150,689	146,438						
Other Liabilities	10,208	10,468	9,352						
Shareholders' Equity	83,907	90,230	91,766						
Total Liabilities and Shareholders' Equity	\$971,893	\$1,013,177	\$996,266						
Interest Rate Spread							2.92%	2.92%	2.99%
Net Interest Margin				\$27,806	\$28,339	\$28,270	3.05%	3.01%	3.07%
Less									
Tax Equivalent Adjustment				906	1,177	1,199			
Net Interest Income				\$26,900	\$27,162	\$27,071			

- (1) Overdrafts on demand deposit accounts are not included in the average volume calculation as they are not considered interest earning assets by the Company. They are included in the “Non-Earning Assets” balance above.
- (2) Earning Assets in Table 2 does not include the dividend paying stock of the Federal Home Loan Bank.
- (3) Demand deposits are not included in the average volume calculation as they are not interest bearing liabilities. They are included within the non-interest bearing liabilities section above.

Table 3 – Net Average Interest Earning Assets illustrates net interest earning assets and liabilities for 2018, 2017, and 2016.

TABLE 3 – NET AVERAGE INTEREST EARNING ASSETS

	(in thousands)		
	2018	2017	2016
Average interest earning assets	\$ 911,175	\$ 942,018	\$ 920,145
Average interest bearing liabilities	713,096	761,790	748,710
Net average interest earning assets	\$ 198,079	\$ 180,228	\$ 171,435

Table 4 – Volume/Rate Analysis depicts the effect on interest income and interest expense of changes in volume and changes in rate from 2016 through 2018. Variances, which were attributable to both volume and rate, are allocated proportionately between rate and volume using the absolute values of each for a basis for the allocation. Non-accruing loans are included in the average loan balances used in determining the yields. Interest income on tax-exempt securities and loans has been adjusted to a tax equivalent basis using a federal income tax rate of 21% and 34% in 2018 and 2017, respectively.

TABLE 4 – VOLUME/RATE ANALYSIS

	(in thousands)					
	2018 Change from 2017			2017 Change from 2016		
	Volume	Rate	Total	Volume	Rate	Total
INTEREST INCOME						
Loans	\$ 1,114	391	\$ 1,505	\$ (678)	\$ 448	\$ (230)
Taxable Securities	(360)	527	167	809	(221)	588
Non-Taxable Securities	(696)	(307)	(1,003)	286	(419)	(133)
Federal Funds Sold and Other	(267)	150	(117)	(121)	210	89
TOTAL INTEREST INCOME	\$ (209)	\$ 761	\$ 552	\$ 296	\$ 18	\$ 314
INTEREST EXPENSE						
Interest-bearing demand deposits	\$ (77)	402	325	\$ 4	\$ 72	76
Savings Deposits	6	(26)	(20)	4	7	11
Time Deposits	20	533	553	(67)	58	(9)
Short-term borrowings	(190)	931	741	149	18	167
Long-term borrowings	-	(514)	(514)	-	-	-
TOTAL INTEREST EXPENSE	\$ (241)	\$ 1,326	1,085	\$ 90	\$ 155	245
NET INTEREST INCOME	\$ 32	\$ (565)	\$ (533)	\$ 206	\$ (137)	\$ 69

## LOANS

The loan portfolio constitutes the major earning asset of the Company and, in the opinion of management, offers the best alternative for maximizing net interest margin. The Company's loan personnel have the authority to extend credit under guidelines established and approved by the Board of Directors. Any aggregate credit that exceeds the authority of the loan officer is forwarded to the Board's loan committee for approval. The loan committee is composed of certain directors, including the Chairman of the Board of Directors. All aggregate loans that exceed the loan committee's lending authority are presented to the full Board of Directors for ultimate approval or denial. The loan committee not only acts as an approval body to ensure consistent application of the Company's loan policy but also provides valuable insight through communication and pooling of knowledge, judgment, and experience of its members.

The Company has stated in its loan policy the following objectives for its loan portfolio:

- to make loans after sound and thorough credit analysis;
- to properly document all loans;
- to eliminate loans from the portfolio that are underpriced, high risk or difficult and costly to administer;
- to seek good relationships with the customer;
- to avoid undue concentrations of loans; and
- to keep non-accrual loans to a minimum by aggressive collection policies.

Loan demand in the Company's market improved after economic conditions began to show some improvement. Although the Company continues to face intense competition for available loans from other financial institutions and the current economic conditions have improved slightly, the Company was able, in 2017 and 2018, to increase the amount of loans outstanding. The overall loan demand in the Company's operating markets has been robust in certain sectors. Commercial, financial and agricultural has seen the most growth with an increase of 6.6%, or 17,652,732, in 2018, by 5.6%, or 14,186,547, in 2017 and decreased by 4.9%, or 12,882,886, in 2016. Commercial, financial and agricultural loans are the largest segment of the loan portfolio and, by nature, bear a higher degree of risk. Management believes the lending practices, policies and procedures applicable to this loan category are adequate to manage any risk represented by the growth of this loan segment.

Real estate mortgage loans originated by the Company decreased by 7.5%, or \$7,177,384 in 2018, by 1.9%, or \$1,887,518, in 2017 and by 6.0%, or \$6,233,615, in 2016 when compared to the prior years. The decrease in mortgage loans in all years reflects the weakness in the local housing markets coupled with increased competition in the mortgage market.

Real estate construction loans increased by \$15,210,472, or 58.7% in 2018 to \$41,133,508 when compared to the \$25,923,036 at December 31, 2017 and by 2,130, or 0.8%



when compared to 2016. Real estate construction loans are usually short term in nature and are dependent on construction activity in the Company's service area. There was a large amount of demand for these types of loans in the Company's service area during 2018.

Consumer loans decreased by \$1,969,249 or 12.3% in 2018, \$3,475,943, or 17.9% in 2017 and \$7,159,006, or 26.9% in 2016, compared to the prior years. The Company believes that changes in consumer purchasing habits and the increase in loan sources have affected the growth of this segment of loans.

Table 5 – Loans Outstanding reflects outstanding balances by loan type for the past five years. Additional loan information is presented in Note 5, "Loans," to the Company's Consolidated Financial Statements included in this Annual Report.

TABLE 5 – LOANS OUTSTANDING  
(in thousands)

	AT DECEMBER 31,				
	2018	2017	2016	2015	2014
Commercial, financial and agricultural	\$285,420	\$267,767	\$253,581	\$266,464	\$217,577
Real estate - construction	41,134	25,923	23,793	33,133	43,233
Real estate - mortgage	88,747	95,925	97,812	104,046	104,170
Consumer	14,021	15,990	19,466	26,625	26,515
<b>TOTAL LOANS</b>	<b>\$429,322</b>	<b>\$405,605</b>	<b>\$394,652</b>	<b>\$430,268</b>	<b>\$391,495</b>

Table 6 – Loan Liquidity and Sensitivity to Changes in Interest Rates reflects the maturity schedule or repricing frequency of all loans. Also presented are fixed and variable rate loans maturing after one year.

TABLE 6 – LOAN LIQUIDITY  
LOAN MATURITIES AT DECEMBER 31, 2018

	1 YEAR OR LESS	1 - 5 YEARS	OVER 5 YEARS	Total
Commercial, financial and agricultural	\$57,059	\$191,401	\$36,960	\$285,420
Real estate - construction	11,809	25,524	3,801	\$41,134
Real estate - mortgage	18,943	55,199	14,605	\$88,747
Consumer	6,501	7,185	335	\$14,021
<b>Total loans</b>	<b>\$94,312</b>	<b>\$279,309</b>	<b>\$55,701</b>	<b>\$429,322</b>

## SENSITIVITY TO CHANGES IN INTEREST RATES

	1 - 5 YEARS	OVER 5 YEARS
Fixed rates	\$323,432	\$34,948
Variable rates	35,513	32,012
Total loans	<u>\$358,945</u>	<u>\$66,960</u>

Each loan the Company makes either has a stated maturity as to when the loan is to be repaid or is subject to an agreement between the Company and the customer governing its progressive reduction. The Company's policy is that every loan is to be repaid by its stated maturity and not carried as a continuing debt. Generally, the Company requires that principal reductions on a loan must have begun prior to the second renewal date of the loan.

## PROVISION FOR LOAN LOSSES AND ASSET QUALITY

The allowance for loan losses represents an amount that in management's judgment will be adequate to absorb estimated probable losses within the existing loan portfolio. Loans that management determines to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of specific loans and prior loss experience. Other factors considered by management include specific economic events, general economic conditions and trends, and loan portfolio mix and growth. The allowance for loan losses is subject to close regulatory review from the FDIC and the Mississippi Department of Banking and Consumer Finance and is also a factor in each agency's determination of the Company's capital adequacy. The estimation of losses in the Company's loan portfolio is susceptible to changes resulting from changes in the financial condition of individual borrowers and economic conditions in the Company's market area.

The allowance for loan losses is established through a provision for loan losses charged against net income. This expense is determined by a number of factors, including historical loan losses, assessment of specific credit weaknesses within the portfolio, assessment of the prevailing economic climate, and other factors that may affect the overall condition of the loan portfolio. Management utilized these factors to determine the provision for loan losses for each of 2016, 2017 and 2018. The ratio of net loans charged off to average loans was 0.00% in 2018, 0.09% in 2017 and 0.61% in 2016. Management evaluates the adequacy of the allowance for loan loss on a monthly basis and makes adjustments to the allowance based on this analysis.

The provision for loan losses in 2018 was a positive \$333,990 compared to a negative \$543,138 in 2017 and negative \$65,056 in 2016. The change in the provision for all three years was mainly due to management's assessment of inherent losses in the loan portfolio, including the impact caused by current local and national economic conditions. The Company uses a model that takes into account historical charge-offs and recoveries and applies that to certain loan segments of the Company's portfolio. At the end of 2018, the total allowance for loan

losses was \$3,371,695, an amount that management believes to be sufficient to cover estimated probable losses in the loan portfolio.

Activity in the allowance for loan losses is reflected in Table 7 – Analysis of Allowance for Loan Losses. The Company’s policy is to charge-off loans when in management’s opinion the loan is deemed uncollectible. Even after it is charged off, however, the Company makes concerted efforts to maximize recovery of such loan.

**TABLE 7 – ANALYSIS OF ALLOWANCE FOR LOAN LOSSES**  
(in thousands except for percentage amounts)

	2018	2017	2016	2015	2014
<b>BALANCE AT BEGINNING OF YEAR</b>	\$ 3,019	\$ 3,903	\$ 6,474	\$ 6,542	\$ 8,078
<b>LOANS CHARGED-OFF</b>					
Commercial, financial and agricultural	35	166	2,397	457	2,213
Real estate - construction	74	112	-	-	249
Real estate - mortgage	133	57	179	201	149
Consumer	146	102	65	164	121
<b>TOTAL CHARGE-OFFS</b>	<b>388</b>	<b>437</b>	<b>2,641</b>	<b>822</b>	<b>2,732</b>
<b>CHARGE-OFFS RECOVERED</b>					
Commercial, financial and agricultural	219	2	18	45	79
Real estate - construction	19	14	18	9	7
Real estate - mortgage	81	16	24	52	126
Consumer	88	64	75	91	61
<b>TOTAL RECOVERIES</b>	<b>407</b>	<b>96</b>	<b>135</b>	<b>197</b>	<b>273</b>
Net loans charged-off	(19)	341	2,506	625	2,459
Additions charged to operating expense	334	(543)	(65)	557	923
<b>BALANCE AT END OF YEAR</b>	<b>\$ 3,372</b>	<b>\$ 3,019</b>	<b>\$ 3,903</b>	<b>\$ 6,474</b>	<b>\$ 6,542</b>
<b>Loans, net of unearned, at year end</b>	<b>\$ 429,277</b>	<b>\$ 406,605</b>	<b>\$ 394,051</b>	<b>\$ 429,582</b>	<b>\$ 390,960</b>
<b>Ratio of allowance to loans at year end</b>	<b>0.79%</b>	<b>0.74%</b>	<b>0.99%</b>	<b>1.51%</b>	<b>1.67%</b>
<b>Average loans - net of unearned</b>	<b>\$ 418,136</b>	<b>\$ 395,217</b>	<b>\$ 409,367</b>	<b>\$ 412,161</b>	<b>\$ 389,720</b>
<b>Ratio of net loans charged-off to average loans</b>	<b>0.00%</b>	<b>0.09%</b>	<b>0.61%</b>	<b>0.15%</b>	<b>0.63%</b>

# ALLOCATION OF ALLOWANCE FOR LOAN LOSSES

(in thousands)

	AT DECEMBER 31,				
	2018	2017	2016	2015	2014
Commercial, financial and agricultural	\$ 2,309	\$ 1,942	\$ 2,434	\$ 4,710	\$ 4,352
Real estate - construction	192	139	120	402	806
Real estate - mortgage	566	417	821	770	918
Consumer	305	521	528	592	466
Total	\$ 3,372	\$ 3,019	\$ 3,903	\$ 6,474	\$ 6,542

# COMPOSITION OF LOAN PORTFOLIO BY TYPE

	AT DECEMBER 31,				
	2018	2017	2016	2015	2014
Commercial, financial and agricultural	66.48%	66.02%	64.25%	61.93%	55.58%
Real estate - construction	9.58%	6.39%	6.03%	7.70%	11.04%
Real estate - mortgage	20.67%	23.65%	24.79%	24.18%	26.61%
Consumer	3.27%	3.94%	4.93%	6.19%	6.77%
	100.00%	100.00%	100.00%	100.00%	100.00%

Loan balances outstanding, as illustrated in Table 5, increased in 2018 even though the Company maintained tight credit standards and the competition for loans was strong. Commercial, financial and agricultural loans along with real estate construction loans increased and real estate mortgage and consumer loans decreased. In 2017 as compared to 2016, loans in all classifications decreased. The allowance for loan losses is allocated to the various categories based on the historical loss percentage for each segment of loan and any specific reserves that might be assigned to those loans.

Non-performing assets and the relative percentages of such assets to loan balances are presented in Table 8 – Non-performing Assets. Non-performing loans include non-accrual loans, loans delinquent 90 days or more based on contractual terms and troubled debt restructurings. Management classifies loans as non-accrual when it believes that collection of interest is doubtful. This typically occurs when payments are past due over 90 days, unless the loans are well secured and in the process of collection. Another measurement of asset quality is OREO, which represents properties acquired by the Company through foreclosure following loan defaults by customers. The percentage of OREO to total loans at December 31, 2018 was 0.80% compared to 0.98% in 2017. OREO decreased in 2018 after increasing in 2017 due to more foreclosures in 2017 and by the sale of several parcels that were acquired in foreclosure in previous years.

Loans on non-accrual status amounted to \$9,838,870 in 2018 as compared to \$7,582,017 in 2017 and \$8,879,393 in 2016. Interest income forgone on loans classified as non-accrual in 2018 was \$428,644 as compared to \$412,915 in 2017 and \$651,560 in 2016. Upon the classification of a loan as non-accrual, all interest accrued on the loan prior to the time it is

classified as non-accrual is reversed and interest accruals are suspended until such time that the loan is in compliance with its terms and deemed collectable.

TABLE 8 – NON-PERFORMING ASSETS  
(in thousands, except percentages)

	As of December 31,				
	2018	2017	2016	2015	2014
PRINCIPAL BALANCE					
Non-accrual	\$9,839	\$7,582	\$8,879	\$14,423	\$11,854
Accruing loans 90 days or more past due	73	807	206	76	880
Troubled debt restructurings	2,782	3,047	3,288	3,858	4,741
<b>TOTAL NON-PERFORMING LOANS</b>	<b>\$12,694</b>	<b>\$11,436</b>	<b>\$12,373</b>	<b>\$18,357</b>	<b>\$17,475</b>
Income on non-accrual loans not recorded	\$429	\$413	\$652	\$732	\$820
Non-performing as a percent of loans	2.96%	2.82%	3.14%	4.26%	4.46%
Other real estate owned	\$3,440	\$3,980	\$4,443	\$3,573	\$4,052
OREO as a percent of loans	0.80%	0.98%	1.13%	0.83%	1.04%
Allowance as a percent of non-performing loans	26.56%	26.40%	31.54%	35.27%	37.44%

ASC Subtopic 310-10, *Loan Impairments* outlines the guidance for evaluating impaired loans. These statements changed the methods of estimating the loan loss allowance for problem loans. In general, when management determines that principal and interest due under the contractual terms of a loan are not fully collectible, management must value the loan using discounted future expected cash flows. Management evaluates the Company's loans for impairment under ASC Subtopic 310-10. The balances of impaired (including non-accruals) loans for the years 2018, 2017 and 2016 were \$10,305,681, \$4,396,293 and \$7,064,185, respectively.

This table details the impaired loans by category for years ending 2018, 2017 and 2016.

	AT DECEMBER 31,		
	2018	2017	2016
Commercial, financial and agricultural	\$ 9,153,423	\$ 4,093,052	\$ 5,615,902
Real estate - mortgage	1,152,258	303,241	1,448,283
Total loans	\$ 10,305,681	\$ 4,396,293	\$ 7,064,185

Management monitors any loans that are classified under FDIC regulations as loss, doubtful or substandard, even if management has not classified the loans as non-performing or impaired. In addition to loans classified for regulatory purposes, management also designates certain loans for internal monitoring purposes in a “watch” category. Loans may be placed on management’s watch list as a result of delinquent status, management’s concern about the borrower’s financial condition or the value of the collateral securing the loan, a substandard classification during regulatory examinations, or simply as a result of management’s desire to monitor more closely a borrower’s financial condition and performance. Watch category loans may include loans that are still performing and accruing interest and may be current under the terms of the loan agreement but which management has a significant degree of concern about the borrowers’ ability to continue to perform according to the terms of the loan agreement. Watch category loans may also include loans, which, although adequately secured and performing, reflect a past delinquency problem or unfavorable financial trends exhibited by the borrower. Loss exposure on these loans is typically evaluated based primarily upon the estimated liquidation value of the collateral securing the loan.

At December 31, 2018, loans totaling \$26,251,510 were included on the Company’s watch list compared to \$18,700,847 at December 31, 2017. The majority of these loans are real estate loans that, although adequately collateralized, have experienced frequent delinquencies in scheduled payments. The inclusion of loans on this list does not indicate a greater risk of loss; rather it indicates that the loan possesses one of the several characteristics described above warranting increased oversight by management.

## SECURITIES

At December 31, 2018, the Company classified all of its securities as AFS. AFS securities are reported at fair value, with unrealized gains and losses included as a separate component of equity, net of tax. The Company does not hold any securities classified as held to maturity or held for trading purposes.

Table 9 – Securities and Securities Maturity Schedule summarizes the amortized cost of securities from 2016 through 2018 and the maturity distribution at December 31, 2018, by classification.

**TABLE 9 – SECURITIES**

(in thousands)

	2018	2017	2016
<b>SECURITIES AVAILABLE-FOR-SALE</b>			
U. S. Government Agencies	\$ 99,366	\$ 180,648	\$ 207,081
Mortgage Backed Securities	259,742	213,707	152,766
State, County and Municipal Obligations	105,591	118,786	150,504
Other Securities	-	2,865	2,870
<b>TOTAL SECURITIES AVAILABLE-FOR-SALE</b>	<b>\$ 464,699</b>	<b>\$ 516,006</b>	<b>\$ 513,221</b>

**SECURITIES MATURITY SCHEDULE**

	1 year or less		1 to 5 years		5 to 10 years		over 10 years	
	Actual Balance	Average Yield	Actual Balance	Average Yield	Actual Balance	Average Yield	Actual Balance	Average Yield
<b>AVAILABLE-FOR-SALE</b>								
U. S. Government Agencies <sup>(1)</sup>	\$ -	0.00%	\$ 84,330	1.85%	\$ 15,036	2.22%	\$ -	0.00%
Mortgage Backed Securities	-	0.00%	4,951	2.19%	254,791	2.45%	-	0.00%
State, County and Municipal <sup>(2)</sup>	1,875	4.28%	7,619	3.65%	17,766	2.84%	78,331	2.71%
<b>TOTAL AVAILABLE-FOR-SALE</b>	<b>\$ 1,875</b>	<b>0.00%</b>	<b>\$ 96,900</b>	<b>0.00%</b>	<b>\$ 287,593</b>	<b>0.00%</b>	<b>\$ 78,331</b>	<b>0.00%</b>

<sup>(1)</sup> The maturities for the mortgage backed securities included in this line item are based on final maturity.

<sup>(2)</sup> Average yields were calculated on tax equivalent basis using a marginal federal income tax rate of 21% and a state tax rate of 5%.

The change in the carrying value of the AFS portfolio is due to market value fluctuations resulting from the changing interest rate environment during 2018. This change is not used in the Tier 1 capital calculation.

As detailed in Table 9, the security portfolio decreased \$60.7 million or 11.9% in 2018, increased \$2.8 million or 0.5% in 2017 and increased \$84.9 million or 19.8% in 2016. The Company strives to maximize the yields on its portfolio while balancing pledging needs and managing risk. The Company seeks to invest most of its funds not needed for loan demand or the reduction of other borrowings in higher yielding securities and not in the lower yielding federal funds sold.

**DEPOSITS**

The Company offers a wide variety of deposit services to individual and commercial customers, such as non-interest-bearing and interest-bearing checking accounts, savings accounts, money market deposit accounts and time deposits. The deposit base is the Company's



major funding source for earning assets. Time deposits decreased in 2018 and 2017 due to customers desiring to stay short and liquid with their deposits. During this time, all other segments of deposits increased.

A three-year schedule of average deposits by type and maturities of time deposits greater than \$250,000 is presented in Table 10 – Deposit Information.

TABLE 10 – DEPOSIT INFORMATION  
(in thousands, except percentages)

	2018		2017		2016	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing	\$164,682		\$150,689		\$146,438	
Interest-bearing demand	325,192	0.35%	347,260	0.23%	345,438	0.21%
Savings	79,281	0.14%	74,923	0.14%	71,127	0.12%
Time deposits	191,836	0.80%	189,359	0.52%	202,261	0.49%
	\$760,991	0.47%	\$762,231	0.25%	\$765,264	0.25%

#### MATURITY RANGES OF TIME DEPOSITS OF \$250,000 OR MORE

AS OF DECEMBER 31, 2018

3 months or less	\$21,251
3 through 12 months	21,426
1 year to 3 years	14,458
over 3 years	4,522
	<u>\$61,657</u>

The Company, in its normal course of business, will acquire large time deposits, generally from public entities, with a variety of maturities. These funds are acquired on a bid basis and are considered to be part of the deposit base of the Company.

#### BORROWINGS

Aside from the core deposit base and large denomination time deposits mentioned above, the remaining funding sources utilized by the Company include short-term and long-term borrowings. Short-term borrowings consist of Federal Funds Purchased from other financial institutions on an overnight basis, short-term advances from the FHLB and securities sold under agreement to repurchase. Long-term borrowings are advances from the FHLB with an initial maturity of greater than one year.

TABLE 11 - SHORT-TERM BORROWINGS  
(in thousands)

	As of December 31,		
	2018	2017	2016
Short-term borrowings			
Year-end balance	\$ 107,966	\$ 153,998	\$ 150,283
Weighted average rate	1.20%	0.75%	0.68%
Maximum month-end balance	\$ 140,115	\$ 201,427	\$ 203,549
Year to date average balance	\$ 116,787	\$ 130,248	\$ 108,884
Weighted average rate	1.41%	0.75%	0.68%

The Company borrows funds for short periods from the FHLB as an alternative to Federal Funds Purchased. The Company foresees short-term borrowings to be a continued source of liquidity and likely will continue to use these borrowings as a method to fund short-term needs. At December 31, 2018, the Company had the capacity to borrow up to \$216,252,131 from the FHLB and other financial institutions in the form of Federal Funds Purchased. The Company generally will use these types of borrowings if loan demand is greater than the growth in deposits. At December 31, 2018 the Company had borrowed \$-0- from the FHLB and \$-0- in Federal Funds Purchased compared to \$20,000,000 borrowed from the FHLB and \$-0- borrowed in Federal Funds Purchased at December 31, 2017. In 2018, the balances in Securities Sold Under Agreement to Repurchase decreased \$34,532,432, or 24.2% to \$107,965,505. In 2017, these balances decreased to \$142,497,938, a decrease of \$7,784,975, or 5.2%.

At the end of 2018, the Company had long-term debt in the amount of \$-0- to the FHLB for advances and \$14,647 payable to the State of Mississippi for advances under the Mississippi Agribusiness Enterprise Loan Program. This program provides interest-free loans to banks to fund loans to qualifying farmers. Farmers that qualify for the program receive 20% of their loan at zero interest. When the loan is repaid, the State of Mississippi receives 20% of the principal payment, which is equal to the amount advanced by the state, and the Company retains the balance of the principal payment.

The remaining maturity schedule of the long-term debt at December 31, 2018 is listed below.

	(in thousands)
	2018
Less than one year	\$ -
One year to three years	15
Over three years	-
Total long-term borrowings	<u>\$ 15</u>

## NON-INTEREST INCOME AND EXPENSE

Table 12 - Non-Interest Income and Expense illustrates the Company's non-interest income and expense from 2016 through 2018 and percentage changes between such years.

TABLE 12 - NON-INTEREST INCOME & EXPENSE

	(in thousands)				
	% CHANGE		% CHANGE		
	2018	FROM '17	2017	FROM '16	2016
<b>NON-INTEREST INCOME</b>					
Service charges on deposit accounts	\$ 4,562	7.62%	\$ 4,239	11.88%	\$ 3,789
Other operating income	4,037	-0.49%	4,057	3.95%	3,903
<b>TOTAL NON-INTEREST INCOME</b>	<b>\$ 8,599</b>	<b>3.65%</b>	<b>\$ 8,296</b>	<b>7.85%</b>	<b>\$ 7,692</b>
<b>NON-INTEREST EXPENSE</b>					
Salaries and employee benefits	\$ 14,530	-1.64%	\$ 14,772	7.85%	\$ 13,697
Occupancy expense, including equipment	5,730	6.41%	5,385	5.42%	5,108
Other operating expense	7,405	-8.24%	8,070	5.15%	7,675
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>\$ 27,665</b>	<b>-1.99%</b>	<b>\$ 28,227</b>	<b>6.60%</b>	<b>\$ 26,480</b>

Non-interest income typically consists of service charges on checking accounts, including debit card fees, and other financial services. With continued pressure on interest rates, the Company has sought to increase its non-interest income through the expansion of fee income and the development of new services. Currently, the Company's main sources of non-interest income are service charges on checking accounts, safe deposit box rentals, credit life insurance premiums and title insurance service fees.

During 2018 as compared to 2017, non-interest income increased by \$303,189, or 3.65%, when compared to 2017. An increase in service charges on deposit accounts and other service charges and fees was partially offset by a decrease in other income and net gains on sales of securities.

During 2017 as compared to 2016, non-interest income increased by \$604,544, or 7.86%, when compared to 2016. An increase in service charges on deposit accounts and in other service charges and fees and was partially offset by a decrease net gains on the sale of securities and other income.

Non-interest expenses consist of salaries and benefits, occupancy expense and other overhead expenses incurred by the Company in the transaction of its business. In 2018 as compared to 2017, non-interest expense decreased by \$562,460, or 2.0%, to \$27,664,959. Included in this decrease was a decrease in salaries and benefits in the amount of \$241,939, or 1.6%, occupancy expense in the amount of \$144,756, or 6.7%, other expense in the amount of \$665,836, or 8.3% partially offset by an increase in equipment expense in the amount of \$490,071, or 15.3%. The increase in equipment expense was primarily due to strategic

investments in technology over the past few years. The decrease in other expense was in large part due to decreased loan collection expense and a decrease in other losses attributable to writedowns on other real estate.

In 2017 as compared to 2016, non-interest expense increased by \$1,747,768, or 6.6%, to \$28,227,419. Included in this increase was an increase in salaries and benefits in the amount of \$1,075,453, or 7.9% and in other expense in the amount of \$395,982, or 5.2% and an increase in occupancy expense in the amount of \$276,333, or 5.4%. The increase in other expense was in large part due to increased loan collection expense, increase in office supply expense caused by upgrades to bank branches and writedowns on other real estate.

In 2018, the Company's efficiency ratio was 75.99%, compared to 76.35% in 2017 and 71.49% in 2016. The efficiency ratio is calculated to measure the cost of generating one dollar of revenue. The efficiency ratio is calculated by dividing non-interest expense by the sum of net interest income, on a fully tax equivalent basis, and non-interest income.

## **INCOME TAXES**

The Company records a provision for income taxes currently payable, along with a provision for deferred taxes to be realized in the future. Such deferred taxes arise from differences in timing of certain items for financial statement reporting rather than income tax reporting. The deferred tax amount of \$6,633,539 is considered realizable without the use of extraordinary tax planning strategies.

The Company's effective tax rate was 11.04%, 52.36% and 19.31% in 2018, 2017 and 2016, respectively. The major difference between the effective tax rate applied to the Company's financial statement income and the federal statutory rate of 21%, 34% and 34% in 2018, 2017 and 2016, respectively, is interest on tax-exempt securities and loans and the impact on deferred tax assets due to tax reform. Further tax information is disclosed in Note 10, "Income Taxes" to the Company's Consolidated Financial Statements included in this Annual Report.

## **LIQUIDITY AND RATE SENSITIVITY**

Liquidity management is the process by which the Company ensures that adequate liquid funds are available to meet its financial commitments on a timely basis. These commitments include honoring withdrawals by depositors, funding credit obligations to borrowers, servicing long-term obligations, making shareholder dividend payments, paying operating expenses, funding capital expenditures and maintaining reserve requirements.

The Company's predominant sources of funding include: core deposits (consisting of both commercial and individual deposits); proceeds from maturities of securities; repayments of loan principal and interest; Federal Funds Purchased; and short-term and long-term borrowing from the FHLB. In 2018 as compared to 2017, the Company experienced an increase in deposits in excess of the increase in loans outstanding. The decrease in investment securities is mainly the result of the desire to invest funds for current loan obligations. The Company relies upon non-core sources of funding, such as Federal Funds Purchased and short and long-term

borrowings from the FHLB, when deposit growth is not adequate to meet its short-term needs. While the strategy of using these wholesale funding sources is adequate to cover liquidity deficiencies in the short term, the Company's goal is to increase core deposits as a source of long term funding. Management does not intend to rely on borrowings from the FHLB as the first choice as a source of funds but prefers to increase core deposits through increased competition for available deposits. Management believes that core deposits will increase by offering competitive rates and superior service to the Bank's customers.

The Company had no FHLB advances outstanding at year end as part of our strategy to rely more on core deposits than wholesale funding. However, the Company will continue to use advances if they are needed to maintain the Company's liquidity position.

The deposit base is diversified between individual and commercial accounts, which the Company believes helps it avoid dependence on large concentrations of funds. The Company does not currently solicit certificates of deposit from brokers. The primary sources of liquidity on the asset side of the balance sheet are securities classified as AFS. All of the \$444,746,454 in the investment securities portfolio is classified in the AFS category, and is available to be sold, should liquidity needs arise. Management, through its Asset Liability Committee ("ALCO"), and the Board review the Company's liquidity position on a monthly basis. At December 31, 2018, both the ALCO and the Board of Directors determined that the Company's liquidity position was adequate.

Table 13 - Funding Uses and Sources details the main components of cash flows for 2018 and 2017.

TABLE 13 - FUNDING USES AND SOURCES

(in thousands)

	2018			2017		
	Average Balance	Increase/(decrease) Amount	Percent	Average Balance	Increase/(decrease) Amount	Percent
<b>FUNDING USES</b>						
Loans, net of unearned income	\$ 418,136	\$ 22,919	5.80%	\$ 395,217	\$ (14,150)	-3.46%
Taxable securities	376,392	(8,329)	-2.16%	384,721	32,110	9.11%
Tax-exempt securities	107,906	(18,506)	-14.64%	126,412	3,309	2.69%
Federal funds sold and other	-	(24,999)	-100.00%	24,999	(11,072)	-30.70%
<b>TOTAL USES</b>	<b>\$ 902,434</b>	<b>\$ (28,915)</b>	<b>-3.10%</b>	<b>\$ 931,349</b>	<b>\$ 10,197</b>	<b>1.11%</b>
<b>FUNDING SOURCES</b>						
Noninterest-bearing deposits	\$ 164,682	\$ 13,993	9.29%	\$ 150,689	\$ 4,251	2.90%
Interest-bearing demand and savings deposits	404,473	(18,462)	-4.37%	422,935	27,370	6.92%
Time deposits	191,836	2,477	1.31%	189,359	(12,902)	-6.38%
Short-term borrowings	21,479	19,167	829.02%	2,312	2,265	4819.15%
Commercial repo	95,308	(32,629)	-25.50%	127,937	19,053	17.50%
Long-term debt	-	(20,029)	-100.00%	20,029	(13)	-0.06%
<b>TOTAL SOURCES</b>	<b>\$ 877,778</b>	<b>\$ (35,483)</b>	<b>-3.89%</b>	<b>\$ 913,261</b>	<b>\$ 40,024</b>	<b>4.58%</b>

The Company's liquidity depends substantially on the ability of the Bank to transfer funds to the Company in the form of dividends. The information under the heading "Market Price and Dividend Information" in this Annual Report discusses federal and state statutory and regulatory restrictions on the ability of the Bank to transfer funds to the Company in the form of dividends.

## CAPITAL RESOURCES

The Company and Bank are subject to various regulatory capital guidelines as required by federal and state banking agencies. These guidelines define the various components of core capital and assign risk weights to various categories of assets.

The Federal Deposit Insurance Corporation Improvement Act of 1991, as amended ("FDICIA"), required federal regulatory agencies to define capital tiers. These tiers are: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under FDICIA, a "well-capitalized" institution must achieve a Tier 1 risk-based capital ratio of at least 6.00%, a total capital ratio of at least 10.00%, a leverage ratio of at least 5.00% and not be under a capital directive order. These ratios generally measure the percentage of a bank's capital to all or certain categories of assets. Failure to meet capital requirements can initiate regulatory action that could have a direct material effect on the Company's financial statements. If a bank is only adequately capitalized, regulatory approval is required before the bank may accept brokered deposits. If undercapitalized, capital distributions,

asset growth, and expansion are limited, and the institution is required to submit a capital restoration plan.

During 2018 as compared to 2017, total capital increased even though total dividends were in excess of book earnings due to the issuance of stock in the form of restricted stock or option exercises in the amount of \$300,935 and the transfer of stranded AOCI in the amount of \$1,588,198 that resulted from the Tax Cut and Jobs Act of 2018.

Management believes the Company and the Bank meet all the capital requirements to be well-capitalized under the guidelines established by FDICIA as of December 31, 2018, as noted below in Table 14 - Capital Ratios. To be classified as well-capitalized, the Company and Bank must maintain the ratios described above.

TABLE 14 – CAPITAL RATIOS  
(in thousands, except percentage amounts)

	At December 31,		
	2018	2017	2016
Tier 1 capital			
Shareholders' equity	\$ 83,866	\$ 88,452	\$ 85,060
Less: Intangibles	(3,150)	(3,150)	(3,150)
Add/less: Unrealized loss/(gain) on securities	14,975	8,225	10,719
<b>TOTAL TIER 1 CAPITAL</b>	<b>\$ 95,691</b>	<b>\$ 93,527</b>	<b>\$ 92,629</b>
Total capital			
Tier 1 capital	\$ 95,691	\$ 93,527	\$ 92,629
Allowable allowance for loan losses	3,372	3,019	3,903
<b>TOTAL CAPITAL</b>	<b>\$ 99,063</b>	<b>\$ 96,546</b>	<b>\$ 96,532</b>
<b>RISK WEIGHTED ASSETS</b>	<b>\$ 549,828</b>	<b>\$ 521,708</b>	<b>\$ 516,925</b>
<b>AVERAGE ASSETS (FOURTH QUARTER)</b>	<b>\$ 963,820</b>	<b>\$ 1,020,107</b>	<b>\$ 1,005,163</b>
<b>TIER 1 LEVERAGE RATIO</b>	<b>9.93%</b>	<b>9.17%</b>	<b>9.22%</b>
<b>COMMON EQUITY TIER 1 CAPITAL RATIO</b>	<b>9.93%</b>	<b>9.17%</b>	<b>9.22%</b>
<b>TIER 1 RISK-BASED CAPITAL RATIO</b>	<b>17.40%</b>	<b>17.93%</b>	<b>17.92%</b>
<b>TOTAL RISK-BASED CAPITAL RATIO</b>	<b>18.02%</b>	<b>18.51%</b>	<b>18.67%</b>

Management's strategy with respect to capital levels is to maintain a sufficient amount of capital to allow the Company to respond to growth and acquisition opportunities in the Bank's service area. Over the past three years, the Company has been able to increase the amount of its capital, through retention of earnings, while still maintaining the dividend payout ratio to



approximately 70% of earnings per share. The Company does not currently have any commitments for capital expenditures that would require the Company to raise additional capital by means other than retained earnings. The Company does not plan to change this strategy unless needed to support future acquisition activity.

## OFF-BALANCE SHEET ARRANGEMENTS

In the ordinary course of business, the Company makes various commitments and incurs certain contingent liabilities to fulfill the financing needs of its customers. These commitments and contingent liabilities include commitments to extend credit and issue standby letters of credit. These off-balance sheet arrangements are further detailed in Note 13, “Off-Balance Sheet Financial Instruments, Commitments and Contingencies and Concentrations of Risks,” in the notes to the Company’s Consolidated Financial Statements included in this Annual Report.

## CONTRACTUAL OBLIGATIONS

The following table summarizes the contractual obligations, excluding deposits, of the Company as of December 31, 2018.

Contractual Obligations	Payments Due by Period (in thousands)				
	Total	Less than 1 year	1-3 Years	3 - 5 Years	Over 5 Years
Operating Leases	\$ 990	\$ 292	\$ 650	\$ 48	\$ -
Other Long-term Liabilities	15	-	15	-	-
Total	<u>\$ 1,005</u>	<u>\$ 292</u>	<u>\$ 665</u>	<u>\$ 48</u>	<u>\$ -</u>

Long-term debt obligations represent borrowings from the FHLB that have an original maturity in excess of one year. Operating leases are primarily for the lease of ATM machines and other leases for mailing equipment. The equipment leases are for various terms. The other long-term liabilities are those obligations of the Company under the Agribusiness Enterprise Loan Program of the State of Mississippi.

## **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### ***OVERVIEW***

The definition of market risk is the possibility of loss that could result from adverse changes in market prices or interest rates. The Company has taken steps to assess the amount of risk that is associated with its asset and liability structure. The Company measures the potential risk on a regular basis and makes changes to its strategies to manage these risks. The Board of Directors reviews important policy limits each month, with a more detailed risk analysis completed on a quarterly basis. These measurement tools are important in allowing the Company to manage market risk and to plan effective strategies to respond to any adverse changes in risk. The Company does not participate in some of the financial instruments that are inherently subject to substantial market risk. All of the financial instruments entered into by the Company are for purposes other than trading. All information presented in this report are denominated in U.S. dollars.

### ***MARKET/INTEREST RATE RISK MANAGEMENT***

Interest rate risk is the primary market risk that management must address. Interest rate risk is the exposure of Company earnings and capital to changes in interest rates. All financial institutions assume interest rate risk as an integral part of normal operations.

The primary purpose in managing interest rate risk is to effectively invest capital and preserve the value created by the core banking business of the Company. The Company utilizes an investment portfolio to manage the interest rate risk naturally created through its business activities. The process of managing interest rate risk generally involves both reducing the exposure of the Company's net interest margin to swings in interest rates and concurrently ensuring that there is sufficient capital and liquidity to support balance sheet growth. The Company uses a quarterly interest rate risk report to evaluate its exposure to interest rate risk, project earnings and manage the composition of the balance sheet and its growth.

In addition to the quarterly interest rate risk report, the Company employs a number of tools to measure interest rate risk. One tool is static gap analysis, which matches assets with specified maturities to liabilities with corresponding maturities. Although management believes that this does not provide a complete picture of the Company's exposure to interest rate risk, it does highlight significant short-term repricing volume mismatches. The following table presents the Company's rate sensitivity static gap analysis at December 31, 2018 (\$ in thousands):

	Interest Sensitive Within	
	90 days	One year
Total rate sensitive assets	\$ 179,419	\$ 62,658
Total rate sensitive liabilities	259,915	102,819
Net gap	\$ (80,496)	\$ (40,161)

The analysis shows a negative gap position over the next three-month period, which indicates that the Company would benefit somewhat from a decrease in market interest rates in the very short term. Although rate increases would be detrimental to the interest rate risk of the Company, management believes there is adequate flexibility to alter the overall rate sensitivity structure as necessary to minimize exposure to these changes.

Management believes that static gap analysis does not fully capture the impact of interest rate movements on interest sensitive assets and liabilities. Thus, the Company also measures interest rate risk by analyzing interest rate sensitivity and the rate sensitivity gap. Table 15 - Interest Rate Sensitivity provides additional information about the financial instruments that are sensitive to changes in interest rates. This tabular disclosure is limited by its failure to depict accurately the effect on assumptions of significant changes in the economy or interest rates or changes in management's expectations or intentions relating to the Company's financial statements. The information in the interest rate sensitivity table below reflects contractual interest rate pricing dates and contractual maturity dates. For indeterminate maturity deposit products (money market, NOW and savings accounts), the tables present principal cash flows in the shortest term. Although these deposits may not reprice within this time frame, the depositors of such funds have the ability to reprice. Weighted average floating rates are based on the rate for that product as of December 31, 2018 and December 31, 2017.

TABLE 15 - INTEREST RATE SENSITIVITY AS OF DECEMBER 31, 2018

(in thousands)

	2019	2020	2021	2022	2023	Thereafter	Carrying Value	Fair Value
Loans								
Fixed Rate	\$81,808	\$54,416	\$70,950	\$32,780	\$83,478	\$34,948	\$358,380	\$353,467
Average Int Rate	4.89%	4.80%	4.49%	4.72%	4.96%	3.58%	4.67%	
Floating Rate	\$6,408	\$18,742	\$8,564	\$589	\$1,210	\$32,012	\$67,525	\$67,525
Average Int Rate	5.54%	5.84%	4.99%	6.50%	6.05%	5.78%	5.68%	
Investment securities								
Fixed Rate	\$1,875	\$2,440	\$11,648	\$56,074	\$26,738	\$365,924	\$464,699	\$444,746
Average Int Rate	4.28%	3.55%	2.07%	1.97%	1.90%	2.52%	2.42%	
Floating Rate								
Average Int Rate								
Other earning assets								
Fixed Rate	\$8,080						\$8,080	\$8,080
Average Int Rate	1.69%						1.69%	
Floating Rate								
Average Int Rate								
Interest-bearing deposits								
Fixed Rate	\$503,446	\$36,890	\$28,376	\$2,865	\$14,615	\$0	\$586,192	\$585,433
Average Int Rate	0.55%	1.41%	2.88%	2.23%	2.75%	0.00%	0.78%	
Floating Rate								
Average Int Rate								
Other int-bearing liabilities								
Fixed Rate								
Average Int Rate								
Floating Rate	\$107,966						\$107,966	\$107,966
Average Int Rate	1.20%						1.20%	

AS OF DECEMBER 31, 2017  
(in thousands)

	2018	2019	2020	2021	2022	Thereafter	Carrying Value	Fair Value
Loans								
Fixed Rate	\$82,965	\$72,897	\$58,986	\$72,193	\$39,682	\$26,954	\$353,677	\$352,992
Average Int Rate	4.64%	4.89%	4.59%	4.40%	4.64%	3.23%	4.53%	
Floating Rate	\$3,086	\$4,345	\$8,896	\$10,022	\$815	\$21,550	\$48,714	\$48,714
Average Int Rate	4.31%	4.11%	4.75%	3.18%	5.26%	5.38%	4.63%	
Investment securities								
Fixed Rate	\$2,414	\$1,877	\$8,107	\$26,894	\$107,667	\$366,182	\$513,141	\$502,181
Average Int Rate	4.98%	5.05%	2.96%	1.96%	2.09%	2.61%	2.50%	
Floating Rate						\$2,865	\$2,865	\$3,074
Average Int Rate						2.78%	2.78%	
Other earning assets								
Fixed Rate	\$1,532						\$1,532	\$1,532
Average Int Rate	0.50%						0.50%	
Floating Rate								
Average Int Rate								
Interest-bearing deposits								
Fixed Rate	\$524,167	\$32,649	\$2,979	\$19	\$1,580	\$0	\$561,394	\$561,530
Average Int Rate	0.27%	0.62%	0.59%	0.55%	0.55%	0.00%	0.29%	
Floating Rate								
Average Int Rate								
Other int-bearing liabilities								
Fixed Rate	\$30,000						\$30,000	\$30,006
Average Int Rate	2.22%						2.22%	
Floating Rate	\$142,498						\$142,498	\$142,498
Average Int Rate	0.99%						0.99%	

Rate sensitivity gap analysis is another tool management uses to measure interest rate risk. The rate sensitivity gap is the difference between the repricing of interest-earning assets and the repricing of interest-bearing liabilities within certain defined time frames. The Company's interest rate sensitivity position is influenced by the distribution of interest-earning assets and interest-bearing liabilities among the maturity categories. Table 16 - Rate Sensitivity Gap reflects interest-earning assets and interest-bearing liabilities by maturity distribution as of December 31, 2018. Product lines repricing in time periods predetermined by contractual agreements are included in the respective maturity categories.

TABLE 16 - RATE SENSITIVITY GAP AT DECEMBER 31, 2018  
(in thousands, except percentage amounts)

	1 - 90 Days	91 - 365 Days	1 - 5 Years	Over 5 years	Total
<b>INTEREST EARNING ASSETS</b>					
Loans	\$ 80,582	\$ 56,103	\$ 248,469	\$ 30,479	\$ 415,633
Investment securities	90,757	6,555	71,187	276,247	444,746
Interest Bearing Due From Bank Accounts	8,080	-	-	-	8,080
<b>TOTAL INTEREST BEARING ASSETS</b>	<b>\$ 179,419</b>	<b>\$ 62,658</b>	<b>\$ 319,656</b>	<b>\$ 306,726</b>	<b>\$ 868,459</b>
<b>INTEREST BEARING LIABILITIES</b>					
Interest bearing demand deposits	\$ 6,945	\$ 20,837	\$ 111,129	\$ 27,782	\$ 166,693
Savings and Money Market deposits	98,489	-	142,015	134,453	374,957
Time deposits	46,515	81,982	82,739	-	211,236
Short term borrowings	107,966	-	15	-	107,981
Long term borrowings	-	-	-	-	-
<b>TOTAL INTEREST BEARING LIABILITIES</b>	<b>\$ 259,915</b>	<b>\$ 102,819</b>	<b>\$ 335,898</b>	<b>\$ 162,235</b>	<b>\$ 860,867</b>
Rate sensitive gap	\$ (80,496)	\$ (40,161)	\$ (16,242)	\$ 144,491	\$ 7,592
Rate sensitive cumulative gap	(80,496)	(120,657)	(136,899)	7,592	-
Cumulative gap as a percentage of total earning assets	-9.27%	-13.89%	-15.76%	0.87%	

The purpose of the above table is to measure interest rate risk utilizing the repricing intervals of interest sensitive assets and liabilities. Rate sensitive gaps constantly change as funds are acquired and invested and as rates change. Rising interest rates are likely to increase net interest income in a positive gap position while falling interest rates are beneficial in a negative gap position.

The above rate sensitivity analysis places interest-bearing demand and savings deposits in the shortest maturity category because these liabilities do not have defined maturities. If these deposits were placed in a maturity distribution representative of the Company's deposit base history, the shortfall of the negative rate sensitive gap position would be reduced in the 1-to-90 day time frame. It is the goal of the Company to achieve a cumulative gap ratio of plus or minus 15% for all periods under one year, with maximum acceptable limits of plus or minus 20%. Quarterly, management discusses with the ALCO and the board of directors the gap position in relation to the established goals, highlights any reasons for variances from the goals and suggests changes to better align the Company's position with the established goals. When reviewing the Company's position, impacting factors and suggested changes, the board of directors also considers other corporate objectives, including increasing core deposits and increasing profitability, before implementing changes intended to align the Company's position with the

established goals. While the board of directors continues to closely monitor the Company's negative gap position, at this time, management does not anticipate making any significant changes to the Company's operating practices in order to mitigate the negative gap position.

The rate sensitivity gap table illustrates that the Company had a large negative cumulative gap position for the 1 to 90-day period as of December 31, 2018. This negative gap position was mainly due to: (1) a large amount of investment securities that have call dates within that period; (2) the commercial repurchase accounts being classified in the 1 to 90 day category; (3) approximately 60.8% of certificates of deposit maturing during the next twelve months; and (4) a significant portion of the Company's loans maturing after one year.

The interest rate sensitivity and rate sensitivity gap tables, taken together, indicate that the Company continues to be in a liability sensitive position when evaluating the maturities of interest-bearing items. Thus, a decline in the interest rate environment would enhance earnings, while an increase in interest rates would have the opposite effect on the Company's earnings. The Company has attempted to mitigate the impact of its interest rate position by increasing the amount of its variable rate loans and also by structuring deposit rates to entice customers to lengthen the maturities of their time deposits. The effect of any changes in interest rates on the Company would be mitigated by the fact that interest-bearing demand and savings deposits may not be immediately affected by changes in general interest rates.

Short term interest rates remained low in 2016, but started increasing in 2017 and all of 2018 in connection with the target Federal Funds rate by the Federal Reserve Bank. In December 2015, the Federal Reserve Bank increased its target Federal Funds rate to 50 basis points and again in December 2016 to 75 basis points. After the rate increase in 2016, medium term rates began to decline but rose again after the presidential election in November 2016. Since the inauguration, rates have begun to rise due to inflation fears caused by an economy that has begun to show signs of growth. Overall, the effect on the Company has been marginal. The Company's net interest margin in 2018 was 3.05% and in 2017 was 3.01%.



## Quarterly Financial Trends

(in thousands, except per share amounts)

<b>2018</b>				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest Income	\$ 7,600	\$ 7,778	\$ 7,888	\$ 8,093
Interest Expense	795	826	1,169	1,669
Net Interest Income	6,805	6,952	6,719	6,424
Provision for Loan Losses	(237)	89	289	193
Non-interest Income	2,100	2,078	2,221	2,200
Non-interest Expense	7,048	6,946	6,895	6,776
Income Taxes	322	306	260	(60)
Net Income	\$ 1,772	\$ 1,689	\$ 1,496	\$ 1,715
Per common share:				
Basic	\$ 0.36	\$ 0.35	\$ 0.31	\$ 0.35
Diluted	\$ 0.36	\$ 0.35	\$ 0.31	\$ 0.35
Cash Dividends	\$ 0.24	\$ 0.24	\$ 0.24	\$ 0.24

<b>2017</b>				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest Income	\$ 7,469	\$ 7,842	\$ 7,544	\$ 7,673
Interest Expense	807	830	825	881
Net Interest Income	6,662	7,012	6,719	6,792
Provision for Loan Losses	(151)	(30)	(74)	(288)
Non-interest Income	1,934	2,123	2,127	2,090
Non-interest Expense	7,109	6,911	6,887	7,321
Income Taxes	201	471	425	2,974
Net Income	\$ 1,437	\$ 1,783	\$ 1,608	\$ (1,125)
Per common share:				
Basic	\$ 0.29	\$ 0.37	\$ 0.33	\$ (0.23)
Diluted	\$ 0.29	\$ 0.36	\$ 0.33	\$ (0.23)
Cash Dividends	\$ 0.24	\$ 0.24	\$ 0.24	\$ 0.24

Amounts of income tax expense recorded during the fourth quarter of 2017 include a \$2,559 charge to income tax expense for the revaluation of the net deferred tax asset as a result of the Tax Cut and Jobs Act. The reduction of income tax expense in the fourth quarter of 2018 is to adjust income taxes to the actual annual effective rate.

## Market Price and Dividend Information

### **MARKET PRICE INFORMATION**

The Company's common stock trades on the NASDAQ Global Market ("NASDAQ") under the symbol "CIZN". On March 4, 2019, the common stock's closing price on NASDAQ was \$21.00.

On March 4, 2019, shares of the Company's common stock were held of record by approximately 412 shareholders.

### **DIVIDENDS**

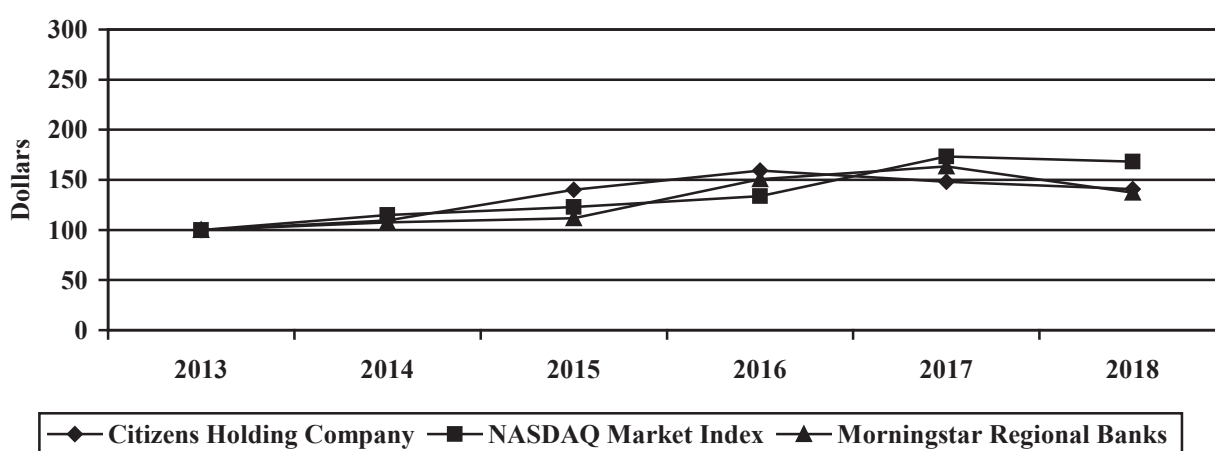
Dividends totaled \$0.96 per share for 2018 and 2017.

If funds are available, the Board of Directors of the Company typically declares dividends on a quarterly basis in March, June, September and December with payment following at the end of the month in which the dividend was declared. Funds for the payment by the Company of cash dividends are obtained from dividends, loans or advances received by the Company from the Bank. Accordingly, the declaration and payment of dividends by the Company depend upon the Bank's earnings and financial condition, general economic conditions, compliance with regulatory requirements, and other factors. The Bank must also receive the approval of the Mississippi Department of Banking and Consumer Finance prior to the payment of a dividend.

## STOCK PERFORMANCE GRAPH

The following performance graph compares the performance of the Company's common stock to the NASDAQ Composite Index and the Morningstar Regional Bank index (a peer group of other regional bank holding companies) for the Company's reporting period. The graph assumes that the value of the investment in the Company's common stock and each index was \$100 at December 31, 2013 and that all dividends were reinvested.

**Performance Graph**  
**December 31, 2013 - December 31, 2018**



	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Citizens Holding Company	100.00	109.51	140.20	159.23	148.16	140.73
NASDAQ Market Index	100.00	114.75	122.74	133.62	173.22	168.30
Morningstar Regional Banks	100.00	107.70	111.61	150.53	163.46	137.08

There can be no assurance that the Company's common stock performance will continue in the future with the same or similar trends depicted in the performance graph above. The Company does not and will not make or endorse any predictions as to future stock performance.

## **THE CITIZENS BANK OFFICERS**

Greg McKee  
President and CEO

Robert T. Smith  
Senior Vice President, CFO

Mark Taylor  
Senior Vice President, COO, Trust Officer

Ray Stone  
Senior Vice President, Chief Credit Officer

Ledale Reynolds  
Senior Vice President and CIO

Liz Owen  
Senior Vice President, Director of  
Human Resources, Chief Risk Officer

Erdis Chaney  
Vice President, Senior Deposit Officer

Jackie Hester  
Vice President, Marketing Officer

Darrel Bates  
Vice President, Collections Manager

Jean T. Fulton  
Vice President, Internal Auditor

Brad Copeland  
Vice President, Branch Manager

Mark Majure  
Vice President, Loan Review Officer

Vicki Brown  
Vice President, BSA Officer

Bob Posey  
Vice President

Mike Chandler  
Vice President

Stacy Arnold  
Vice President, Compliance Officer

Joshua Sullivan  
Vice President, Senior Credit Analyst

Phillip Branch  
Vice President

Ashley Peebles  
Vice President, Director of Deposit Services

Sommer Vick  
Assistant Vice President, Assistant Trust Officer

Beth Branning  
Assistant Vice President

Mitch Peden  
Assistant Vice President, Information Services Manager

Pat Stokes  
Assistant Vice President, Operations Officer

Scott Lewis  
Assistant Vice President, Information Security Officer

Sam Mars  
Assistant Vice President, Loan Officer

Shon Kirkland  
Assistant Vice President, Security Officer/  
Facilities Manager

Charles Wilkerson  
Assistant Vice President, Loan Operations Officer

Tammy Pope  
Accounting Officer

Greg Jackson  
Accounting Officer

Deborah Ladd  
Item Processing Officer

Sandra Curtis  
Assistant Cashier, Teller Administrator

Temika Triplett  
Assistant Cashier, Electronic Services Officer

Craig Stevens  
Deposit Operations Officer

### **Carthage Branch**

Mike Brooks  
President

Billy Cook  
Vice President

Sue Fisher  
Assistant Vice President, Deposit Operations Officer

### **Sebastopol Branch**

Connie Comans  
President

### **Union and Decatur Branches**

Susan Brown  
Deposit Operations Officer

**Kosciusko Branch**

Teresa Patterson  
Vice President, Branch Manager

David Blair, Mortgage Loan Officer  
Vice President

**Scooba and DeKalb Branches**

Reggie Moore  
Assistant Vice President, Branch Manager

Jan White  
Branch Operations Officer

**Forest Branch**

Richard Latham  
Vice President

Lawanda McCaughn  
Deposit Operation Officer

**Louisville Branch**

Bruce Lee  
President

Lynn Graham  
Assistant Vice President, Branch Operations Officer

**Starkville Branch**

Rhonda Edmonson  
Assistant Vice President, Branch Manager

**Collinsville Branch**

Mike Shelby  
Vice President, Branch Manager

**Meridian Eastgate and Broadmoor Branches**

Jay Hines  
Vice President, Regional Commercial Lender

Vikki Gunter  
Assistant Vice President, Branch Operations Officer

**Hattiesburg Branch**

Chad Hill  
Vice President, Branch Manager

Tammy McAlpin  
Commercial Loan Portfolio Manager

**Flowood Branch**

Billy Cook  
Vice President, Manager

**Biloxi Cedar Lake and Lemoyne Branches**

Travis Moore  
Regional President

Brandon Sherwood  
Gulf Coast President

Tammy Warren  
Assistant Vice President, Mortgage Loan Officer

Katie Hancock  
Vice President, Branch Manager

**Mortgage Loan Department**

Charlene Deweese  
Assistant Vice President, Mortgage Loan Officer

**Oxford Loan Production Office**

Marion Boyd  
Vice President, Regional Commercial Lender

## **BOARD OF DIRECTORS**

Don Fulton  
Retired  
W. G. Yates and Sons Construction Co.

Donald L. Kilgore  
Special Assistant Attorney General  
State of Mississippi

David A. King  
Proprietor  
Philadelphia Motor Company

Herbert A. King  
Civil Engineer  
King Engineering Associates, Inc.

Adam Mars  
Business Manager  
Mars, Mars & Mars

Craig Dungan, MD  
Physician  
Meridian Gastroenterology PLLC

Greg L. McKee  
President & Chief Executive Officer  
Citizens Holding Company and  
The Citizens Bank

David P. Webb  
Attorney  
Baker, Donelson, Bearman, Caldwell &  
Berkowitz, PC

A. T. Williams  
Certified Public Accountant  
A. T. Williams, CPA

Terrell E. Winstead  
Chief Financial Officer  
Molpus Woodlands Group

## **CITIZENS HOLDING COMPANY OFFICERS**

Herbert A. King  
Chairman

Greg L. McKee  
President and Chief Executive Officer

Mark Taylor  
Secretary

Robert T. Smith  
Treasurer and Chief Financial Officer

## **BANKING LOCATIONS**

### **Philadelphia Main Office**

521 Main Street  
Philadelphia, MS 39350  
601.656.4692

### **Westside Branch**

912 West Beacon Street  
Philadelphia, MS 39350  
601.656.4692

### **Northside Branch**

802 Pecan Avenue  
Philadelphia, MS 39350  
601.656.4692

### **Eastside Branch**

599 East Main Street  
Philadelphia, MS 39350  
601.656.4692

### **Union Branch**

502 Bank Street  
Union, MS 39365  
601.774.9231

### **Starkville Branch**

201 Highway 12 West  
Starkville, MS 39759  
662.323.1420

### **Carthage Main Office**

301 West Main Street  
Carthage, MS 39051  
601.257.4525

### **Biloxi Cedar Lakes**

1830 Popp's Ferry Road  
Biloxi, MS 39532  
228.594.6913

### **Oxford Loan Production**

304 Enterprise Dr., Ste A  
Oxford, MS 38655

### **Collinsville Branch**

9065 Collinsville Road  
Collinsville, MS 39325  
601.626.7608

### **Flowood Branch**

5419 Hwy 25 Ste. Q  
Flowood, MS 39232  
601.992.7688

### **Sebastopol Branch**

24 Pine Street  
Sebastopol, MS 39359  
601.625.7447

### **DeKalb Branch**

176 Main Avenue  
DeKalb, MS 39328  
601.743.2115

### **Kosciusko Branch**

775 North Jackson Street  
Kosciusko, MS 39090  
662.289.4356

### **Scooba Branch**

27597 Highway 16 East  
Scooba, MS 39358  
662.476.8431

### **Meridian Eastgate**

1825 Hwy 39 North  
Meridian, MS 39301  
601.693.8367

### **Hattiesburg Branch**

6222 Highway 98  
Hattiesburg, MS 39402  
601.264.4425

### **Phone Teller**

1.800.397.0344

### **Decatur Branch**

15330 Hwy 15 South  
Decatur, MS 39327  
601.635.2321

### **Forest Branch**

247 Woodland Drive North  
Forest, MS 39074  
601.469.3424

### **Louisville-Main Branch**

100 East Main Street  
Louisville, MS 39339  
662.773.6261

### **Noxapater Branch**

45 East Main Street  
Noxapater, MS 39346  
662.724.4261

### **Louisville-Industrial Branch**

803 South Church Street  
Louisville, MS 39339  
662.773.6261

### **Biloxi Lemoyne Boulevard**

15309 Lemoyne Boulevard  
Biloxi, MS 39532  
228.207.2343

### **Meridian Broadmoor**

5015 Highway 493  
Meridian, MS 39305  
601.581.1541

### **Flowood Branch**

5419 Highway 25, Suite Q  
Flowood, MS 39232  
601.992.7688

### **Internet Banking**

<http://www.thecitizensbankphila.com>



## **FINANCIAL INFORMATION**

### **CORPORATE HEADQUARTERS**

521 Main Street  
P.O. Box 209  
Philadelphia, MS 39350

**601.656.4692**

### **ANNUAL SHAREHOLDER MEETING**

The Annual Shareholder meeting of the Citizens Holding Company, Inc. will be held Tuesday, April 23, 2019, at 4:30 P.M. in the lobby of the main office of The Citizens Bank, 521 Main Street, Philadelphia, Mississippi.

### **STOCK REGISTRAR AND TRANSFER AGENT**

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, NY 10038

### **FORM 10-K**

The Company's most recent Annual Report on Form 10-K, filed with the Securities and Exchange Commission, is available without charge to shareholders upon request to the Treasurer of the Citizens Holding Company.

### **FINANCIAL CONTACT**

Robert T. Smith  
Treasurer and Chief Financial Officer  
P.O. 209  
Philadelphia, Mississippi 39350

Additional information can be obtained from the Company's website at [www.citizensholdingcompany.com](http://www.citizensholdingcompany.com).

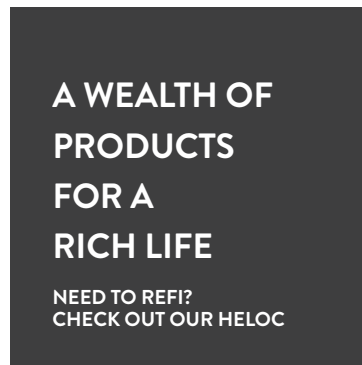
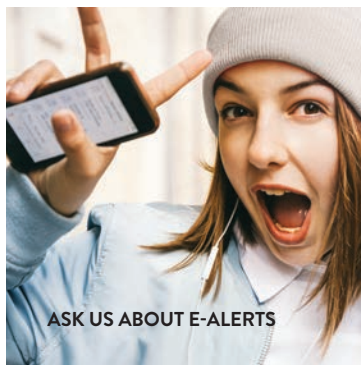
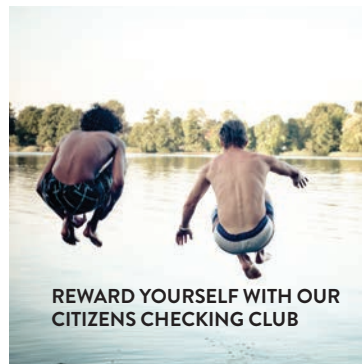
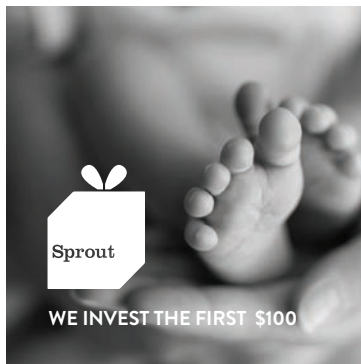




IN YOUR  
CORNER  
AT EVERY  
TURN



WE'RE ON THE  
SAME PAGE  
WITH YOUR  
LIFE STORY



**Citizens Holding Company**  
521 Main Street, Philadelphia, MS 39350  
[www.thecitizensbankphila.com](http://www.thecitizensbankphila.com)