

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549**

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005**

or

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

Commission file number: 000-25221

**CITIZENS HOLDING COMPANY**

(Exact Name of Registrant as Specified in Its Charter)

**MISSISSIPPI**  
(State or Other Jurisdiction of  
Incorporation or Organization)

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

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

**39350**  
(Zip Code)

Registrant's telephone number, including area code: 601-656-4692

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of Each Exchange on Which Registered
<b>Common Stock, \$.20 par value</b>	<b>American Stock Exchange</b>

**Securities registered pursuant to section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. YES  NO

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of June 30, 2005, the aggregate market value of the registrant's common stock, \$.20 par value, held by non-affiliates of the registrant was \$99,564,864 based on the closing sale price as reported on the American Stock Exchange for such date.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class	Outstanding at March 7, 2006
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Common stock, \$.20 par value

5,012,278 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Citizens Holding Company's Annual Report to Shareholders for the fiscal year ended December 31, 2005 are incorporated by reference into Part II of this Annual Report on Form 10-K.

Portions of Citizens Holding Company's definitive proxy statement with respect to its 2006 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

In addition to historical information, this report contains statements which constitute forward-looking statements and information which 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 the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of the business of the Company and the Company's majority-owned subsidiary, The Citizens Bank of Philadelphia, Mississippi (the "Bank"), include, but are not limited to, the following:

- the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Company operates;
- changes in the legislative and regulatory environment that negatively impact the Company and the Bank through increased operating expenses;
- increased competition from other financial institutions;
- the impact of technological advances;
- expectations about the movement of interest rates, including actions that may be taken by the Federal Reserve Board in response to changing economic conditions;
- changes in asset quality and loan demand;
- expectations about overall economic strength and the performance of the economy in the Company's market area; and
- other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission.

The Company does not undertake any obligation to update or revise any forward-looking statements subsequent to the date on which they are made. Please also refer to Item 1A, "Risk Factors," for a detailed discussion of the risks related to the Company in particular and the banking industry generally.

ITEM 1. BUSINESS

BACKGROUND

The Company is a one-bank holding company that holds 97.86% of the outstanding shares of the Bank. The Company was incorporated under Mississippi law on February 16, 1982, at the direction of the Board of Directors of the Bank in order to facilitate the Bank's adoption of a one-bank holding company structure.

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The Bank was opened on February 8, 1908 as The First National Bank of Philadelphia. In 1917, the Bank surrendered its national charter and obtained a state charter, at which time the name of the Bank was changed to The Citizens Bank of Philadelphia, Mississippi. At December 31, 2005, the Bank was the largest bank headquartered in Neshoba County, Mississippi, with total assets of \$607,709,136 and total deposits of \$475,326,560. For more information regarding the assets, revenue and profits of the Company, refer to the Consolidated Financial Statements of the Company contained in Item 8 of this Annual Report on Form 10-K.

The principal executive offices of both the Company and the Bank are located at 521 Main Street, Philadelphia, Mississippi 39350, and the main telephone number is (601) 656-4692. All references hereinafter to the activities or operations of the Company reflect the Company's activities or operations through the Bank.

The Company acquired by merger CB&T Capital Corporation and its subsidiary Citizens Bank & Trust Company in Louisville, Mississippi, in the second quarter of 2002. This acquisition added approximately \$70 million in assets to the Company. The purchase price of the net assets totaled approximately \$12.3 million in cash and was based on a multiple of approximately 1.505 times the book value, subject to certain adjustments, of the acquired company.

In July 2001, the Company purchased two branches of Union Planters National Bank located in Forest and Decatur, Mississippi. This acquisition had the effect of adding \$30,506,745 in assets, including \$11,703,517 in loans and \$30,284,185 in deposits.

### OPERATIONS

Through its ownership of the Bank, the Company engages in a wide range of commercial and personal banking activities, including accepting demand deposits, savings and time deposit accounts, making secured and unsecured loans, issuing letters of credit, originating mortgage loans, and providing personal and corporate trust services. The Company also provides certain services that are closely related to commercial banking such as credit life insurance and title insurance for its loan customers.

Revenues from the Company's lending activities constitute the largest component of the Company's operating revenues. Revenue from loan interest and fees made up 68.2% of gross revenues in 2005, 68.0% in 2004 and 67.6% in 2003. Such lending activities include commercial, real estate, installment (direct and indirect) and credit card loans. The Company's primary lending area is East Central Mississippi, specifically Neshoba, Newton, Leake, Scott, Attala, Lauderdale, Winston and Kemper counties and contiguous counties. On a very limited basis, the Company extends out-of-area credit only to borrowers who are considered to be low risk. The Company is not dependent upon any single customer or small group of customers, and it has no foreign operations.

The Company's eight county market area is mainly rural, with Meridian, population 41,036, being the largest city. Agriculture and some light industry comprise a significant portion of the economy of this area. The largest employer in the Company's service area is the Mississippi Band of Choctaw Indians; their schools, manufacturing plants and their main source of income, The Pearl River Resort (the "Resort"), generate a significant number of jobs in the area. The Resort and its related services employ approximately 5,000 people within the Company's market area.

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The Company has historically made, and intends to continue to make, most types of real estate loans, including, but not limited to, single and multi-family housing, farm, residential and commercial construction and commercial real estate loans. Historically, approximately 68.7% of the Company's loan portfolio has been attributed to this category of lending. Another 13.5% of the Company's loan portfolio is comprised of commercial, industrial and agricultural production loans. Consumer loans make up the remaining 17.8% of the total loan portfolio.

The Company's loan personnel have the authority to extend credit under guidelines established and approved by the Company's 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 various Company directors, including the Chairman of the Board. All aggregate credits 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 the communication and pooling of knowledge, judgment and experience of its members.

All loans in the Company's portfolio are subject to risk based on the state of both the local and national economy. However, because the Company's local economy in the past few years has been strong, with unemployment at historic lows, and is projected to remain strong in the near future, management believes that general risk levels are low.

In addition to lending services, the Company provides limited trust services. The Company serves as custodian of cemetery upkeep funds and insurance trusts. The Company also offers discount brokerage services through First Tennessee Bank.

Through such innovations as its VISA Checkcard program, the 24 Hour Phone Teller and its Internet site (<http://www.thecitizensbankphila.com>), the Company's customers have easy and convenient access to their funds and account balances 24 hours a day, 7 days a week. Additionally, the Internet site enables the Company's customers to review their accounts in detail, make transfers between their accounts and pay bills from anywhere in the world.

### EXECUTIVE OFFICERS OF THE REGISTRANT

Greg L. McKee, who is 44 years old, has been employed by the Bank since 1984. He was named President and Chief Executive Officer of the Company and Chief Executive Officer of the Bank in January 2003. He has served as President of the Bank since January 2002 and served as Chief Operating Officer of the Bank from January 2002 until December 31, 2002. He has also been a member of the Board of Directors of both the Company and the Bank since 2001. Mr. McKee served as Executive Vice-President of the Bank from 2001 to 2002, Senior Vice-President of the Bank from 2000 to 2001, Vice-President of the Bank from 1992 to 2000, Assistant Vice-President of the Bank from 1989 to 1992, and Assistant Cashier of the Bank from 1984 to 1989.

Robert T. Smith, who is 54 years old, has been employed by the Bank since 1986. He has served as Senior Vice-President and Chief Financial Officer since January 2001. Prior to January 2001, Mr. Smith held the title of Vice-President and Controller from 1987 until 2001 and Assistant Vice-President from 1986 to 1987. In addition to his position with the Bank, Mr. Smith has served as Treasurer of the Company since February 1996.

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EMPLOYEES

The Company has no employees other than three Bank officers who provide services to the Company. These officers receive no compensation from the Company for their services to it; their entire salary is paid by the Bank. At December 31, 2005, the Bank employed 213 full-time employees and 37 part-time employees. The Bank is not a party to any collective bargaining agreements, and employee relations are considered to be good.

SUPERVISION AND REGULATION

The Bank is chartered under the banking laws of the State of Mississippi and is subject to the supervision of, and is regularly examined by, the Mississippi Department of Banking and Consumer Finance and the Federal Deposit Insurance Corporation (“FDIC”). The Company is a registered bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the “BHC Act”), and is subject to the supervision of the Federal Reserve Board (“FRB”). Certain legislation and regulations affecting the businesses of the Company and the Bank are discussed below.

*General.*

The FRB requires the Company to maintain certain levels of capital and to file an annual report with the FRB. The FRB also has the authority to conduct examinations of the Company and the Bank and to take enforcement action against any bank holding company that engages in any unsafe or unsound practice or that violates certain laws, regulations, or conditions imposed in writing by the FRB.

*Capital Standards.*

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%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. The Company’s leverage capital ratio at December 31, 2005 was 10.11%.

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### *Prompt Corrective Action and Other Enforcement Mechanisms.*

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more of the prescribed minimum capital ratios. The law requires each federal banking agency to promulgate regulations defining the following five categories in which an insured depository institution will be placed, based on the level of its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The Company and Bank are classified as well capitalized under the guidelines promulgated by the Federal Reserve Bank under Regulation H and Regulation Y.

### *Safety and Soundness Standards.*

FDICIA also implemented certain specific restrictions on transactions and required the regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation, and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, the use of brokered deposits and the aggregate extension of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts.

### *Restrictions on Dividends and Other Distributions.*

The Company's ability to pay dividends depends in large part on the ability of the Bank to pay dividends to the Company. The power of the board of directors of an insured depository institution to declare a cash dividend or other distribution with respect to capital is subject to federal statutory and regulatory restrictions which limit the amount available for such distribution depending upon the earnings, financial condition and cash needs of the institution, as well as general business conditions.

The approval of the Mississippi Department of Banking and Consumer Finance is also required prior to the Bank paying dividends. The department's regulations limit dividends to earned surplus in excess of three times the Bank's capital stock. At December 31, 2005, the maximum amount available for transfer from the Bank to the Company in the form of a dividend was \$60,342,000, or 10% of the Bank's consolidated net assets.

FRB regulations limit the amount the Bank may loan to the Company unless those loans are collateralized by specific obligations. At December 31, 2005, the maximum amount available for transfer from the Bank in the form of cash dividends and loans was \$120,620,765, or 20% of the Bank's consolidated net assets.

### *FDIC Insurance Assessments.*

The FDIC has established several mechanisms to increase funds to protect deposits insured by the Bank Insurance Fund ("BIF") and the Savings Association Insurance Fund ("SAIF"), both of which are administered by the FDIC. The Bank's deposits are insured through BIF except for those deposits the Bank acquired from the Resolution Trust Corporation in April, 1994. This acquisition consisted of one branch of the former Security Federal Savings and Loan in Kosciusko, Mississippi, and these deposits remain insured through the SAIF.



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Deposit insurance premiums for banks and savings associations were increased as a result of The Financial Institutions Reform, Recovery and Enforcement Act of 1989. Losses incurred by the FDIC in connection with the default or assistance of troubled federally insured financial institutions are required to be reimbursed by other federally insured financial institutions.

### *Other BHC Act Provisions*

The BHC Act requires a bank holding company to obtain the prior approval of the FRB before acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank that is not already majority-owned by such bank holding company. The BHC Act provides that the FRB shall not approve any acquisition, merger or consolidation which would result in a monopoly or which would be in furtherance of any combination or conspiracy to monopolize or attempt to monopolize the business of banking. The FRB also will not approve any other transactions in which the effect might be to substantially lessen competition or in any manner be a restraint on trade, unless the anti-competitive effects of the proposed transaction are clearly outweighed by the public interest in the probable effect of the transaction in meeting the convenience and needs of the community to be served.

The BHC Act also prohibits a bank holding company, with certain exceptions, from itself engaging in or from acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in non-banking activities. The principal exception to this rule is for engaging in or acquiring shares of a company whose activities are found by the FRB to be so closely related to banking or managing banks as to be a proper incident thereto. In making such determinations, the FRB is required to consider whether the performance of such activities by a bank holding company or its subsidiaries can reasonably be expected to produce benefits to the public such as greater convenience, increased competition, or gains in efficiency of resources that outweigh the risks of possible adverse effects such as decreased or unfair competition, conflicts of interest, or unsound banking practices.

The BHC Act prohibits the acquisition by a bank holding company of more than 5% of the outstanding voting shares of a bank located outside the state in which the operations of its banking subsidiaries are principally conducted, unless such an acquisition is specifically authorized by statute of the state in which the bank to be acquired is located.

The Company and the Bank are subject to certain restrictions imposed by the Federal Reserve Act and the Federal Deposit Insurance Act on any extensions of credit to the Company or the Bank, on investments in the stock or other securities of the Company or the Bank, and on taking such stock or other securities as collateral for loans of any borrower.

The BHC Act was amended in 2000 by the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 to permit “financial holding companies” to engage in a broader range of nonbanking financial activities, such as underwriting and selling insurance, providing financial or investment advice, and dealing and making markets in securities and merchant banking. In order to qualify as a financial holding company, the Company must declare to the FRB its intention to become a financial holding company and certify that the Bank meets the capitalization management requirements and that it has at least a satisfactory rating under the Community Reinvestment Act of 1997. As of December 31, 2005, we had not elected to become a financial holding company.

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### *Interstate Banking and Branching.*

On September 29, 1994, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the “Interstate Act”) was signed into law. The Interstate Act effectively permits nationwide banking by removing territorial restrictions on interstate bank mergers.

Interstate branching by merger with, or acquisition or consolidation of, banks located in different states was permitted beginning June 1, 1997, except in states that have passed legislation prior to that date “opting-out” of interstate branching. If a state opted-out prior to June 1, 1997, then banks located in that state can not participate in interstate branching. Effective May 1, 1997, Mississippi “opted in” to the interstate branching provision of the Interstate Act.

### *Community Reinvestment Act.*

The Community Reinvestment Act of 1997, as amended (“CRA”), requires the assessment by the appropriate regulatory authority of a financial institution’s record in meeting the credit needs of the local community, including low and moderate-income neighborhoods. The regulations promulgated under CRA emphasize an assessment of actual performance in meeting local credit needs, rather than of the procedures followed by a bank, to evaluate compliance with the CRA. CRA compliance is also a factor in evaluations of proposed mergers, acquisitions and applications to open new branches or facilities. Overall CRA compliance is rated across a four-point scale from “outstanding” to “substantial noncompliance.” Different evaluation methods are used depending on the asset size of the bank.

The FDIC examined the Bank on August 21, 2001 and again most recently on August 17, 2004, for its performance under the CRA. The Bank was rated Satisfactory during both of these examinations. No discriminatory practices or illegal discouragement of applications were found.

### *Anti-Money Laundering Efforts.*

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (“USA PATRIOT Act”) requires financial institutions to establish anti-money laundering programs and due diligence policies, procedures and controls with respect to bank accounts involving foreign individuals and certain foreign banks, and to avoid establishing and maintaining accounts in the United States for, or on the behalf of, foreign banks that do not have a physical presence in any country.

### *Corporate Governance.*

The Sarbanes-Oxley Act of 2002 (“Sarbanes Act”) requires publicly traded companies such as the Company to adhere to several directives designed to prevent corporate misconduct. Additional duties have been placed on officers, directors, auditors and attorneys of public companies. The Sarbanes Act requires certifications regarding financial statement accuracy and internal control adequacy by the chief executive officer and the chief financial officer to accompany periodic reports filed with the Securities and Exchange Commission (“SEC”). The Sarbanes Act also accelerates Section 16 insider reporting obligations, restricts certain executive officer and director transactions, imposes new obligations on corporate audit committees and provides for enhanced review by the SEC.

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### *Impact of Monetary Policies.*

Banking is a business that substantially depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and other borrowings and the interest rate earned by banks on loans, securities and other interest-earning assets comprises the major source of banks' earnings. Thus, the earnings and growth of banks are subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies including the FRB. The nature and timing of any future changes in such policies and their impact on the Company cannot be predicted.

### COMPETITION

The banking business is highly competitive. The Company's market area consists principally of Neshoba, Newton, Leake, Scott, Attala, Lauderdale, Winston and Kemper counties in Mississippi. The Company competes with other financial institutions in these counties and in surrounding counties in Mississippi in obtaining deposits and providing many types of financial services. The Company also competes with larger regional banks for the business of companies located in the Company's market area.

All financial institutions, including the Company, compete for customers' deposits. The Company competes with savings and loan associations, credit unions, production credit associations, federal land banks, finance companies, personal loan companies, money market funds and other non-depository financial intermediaries. Many of these financial institutions have resources many times greater than those of the Company. In addition, new financial intermediaries such as money-market mutual funds and large retailers are not subject to the same regulations and laws that govern the operation of traditional depository institutions. The Company believes it benefits from a good reputation in the community and from the significant length of time it has provided needed banking services to its customers. Also, as a locally owned financial institution, the Company believes it is able to respond to the needs of the community with services tailored to the particular demands of its customers. Furthermore, as a local institution, the Company believes it can provide these services faster than a larger institution not based in the Company's market area.

Recent changes in federal and state law have resulted in, and are expected to continue to result in, increased competition. The reductions in legal barriers to the acquisition of banks by out-of-state bank holding companies resulting from implementation of the Interstate Act and other recent and proposed changes in banking laws and regulations are expected to continue to further stimulate competition in the markets in which the Company operates, although it is not possible to predict the extent or timing of such increased competition.

Currently, there are approximately fourteen different financial institutions in the Company's market area competing for the same customer base. As of June 30, 2005, the Company's market share in its market area was approximately 16.3%. The Company competes in its market for loan and deposit products, along with many of the other services required by today's banking customer, on the basis of availability, quality and pricing. The Company believes it is able to compete favorably in its markets, in terms of both the rates we offer and the level of service that we provide to our customers.

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AVAILABILITY OF INFORMATION

The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to any of the foregoing are not currently available on the Company's website, <http://www.thecitizensbankphila.com>. The Company is in the process of launching a new corporate website and, after its completion, the Company's annual, quarterly and current reports will be available on this website. Upon request, the Company will provide to any record holder or beneficial holder of its shares a copy of such reports without charge. Requests should be made to Robert T. Smith, Treasurer and Chief Financial Officer, Citizens Holding Company, 521 Main Street, Philadelphia, Mississippi 39350.

ITEM 1A. RISK FACTORS

In addition to the other information contained in or incorporated by reference into this Annual Report on Form 10-K and the exhibits hereto, the following risk factors should be considered carefully in evaluating our business. The risks disclosed below, either alone or in combination, could materially adversely affect the business, financial condition or results of operations of the Company. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations.

*Risks Related To Our Business and Industry*

*We are subject to interest rate risk.*

Our earnings and cash flows are largely dependent upon the net interest income of the Company. Net interest income is the difference between interest earned on assets, such as loans and securities, and the cost of interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the FRB. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, which could reduce the amount of fee income generated, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of our mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income could be adversely affected, which in turn could negatively affect our earnings. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the results of operations of the Company, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations. Volatility in interest rates may also result in disintermediation, which is the flow of funds away from financial

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institutions into direct investments, such as U.S. Government and Agency securities and other investment vehicles, including mutual funds, which generally pay higher rates of return than financial institutions because of the absence of federal insurance premiums and reserve requirements. Disintermediation could also result in material adverse effects on our financial condition and results of operations.

A discussion of the policies and procedures used to identify, assess and manage certain interest rate risk is set forth in Item 7A, "Qualitative and Quantitative Disclosures about Market Risk."

*We are subject to lending risk.*

There are inherent risks associated with our lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where we operate as well as those across the United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans.

As of December 31, 2005, approximately 82% of our loan portfolio consisted of commercial, construction and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans due primarily to the large amounts loaned to individual borrowers. Because the loan portfolio contains a significant number of commercial, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

*The allowance for possible loan losses may be insufficient.*

Although we try to maintain diversification within our loan portfolio in order to minimize the effect of economic conditions within a particular industry, management also maintains an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, to absorb probable credit losses inherent in the entire loan portfolio. The appropriate level of the allowance is based on management's quarterly analysis of the loan portfolio and represents an amount that management deems adequate to provide for inherent losses, including collective impairment. Among other considerations in establishing the allowance for loan losses, management considers economic conditions reflected within industry segments, the unemployment rate in our markets, loan segmentation, and historical losses that are inherent in the loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires management to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses.

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In addition, bank regulatory agencies periodically review the allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on our financial condition and results of operations. A discussion of the policies and procedures related to management's process for determining the appropriate level of the allowance for loan losses is set forth in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

*Bank holding companies depend on the accuracy and completeness of information about customers and counterparties.*

In deciding whether to extend credit or enter into other transactions, we often rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

*We are subject to environmental liability risk associated with lending activities.*

A significant portion of the loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit the ability of the Company to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although management has policies and procedures to perform an environmental review during the loan application process and also before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

*The profitability of the Company depends significantly on economic conditions in the State of Mississippi.*

Our success depends primarily on the general economic conditions of the State of Mississippi and the specific local markets in which we operate. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers primarily in East Central Mississippi. The local economic conditions in this area have a significant impact on the demand for our products and services as well as the ability of our customers to repay loans, the value of the collateral securing loans and the stability of our deposit funding sources.

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*The earnings of bank holding companies are significantly affected by general business and economic conditions.*

In addition to the risks associated with the general economic conditions in the markets in which we operate, our operations and profitability are also impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, and the strength of the U.S. economy and the local economies in which we operate, all of which are beyond our control. A deterioration in economic conditions could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for our products and services, among other things, any of which could have a material adverse impact on our financial condition and results of operations.

*We operate in a highly competitive industry and market area.*

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional and community banks within the various markets in which we operate. We also face competition from many other types of financial institutions, including savings and loans, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. The information under the heading "Competition" in Item 1, "Business," provides more information regarding the competitive conditions in our markets.

Our industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, many of our competitors have substantially greater resources than us, including higher total assets and capitalization, greater access to capital markets and a broader offering of financial services.

Our ability to compete successfully depends on a number of factors, including, among other things:

- The ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets.
- The ability to expand the Company's market position.
- The scope, relevance and pricing of products and services offered to meet customer needs and demands.
- The rate at which we introduce new products and services relative to our competitors.
- Customer satisfaction with our level of service.
- Industry and general economic trends.

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Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

*We are subject to extensive government regulation and supervision.*

The Company and the Bank are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not the economic or other interests of shareholders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of the foregoing, could affect the Company and/or the Bank in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things.

Under regulatory capital adequacy guidelines and other regulatory requirements, the Company and the Bank must meet guidelines that include quantitative measures of assets, liabilities and certain off-balance sheet items, subject to qualitative judgments by regulators about components, risk weightings and other factors. If we fail to meet these minimum capital guidelines and other regulatory requirements, our financial condition would be materially and adversely affected. Our failure to maintain the status of "well capitalized" under our regulatory framework could affect the confidence of our customers in us, thus compromising our competitive position. In addition, failure to maintain the status of "well capitalized" under our regulatory framework or "well managed" under regulatory examination procedures could compromise our status as a bank holding company and related eligibility for a streamlined review process for acquisition proposals.

We are also subject to laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes Act and new SEC regulations. These laws, regulations and standards are subject to varying interpretations in many cases, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased expenses and a diversion of management time and attention.

Failure to comply with laws, regulations or policies could also result in sanctions by regulatory agencies and/or civil money penalties, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. The information under the heading "Supervision and Regulation" in Item 1, "Business," and Note 14, "Regulatory Matters" to the Consolidated Financial Statements of the Company in Item 8, "Financial Statements and Supplementary Data," provides more information regarding the regulatory environment in which we and our Bank operate.



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### *Our controls and procedures may fail or be circumvented.*

Management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures and corporate governance policies and procedures. Any system of controls, however well designed and operated, 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 our adherence to financial reporting, disclosure and corporate governance policies and procedures.

### *Slower than anticipated growth in new branches and new product and service offerings could result in reduced income.*

We have placed a strategic emphasis on expanding our branch network and product offerings. Executing this strategy carries risks of slower than anticipated growth both in new branches and new products. New branches and products require a significant investment of both financial and personnel resources. Lower than expected loan and deposit growth in new investments can decrease anticipated revenues and net income generated by those investments, and opening new branches and introducing new products could result in more additional expenses than anticipated and divert resources from current core operations.

### *We are substantially dependent on dividends from the Bank for our revenues.*

The Company is a separate and distinct legal entity from the Bank, and it receives substantially all of its revenue from dividends from the Bank. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on debt. Various federal and/or state laws and regulations limit the amount of dividends that the Bank may pay to the Company. In the event the Bank is unable to pay dividends to us, we may not be able to service debt, pay obligations or pay dividends on our common stock. The inability to receive dividends from the Bank could have a material adverse effect on our business, financial condition and results of operations. The information under the heading "Supervision and Regulation" in Item 1, "Business," provides a discussion about the restrictions governing the Bank's ability to transfer funds to us.

### *Potential acquisitions may disrupt the our business and dilute shareholder value.*

We seek merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. Acquiring other banks, businesses or branches involves various risks commonly associated with acquisitions, including, among other things:

- Potential exposure to unknown or contingent liabilities of the target company.
- Exposure to potential asset quality issues of the target company.
- Difficulty and expense of integrating the operations and personnel of the target company.

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- Potential disruption to our business.
- Potential diversion of management's time and attention.
- The possible loss of key employees and customers of the target company.
- Difficulty in estimating the value of the target company.
- Potential changes in banking or tax laws or regulations that may affect the target company.

We regularly evaluate merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of our tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on our financial condition and results of operations.

*We may not be able to attract and retain skilled people.*

Our success depends in part on our ability to retain key executives and to attract and retain additional qualified personnel who have experience both in sophisticated banking matters and in operating a bank of our size. Competition for such personnel is strong in the banking industry, and we may not be successful in attracting or retaining the personnel we require. The unexpected loss of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our markets, years of industry experience and the difficulty of promptly finding qualified replacements. We expect to effectively compete in this area by offering financial packages that are competitive within the industry.

*Our information systems may experience an interruption or breach in security.*

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on the financial condition and results of operations of the Company.

*We continually encounter technological change.*

Our industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs.

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Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting our industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

*Consumers may decide not to use banks to complete their financial transactions.*

While we continually attempt to use technology to offer new products and services, at the same time, technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as disintermediation, could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

*Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact our business.*

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on the ability of the Company to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. For example, during 2005, Hurricanes Katrina and Rita made landfall and subsequently caused extensive flooding and destruction along the coastal areas of the Gulf of Mexico. Although our operations were not disrupted by these hurricanes or their aftermath, other severe weather or natural disasters, acts of war or terrorism or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

*Risks Associated With Our Common Stock*

*Our stock price can be volatile.*

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Our stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Actual or anticipated variations in quarterly results of operations.

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- Recommendations by securities analysts.
- Operating and stock price performance of other companies that investors deem comparable to the Company.
- News reports relating to trends, concerns and other issues in the banking and financial services industry.
- Perceptions in the marketplace regarding us and/or our competitors.
- New technology used, or services offered, by competitors.
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors.
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions.
- Changes in government regulations.
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results.

*The trading volume in our common stock is less than that of other larger bank holding companies.*

Our common stock is listed for trading on the American Stock Exchange; the average daily trading volume in our common stock is low, generally less than that of many of our competitors and other larger bank holding companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause volatility in the price of our common stock.

*An investment in our common stock is not an insured deposit.*

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this “Risk Factors” section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you may lose some or all of your investment.

*Our Articles of Incorporation and Bylaws, as well as certain banking laws, may have an anti-takeover effect.*

Provisions of our Articles of Incorporation and Bylaws, which are exhibits to this Annual Report on Form 10-K, and federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire the Company, even if doing so would be perceived to be beneficial to our shareholders. The combination of these provisions impedes a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of our common stock.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company, through the Bank, currently operates from its main office in downtown Philadelphia, and from 18 additional branches in Neshoba, Newton, Leake, Scott, Attala, Lauderdale, Winston and Kemper counties, Mississippi. Information about these branches is set forth in the table below:

<u>NAME OF OFFICE</u>	<u>LOCATION/TELEPHONE NUMBER</u>	<u>BANKING FUNCTIONS OFFERED</u>
Main Office	521 Main Street Philadelphia, Mississippi (601) 656-4692	Full Service; Trust
Eastside Branch	585 East Main Street Philadelphia, Mississippi (601) 656-4976	Drive-up
Westside Branch	912 West Beacon Street Philadelphia, Mississippi (601) 656-4978	Full Service; 24 Hour Teller
Northside Branch	802 Pecan Avenue Philadelphia, Mississippi (601) 656-4977	Deposits; 24 Hour Teller
Pearl River Branch	110 Choctaw Town Center Philadelphia, Mississippi (601) 656-4971	Full Service; 24 Hour Teller
Union Branch	Corner of Home & Bank Union, Mississippi (601) 774-9231	Full Service
Carthage Main Office	219 West Main Street Carthage, Mississippi (601) 267-4525	Full Service
Crossroads Branch	Highways 35 & 16 Carthage, Mississippi (601) 267-4525	Drive-up

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Madden Branch	Highway 488 Madden, Mississippi (601) 267-7366	Deposits
Sebastopol Branch	24 Pine Street Sebastopol, Mississippi (601) 625-7447	Full Service; 24-Hour Teller
DeKalb Branch	Corner of Main & Bell DeKalb, Mississippi (601) 743-2115	Full Service
Kosciusko Branch	775 North Jackson Avenue Kosciusko, Mississippi (662) 289-4356	Full Service; 24-hour Teller
Scooba Branch	1048 Johnston Street Scooba, Mississippi (662) 476-8431	Full Service
Meridian Branch	1825 Highway 39 North Meridian, Mississippi (601) 693-8367	Full Service; 24-Hour Teller
Decatur Branch	15330 Highway 15 South Decatur, Mississippi (601) 635-2321	Full Service; 24-Hour Teller
Forest Branch	247 Woodland Drive North Forest, Mississippi (601) 469-3424	Full Service; 24-Hour Teller
Louisville Main Branch	100 East Main Street Louisville, MS (662) 773-6261	Full Service
Industrial Branch	803 South Church Street Louisville, MS (662) 773-6261	Drive-Up
Noxapater Branch	45 East Main Street Noxapater, MS (662) 724-4261	Deposits

The Bank owns its main office and its branch offices, except for the Pearl River branch office, which is leased. The main office facility, originally occupied in 1966, is used solely by the Company and the Bank. This facility contains approximately 20,000 square feet and houses the executive offices and all operations-related departments of the Company. The other branches range in size from nearly 4,000 square feet to 1,000 square feet.

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ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings, other than routine litigation incidental to their business, to which either the Company or the Bank is a party or to which any of their property is subject.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to the Company's shareholders during the fourth quarter of 2005.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Information required in partial response to this Item 5 can be found under the heading "Market Price and Dividend Information" in the 2005 Annual Report to Shareholders, a copy of which is filed as an Exhibit to this Annual Report on Form 10-K. Such information is incorporated herein by reference.

The information appearing under the caption "Equity Compensation Plan Information" in Item 12 of this Form 10-K is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA

Information required in response to this Item 6 can be found under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2005, 2004 and 2003 - Selected Financial Data" in the 2005 Annual Report to Shareholders, a copy of which is filed as an Exhibit to this Annual Report on Form 10-K. Such information is incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Information required in response to this Item 7 can be found under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2005, 2004 and 2003" in the 2005 Annual Report to Shareholders, a copy of which is filed as an Exhibit to this Annual Report on Form 10-K. Such information is incorporated herein by reference.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information required in response to this Item 7A can be found under the headings “Quantitative and Qualitative Disclosures about Market Risk” in the 2005 Annual Report to Shareholders, a copy of which is filed as an Exhibit to this Annual Report on Form 10-K. Such information is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Information required in response to this Item 8 can be found under the heading “Consolidated Financial Statements” and “Quarterly Financial Trends” in the 2005 Annual Report to Shareholders, a copy of which is filed as an Exhibit to this Annual Report on Form 10-K. Such information is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

**Disclosure Controls and Procedures**

Within the 90 days prior to the date of this Annual Report on Form 10-K, the Company’s principal executive officer and principal financial officer carried out an evaluation of the effectiveness of the design and operation of the Company’s disclosure controls and procedures, as defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, the Company’s principal executive officer and principal financial officer concluded that, as of December 31, 2005, the Company’s disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company’s SEC reports. There have been no significant changes in the Company’s internal controls or in other factors that could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

**Management’s Annual Report on Internal Control over Financial Reporting and Attestation Report of Independent Registered Public Accounting Firm**

Information required in response to this item can be found under the headings “Management’s Assessment of Internal Control over Financial Reporting” and “Report of Independent Registered Public Accounting Firm (Internal Control)” in the Company’s Consolidated Financial Statements contained in its 2005 Annual Report to Shareholders, a copy of which is filed as an Exhibit to this Annual Report on Form 10-K. Such information is incorporated herein by reference.



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**Changes in Internal Control over Financial Reporting**

There were no changes to the internal control over financial reporting in the fourth quarter of 2005 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information required in partial response to this Item 10 can be found under the heading “Executive Officers of the Registrant” in Item 1 of this Annual Report on Form 10-K and under the headings “Stock Ownership” and “Board of Directors” in the Company’s Definitive Proxy Statement to be filed with the SEC on or about March 21, 2006, relating to its 2006 Annual Meeting of Shareholders. Such information is incorporated herein by reference.

**Code of Ethics**

The Company has adopted a code of business ethics in compliance with Item 406 of Regulation S-K for the Company’s principal executive officer, principal financial officer, principal accounting officer and controller. A copy of the Company’s Code of Ethics was filed as an exhibit to the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2003, filed on March 26, 2004 and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information required in response to this Item 11 can be found under the headings “Board of Directors,” “Executive Officers and Executive Compensation,” “Report of the Compensation Committee,” “Compensation Committee Interlocks and Insider Participation” and “Stock Performance Graph” in the Company’s Definitive Proxy Statement to be filed with the SEC on or about March 21, 2006, relating to its 2006 Annual Meeting of Shareholders. Such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required in partial response to this Item 12 can be found under the heading “Stock Ownership” in the Company’s Definitive Proxy Statement to be filed with the SEC on or about March 21, 2006, relating to its 2006 Annual Meeting of Shareholders. Such information is incorporated herein by reference.

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**Equity Compensation Plan Information**

The following table provides additional information about the Company's equity compensation plans as of December 31, 2005.

**Equity Compensation Plan Information**

<u>Plan category</u>	<u>(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>(b) Weighted-average exercise price of outstanding options, warrants and rights</u>	<u>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities in column (a))</u>
Equity compensation plans approved by security holders <sup>(1)</sup>	256,050	\$ 16.68	249,962 <sup>(2)</sup>
Equity compensation plans not approved by security holders	-0-	\$ 0.00	-0-
<u>Total</u>	<u>256,050</u>	<u>\$ 16.68</u>	<u>249,962</u>

<sup>(1)</sup> Two equity compensation plans have been approved by the shareholders: the 1999 Directors' Stock Compensation Plan and the 1999 Employees' Long-Term Incentive Plan.

<sup>(2)</sup> Includes 97,200 shares that remain available for future issuance under the 1999 Directors' Stock Compensation Plan. Also includes 152,762 shares available for future issuance under the 1999 Employees' Long-Term Incentive Plan ("LTIP"). Under the terms of the LTIP, the number of shares that may be issued cannot exceed 7% of the total number of shares issued and outstanding from time to time. In addition to stock options, restricted stock may be awarded under the LTIP. No restricted stock has been awarded under the LTIP.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Information required in response to this Item 13 can be found under the heading "Board of Directors" in the Company's Definitive Proxy Statement to be filed with the SEC on or about March 21, 2006, relating to its 2006 Annual Meeting of Shareholders. Such information is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information required in response to this Item 14 can be found under the heading "Proposal No. 3 - Appointment of HORNE LLP as the Company's Independent Registered Public Accounting Firm" in the Company's Definitive Proxy Statement to be filed with the SEC on or about March 21, 2006, relating to its 2006 Annual Meeting of Shareholders. Such information is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements

1. Consolidated Financial Statements and Supplementary Information for years ended December 31, 2003, 2004 and 2005, which include the following:

- (i) Report of Independent Registered Public Accounting Firm (Financial Statements)
- (ii) Report of Independent Registered Public Accounting Firm (Internal Control)
- (iii) Management's Assessment of Internal Control over Financial Reporting
- (iv) Consolidated Balance Sheets
- (v) Consolidated Statements of Income
- (vi) Consolidated Statements of Comprehensive Income
- (vii) Consolidated Statements of Changes in Shareholders' Equity
- (viii) Consolidated Statements of Cash Flows
- (ix) Notes to Consolidated Financial Statements

2. Financial Statement Schedules

None.

3. Exhibits required by Item 601 of Regulation S-K

- 3(i) Amended Articles of Incorporation of the Company \*
- 3(ii) Amended and Restated Bylaws of the Company \*
- 4 Rights Agreement between Citizens Holding Company and The Citizens Bank of Philadelphia, Mississippi \*
- 10(a) Directors' Deferred Compensation Plan - Form of Agreement \*†
- 10(b) Citizens Holding Company 1999 Directors' Stock Compensation Plan \*†
- 10(c) Citizens Holding Company 1999 Employees' Long-Term Incentive Plan \*†
- 10(d) Change in Control Agreement dated December 10, 2002 between the Company and Greg L. McKee \*\*†
- 10(f) Supplemental Executive Retirement Plan \*\*\*†
- 13 2005 Annual Report to Shareholders
- 14 Code of Ethics \*\*\*\*
- 21 Subsidiaries of Registrant
- 23 Consent of Independent Registered Public Accounting Firm
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
- 32.1 Section 1350 Certification of Chief Executive Officer
- 32.2 Section 1350 Certification of Chief Financial Officer

\* Filed as an exhibit to the Form 10 Registration Statement of the Company (File No. 000-25221) filed on December 30, 1998 and incorporated herein by reference, and also filed as an exhibit to Amendment No. 1 to Form 10 Registration Statement of the Company (File No. 000-25221) filed on June 21, 1999 and incorporated herein by reference.

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- \*\* Filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002 (File No. 000-25221) filed on March 31, 2003 and incorporated herein by reference.
- \*\*\* Filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 (File No. 000-25221) filed on March 16, 2005 and incorporated herein by reference.
- \*\*\*\* Filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003 (File No. 000-25221) filed on March 26, 2004 and incorporated herein by reference.
- † Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K pursuant to Item 15(b) of this report.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CITIZENS HOLDING COMPANY

Date: March 7, 2006

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

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

<u>SIGNATURES</u>	<u>CAPACITIES</u>	<u>DATE</u>
<u>/s/ Donald L. Kilgore</u> Donald L. Kilgore	Director	March 7, 2006
<u>/s/ Karl Brantley</u> Karl Brantley	Director	March 7, 2006
<u>/s/ David A. King</u> David A. King	Director	March 7, 2006
<u>/s/ Herbert A. King</u> Herbert A. King	Director	March 7, 2006
<u>/s/ Don L. Fulton</u> Don L. Fulton	Director	March 7, 2006
<u>/s/ David P. Webb</u> David P. Webb	Director	March 7, 2006
<u>/s/ A. T. Williams</u> A.T. Williams	Director	March 7, 2006
<u>/s/ Greg L. McKee</u> Greg L. McKee	Director, President and Chief Executive Officer	March 7, 2006
<u>/s/ Robert T. Smith</u> Robert T. Smith	Treasurer, Chief Financial Officer and Controller	March 7, 2006
<u>/s/ William M. Mars</u> William M. Mars	Chairman of the Board	March 7, 2006

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
13	2005 Annual Report to Shareholders
21	Subsidiaries of Registrant
23	Consent of Independent Registered Public Accounting Firm
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer



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Dear Stockholder:

As we look back at 2005, it is obvious that many of our neighbors and colleagues within our markets and across our state suffered grievously this year. A natural disaster such as Hurricane Katrina affects many facets of many lives. I am thankful that as a company we were fortunate to be able to offer assistance to many of these individuals and financial institutions. I am glad we were able to consider positive changes and remodeling instead of replacing destroyed properties. I would like to mention a few of the things that have been done to better employ our capital and further maximize the value of your investment.

We are in the process of remodeling the Main Office in order to make our facility more up-to-date in regard to customer service. The Eastside Branch has been remodeled and enlarged to be a full-service branch. This branch will now have a lender, ATM and other services available as we attempt to provide service to the prevailing traffic flows in our markets. We have the architect's renderings of our new branch in Starkville, Ms. This project will soon be underway. We are anxious to offer our type of full-service banking in this dynamic, growing market.

The past year brought about changes, not only in buildings but in personnel and their functions. We continue to realign employees and functions that make for a stronger, more efficient organization.

During the year, the composition of your Board of Directors changed. Two long-time, devoted directors retired from their positions. Steve Webb served many years as a Director, CEO and finally as Chairman of the Board. W. W. Dungan also served many years as a Director and an active participant on various board committees. I personally thank these men for their time and efforts that have helped make this company what it is today.

The Board's newest member, A. T. (Tommy) Williams, has a background of bank accounting that will provide sound, prudent advice in the years to come. We thank Tommy for his willingness to serve.

The attached financials show net income increased by 5.6% over 2004. This equates to a basic per share earnings of \$1.59 compared to \$1.51 for 2004. The assets of The Citizens Bank grew approximately 3.5%. We are very pleased to report these positive trends.

It is obvious we are pleased with the Company's accomplishments for the year 2005. With your continued interest and support, we will attempt to maximize your investment in this great company with every decision made and every action taken.

*/s/ Greg L. McKee*

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Greg L. McKee

President and Chief Executive Officer



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**CITIZENS HOLDING COMPANY  
AND SUBSIDIARY**

Philadelphia, Mississippi

Consolidated Financial Statements

Years Ended December 31, 2005, 2004 and 2003

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors & Stockholders  
Citizens Holding Company  
Philadelphia, Mississippi

We have audited the consolidated balance sheets of Citizens Holding Company and Subsidiary (the “Company”) as of December 31, 2005 and 2004, and the related consolidated statements of income, comprehensive income, changes in stockholders’ equity and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provided a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citizens Holding Company and Subsidiary as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Citizens Holding Company and Subsidiary’s internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 2, 2006 expressed an unqualified opinion on management’s assessment of the effectiveness of Citizens Holding Company and Subsidiary’s internal control over financial reporting and an unqualified opinion on the effectiveness of Citizens Holding Company and Subsidiary’s internal control over financial reporting.

/s/ Horne LLP  
Jackson, Mississippi  
March 2, 2006



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors & Stockholders  
Citizens Holding Company  
Philadelphia, Mississippi

We have audited management’s assessment, included in the accompanying Management’s Assessment of Internal Control over Financial Reporting, that Citizens Holding Company and Subsidiary (the “Company”) maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). 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. Our responsibility is to express an opinion on management’s assessment and an opinion on the effectiveness of the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management’s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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 (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 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 (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.

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To the Board of Directors  
Citizens Holding Company

Page Two

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.

In our opinion, management's assessment that Citizens Holding Company and Subsidiary maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by COSO. Also in our opinion, Citizens Holding Company and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control - Integrated Framework* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Citizens Holding Company and Subsidiary and our report dated March 2, 2006 expressed an unqualified opinion.

/s/ Home LLP

Jackson, Mississippi  
March 2, 2006

**MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of Citizens Holding Company (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed under the supervision of the Company's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Management assessed the Company's internal control over financial reporting as of December 31, 2004 based on the criteria for effective internal control over financial reporting established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2005, the Company maintained effective internal control over financial reporting.

The Company's internal control over financial reporting includes policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company, (ii) 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 (iii) 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. Projections of any evaluation of effectiveness to future periods are subject to 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, the Company's Independent Registered Public Accounting Firm, has audited management's assessment of the Company's internal control over financial reporting as of December 31, 2005, as stated in their report, appearing on pages 2 and 3, which expresses unqualified opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting as of December 31, 2005.

/s/ Greg L. McKee

Greg L. McKee  
President and Chief Executive Officer

/s/ Robert T. Smith

Robert T. Smith  
Treasurer and Chief Financial Officer

March 2, 2006

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**

Consolidated Balance Sheets

December 31, 2005 and 2004

	2005	2004
<b>ASSETS</b>		
Cash and due from banks	\$ 26,743,200	\$ 16,837,433
Interest bearing deposits with other banks	312,825	818,716
Federal funds sold	—	11,000,000
Securities available for sale, at fair value (amortized cost of \$163,778,332 in 2005 and \$151,095,249 in 2004)	162,203,117	151,716,083
Loans, net of allowance for loan losses of \$4,561,817 in 2005 and \$4,720,875 in 2004	374,964,316	364,868,117
Bank premises, furniture, fixtures and equipment, net	9,894,215	9,772,213
Real estate acquired by foreclosure	2,975,047	2,786,716
Accrued interest receivable	4,695,147	4,385,892
Cash value of life insurance	16,045,673	15,504,829
Intangible assets	5,290,076	5,827,579
Other assets	4,585,520	3,721,413
<b>Total assets</b>	<b><u>\$607,709,136</u></b>	<b><u>\$587,238,991</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Non-interest bearing demand deposits	\$ 87,333,891	\$ 78,070,820
Interest bearing NOW and money market accounts	148,434,618	148,617,480
Interest bearing savings deposits	35,579,157	38,151,914
Interest bearing time deposits	202,464,568	209,623,530
<b>Total deposits</b>	<b>473,812,234</b>	<b>474,463,744</b>
Federal funds purchased	1,600,000	—
Federal Home Loan Bank advances	60,048,818	46,118,566
Accrued interest payable	798,667	620,590
Deferred compensation payable	2,366,592	2,157,041
Other liabilities	3,950,890	2,221,390
<b>Total liabilities</b>	<b><u>542,577,201</u></b>	<b><u>525,581,331</u></b>
Commitments and contingencies	—	—
Minority interest	1,357,830	1,466,435
<b>Stockholders' equity</b>		
Common stock, \$.20 par value, authorized 22,500,000 shares; 5,009,278 shares issued at 2005 and 5,000,278 at 2004	1,001,856	1,000,056
Additional paid-in capital	3,386,248	3,150,246
Accumulated other comprehensive income (loss), net of taxes of (\$587,555) in 2005 and \$211,084 in 2004	(966,542)	399,921
Retained earnings	60,352,543	55,641,002
<b>Total stockholders' equity</b>	<b><u>63,774,105</u></b>	<b><u>60,191,225</u></b>
<b>Total liabilities and stockholders' equity</b>	<b><u>\$607,709,136</u></b>	<b><u>\$587,238,991</u></b>

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

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**

Consolidated Statements of Income  
Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
<b>Interest income</b>			
Interest and fees on loans	\$26,435,191	\$24,159,391	\$23,693,234
Interest on securities			
Taxable	3,022,520	2,846,951	3,760,630
Non-taxable	3,406,130	2,882,402	2,237,257
Other	179,863	82,967	33,814
Total interest income	<u>33,043,704</u>	<u>29,971,711</u>	<u>29,724,935</u>
<b>Interest expense</b>			
Deposits	7,431,479	5,772,547	6,605,373
Other borrowed funds	2,415,801	1,764,422	1,583,075
Total interest expense	<u>9,847,280</u>	<u>7,536,969</u>	<u>8,188,448</u>
Net interest income	23,196,424	22,434,742	21,536,487
<b>Provision for loan losses</b>	<u>(1,084,326)</u>	<u>(1,067,443)</u>	<u>(2,002,570)</u>
Net interest income after provision for loan losses	<u>22,112,098</u>	<u>21,367,299</u>	<u>19,533,917</u>
<b>Non-interest income</b>			
Service charges on deposit accounts	3,556,824	3,391,188	3,235,400
Other service charges and fees	585,288	670,582	895,375
Net gains on investment securities sales	—	7,020	467,210
Other income	1,594,811	1,505,841	725,713
Total non-interest income	<u>5,736,923</u>	<u>5,574,631</u>	<u>5,323,698</u>
<b>Non-interest expense</b>			
Salaries and employee benefits	9,523,367	8,607,066	7,925,908
Occupancy expense	1,163,219	1,199,437	1,177,346
Equipment expense	1,739,751	1,738,348	1,567,289
Earnings applicable to minority interest	198,872	189,395	167,730
Other expense	4,891,696	4,978,710	4,203,714
Total non-interest expense	<u>17,516,905</u>	<u>16,712,956</u>	<u>15,041,987</u>
Income before income taxes	10,332,116	10,228,974	9,815,628
<b>Income tax expense</b>	<u>2,365,984</u>	<u>2,682,889</u>	<u>2,844,699</u>
Net income	<u>\$ 7,966,132</u>	<u>\$ 7,546,085</u>	<u>\$ 6,970,929</u>
Net income per share – basic	<u>\$ 1.59</u>	<u>\$ 1.51</u>	<u>\$ 1.40</u>
Net income per share – diluted	<u>\$ 1.57</u>	<u>\$ 1.49</u>	<u>\$ 1.39</u>
<b>Average shares outstanding</b>			
Basic	<u>5,006,493</u>	<u>4,992,792</u>	<u>4,974,910</u>
Diluted	<u>5,066,165</u>	<u>5,056,637</u>	<u>5,019,759</u>

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



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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**

## Consolidated Statements of Comprehensive Income

Years Ended December 31, 2005, 2004 and 2003

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income	\$ 7,966,132	\$ 7,546,085	\$ 6,970,929
Other comprehensive income (loss)			
Unrealized holding gains (losses) during year	(2,196,048)	(1,661,064)	(1,808,269)
Income tax effect	798,637	562,385	624,185
Net unrealized gains (losses)	<u>(1,397,411)</u>	<u>(1,098,679)</u>	<u>(1,184,084)</u>
Reclassification adjustment for gains included in net income	—	(7,020)	(467,210)
Income tax effect	—	2,377	161,273
Net gains included in net income	<u>—</u>	<u>(4,643)</u>	<u>(305,937)</u>
Change in minority interest in net unrealized gains	30,948	33,205	28,385
Total other comprehensive loss	<u>(1,366,463)</u>	<u>(1,070,117)</u>	<u>(1,461,636)</u>
Comprehensive income	<u>\$ 6,599,669</u>	<u>\$ 6,475,968</u>	<u>\$ 5,509,293</u>

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

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Consolidated Statements of Changes in Stockholders' Equity  
Years Ended December 31, 2005, 2004 and 2003

	Number of Shares Issued	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance, December 31, 2002	4,974,578	\$ 994,916	\$2,899,331	\$ 2,931,674	\$46,956,638	\$53,782,559
Net income	—	—	—	—	6,970,929	6,970,929
Dividends paid (\$0.57 per share)	—	—	—	—	(2,835,769)	(2,835,769)
Options exercised	5,050	1,010	44,983	—	—	45,993
Other comprehensive (loss), net	—	—	—	(1,461,636)	—	(1,461,636)
Balance, December 31, 2003	4,979,628	995,926	2,944,314	1,470,038	51,091,798	56,502,076
Net income	—	—	—	—	7,546,085	7,546,085
Dividends paid (\$0.60 per share)	—	—	—	—	(2,996,881)	(2,996,881)
Options exercised	20,650	4,130	205,932	—	—	210,062
Other comprehensive (loss), net	—	—	—	(1,070,117)	—	(1,070,117)
Balance, December 31, 2004	5,000,278	1,000,056	3,150,246	399,921	55,641,002	60,191,225
Net income	—	—	—	—	7,966,132	7,966,132
Dividends paid (\$0.65 per share)	—	—	—	—	(3,254,591)	(3,254,591)
Options exercised, including tax benefit of \$106,192	9,000	1,800	236,002	—	—	237,802
Other comprehensive (loss), net	—	—	—	(1,366,463)	—	(1,366,463)
Balance, December 31, 2005	<u>5,009,278</u>	<u>\$1,001,856</u>	<u>\$3,386,248</u>	<u>\$ (966,542)</u>	<u>\$60,352,543</u>	<u>\$63,774,105</u>

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

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**

Consolidated Statements of Cash Flows  
Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
<b>Cash flows from operating activities</b>			
Net income	\$ 7,966,132	\$ 7,546,085	\$ 6,970,929
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	1,024,320	1,056,647	1,020,645
Amortization of intangibles	537,503	537,503	537,503
Amortization of premiums and accretion of discounts on investment securities	1,182,298	1,387,598	(55,128)
Provision for loan losses	1,084,326	1,067,443	2,002,570
Realized investment securities gains	—	(7,020)	(467,210)
Deferred income tax expense (benefit)	(310,432)	11,432	(472,691)
Net earnings applicable to minority interest	198,872	189,395	167,730
Earnings from equity method of investment	(131,664)	(188,911)	(78,389)
Write downs of real estate acquired by foreclosure	—	233,610	149,605
Increase in accrued interest receivable	(309,255)	(179,788)	(94,905)
Increase in cash value life insurance	(540,844)	(624,211)	(313,618)
Increase (decrease) in accrued interest payable	178,077	(47,948)	(287,182)
Increase in deferred compensation liability	209,551	324,830	649,805
Net change in other operating assets and liabilities	2,212,319	973,112	(161,766)
Net cash provided by operating activities	<u>13,301,203</u>	<u>12,279,777</u>	<u>9,567,898</u>
<b>Cash flows from investing activities</b>			
Proceeds from maturities of securities available-for-sale	37,496,514	38,276,877	62,778,307
Proceeds from sales of securities available-for-sale	—	22,515,102	58,103,673
Purchases of securities available-for-sale	(51,638,423)	(72,448,447)	(103,672,153)
Purchases of bank premises, furniture, fixtures and equipment	(1,146,322)	(829,887)	(1,619,676)
Proceeds from sale of real estate acquired by foreclosure	2,043,687	1,381,344	733,274
Net (increase) decrease in interest bearing deposits with other banks	505,891	(720,680)	1,267,613
Net increase in loans	(13,412,543)	(17,705,207)	(50,278,536)
Net (increase) decrease in federal funds sold	11,000,000	(11,000,000)	2,300,000
Cash paid for acquisitions, net	—	25,398	(114,209)
Purchase of company owned life insurance	—	—	(11,404,152)
Net cash used by investing activities	<u>(15,151,196)</u>	<u>(40,505,500)</u>	<u>(41,905,859)</u>

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**

Consolidated Statements of Cash Flows  
Years Ended December 31, 2005, 2004 and 2003

Page 2 of 2

	2005	2004	2003
Cash flows from financing activities			
Net increase in deposits	\$ (651,511)	\$ 35,766,446	\$ 5,929,123
Net increase (decrease) in federal funds purchased	1,600,000	(1,500,000)	1,500,000
Proceeds from exercise of stock options	131,610	210,062	45,993
Dividends paid to stockholders	(3,254,591)	(2,996,881)	(2,835,769)
Federal Home Loan Bank advance proceeds	25,000,000	13,500,000	24,000,000
Federal Home Loan Bank advance payments	(11,069,748)	(15,018,281)	(969,288)
Net cash provided by financing activities	<u>11,755,760</u>	<u>29,961,346</u>	<u>27,670,059</u>
Net increase (decrease) in cash and due from banks	9,905,767	1,735,623	(4,667,902)
Cash and due from banks, beginning of year	16,837,433	15,101,810	19,769,712
Cash and due from banks, end of year	<u>\$ 26,743,200</u>	<u>\$ 16,837,433</u>	<u>\$ 15,101,810</u>
Supplemental disclosures of cash flow information			
Cash paid for Interest	<u>\$ 9,669,203</u>	<u>\$ 7,584,917</u>	<u>\$ 8,475,630</u>
Income taxes	<u>\$ 786,026</u>	<u>\$ 2,762,059</u>	<u>\$ 2,478,332</u>
Non-cash disclosures			
Real estate acquired by foreclosure	<u>\$ 2,232,018</u>	<u>\$ 3,706,652</u>	<u>\$ 291,488</u>
Unrealized loss on investments	<u>\$ (2,196,048)</u>	<u>\$ (1,661,064)</u>	<u>\$ (1,808,269)</u>

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

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Basis of Financial Statement Presentation

The accounting policies of Citizens Holding Company and Subsidiary conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements of Citizens Holding Company include the accounts of its 97.86 percent-owned subsidiary, The Citizens Bank of Philadelphia, Mississippi (collectively referred to as the "Company"). All significant intercompany transactions have been eliminated in consolidation.

Nature of Business

The Citizens Bank of Philadelphia, Mississippi (the "Bank") operates under a state bank charter and provides general banking services. As a state bank, the Bank is subject to regulations of the Mississippi Department of Banking and Consumer Finance and the Federal Deposit Insurance Corporation. Citizens Holding Company is subject to the regulations of the Federal Reserve. The area served by the Bank is Neshoba County, Mississippi and the immediately surrounding areas. Services are provided at several branch offices.

Estimates

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.

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 foreclosed real estate, future additions to the allowance 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 allowances for loan losses and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of 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.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

Cash and Due from Banks

For the purpose of reporting cash flows, cash and due from banks include 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. The average reserve required by the Federal Reserve Bank at December 31, 2005 and 2004 was \$837,000 and \$911,000, respectively.

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

At December 31, 2005 and 2004, the Company had deposits in financial institutions in excess of federally insured limits. Management monitors the soundness of the financial institutions and believes there is minimal risk.

Investment Securities

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities," 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 held-to-maturity or trading securities.

Securities Available-for-Sale

Securities available-for-sale are reported at fair value with unrealized gains and losses reported as a separate component of stockholders' equity. 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.

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.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

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 discounts and unearned finance charges. The Company has no loans held-for-sale.

Loan origination and commitment fees and direct loan origination costs attributable to loans held with a maturity of more than one year are not significant and are, therefore, recognized as income or expense, as applicable in the period received or incurred.

Unearned discounts on installment loans are recognized as income over the terms of the loans by a method that approximates the interest method. Unearned finance charges 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.

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.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

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. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans and prior loss experience. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, review of specific problem loans, the Company's past loan loss experience, adverse situations that may affect the borrowers' ability to pay, the estimated value of any underlying collateral, current economic conditions, and other relevant factors.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard or special mention as well as loans considered impaired. For such loans that are also classified as impaired, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative and other factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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.



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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**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 primarily by straight-line methods over the estimated useful lives of the assets. Costs of major additions and improvements are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred.

Real Estate Acquired by Foreclosure

Real estate acquired by foreclosure consists of properties repossessed by the Company on foreclosed loans. These assets are stated at the lower of the outstanding loan amount (including accrued interest, if any) or 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. Revenue and expenses from operations of other real estate owned are reflected as other income (expense).

Cash Value of Life Insurance

The Company has purchased life insurance contracts on certain employees and directors. Certain of such policies were acquired pursuant to "split-dollar" arrangements with employees. During 2004 and 2003, several of these policies were converted to bank owned policies and the remainder of each policy was surrendered for cash. The cash surrender value of the remaining "split-dollar" policies as well as other Company owned policies is carried at the actual cash surrender value of the policy at the balance sheet date.

Intangible Assets

Intangible assets include core deposits purchased and goodwill. Core deposits intangibles are amortized on a straight-line basis over their estimated economic lives ranging from 5 to 10 years. Prior to 2002, goodwill was amortized over 40 years. 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.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

Investment – Insurance Company

The Company accounts for its investment in New South Life Insurance Company (“New South”), a 33 percent owned affiliate, by the equity method of accounting. The Company’s share of the net income of New South is recognized as income in the Company’s income statement and added to the investment account, and dividends received from New South would be treated as a reduction of the investment account. New South has not paid dividends.

The fiscal year of New South ends on November 30, and the Company follows the practice of recognizing the net income of New South on that basis.

The investment in New South, which is included in other assets, totaled \$1,898,643 and \$1,766,979 at December 31, 2005 and 2004, respectively. Income from the investment for the years ended December 31, 2005, 2004, and 2003 included in other income totaled \$131,664, \$188,911 and \$78,389, respectively.

Trust Assets

Assets held by the Trust Department of the Company in 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 deferred taxes on temporary differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. 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 described in SFAS No. 109, “Accounting for Income Taxes.” 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.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

Comprehensive Income

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

Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted net income per share 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. The effect of the dilutive shares for the years 2005, 2004 and 2003 is illustrated in the following table.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Basic weighted average shares outstanding	5,006,493	4,992,792	4,974,910
Dilutive effect of stock options	59,672	63,845	44,849
Dilutive weighted average shares outstanding	<u>5,066,165</u>	<u>5,056,637</u>	<u>5,019,759</u>
Net income	<u>\$7,966,132</u>	<u>\$7,546,085</u>	<u>\$6,970,929</u>
Net income per share-basic	\$ 1.59	\$ 1.51	\$ 1.40
Net income per share-diluted	\$ 1.57	\$ 1.49	\$ 1.39

Stock Based Compensation

Stock option grants are accounted for in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation expense is recognized for stock options granted if the option price is not less than the fair market value of the underlying stock at the grant date. For each of the years ended December 31, 2005, 2004 and 2003, no stock based compensation expense was included in the determination of net income as all options granted during the years had an exercise price equal to the market value of the stock on the date of grant.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

Had compensation expense been determined on the basis of fair value pursuant to SFAS No. 123, "Accounting for Stock-Based Compensation," net income and earnings per share would have been reduced as follows:

	2005	2004	2003
Net income			
As reported	\$7,966,132	\$7,546,085	\$6,970,929
Stock based employee compensation expense included in reported net income	—	—	—
Less stock based compensation expense determined under fair value method for all stock options, net of related income tax benefit	(55,340)	(201,610)	(143,654)
Pro forma net income	<u>\$7,910,792</u>	<u>\$7,344,475</u>	<u>\$6,827,275</u>

	2005	2004	2003
Basic earnings per share			
As reported	\$ 1.59	\$ 1.51	\$ 1.40
Pro forma	\$ 1.58	\$ 1.47	\$ 1.37

Diluted earnings per share			
As reported	\$ 1.57	\$ 1.49	\$ 1.39
Pro forma	\$ 1.56	\$ 1.45	\$ 1.36

The fair value of each option is estimated on the grant date using the Black-Scholes option pricing model. The following weighted average assumptions were made in estimating fair values in 2005, 2004 and 2003:

Assumption	2005	2004	2003
Dividend yield	3.0%	3.0%	1.5%
Risk-free interest rate	4.0%	4.0%	4.0%
Expected life	7 years	7 years	7 years
Expected volatility	5.36%	20.40%	15.00%

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

Advertising Costs

Advertising costs are charged to expense when incurred. Advertising expense was \$495,579, \$440,538 and \$379,319 for the years ended December 31, 2005, 2004 and 2003, respectively.

Fair Value of Financial Instruments

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," requires disclosure of financial instruments' fair values, as well as the methodology and significant assumptions used in estimating fair values. These requirements have been incorporated in Note 15. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. SFAS No. 107 excludes certain financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company and may not be indicative of amounts that might ultimately be realized upon disposition or settlement of those assets and liabilities.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), "Share Based Payment," or SFAS No. 123(R). SFAS No. 123(R) is effective for public companies at the beginning of the first interim or annual period after December 15, 2005. This statement prohibits the use of the intrinsic value-based method under APB Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for share-based compensation. SFAS No. 123(R) requires the Company to calculate equity-based compensation expense for stock options and employee stock purchase plan rights granted to employees based on the fair value of the equity instrument at the time of grant. Currently, the Company discloses the pro forma net income (loss) and the related pro forma income (loss) per share information in accordance with SFAS No. 123 and SFAS No. 148, "Accounting for Stock-Based Compensation Costs-Transition and Disclosure." The Company will record compensation expense for stock options granted to employees after January 1, 2006 as all outstanding options of the Company at December 31, 2005 are fully vested. SFAS No. 123(R) is not expected to have a material impact on the Company's results of operations or financial condition. Additionally, on March 29, 2005, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin ("SAB") No. 107, "Share-Based Payment". SAB No. 107 provides companies implementation guidance for the adoption of SFAS No. 123(R), including valuation methodologies to determine the fair value of stock based grants.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

FASB Staff Position No. FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" the ("FSP"), was issued in November 2005 and addresses the determination of when an investment is considered impaired; whether the impairment is other than temporary; and to measure an impairment loss. The FSP also addresses accounting considerations subsequent to the recognition of an other-than-temporary impairment on a debt security, and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The FSP replaces the impairment guidance in Emerging Issues Task Force Issue No. 03-1 with references to existing authoritative literature concerning other-than-temporary determinations (principally SFAS No. 115 and SEC Staff Accounting Bulletin 59). Under the FSP, impairment losses must be recognized in earnings in an amount equal to the entire difference between the security's cost and its fair value at the financial statement date, without considering partial recoveries subsequent to that date. The FSP also requires that an investor recognize an other-than-temporary impairment loss when a decision to sell a security has been made and the investor does not expect the fair value of the security to fully recover prior to the expected time of sale. The FSP is effective for reporting periods beginning after December 15, 2005. The Company does not expect that the adoption of the FSP will have a material impact on its financial condition, results of operations or financial statement disclosures.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," or SFAS No. 154, which replaces APB Opinion No. 20, "Accounting Changes" or APB No. 20, and SFAS No. 3, "Reporting Account Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle and to changes required by an accounting pronouncement when the pronouncement does not include specific transition provisions. SFAS No. 154 requires retrospective application of changes in accounting principle to prior periods' financial statements unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. APB No. 20 previously required that most voluntary changes in accounting principles be recognized by including the cumulative effect of the change in net income for the period of the change in accounting principle. SFAS No. 154 carries forward without change the guidance contained in APB No. 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. SFAS No. 154 also carries forward the guidance in APB No. 20 requiring justification of a change in accounting principle on the basis of preferability. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005, with early adoption permitted. The adoption of this statement is not expected to have an impact on the Company's financial conditions or results of operations.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Continued**

In December 2003, the Accounting Standards Executive Committee issued Statement of Position ("SOP") 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer." The SOP is effective for loans acquired in fiscal years beginning after December 15, 2004. The SOP addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. The SOP applies to loans acquired in business combinations but does not apply to loans originated by the Company. Management does not believe the provisions of this standard will have a material impact on the Company's results of operations or financial condition.

On March 9, 2004, the SEC issued Staff Accounting Bulletin ("SAB") No. 105, Application of Accounting Principles to Loan Commitments. SAB No. 105 requires that when a company is recognizing and valuing a loan commitment at fair value, only differences between the guaranteed interest rate in the loan commitment and a market interest rate should be included. Any expected future cash flows related to the customer relationships or loan servicing should be excluded from the fair value measurement. The expected future cash flows that are excluded from the fair-value determination include anticipated fees for servicing the funded loan, late-payment charges, other ancillary fees, or other cash flows from the servicing rights. The guidance in SAB No. 105 is effective for mortgage-loan commitments that are accounted for as derivatives and are entered into after March 31, 2004. The adoption of the provisions of this standard did not have any impact on the Company's results of operations or financial condition.

Reclassifications

Certain information for 2004 and 2003 have been reclassified to conform to the financial presentation for 2005. Such reclassifications are not considered material and had no effect on net income or stockholders' equity.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 2. Intangible Assets**

In 2002, the Company acquired CB&T Capital Corporation, a one-bank holding company, whose wholly-owned subsidiary was Citizens Bank & Trust Company in Louisville, Mississippi. In addition to the intangible assets related to the purchase of CB&T Capital Corporation, the Company recorded intangible assets from the purchase of branches located in Kosciusko, Scooba, Forest and Decatur, Mississippi along with the purchase of Three D Mortgage Company. The following table details the goodwill associated with each purchase which is no longer being amortized.

Purchase	Total	Life to Date Amortization	Unamortized
Kosciusko Branch	\$ 605,122	\$ 309,285	\$ 295,837
Scooba Branch	400,000	180,000	220,000
Three D Mortgage Company	76,408	10,188	66,220
CB&T Capital Corporation	2,567,600	—	2,567,600
Total goodwill	<u>\$3,649,130</u>	<u>\$ 499,473</u>	<u>\$3,149,657</u>

The Company has also allocated intangible assets to be recognized as core deposit intangibles on the acquisition of the Forest and Decatur branches and the CB&T Capital Corporation acquisition. These transactions are detailed in the following table.

Purchase	Total	Current Amortization Per Year	Life to Date Amortization	Unamortized
Decatur and Forest branches	\$2,487,574	\$ 352,812	\$1,532,255	\$ 955,319
CB&T Capital Corporation	1,846,909	184,691	661,809	1,185,100
Total core deposit intangible	<u>\$4,334,483</u>	<u>\$ 537,503</u>	<u>\$2,194,064</u>	<u>\$2,140,419</u>

Total amortization expense related to all intangible assets for the years ended December 31, 2005, 2004 and 2003 was \$537,503, \$537,503 and \$537,503, respectively. Estimated amortization expense attributable to core deposit intangible assets for the next five years is detailed in the table below.

Year Ending December 31,	Amount
2006	\$537,503
2007	537,503
2008	434,386
2009	184,691
2010	184,691



**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3. Investment Securities**

The amortized cost and fair value of investment securities at December 31, 2005 is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Securities available-for-sale Obligations of U.S.</b>				
Government agencies	\$ 12,200,149	\$ 27,462	\$ 255,547	\$ 11,972,064
U.S. Treasuries	2,000,836	1,664	—	2,002,500
Mortgage-backed securities	58,096,368	122,317	948,220	57,270,465
Other investments	91,480,979	1,054,497	1,577,388	90,958,088
Total	<u>\$163,778,332</u>	<u>\$1,205,940</u>	<u>\$2,781,155</u>	<u>\$162,203,117</u>

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2005.

Description of Securities	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U. S. Government agencies	\$10,806	\$ 256	\$ —	\$ —	\$ 10,806	\$ 256
U. S. Treasuries	—	—	—	—	—	—
Mortgage-backed securities	25,877	507	25,420	441	51,297	948
Other investments	24,260	822	20,499	755	44,759	1,577
Total	<u>\$60,943</u>	<u>\$ 1,585</u>	<u>\$45,919</u>	<u>\$ 1,196</u>	<u>\$106,862</u>	<u>\$ 2,781</u>

**Mortgage-backed Securities.** The unrealized losses on the Company's investment in mortgage-backed securities were caused by interest rate increases. The contractual cash flows of these investments are guaranteed either by the full faith and credit of the United States or by an agency of the United States Government and it is not expected that the securities would be settled at a price less than the amortized cost of the Company's investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality and because the Company

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3. Continued**

has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2005.

**Other investments.** The Company's unrealized loss on other investments relates to state, county and municipal bonds that have seen a decline in value due to changes in interest rates. It is not expected that these securities would be settled at a price less than amortized cost of the Company's investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2005.

The amortized cost and fair value of investment securities at December 31, 2004 is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale Obligations of U.S.				
Government agencies	\$ 17,981,545	\$ 120,640	\$ —	\$ 18,102,185
U.S. Treasuries	4,031,294	71,826	—	4,103,120
Mortgage-backed securities	49,420,029	299,317	315,176	49,404,170
Other investments	79,662,381	1,345,248	901,021	80,106,608
Total	<u>\$151,095,249</u>	<u>\$1,837,031</u>	<u>\$1,216,197</u>	<u>\$151,716,083</u>

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2004.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3. Continued**

Description of Securities	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U. S. Government Agencies	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
U. S. Treasuries	—	—	—	—	—	—
Mortgage-backed securities	36,000	315	—	—	36,000	315
Other Investments	33,680	850	661	51	34,341	901
<b>Total</b>	<b>\$69,680</b>	<b>\$ 1,165</b>	<b>\$661</b>	<b>\$ 51</b>	<b>\$70,341</b>	<b>\$ 1,216</b>

The Company, as a member of the Federal Home Loan Bank of Dallas (“FHLB”) system, owns stock in such 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 \$3,497,400 and \$3,227,300 at December 31, 2005 and 2004, respectively, and is included in other investments.

The amortized cost and estimated fair value of securities at December 31, 2005, 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.

	Amortized Cost	Fair Value
Securities available-for-sale		
Due in one year or less	\$ 7,258,741	\$ 7,261,706
Due after one year through five years	8,915,058	8,958,974
Due after five years through ten years	20,149,428	20,318,487
Due after ten years	127,455,105	125,663,950
<b>Total</b>	<b>\$ 163,778,332</b>	<b>\$ 162,203,117</b>

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 3. Continued**

Investment securities with carrying values of \$98,540,046 and \$74,620,615 at December 31, 2005 and 2004, respectively, were pledged as collateral for public deposits.

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Gross realized gains	\$—	\$10,141	\$ 780,705
Gross realized losses	—	(3,121)	(313,495)
	<u>\$—</u>	<u>\$ 7,020</u>	<u>\$ 467,210</u>

**Note 4. Loans**

The composition of net loans at December 31, 2005 and 2004 is as follows:

	<u>2005</u>	<u>2004</u>
	<u>(In Thousands)</u>	
Commercial, financial and agricultural loans	\$213,444	\$201,424
Real estate – construction loans	8,779	10,706
Real estate – mortgage loans	90,952	92,503
Consumer loans	<u>67,712</u>	<u>66,666</u>
	380,887	371,299
Unearned discount	(1,361)	(1,710)
Allowance for loan losses	<u>(4,562)</u>	<u>(4,721)</u>
Loans, net	<u>\$374,964</u>	<u>\$364,868</u>

Loans are made principally to customers in the Company's trade area. The Company's lending policy provides that loans collateralized by real estate are normally made with loan-to-loan value ratios of 80 percent or less. Commercial loans are typically collateralized by property, equipment, inventories and/or receivables with loan-to-value ratios from 50 percent to 80 percent. Real estate mortgage loans are collateralized by personal residences with loan-to-value ratios of 80 percent or less. Consumer loans are typically collateralized by real estate, vehicles and other consumer durable goods. Approximately \$87,198,406 and \$87,127,000 of the loans outstanding at December 31, 2005 and 2004, respectively, were variable rate loans.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4. Continued**

Changes in the allowance for loan losses at December 31, 2005, 2004 and 2003 are as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Balance, beginning	\$ 4,720,875	\$ 5,126,735	\$ 4,222,341
Provision for loan losses	1,084,326	1,067,443	2,002,570
Loans charged off	(1,567,186)	(1,799,687)	(1,399,947)
Recoveries of loans previously charged off	323,802	326,384	301,771
Balance, end of year	<u>\$ 4,561,817</u>	<u>\$ 4,720,875</u>	<u>\$ 5,126,735</u>

Loans on nonaccrual (impaired) status were \$4,346,512, \$3,146,041 and \$1,502,971 at December 31, 2005, 2004 and 2003, respectively. Allowance for loan losses attributable to the entire balance of nonaccrual (impaired) loans totaled \$883,041 and \$1,451,357 at December 31, 2005 and 2004, respectively. Interest income forgone on loans classified as nonaccrual (impaired) during the years ended December 31, 2005, 2004 and 2003 was \$348,804, \$229,286 and \$169,135, respectively.

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

Bank premises, furniture, fixtures and equipment consist of the following at December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Land and buildings	\$ 11,357,801	\$ 10,545,802
Furniture, fixtures and equipment	8,901,348	8,626,549
	<u>20,259,149</u>	<u>19,172,351</u>
Less accumulated depreciation	<u>10,364,934</u>	<u>9,400,138</u>
Total	<u>\$ 9,894,215</u>	<u>\$ 9,772,213</u>

Depreciation expense for the years ended December 31, 2005, 2004 and 2003 was \$1,024,320, \$1,056,647 and \$1,020,645, respectively.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 6. Deposits**

The composition of deposits is as follows:

	<u>2005</u>	<u>2004</u>
Non-interest bearing	\$ 87,333,891	\$ 78,070,820
NOW and money market accounts	148,434,618	148,617,480
Savings deposits	35,579,157	38,151,914
Time certificates, \$100,000 or more	79,393,146	82,016,625
Other time certificates	<u>123,071,422</u>	<u>127,606,905</u>
Total	<u>\$ 473,812,234</u>	<u>\$ 474,463,744</u>

The scheduled maturities of certificates of deposit at December 31, 2005 are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2006	\$157,037,228
2007	36,987,203
2008	8,080,136
2009	165,258
2010	<u>194,743</u>
	<u>\$202,464,568</u>

Interest expense for certificates of deposit over \$100,000 was approximately \$2,074,000, \$1,691,000 and \$1,997,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Pursuant to collateral agreements with the FHLB, advances are collateralized by all the Company's stock, FHLB securities (\$3,497,400 included in securities available-for-sale at December 31, 2005) and qualifying first mortgage and other loans. As of December 31, 2005, the balance in qualifying first mortgage loans was \$88,653,972. At December 31, 2005, advances from the FHLB, along with their rate and maturity date, consist of the following:

Advance Amount at December 31,		Interest Rate	Final Maturity
2005	2004		
\$10,000,000	\$10,000,000	3.76	May 24, 2006
648,818	1,718,566	4.94	July 3, 2006
5,000,000	5,000,000	5.46	February 26, 2008
5,000,000	5,000,000	5.66	April 28, 2008
15,000,000	—	4.50	June 23, 2008
3,000,000	3,000,000	5.24	April 20, 2009
2,000,000	2,000,000	5.29	April 20, 2009
2,000,000	2,000,000	4.47	September 7, 2010
2,000,000	2,000,000	4.88	August 22, 2011
1,000,000	1,000,000	4.76	August 29, 2011
900,000	900,000	4.43	September 19, 2011
10,000,000	10,000,000	3.66	June 17, 2013
3,500,000	3,500,000	4.67	December 16, 2014
<u>\$60,048,818</u>	<u>\$46,118,566</u>		

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

Year Due	Payment
2006	\$10,648,818
2007	—
2008	25,000,000
2009	5,000,000
2010	2,000,000
Thereafter	17,400,000
	<u>\$60,048,818</u>

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**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.

<u>Other Income</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
BOLI Insurance	\$ 485,890	\$ 410,436	\$ —
Mortgage Loan Origination Fees	380,049	328,295	324,791
Other Income	<u>728,872</u>	<u>767,110</u>	<u>400,922</u>
Total Other Income	<u>\$1,594,811</u>	<u>\$1,505,841</u>	<u>\$725,713</u>

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

<u>Other Expense</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Intangible Amortization	\$ 537,503	\$ 537,503	\$ 537,503
Advertising	495,579	440,538	379,319
Office Supplies	559,442	535,628	581,673
Legal and Audit Fees	404,183	454,131	231,675
Telephone Expense	398,435	394,270	343,165
Other Expenses	<u>2,496,554</u>	<u>2,616,640</u>	<u>2,130,379</u>
Total Other Expense	<u>\$4,891,696</u>	<u>\$4,978,710</u>	<u>\$4,203,714</u>

**Note 9. Income Taxes**

The consolidated provision for income taxes consists of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Currently payable			
Federal	\$2,250,896	\$2,297,257	\$2,939,498
State	<u>425,520</u>	<u>374,200</u>	<u>377,892</u>
	2,676,416	2,671,457	3,317,390
Deferred tax expense (benefit)	<u>(310,432)</u>	<u>11,432</u>	<u>(472,691)</u>
Income tax expense	<u>\$2,365,984</u>	<u>\$2,682,889</u>	<u>\$2,844,699</u>



**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 9. Continued**

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Federal taxes based on statutory rate	\$ 3,512,919	\$3,477,851	\$3,337,314
State income taxes, net of federal benefit	280,843	246,972	249,409
Tax-exempt investment interest	(1,067,853)	(922,520)	(714,510)
Other, net	(359,925)	(119,414)	(27,514)
Income tax expense	<u>\$ 2,365,984</u>	<u>\$2,682,889</u>	<u>\$2,844,699</u>

At December 31, 2005 and 2004, net deferred tax assets consist of the following:

	<u>2005</u>	<u>2004</u>
<b>Deferred tax assets</b>		
Allowance for loan losses	\$1,511,038	\$ 1,427,477
Deferred compensation liability	882,739	804,577
Unrealized loss on available-for-sale securities	587,555	—
Other	86,123	102,271
Total	<u>3,067,455</u>	<u>2,334,325</u>
<b>Deferred tax liabilities</b>		
Unrealized gain on available-for-sale securities	—	211,084
Premises and equipment	553,955	650,656
Intangible assets	151,712	280,238
Other	400,354	339,984
Total	<u>1,106,021</u>	<u>1,478,242</u>
Net deferred tax asset	<u>\$1,961,434</u>	<u>\$ 852,363</u>

The net deferred tax asset of \$1,961,434 and \$852,363 at December 31, 2005 and 2004, respectively, is included in other assets. 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.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Summarized financial information of Citizens Holding Company, parent company only, at December 31, 2005 and 2004, and for the years ended December 31, 2005, 2004 and 2003, is as follows:

**Balance Sheets**  
December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<b>Assets</b>		
Cash (a)	\$ 1,514,327	\$ 1,110,270
Securities available-for-sale, at fair value	—	510,940
Investment in bank subsidiary (a)	62,144,841	58,584,644
Other assets (a)	117,338	25,091
Total assets	<u>\$63,776,506</u>	<u>\$ 60,230,945</u>
<b>Liabilities</b>		
Other liabilities	\$ 2,401	\$ 39,720
<b>Stockholders' equity</b>	<u>63,774,105</u>	<u>60,191,225</u>
Total liabilities and stockholders' equity	<u>\$63,776,506</u>	<u>\$ 60,230,945</u>

(a) Eliminates in consolidation.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 10. Continued**

**Income Statements**

Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
Interest income	\$ 30,359	\$ 38,994	\$ 38,706
Other income			
Other	—	—	14,426
Dividends from bank subsidiary (a)	3,265,783	3,017,969	2,918,280
Equity in undistributed earnings of bank subsidiary (a)	4,717,327	4,540,676	4,066,482
Total other income	7,983,110	7,558,645	6,999,188
Other expense	58,468	60,605	76,771
Income before income taxes	7,955,001	7,537,034	6,961,123
Income tax expense (benefit)	(11,131)	(9,051)	(9,806)
Net income	<u>\$7,966,132</u>	<u>\$7,546,085</u>	<u>\$6,970,929</u>

**Statements of Cash Flows**

Years Ended December 31, 2005, 2004 and 2003

	2005	2004	2003
Cash flows from operating activities			
Net income	\$ 7,966,132	\$ 7,546,085	\$ 6,970,929
Adjustments to reconcile net income to net cash provided by operating activities			
Equity in undistributed earnings of Bank	(4,717,327)	(4,540,676)	(4,066,482)
(Increase) decrease in other assets	13,961	(9,051)	—
Increase (decrease) in other liabilities	(36,603)	(10,075)	851
Net cash provided by operating activities	<u>3,226,163</u>	<u>2,986,283</u>	<u>2,905,298</u>
Cash flows from investing activities			
Other	300,890	4,259	(115,378)
Net cash provided by (used by) investing activities	<u>300,890</u>	<u>4,259</u>	<u>(115,378)</u>

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 10. Continued**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cash flows from financing activities			
Dividends paid to stockholders	\$(3,254,591)	\$(2,996,881)	\$(2,835,769)
Proceeds from exercise of stock options	131,595	210,062	45,993
Net cash used by financing activities	<u>(3,122,996)</u>	<u>(2,786,819)</u>	<u>(2,789,776)</u>
Net increase in cash	404,057	203,723	144
Cash, beginning of year	1,110,270	906,547	906,403
Cash, end of year	<u>\$ 1,514,327</u>	<u>\$ 1,110,270</u>	<u>\$ 906,547</u>

The Bank is required to obtain approval from state regulators before paying dividends. The Bank paid dividends of \$3,265,783, \$3,017,969 and \$2,918,280 to the Citizens Holding Company during the years ended December 31, 2005, 2004 and 2003, respectively.

**Note 11. Related Party Transactions**

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, significant stockholders, principal officers, their immediate families, and affiliated companies in which they are principal stockholders (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 collectibility at the time of the transaction.

The balance of loans made to related parties at December 31, 2005 and 2004 was \$355,698 and \$1,133,660, respectively. Advances to related parties during the year ended December 31, 2005 totaled \$2,342,859. Payments received from related parties during the year ended December 31, 2005 totaled \$2,562,619.

Deposits from related parties at December 31, 2005 and 2004 approximated \$2,469,000 and \$3,026,000, respectively.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**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, 2005 and 2004, commitments related to unused lines of credit were \$21,477,893 and \$19,832,752 and standby letters of credit were \$1,261,236 and \$4,250,996, respectively. The fair value of such commitments is not material. 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.

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

The Company is party to lawsuits and other claims that arise in the ordinary course of business. The lawsuits assert claims related to the general business activities of the Company. The cases are being vigorously contested. In the regular course of business, management evaluates estimated losses or costs related to litigation, and provision is made for anticipated losses whenever management believes that such losses are probable and can be reasonably estimated. While management believes that the final resolution of pending legal proceedings will not have a material impact on the Company's financial position or results of operations, the final resolution of such proceedings could have such a material adverse effect.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 12. Continued**

Concentration of Risk

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

The nature of the Company's business requires that it maintain amounts due from banks, which at times may exceed federally insured limits. The Company has not experienced any losses in such accounts.

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

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

<u>Years Ending December 31,</u>	<u>Amounts</u>
2006	\$ 84,048
2007	80,335
2008	60,534
2009	58,531
2010	<u>58,531</u>
	<u>\$341,979</u>

The total rental expense included in the income statements for the years ended December 31, 2005, 2004 and 2003 is \$63,398, \$58,847, and \$59,330, respectively.

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**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 100 percent matching contribution for up to 6 percent of each participant's compensation, plus discretionary non-matching contributions. Employees are eligible after one year of service. For 2005, 2004 and 2003, the Company's contributions were \$516,555, \$448,334 and \$407,577, 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. Net expenses related to this plan were \$144,158, \$131,120 and \$137,364 for the plan years ended December 31, 2005, 2004 and 2003, 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 which may be used to fund payments under these arrangements. The obligations of the Company under both the directors and officers deferred compensation arrangements are on a systematic basis over the remaining expected service period of the individual directors and officers.

During 2004 and 2003, the Company surrendered certain life insurance policies that were acquired pursuant to "split-dollar" arrangements with employees and settled the Company's obligations to such employees under such arrangements. The impact of such transactions on the Company's financial statements was not significant.

Also during 2003, one of the Company's directors died and the Company received life insurance proceeds of approximately \$600,000 in excess of the carrying amount of the related policy. In addition, as a result of the death, the Company's liability for amounts due under the deferred compensation agreement increased by approximately the same amount. Accordingly, the Company did not realize a significant gain or loss. The Company did, however, realize an income tax benefit as the proceeds received from the life insurance policy was not subject to income taxes.

**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 affect on the Company.

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 15. Continued**

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, 2005, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2005 and 2004, 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:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2005						
Total Capital						
(to Risk-Weighted Assets)						
Citizens Holding Company	\$65,370,218	16.20%	\$32,279,732	8%	\$ N/A	—
Citizens Bank	63,762,072	15.80	32,279,732	8	40,349,665	10%
Tier I Capital						
(to Risk-Weighted Assets)						
Citizens Holding Company	60,808,401	15.07	16,139,866	4	N/A	—
Citizens Bank	59,200,255	14.67	16,139,866	4	24,209,799	6
Tier I Capital						
(to Average Assets)						
Citizens Holding Company	60,808,401	10.11	24,064,264	4	N/A	—
Citizens Bank	59,200,255	9.84	24,066,894	4	30,083,618	5



**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 15. Continued**

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2004						
Total Capital						
(to Risk-Weighted Assets)						
Citizens Holding Company	\$60,327,088	15.39%	\$31,354,423	8%	\$ N/A	—
Citizens Bank	58,716,354	14.99	31,344,415	8	39,180,519	10%
Tier I Capital						
(to Risk-Weighted Assets)						
Citizens Holding Company	55,430,160	14.14	15,677,212	4	N/A	—
Citizens Bank	53,820,971	13.74	15,672,207	4	23,508,311	6
Tier I Capital						
(to Average Assets)						
Citizens Holding Company	55,430,160	9.72	22,813,669	4	N/A	—
Citizens Bank	53,820,971	9.46	22,745,381	4	28,431,727	5

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

The following represents the carrying value and estimated fair value of the Company's financial instruments at December 31, 2005 and 2004:

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets</b>				
Cash and due from banks	\$ 26,743,200	\$ 26,743,200	\$ 16,837,433	\$ 16,837,433
Interest bearing deposits with banks	312,825	312,825	818,716	818,716
Federal funds sold	—	—	11,000,000	11,000,000
Securities available-for-sale	162,203,117	162,203,117	151,716,083	151,716,083
Net loans	374,964,316	372,219,005	364,868,117	363,276,796
Accrued interest receivable	4,695,147	4,695,147	4,385,892	4,385,892
<b>Financial liabilities</b>				
Deposits	\$473,812,234	\$473,587,831	\$474,463,744	\$474,627,262
Federal Home Loan Bank advances	60,048,818	59,344,446	46,118,566	46,711,095
Accrued interest payable	798,667	798,667	620,590	620,590
Federal funds purchased	1,600,000	1,600,000	—	—

The fair value estimates, methods and assumptions used by the Company in estimating its fair value disclosures for financial instruments were:

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 16. Continued**

Cash and Due from Banks and Interest Bearing Deposits with Banks

The carrying amounts reported in the balance sheet for these instruments approximate those assets' fair values because of their immediate and shorter-term maturities.

Securities Available-for-Sale

Fair values for investment 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.

Net Loans

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

Federal Funds Sold and Purchased

Due to the short term nature of these instruments, the carrying amount is equal to the fair value.

Deposits

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

Federal Home Loan Bank Borrowings

The fair value of the portion of FHLB advances that matures within 90 days approximates its fair value. For longer term maturities, the fair value is based on discounted cash flow analysis.

Off-Balance Sheet Instruments

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

**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 17. Stock Options**

The Company has a directors' stock compensation plan and 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 6 months and expire after 10 years. Under the employees' incentive plan the Company may grant options for up to 7 percent of the total number of shares of common stock, which may be issued and outstanding. Incentive options must be granted within 10 years of the adoption of the plan and expire no later than 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.

Following is a summary of the status of the plans for the years ending December 31, 2005, 2004 and 2003:

	<u>Directors' Plan</u>		<u>Employees' Plan</u>	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at January 1, 2003	70,800	\$ 10.37	53,900	\$ 13.33
Granted	16,500	16.40	41,500	14.57
Exercised	(3,300)	7.15	(1,750)	12.80
Forfeited	—	—	—	—
Outstanding at December 31, 2003	<u>84,000</u>	<u>\$ 11.68</u>	<u>93,650</u>	<u>\$ 13.89</u>
Granted	13,500	22.25	43,500	21.85
Exercised	(19,650)	9.94	(1,000)	14.65
Forfeited	—	—	—	—
Outstanding at December 31, 2004	<u>77,850</u>	<u>\$ 13.95</u>	<u>136,150</u>	<u>\$ 16.43</u>
Granted	12,000	20.00	43,500	21.05
Exercised	(6,000)	14.66	(3,000)	14.55
Forfeited	—	—	(4,450)	17.24
Outstanding at December 31, 2005	<u>83,850</u>	<u>\$ 14.77</u>	<u>172,200</u>	<u>\$ 17.60</u>
Options exercisable at:				
December 31, 2005	<u>83,850</u>	<u>\$ 14.77</u>	<u>172,200</u>	<u>\$ 17.60</u>
Weighted average fair value of Options granted during years ended				
December 31, 2003		<u>\$ 4.21</u>		<u>\$ 3.74</u>
December 31, 2004		<u>\$ 5.69</u>		<u>\$ 5.59</u>
December 31, 2005		<u>\$ 1.48</u>		<u>\$ 1.56</u>

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**CITIZENS HOLDING COMPANY AND SUBSIDIARY**  
Years Ended December 31, 2005, 2004 and 2003

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 17. Continued**

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

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>	<u>Weighted Average Price</u>	<u>Weighted Average Life Remaining</u>
\$7.15 to \$10.00	14,850	\$ 7.27	3 years, 2 months
\$10.01 to \$15.00	117,200	13.46	6 years, 1 month
\$15.01 to \$20.00	25,500	18.09	8 years, 3 months
\$20.01 and above	98,500	21.56	8 years, 8 months
Total	<u>256,050</u>	<u>\$ 16.68</u>	<u>7 years, 1 month</u>

## **OVERVIEW**

The following information discusses the financial condition and results of operations of Citizens Holding Company (the "Company") as of December 31, 2005, 2004 and 2003. 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 majority-owned subsidiary, The Citizens Bank of Philadelphia, Mississippi (the "Bank"), unless otherwise specifically noted.

Over the past three years, the Company has experienced growth in asset size and earnings as management has capitalized on opportunities for natural economic growth within our market area. Growth in 2004 and 2003 is attributable to steady loan demand fueled by continued low interest rates. Much of the loan growth in 2003 was funded by low interest rate borrowings from the Federal Home Loan Bank, while the loan growth in 2004 was funded in part by an increase in demand deposit accounts. In 2005, both an increase in demand deposits and an increase in Federal Home Loan Bank borrowings funded the growth in loans despite a decrease in certificate of deposit balances. Earnings have increased steadily over the three-year period as management utilized low cost funds to increase net interest income. At the same time, management believes it has made appropriate provisions for loan losses.

In 2005, the Company continued to grow although the growth rate was less than the two previous years. The Company's assets grew to \$607,709,136, or 3.5% from 2004, loans increased to \$374,964,316, or 2.8% and deposits decreased \$651,511, or .1%. The decrease in savings accounts and certificates of deposit were the primary reason for the decrease in deposits as they ended 2005 at \$9,731,729, or 3.9% lower than 2004. Demand, NOW and money market accounts grew \$9,080,209, or 4.0% to \$235,768,509, at December 31, 2005.

In 2004, the Company grew through the expansion of its existing customer base within the Company's market area. Total assets for the year increased 6.6% from 2003 to \$587,238,991, and net loans increased 3.7% from 2003 to \$364,868,117. The loan growth in 2004 was funded in part by an increase in demand deposit accounts. Deposits grew 8.2% in 2004 to \$474,463,744 even though certificates of deposits declined by \$12,135,472, or 5.5%.

In 2003, the Company experienced normal growth in assets without any acquisitions, relying on the continued growth of the Company's market area. Total assets for the year increased 6.2% from 2002 to \$550,761,143, and net loans increased 15.8% from 2002 to \$351,937,005. Deposit growth for the year was 1.4% to \$438,697,298.

The Company's net income after taxes for 2005 increased 5.6% to \$7,966,132 over 2004. Interest rates continued to rise in 2005 resulting in a higher cost of investible funds for the Company. This increase was offset by a corresponding increase in interest rates on loans and investments. Net income for 2005 produced, on a fully diluted basis, earnings per share of \$1.57 compared to \$1.49 in 2004 and \$1.39 for 2003.

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Net income after taxes of the Company for 2004 increased 8.3% over 2003 to \$7,546,085. Net income after taxes of the Company for 2003 increased by 10.7% over 2002 to \$6,970,929. Net income was positively affected in both 2004 and 2003 by a decrease in interest paid on deposits and other borrowed money.

The Company's Return on Average Assets (ROA) was 1.35% in 2005, compared to 1.33% in 2004 and 1.27% in 2003. Its Return on Average Equity (ROE) was 12.63% in 2005, 12.84% in 2004 and 12.42% in 2003. During these periods, leverage capital ratios (the ratio of equity to average total assets) increased from 9.11% in 2003 to 9.72% in 2004 and to 10.11% in 2005. The increase in ROE indicates that the Company has been successful in using its capital to support growth in both assets and earnings. This growth has enabled the Company to increase the annual dividend payout rate to approximately 40.9% of 2005 earnings per share. Even though the dividend payout ratio has increased, the leverage capital ratio increased to 10.11% in 2005, which is well above the regulatory requirement of 5% to be considered "well capitalized" under applicable Federal Deposit Insurance Corporation (the "FDIC") guidelines for the Bank.

### **CRITICAL ACCOUNTING POLICIES**

The allowance for loan losses is established through a provision for loan losses charged against net income. The allowance represents an amount, which 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 collectibility 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 their determination of capital adequacy. The estimation of losses in our 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.

Prior to the adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share Based Payment" ("SFAS No. 123(R)," effective January 1, 2006), the Company accounted for stock options in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). APB No. 25 did not require the Company to recognize compensation expense for stock options granted to employees if the option price was not less than the fair market value of the underlying stock at the grant date. Accordingly, the Company did not recognize compensation expense for the 55,500, 57,000 and 58,000 options granted to employees and directors for 2005, 2004 and 2003, respectively. If the Company had applied the provisions of SFAS No. 123(R) for the options granted, the Company would have reported compensation expense of \$55,340, \$201,610 and \$143,654 for 2005, 2004, and 2003, respectively.

Generally, all options granted to employees and directors have become fully vested at the date of grant rather than a vesting period. Since all options outstanding at December 31, 2005 are fully vested, no future compensation expense will be required upon the adoption of SFAS No. 123(R). Furthermore, no cumulative effect of the adoption will be recorded by the Company for options granted prior to December 31, 2005. The Company has not changed the amount or terms of any outstanding option arrangements in anticipation of the adoption of SFAS No. 123(R).

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In future periods, the Company will be required to expense the fair value of options granted; the Company intends to use the Black-Scholes valuation model to determine the fair value. The Black-Scholes model requires the use of certain assumptions, including the volatility of the Company's stock price (the Company has used the historical volatility in prior periods to determine the estimated compensation expense), the expected life of the option, the expected dividend rate and the discount rate. The Company does not expect to change the methods in determining the assumptions underlying the valuation of future stock option grants.

Accordingly, the Company does not expect the adoption of SFAS No. 123(R) to have a material impact on the Company's income or financial position. For more information on the Company's stock options, please refer to Notes 1 and 17 to the Company's Consolidated Financial Statements included in this Annual Report.

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 recent account pronouncements affecting the Company.

#### **DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS**

In addition to historical information, this report contains statements which constitute forward-looking statements and information which 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." The Company notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of the business of the Company and the Bank, include, but are not limited to, the following:

- the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Company operates;
- changes in the legislative and regulatory environment that negatively impact the Company and the Bank through increased operating expenses;
- increased competition from other financial institutions;
- the impact of technological advances;
- expectations about the movement of interest rates, including actions that may be taken by the Federal Reserve Board in response to changing economic conditions;
- changes in asset quality and loan demand;
- expectations about overall economic strength and the performance of the economy in the Company's market area; and
- other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission.

The Company does not undertake any 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. All per share data has been adjusted to give effect to the three-for-two stock split effected January 2, 2002.

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 000's except for per share data)

	2005	2004	2003	2002	2001
<b>Summary of Earnings</b>					
Total interest income	\$ 33,043	\$ 29,972	\$ 29,725	\$ 30,197	\$ 29,119
Total interest expense	9,847	7,537	8,188	9,746	13,399
Provision for loan losses	1,084	1,067	2,003	1,758	1,123
Non-interest income	5,737	5,574	5,324	4,435	3,980
Non-interest expense	17,517	16,713	15,042	13,865	10,308
Income tax expense	2,366	2,683	2,845	2,965	2,558
Net income	7,966	7,546	6,971	6,298	5,711
<b>Per Share Data</b>					
Earnings-basic	\$ 1.59	\$ 1.51	\$ 1.40	\$ 1.27	\$ 1.15
Earnings-diluted	1.57	1.49	1.39	1.26	1.15
Cash dividends	0.65	0.60	0.57	0.52	0.38
Book value at year end	12.73	12.04	11.35	10.81	9.51
<b>Selected Year End Actual Balances</b>					
Loans, net of unearned income	\$379,526	\$369,589	\$357,064	\$308,175	\$264,278
Allowance for loan losses	4,562	4,721	5,127	4,222	3,375
Securities available for sale	162,203	151,716	143,181	162,276	122,567



Earning assets	535,322	525,155	493,209	468,592	394,315
Total assets	607,709	587,239	550,761	518,450	427,213
Deposits	473,812	474,464	438,697	432,768	359,309
Long term borrowings	60,049	46,119	47,637	24,606	14,629
Shareholders' equity	63,774	60,191	56,502	53,783	47,182

#### **Selected Year End Average Balances**

Loans, net of unearned income	\$371,925	\$364,922	\$337,763	\$289,407	\$255,185
Allowance for loan losses	4,646	5,532	4,495	3,905	3,335
Securities available for sale	156,333	142,994	164,371	153,726	106,632
Earning assets	528,562	506,898	499,726	450,174	372,923
Total assets	591,872	565,892	549,520	491,833	403,881
Deposits	464,629	457,510	447,188	414,135	327,536
Long term borrowings	54,823	41,607	35,314	19,301	14,815
Shareholders' equity	63,068	58,750	56,121	51,304	47,664

#### **Selected Ratios**

Return on average assets	1.35%	1.33%	1.27%	1.28%	1.41%
Return on average equity	12.63%	12.84%	12.42%	12.28%	11.98%
Dividend payout ratio	40.86%	39.71%	40.71%	40.98%	33.31%
Equity to year end assets	10.49%	10.25%	10.26%	10.37%	11.04%
Total risk-based capital to risk-adjusted assets	16.20%	15.35%	14.94%	15.57%	18.40%
Leverage capital ratio	10.11%	9.72%	9.11%	8.83%	10.51%
Efficiency ratio	58.14%	57.65%	54.45%	54.51%	51.32%

The year-end and average balances for 2002 reflect the increase in loans, assets and deposits that resulted from the May 2002 acquisition of CB&T Capital Corporation and its bank subsidiary, Citizens Bank and Trust Company of Louisville. Similarly, the balances in 2001 increased in part by the acquisition of two Union Planters branches located in Forest and Decatur, Mississippi in July 2001.

#### **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.

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Net interest income on a tax equivalent basis was \$24,373,000, \$23,435,000 and \$22,317,000 for the years 2005, 2004 and 2003, respectively. Net interest margin was 4.61%, 4.61% and 4.49% for the same periods. During 2005, the rates on interest earning assets and interest bearing liabilities both rose to the extent that the net interest margin in 2005 was unchanged from 2004. Both volume and rates increased on both interest bearing assets and liabilities.

The increase in net interest income in 2004 was due to the increases in the volume and yield of interest-bearing assets exceeding the increases in the volume of and rates paid on deposits. For the year ended December 31, 2004, the average yield on earnings assets decreased 4 basis points to 6.09% from 2003 and the average rate paid on interest-bearing liabilities decreased 18 basis points to 1.76% from 2003. The volume of earning assets increased 2.1% while the volume of interest-bearing liabilities increased 1.7% in 2004.

In 2003, the increase in the volume of interest-bearing assets, partially offset by the slightly larger decrease in the interest rate charged on loans than the decrease in the interest rate paid on deposits, caused the rise in net interest income in 2003. The average yield on earnings assets in 2003 decreased to 6.13% from 6.83% in 2002, while the average rate on interest-bearing liabilities decreased to 1.94% from 2.59% in 2002. Earning assets volume increased 10.6% while interest-bearing liabilities volume increased 12.0% in 2003.

During this three-year period, loan demand has remained strong and has allowed the Company to continue to invest its available funds in loans. Loans generally provide the Company with yields that are greater than the yields on typical investment securities.

During 2003, the Company purchased \$11.4 million of additional bank-owned life insurance, increasing the Company's investment in such insurance to \$14.9 million at December 31, 2003. The income received by the Company on these policies increased the Company's total investment from \$14.9 million at December 31, 2003 to approximately \$15.5 million at December 31, 2004 and \$16.0 million at December 31, 2005. The additional purchases were made to provide a future funding source for certain of the Company's deferred compensation arrangements. Such insurance also offers more attractive yields than other 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, 2005, 2004 and 2003.

TABLE 2 - AVERAGE BALANCE SHEETS AND INTEREST RATES

	Average Balance			Income/Expense			Average Yield/Rate		
	2005	2004	2003	2005	2004	2003	2005	2004	2003
<b>Loans:</b>									
Loans, net of unearned	\$370,982	\$363,405	\$336,275	\$25,435	\$24,162	\$23,697	7.13%	6.65%	7.05%
<b>Investment Securities</b>									
Taxable	71,916	72,023	108,695	3,023	2,847	3,761	4.20%	3.95%	3.39%
Tax-exempt	80,728	66,542	49,183	4,564	3,863	2,998	5.65%	5.80%	6.10%
Total Investment Securities	152,644	138,565	157,878	7,587	6,710	6,759	4.97%	4.84%	4.28%
<b>Federal Funds Sold and Other</b>									
Total Interest Earning Assets	529,517	508,001	497,728	34,202	30,955	30,490	6.46%	6.09%	6.13%
<b>Non-Earning Assets</b>									
Total Assets	\$591,872	\$565,892	\$549,520						
<b>Deposits:</b>									
Interest-bearing Demand Deposits	\$144,134	\$127,902	\$123,338	\$ 2,098	\$ 1,372	\$ 1,212	1.46%	1.07%	0.98%
Savings	35,494	37,591	34,696	301	319	354	0.89%	0.85%	1.02%
Time	204,265	219,150	222,695	5,014	4,065	5,024	2.45%	1.85%	2.26%
Total Deposits	383,893	384,643	380,729	7,413	5,756	6,590	1.93%	1.50%	1.73%
<b>Borrowed Funds</b>									
Short-term Borrowings	2,344	1,113	4,065	84	18	56	3.58%	1.62%	1.37%
Long-term Borrowings	54,823	41,607	35,314	2,332	1,746	1,527	4.25%	4.20%	4.32%
Total Borrowed Funds	57,167	42,720	39,379	2,416	1,764	1,583	4.23%	3.70%	4.02%
Total Interest-Bearing Liabilities	441,060	427,363	420,108	9,829	7,520	8,173	2.22%	1.76%	1.94%
<b>Non-Interest Bearing Liabilities</b>									
Demand Deposits	80,737	72,867	65,985						
Other Liabilities	7,007	6,912	7,306						
Shareholders' Equity	63,068	58,750	56,121						
Total Liabilities and Shareholders' Equity	\$591,872	\$565,892	\$549,520						
<b>Interest Rate Spread</b>							4.24%	4.33%	4.19%
<b>Net Interest Margin</b>				\$24,373	\$23,435	\$22,317	4.61%	4.61%	4.49%
<b>Less</b>									
<b>Tax Equivalent Adjustment</b>				1,177	1,000	781			
<b>Reported Net Interest Income</b>				\$23,196	\$22,435	\$21,536			

Table 3 - Net Average Interest Earning Assets illustrates net interest earning assets and liabilities for 2005, 2004, and 2003.

TABLE 3 - NET AVERAGE INTEREST EARNING ASSETS

	2005	2004	2003
Average interest earning assets	\$529,517	\$508,001	\$497,728
Average interest bearing liabilities	441,614	427,363	420,108
Net average interest earning assets	<u>\$ 87,903</u>	<u>\$ 80,638</u>	<u>\$ 77,620</u>

Table 4 – Volume/Rate Analysis depicts the dollar effect on interest income and interest expense of changes in volume and changes in rate from 2003 through 2005. 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 34%.

TABLE 4 - VOLUME/RATE ANALYSIS

	2005 Change from 2004			2004 Change from 2003		
	Volume	Rate	Total	Volume	Rate	Total
<b>INTEREST INCOME</b>						
Loans	\$ 540	\$ 1,733	\$ 2,273	\$ 1,804	\$(1,339)	\$ 465
Taxable Securities	(4)	180	176	(1,449)	536	(913)
Non-Taxable Securities	801	(100)	701	1,007	(143)	864
Federal Funds Sold and Other	(4)	101	97	34	15	49
TOTAL INTEREST INCOME	<u>\$ 1,333</u>	<u>\$ 1,914</u>	<u>\$ 3,247</u>	<u>\$ 626</u>	<u>\$ (161)</u>	<u>\$ 465</u>
<b>INTEREST EXPENSE</b>						
Interest-bearing demand deposits	\$ 237	\$ 489	726	\$ 49	\$ 111	\$ 160
Savings Deposits	(18)	—	(18)	25	(60)	(35)
Time Deposits	(365)	1,314	949	(66)	(893)	(959)
Short-term borrowings	44	22	66	(48)	10	(38)
Long-term borrowings	562	24	586	264	(45)	219
TOTAL INTEREST EXPENSE	<u>\$ 460</u>	<u>\$ 1,849</u>	<u>2,309</u>	<u>\$ 224</u>	<u>\$ (877)</u>	<u>\$ (653)</u>
NET INTEREST INCOME	<u>\$ 873</u>	<u>\$ 65</u>	<u>\$ 938</u>	<u>\$ 402</u>	<u>\$ 716</u>	<u>\$ 1,118</u>

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## LOANS

The loan portfolio constitutes the major earning asset of the Company and, in the opinion of management, offers the best alternative for maximizing interest spread above the cost of funds. 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 various directors, including the Chairman. All aggregate credits which 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 on sound and thorough credit analysis;
- to properly document all loans;
- to eliminate loans from the portfolio that are under-priced, 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 has remained strong in the Company's market area over the past three years. In general, the loan growth experienced in 2005, 2004 and 2003 was due to a continuation of the overall growth in the market area served by the Company. The impact on housing caused by the opening of a casino on the nearby Choctaw Indian Reservation in 1995 is beginning to show less of an impact on the housing market in the area. Real estate mortgage loans originated by the Company declined by 1.7%, or \$1,550,809, in 2005, after having increased by .5%, or \$500,699, in 2004 and 3.3%, or \$2,959,217, in 2003.

Commercial and agricultural loans showed significant growth during this period. These loans grew \$12,019,676, or 6.0%, in 2005, \$14,317,978, or 7.7%, in 2004 and \$37,188,745, or 24.8%, in 2003. This increase was caused by the influence of the casino in the area and by an increase in the number of loans originated during these years to poultry producers. Commercial 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 surrounding this loan category are adequate to manage any risk represented by the growth of the loans in this category.

Consumer loans have shown moderate growth during the period. This category increased \$1,046,248, or 1.6%, in 2005, \$1,919,155, or 3.2%, in 2004 and \$4,649,580, or 7.8%, in 2003. The Company believes that changes in consumer purchasing habits and the increase in loan sources have affected the growth of this segment of loans. Sustained low unemployment may also have lessened the dependence on consumer loans for some purchases.

Table 5 - Loans Outstanding reflects outstanding balances by loan type for the past five years. Additional loan information is presented in Note 4 to the Company's Consolidated Financial Statements included in this Annual Report.

TABLE 5 - LOANS OUTSTANDING

	AT DECEMBER 31,				
	2005	2004	2003	2002	2001
Commercial, financial and agricultural	\$213,444	\$201,424	\$186,950	\$149,762	\$126,131
Real estate – construction	8,779	10,706	15,409	11,708	6,036
Real estate – mortgage	90,952	92,503	92,412	89,452	80,548
Consumer	67,712	66,666	64,309	59,660	54,218
<b>TOTAL LOANS</b>	<b>\$380,887</b>	<b>\$371,299</b>	<b>\$359,080</b>	<b>\$310,582</b>	<b>\$266,933</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 for all loans.

TABLE 6 - LOAN LIQUIDITY  
LOAN MATURITIES AT DECEMBER 31, 2005

	1 YEAR OR LESS	1 - 5 YEARS	OVER 5 YEARS	Total
Commercial, financial and agricultural	\$ 62,910	\$126,327	\$24,207	\$213,444
Real estate - construction	8,595	184	—	\$ 8,779
Real estate - mortgage	12,165	55,031	23,756	\$ 90,952
Consumer	25,722	37,147	4,843	\$ 67,712
<b>Total loans</b>	<b>\$109,392</b>	<b>\$218,689</b>	<b>\$52,806</b>	<b>\$380,887</b>

SENSITIVITY TO CHANGES IN INTEREST RATES

	1 - 5 YEARS	OVER 5 YEARS
Fixed rates	\$193,965	\$36,446
Variable rates	24,724	16,360
<b>Total loans</b>	<b>\$218,689</b>	<b>\$52,806</b>

Each loan 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.

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## PROVISION FOR LOAN LOSSES AND ASSET QUALITY

The provision for loan losses represents a charge against operations to establish reserves for probable loan losses inherent in the Company's loan portfolio. 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 2003, 2004 and 2005. The ratio of net loans charged off to average loans was .33% in 2005, .40% in 2004 and .33% in 2003. These percentages are representative of normal loan charge-offs and are not the result of an economic downturn in any particular segment of the Company's market. 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 was \$1,084,326 in 2005, \$1,067,443 in 2004 and \$2,002,570 in 2003. At the end of 2005, the total allowance for loan losses was \$4,561,817, 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

	2005	2004	2003	2002	2001
BALANCE AT BEGINNING OF YEAR	\$ 4,721	\$ 5,127	\$ 4,222	\$ 3,375	\$ 3,325
<b>LOANS CHARGED-OFF</b>					
Commercial, financial and agricultural	861	1,394	700	935	612
Real estate – construction	—	—	—	23	—
Real estate – mortgage	64	15	145	122	36
Consumer	642	390	555	957	675
TOTAL CHARGE-OFFS	1,567	1,799	1,400	2,037	1,323
<b>CHARGE-OFFS RECOVERED</b>					
Commercial, financial and agricultural	189	144	65	54	22
Real estate – construction	—	—	—	—	—
Real estate – mortgage	2	11	2	4	26
Consumer	133	171	235	221	202
TOTAL RECOVERIES	324	326	302	279	250
Net loans charged-off	1,243	1,473	1,098	1,758	1,073
Additions charged to operating expense	1,084	1,067	2,003	1,758	1,123
Other increases attributed to acquisition	—	—	—	847	—
BALANCE AT END OF YEAR	\$ 4,562	\$ 4,721	\$ 5,127	\$ 4,222	\$ 3,375
Loans, net of unearned interest, at year end	\$379,526	\$369,589	\$357,064	\$308,175	\$264,278
Ratio of allowance to loans at year end	1.20%	1.28%	1.44%	1.37%	1.28%
Average loans - net of unearned interest	\$371,925	\$364,922	\$337,763	\$289,407	\$255,185
Ratio of net loans charged-off to average loans	0.33%	0.40%	0.33%	0.61%	0.42%



ALLOCATION OF ALLOWANCE FOR LOAN LOSSES

	AT DECEMBER 31,				
	2005	2004	2003	2002	2001
Commercial, financial and agricultural	\$1,713	\$1,872	\$2,300	\$1,700	\$1,200
Real estate – construction	300	300	300	200	250
Real estate – mortgage	900	900	900	800	700
Consumer	1,550	1,550	1,550	1,475	1,175
Other	99	99	77	47	50
Total	<u>\$4,562</u>	<u>\$4,721</u>	<u>\$5,127</u>	<u>\$4,222</u>	<u>\$3,375</u>

COMPOSITION OF LOAN PORTFOLIO BY TYPE

	AT DECEMBER 31,				
	2005	2004	2003	2002	2001
Commercial, financial and agricultural	56.04%	54.25%	52.06%	48.22%	47.25%
Real estate – construction	2.30%	2.88%	4.29%	3.77%	2.26%
Real estate – mortgage	23.88%	24.91%	25.74%	28.80%	30.18%
Consumer	17.78%	17.96%	17.91%	19.21%	20.31%
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

The loan portfolio has increased steadily in the past three years, with the most significant portion of the growth occurring in the commercial, financial and agricultural loan category, as reflected in the above table. A larger portion of the allowance for loan losses is allocated to commercial, financial and agricultural loans and consumer loans. This reflects the higher risks associated with commercial and consumer lending as compared to real estate mortgages and construction 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, troubled debt restructurings, and loans delinquent 90 days or more based on contractual terms. 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 other real estate owned (OREO), which represents properties acquired by the Company through foreclosure following loan defaults by customers; the percentage of OREO to total loans is .78% in 2005. OREO increased in 2005 due to the foreclosure on several loans that were collateralized by real estate. These loans were reported in the 90 days or more past due category in 2004.

Loans on non-accrual status amounted to \$4,346,512 in 2005 as compared to \$3,146,041 in 2004 and \$1,502,971 in 2003. Non-accrual loans increased in the fourth quarter of 2005 as management reclassified certain performing loans as non-accrual loans. Included in these reclassified loans was a single loan in the amount of \$2.33 million, to a single borrower that filed for bankruptcy protection. Although management believes that this loan is adequately

collateralized, the Company has allocated a loan loss reserve equal to 5% of the outstanding balance of this loan. These loans were reclassified based on management's uncertainty as to whether the Company would fully collect all principal and accrued interest due on these loans. Interest income forgone on loans classified as non-accrual in 2005 was \$348,804 as compared to \$229,286 in 2004 and \$169,135 in 2003. 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/or deemed collectable.

TABLE 8 - NON-PERFORMING ASSETS

	AS OF DECEMBER 31,				
	2005	2004	2003	2002	2001
<b>PRINCIPAL BALANCE - DOMESTIC</b>					
Non-accrual	\$4,347	\$ 3,146	\$1,503	\$ 358	\$ 419
Accruing loans 90 days or more past due	911	904	4,396	5,117	2,918
Troubled debt restructuring	—	—	—	—	—
<b>TOTAL DOMESTIC LOANS</b>	<b>\$5,258</b>	<b>\$ 4,050</b>	<b>\$5,899</b>	<b>\$5,475</b>	<b>\$ 3,337</b>
<b>TOTAL NON-PERFORMING LOANS</b>	<b>\$5,258</b>	<b>\$ 4,050</b>	<b>\$5,899</b>	<b>\$5,475</b>	<b>\$ 3,337</b>
Income on non-accrual loans not recorded	\$ 349	\$ 229	\$ 169	\$ 69	\$ 31
Non-performing as a percent of loans	1.39%	1.10%	1.65%	1.78%	1.27%
Other real estate owned	\$2,975	\$ 2,787	\$ 695	\$1,286	\$ 340
OREO as a percent of loans	0.78%	0.75%	0.19%	0.42%	0.13%
Allowance as a percent of non-performing loans	86.76%	116.57%	86.91%	77.11%	101.14%

SFAS Nos. 114 and 118, "Accounting by Creditors for Impairment of a Loan," was effective January 1, 1995. 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 considers the Company's nonaccrual loans as being impaired under FASB 114 and 118. The balances of nonaccrual (impaired) loans for the years 2005, 2004, 2003 were \$4,346,512, \$3,146,041 and \$1,502,971, respectively.

Management monitors any loans which 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 about 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 credits 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, 2005, loans totaling \$18,431,504 were included on the watch list of the Company compared to \$16,291,783 at December 31, 2004. 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, 2005, the Company classified all of its securities as available-for-sale. Securities available-for-sale 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 carrying value of securities from 2003 through 2005 and the maturity distribution at December 31, 2005, by classification.

TABLE 9 – SECURITIES

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>SECURITIES AVAILABLE FOR SALE</b>			
U. S. Treasury	\$ 2,003	\$ 4,103	\$ 15,528
U. S. Agencies	11,972	18,102	5,679
Mortgage Backed	57,270	49,404	59,368
State, Municipal and Other	90,958	80,107	62,606
<b>TOTAL SECURITIES AVAILABLE FOR SALE</b>	<u>\$162,203</u>	<u>\$151,716</u>	<u>\$143,181</u>

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
AVAILABLE-FOR-SALE								
U. S. Treasury	\$2,003	4.49%	\$ 0	0.00%	\$ 0	0.00%	\$ 0	0.00%
U. S. Agencies	0	0.00%	0	0.00%	2,181	4.63%	9,791	4.76%
Mortgage Backed (1)	0	0.00%	288	5.67%	67	8.06%	56,915	5.28%
State, Municipal and Other (2)	5,259	5.48%	8,671	5.43%	18,070	6.34%	58,958	6.22%
TOTAL AVAILABLE-FOR-SALE	<u>\$7,262</u>	<u>5.21%</u>	<u>\$8,959</u>	<u>5.44%</u>	<u>\$20,318</u>	<u>6.16%</u>	<u>\$125,664</u>	<u>5.68%</u>

- (1) The maturities for mortgage backed securities in the above table are based on final maturity.  
(2) Average rates were calculated on tax equivalent basis using a marginal federal income tax rate of 34% and a state tax rate of 5%.

The change in the carrying value of the available-for-sale portfolio is due to market value fluctuations resulting from the changing interest rate environment during 2005. This change is not used in the Tier 1 capital calculation.

**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 certificates of deposit. The deposit base is the Company's major funding source for earning assets. Although time deposits declined in 2005, they continue to be the largest single segment of the Company's total deposits. Time deposits declined because management did not aggressively price time deposits in the Company's markets, as management believed the Company had sufficient funds to meet loan demand.

A three-year schedule of deposits by type and maturities of time deposits greater than \$100,000 is presented in Table 10—Deposit Information.

TABLE 10 - DEPOSIT INFORMATION

	2005		2004		2003	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing	\$ 80,183		\$ 72,867		\$ 65,985	
Interest-bearing demand	144,134	1.46%	127,902	1.07%	123,338	0.98%
Savings	36,048	0.83%	37,591	0.85%	34,696	1.02%
Certificates of deposit	204,265	2.45%	219,150	1.85%	222,695	2.26%
	<u>\$464,630</u>	<u>1.59%</u>	<u>\$457,510</u>	<u>1.44%</u>	<u>\$446,714</u>	<u>1.48%</u>

MATURITY RANGES OF TIME CERTIFICATES OF DEPOSIT  
OF \$100,000 OR MORE,

	as of December 31, 2005
3 months or less	\$ 21,293
3 through 6 months	10,500
6 through 12 months	33,894
over 12 months	13,706
	\$ 79,393

The Company in its normal course of business will acquire large certificates of deposit, 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 certificates of deposit 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 and short-term advances from the Federal Home Loan Bank of Dallas ("FHLB"). Long-term borrowings are advances from the FHLB with an initial maturity of greater than one year.

TABLE 11 - SHORT-TERM BORROWINGS

	As of December 31,		
	2005	2004	2003
Short-term borrowings			
Year-end balance	\$ 1,600	\$ 0	\$14,000
Weighted average rate	4.20%	0.00%	1.11%
Maximum month-end balance	\$12,600	\$12,000	\$15,000
Year to date average balance	\$ 2,344	\$ 2,907	\$ 1,229
Weighted average rate	3.54%	1.05%	1.15%

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, 2005, the Company had the capacity to borrow up to \$151,773,280 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.

The Company, at the end of 2005, had long-term debt in the amount of \$60,048,818 to the FHLB for advances and \$1,521,521 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. The remaining maturity schedule of the long-term debt at December 31, 2005 is listed below.

	<u>2005</u>
Less than one year	\$10,655
One year to three years	25,044
Over three years	<u>25,871</u>
Total Long-term borrowings	<u>\$61,570</u>

#### NON-INTEREST INCOME AND EXPENSE

Table 12 - Non-interest Income and Expense illustrates the Company's non-interest income and expense from 2003 through 2005 and percentage changes between such years.

TABLE 12 - NON-INTEREST INCOME & EXPENSE

	<u>2005</u>	<u>% CHANGE FROM 2004</u>	<u>2004</u>	<u>% CHANGE FROM 2003</u>	<u>2003</u>
<b>NON-INTEREST INCOME</b>					
Service charges on deposit accounts	\$ 3,557	4.90%	\$ 3,391	4.82%	\$ 3,235
Other operating income	2,180	-0.18%	2,184	4.55%	2,089
TOTAL NON-INTEREST INCOME	<u>\$ 5,737</u>	<u>2.91%</u>	<u>\$ 5,575</u>	<u>4.71%</u>	<u>\$ 5,324</u>
<b>NON-INTEREST EXPENSE</b>					
Salaries and employee benefits	\$ 9,523	10.64%	\$ 8,607	8.59%	\$ 7,926
Occupancy expense, including equipment	2,903	-1.19%	2,938	7.03%	2,745
Other operating expense	5,091	-1.49%	5,168	18.23%	4,371
TOTAL NON-INTEREST EXPENSE	<u>\$17,517</u>	<u>4.81%</u>	<u>\$16,713</u>	<u>11.11%</u>	<u>\$15,042</u>

Non-interest income typically consists of service charges on checking accounts 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, title insurance service fees and income contributions from the Company's credit life insurance subsidiary.

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During the year of 2005, non-interest income increased \$162,292, or 2.91% when compared to the year of 2004. The majority of this increase came from service charge income from checking accounts.

For the year 2004, non-interest income increased \$250,933, or 4.71%, when compared to the same period in 2003. This increase was due mainly to an increase in income derived from the purchase of \$11.4 million in bank-owned life insurance in November, 2003.

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 2005, non-interest expenses increased \$803,949, or 4.81%, to \$17,516,905. The main reason for this increase was a \$916,301 increase in salaries and benefits. At the same time, the Company was able to decrease the amount of other operating expenses.

For 2004, non-interest expenses increased \$1,670,969, or 11.1%, to \$16,712,956. This increase was caused mainly by increases in salaries and benefits and normal growth in other operating expenses. Legal, audit and accounting expenses increased \$222,456, or 96%, in large part to efforts undertaken by the Company to comply with the Sarbanes-Oxley Act of 2002.

In 2005, the Company's efficiency ratio was 58.14%, compared to 57.65% in 2004 and 54.45% in 2003. 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. The increase in the efficiency ratio over the past three years reflects increases in non-interest expense associated with managing the growth in assets during the period and incorporating the personnel added in connection with the CB&T acquisition.

#### **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 \$1,961,434 is considered realizable without the use of extraordinary tax planning strategies.

The Company's effective tax rate was 22.90%, 26.23% and 28.98% in 2005, 2004 and 2003, respectively. The major difference between the effective tax rate applied to the Company's financial statement income and the federal statutory rate of 34% is interest on tax-exempt securities and loans. Further tax information is disclosed in Note 9 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 2005, the Company's growth in deposits, on average, was less than the growth in loans and securities and the Company was required to use long and short term borrowings to fund loan and security growth. 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 can be increased by offering more competitive rates and superior service to our customers.

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 solicit certificates of deposit from brokers. The primary sources of liquidity on the asset side of the balance sheet are federal funds sold and securities classified as available-for-sale. The entire investment securities portfolio is classified in the available-for-sale 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, 2005, both the ALCO and the Board determined that the Company's liquidity position was adequate.

Table 13 - Funding Uses and Sources details the main components of cash flows for 2005 and 2004.

TABLE 13 - FUNDING USES AND SOURCES

	2005			2004		
	Average Balance	Increase/(decrease) Amount	Percent	Average Balance	Increase/(decrease) Amount	Percent
<b>FUNDING USES</b>						
Loans, net of unearned income	\$371,925	\$ 7,003	1.92%	\$364,922	\$ 27,159	8.04%
Taxable securities	71,608	(415)	-0.58%	72,023	(36,672)	-33.74%
Tax-exempt securities	81,134	14,592	21.93%	66,542	17,359	35.29%
Federal funds sold and other	5,891	(140)	-2.32%	6,031	2,456	68.70%
<b>TOTAL USES</b>	<b>\$530,558</b>	<b>\$ 21,040</b>	<b>4.13%</b>	<b>\$509,518</b>	<b>\$ 10,302</b>	<b>2.06%</b>
<b>FUNDING SOURCES</b>						
Noninterest-bearing deposits	\$ 80,183	\$ 7,316	10.04%	\$ 72,867	\$ 6,882	10.43%
Interest-bearing demand and savings deposits	180,181	14,688	8.88%	165,493	7,459	4.72%
Time Deposits	204,265	(14,885)	-6.79%	219,150	(3,545)	-1.59%
Short-term borrowings	2,344	1,231	110.60%	1,113	(2,952)	-72.62%
Long-term debt	54,823	13,216	31.76%	41,607	6,293	17.82%
<b>TOTAL SOURCES</b>	<b>\$521,796</b>	<b>\$ 21,566</b>	<b>4.31%</b>	<b>\$500,230</b>	<b>\$ 14,137</b>	<b>2.91%</b>



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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 (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.

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, 2005, 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

	At December 31,		
	2005	2004	2003
<b>Tier 1 capital</b>			
Shareholders' equity	\$ 63,774	\$ 60,191	\$ 56,502
Less: Intangibles	(5,290)	(5,827)	(6,390)
Add/less: Unrealized loss/(gain) on securities	966	(400)	(1,470)
Add: Minority interest in equity accounts of unconsolidated subsidiaries	1,358	1,466	1,383
<b>TOTAL TIER 1 CAPITAL</b>	<u>\$ 60,808</u>	<u>\$ 55,430</u>	<u>\$ 50,025</u>
<b>Total capital</b>			
Tier 1 capital	\$ 60,808	\$ 55,430	\$ 50,025
Allowable allowance for loan losses	4,562	4,721	4,577
<b>TOTAL CAPITAL</b>	<u>\$ 65,370</u>	<u>\$ 60,151</u>	<u>\$ 54,602</u>
<b>RISK WEIGHTED ASSETS</b>	<u>\$403,497</u>	<u>\$391,754</u>	<u>\$365,589</u>
<b>AVERAGE ASSETS (FOURTH QUARTER)</b>	<u>\$601,607</u>	<u>\$570,342</u>	<u>\$549,314</u>
<b>RISK BASED RATIOS</b>			
TIER 1	<u>15.07%</u>	<u>14.14%</u>	<u>13.68%</u>
<b>TOTAL CAPITAL</b>	<u>16.20%</u>	<u>15.39%</u>	<u>14.94%</u>
<b>LEVERAGE RATIOS</b>	<u>10.11%</u>	<u>9.72%</u>	<u>9.11%</u>

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 our 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 increasing the dividend payout ratio to approximately 40.9% 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 12, "Off-Balance Sheet Financial Instruments, Commitments and Contingencies and Concentration 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 of the Company as of December 31, 2005.

Contractual Obligations	Payments Due by Period (amounts in thousands)				
	Total	Less than 1 year	1-3 Years	3 - 5 Years	Over 5 Years
Long Term Debt	\$ 60,049	\$10,649	\$ 25,000	\$ 7,000	\$17,400
Operating Leases	344,697	84,048	140,871	117,062	2,716
Other Long-term Liabilities	1,472	6	44	643	779
Total	<u>\$406,218</u>	<u>\$94,703</u>	<u>\$165,915</u>	<u>\$124,705</u>	<u>\$20,895</u>

Long-term debt obligations represent borrowings from the FHLB that have an original maturity in excess of one (1) year. Operating leases are primarily for a lease on a branch and other leases for mailing equipment. The branch lease is for 60 months and 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 and/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.

## 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. This report utilizes an immediate 200 basis point rate movement up and down and measures the effect this change has on earnings and the value of equity.

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, 2005 (\$ in thousands):

	Interest Sensitive Within	
	90 days	One year
Total rate sensitive assets	\$ 93,996	\$ 61,679
Total rate sensitive liabilities	238,835	114,291
Net gap	<u>(\$144,839)</u>	<u>(\$ 52,612)</u>

The analysis shows a negative gap position over the next three- and twelve -month periods which indicates that the Company would benefit somewhat from a decrease in market interest rates. 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



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, 2005. 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, 2005				Total
	1 - 90 Days	91 - 365 Days	1 - 5 Years	Over 5 years	
<b>INTEREST EARNING ASSETS</b>					
Loans	\$ 92,389	\$ 47,021	\$193,321	\$ 35,829	\$368,560
Investment securities	1,294	14,658	47,839	94,665	158,456
Federal Home Loan Bank Account	313	—	—	—	313
Federal Funds Sold	—	—	—	—	—
<b>TOTAL INTEREST BEARING ASSETS</b>	<b>\$ 93,996</b>	<b>\$ 61,679</b>	<b>\$241,160</b>	<b>\$130,494</b>	<b>\$527,329</b>
<b>INTEREST BEARING LIABILITIES</b>					
Interest bearing demand deposits	\$ 130,939	\$ —	\$ —	\$ —	\$130,939
Savings and Money Market deposits	52,902	—	—	—	52,902
Time deposits	53,118	103,918	45,428	—	202,464
Federal Funds Purchased	1,600	—	—	—	1,600
Short term borrowings	—	—	—	—	—
Long term borrowings	276	10,373	32,000	17,400	60,049
<b>TOTAL INTEREST BEARING LIABILITIES</b>	<b>\$ 238,835</b>	<b>\$ 114,291</b>	<b>\$ 77,428</b>	<b>\$ 17,400</b>	<b>\$447,954</b>
Rate sensitive gap	\$(144,839)	\$ (52,612)	\$163,732	\$113,094	\$ 79,375
Rate sensitive cumulative gap	(144,839)	(197,451)	(33,719)	79,375	
Cumulative gap as a percentage of total earning assets	-27.47%	-37.44%	-6.39%	15.05%	

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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.

The rate sensitivity gap table illustrates that the Company had a large negative cumulative gap position for the one-year period ending December 31, 2005. This negative gap position was mainly due to: (1) the interest-bearing and savings deposits being classified in the 1-90 day category; (2) approximately 78% of certificates of deposit maturing during the next twelve months; and (3) 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 corporate 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 increasing the amount of its transaction accounts by paying a competitive rate on those accounts. At the same time, it has not participated in the higher yielding certificates of deposit. 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.

Although short and medium term interest rates increased again in 2005 in connection with increases in the target Federal Funds rate by the Federal Reserve Bank, the effect on the Company was marginal. The Company's net interest margin in 2005 and 2004 was 4.61%. Even as rates were rising, the Company lessened the impact of higher rates because of a shift in deposits from certificates of deposit to interest bearing transaction accounts.

Quarterly Financial Trends

	2005				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year to Date
Interest Income	\$8,016	\$8,072	\$8,449	\$8,506	\$33,043
Interest Expense	2,098	2,278	2,588	2,883	\$ 9,847
Net Interest Income	5,918	5,794	5,861	5,623	\$23,196
Provision for Loan Losses	163	343	541	38	\$ 1,084
Non-interest Income	1,321	1,577	1,554	1,285	\$ 5,737
Non-interest Expense	4,556	4,400	4,370	4,191	\$17,517
Income Taxes	600	602	572	592	\$ 2,366
Net Income	<u>\$1,920</u>	<u>\$2,026</u>	<u>\$1,932</u>	<u>\$2,087</u>	<u>\$ 7,966</u>
Per common share:					
Basic	\$ 0.38	\$ 0.40	\$ 0.39	\$ 0.42	\$ 1.59
Diluted	\$ 0.38	\$ 0.40	\$ 0.38	\$ 0.41	\$ 1.57
Cash Dividends	\$ 0.16	\$ 0.16	\$ 0.16	\$ 0.17	\$ 0.65
	2004				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year to Date
Interest Income	\$7,233	\$7,366	\$7,502	\$7,871	\$29,972
Interest Expense	1,824	1,807	1,908	1,998	\$ 7,537
Net Interest Income	5,409	5,559	5,594	5,873	\$22,435
Provision for Loan Losses	450	450	122	45	\$ 1,067
Non-interest Income	1,261	1,531	1,365	1,418	\$ 5,575
Non-interest Expense	3,977	4,145	4,190	4,402	\$16,714
Income Taxes	570	693	709	712	\$ 2,683
Net Income	<u>\$1,673</u>	<u>\$1,802</u>	<u>\$1,938</u>	<u>\$2,132</u>	<u>\$ 7,546</u>
Per common share:					
Basic	\$ 0.34	\$ 0.36	\$ 0.39	\$ 0.43	\$ 1.51
Diluted	\$ 0.33	\$ 0.36	\$ 0.38	\$ 0.42	\$ 1.49
Cash Dividends	\$ 0.15	\$ 0.15	\$ 0.15	\$ 0.15	\$ 0.60



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## Market Price and Dividend Information

### MARKET PRICE

The Company's common stock is traded on the American Stock Exchange ("AMEX") under the symbol "CIZ". The stock began trading on the AMEX on October 19, 1999 and prior to that date was sold in private transactions between parties. On December 31, 2005, the common stock's closing price was \$22.55. The following table sets forth the high and low sales prices for the common stock, as well as the dividends declared, in each quarter in the past two fiscal years.

<u>2004</u>	<u>High</u>	<u>Low</u>	<u>Dividends Declared (per common share)</u>
January - March	\$22.95	\$21.12	\$ 0.15
April - June	23.45	20.80	0.15
July - September	21.65	20.05	0.15
October - December	21.75	19.90	0.15

  

<u>2005</u>	<u>High</u>	<u>Low</u>	<u>Dividends Declared (per common share)</u>
January - March	\$21.40	\$19.70	\$ 0.16
April - June	23.05	20.00	0.16
July - September	23.75	21.47	0.16
October - December	22.85	21.30	0.17

On March 3, 2006, shares of our common stock were held of record by approximately 475 shareholders.

### DIVIDENDS

Dividends totaled \$0.65 per share for 2005 compared to \$0.60 per share for 2004. These dividends reflect an 8.3% increase in 2005 over 2004.

If funds are available, 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 dividends; the amount of any dividend is limited to earned surplus in excess of three times its capital stock. At December 31, 2005, the maximum amount available for transfer from the Bank in the form of cash dividends 10% of its consolidated net assets.

Federal Reserve regulations also limit the amount the Bank may loan to the Company unless such loans are collateralized by specific obligations. At December 31, 2005, the maximum amount available for transfer from the Bank in the form of cash dividends and loans was 20% of its consolidated net assets.

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**THE CITIZENS BANK OFFICERS**

Greg McKee  
President & CEO

Danny Hicks  
Sr. Vice President

Robert T. Smith  
Sr. Vice President & CFO

Erdis Chaney  
Vice President & Cashier

Tim Lofton  
Vice President & CIO

Randy Cheatham  
Vice President

Mike Guthrie  
Vice President & Senior Credit Officer

Joe Foster  
Vice President & Trust

Murray Johnson  
Vice President

Jackie Hester  
Vice President & Marketing

Kaye Johnson  
Vice President

Stanley Salter  
Vice President

Darrell Bates  
Vice President

David Sharp  
Vice President

Jean T. Fulton  
Vice President

Gayle Sharp  
Vice President

Brad Copeland  
Vice President

Mark Majure  
Assistant Vice President

Carolyn K. McKee  
Student Loan Officer

Beth Branning  
Assistant Vice President

Tommie Jackson  
Assistant Vice President

Pat Stokes  
Assistant Cashier

Adriana Burt  
Assistant Cashier

Mitch Peden  
Data Processing Officer

Sommer Vick  
Accounting Officer

Mark Flake  
Data Processing Officer

Barbara Lewis  
Assistant Cashier

Greg Jackson  
Accounting Officer

Patsy Smith  
Assistant Cashier

Camp Keith  
Assistant Cashier

Vicki Brown  
Assistant Cashier

**Carthage Branch**

Mike Brooks  
President

J. Michael Ellis  
Vice President

Billie Nell Dowdle  
Vice President

Byron Hines  
Vice President

Margaret Thompson  
Assistant Cashier

Carol Wright  
Assistant Cashier

**Sebastopol Branch**

Linda Bennett  
President

**Union Branch**

Robert C. Palmer, Jr.  
President

Karen Foster  
Assistant Vice President

Deborah Rigdon  
Assistant Cashier

**Kosciusko Branch**

Charlie Hudson  
President

David Blair  
Vice President

Joanne Sanders  
Assistant Cashier

**Scooba Branch**

Fran Knight  
Vice President

**Meridian Branch**

Charles Young  
President

Mac Hodges  
Vice President

**Forest Branch**

Richard Latham  
Vice President

Dymple Winstead  
Assistant Vice President

**Decatur Branch**

Ken Jones  
Vice President

**Louisville Branch**

Terry Woods  
President

Edna Bell  
Vice President

Stan Acy  
Vice President

Marion Gardner  
Assistant Cashier

Danny Parker  
Assistant Cashier

Bruce Lee  
Assistant Vice President

**Mortgage Loan Department**

Linda Stribling  
Mortgage Loan Officer

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**BOARD OF DIRECTORS**

Karl Brantley  
Retired Plant Manager  
U. S. Electrical Motors

Don Fulton  
President & General Manager  
Nemanco, Inc.

Donald L. Kilgore  
Attorney General  
Mississippi Band of Choctaw Indians

David A. King  
Proprietor  
Philadelphia Motor Company

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

**CITIZENS HOLDING COMPANY OFFICERS**

William M. Mars  
Chairman

Greg L. McKee  
President and CEO

Carolyn K. McKee  
Secretary

Robert T. Smith  
Treasurer and Chief Financial Officer

William M. Mars  
Retired Attorney  
Mars, Mars, Mars & Chalmers

Greg L. McKee  
President & CEO  
Citizens Holding Company and  
The Citizens Bank

David P. Webb  
Attorney  
Phelps Dunbar, LLP

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

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**BANKING LOCATIONS****The Citizens Bank****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**

585 East Main Street  
Philadelphia, MS 39350  
601.656.4976

**Pearl River Branch**

110 Choctaw Town Center  
Philadelphia, MS 39350  
601.656.4971

**Union Branch**

502 Bank Street  
Union, MS 39365  
601.656.4879  
601.774.9231

**Carthage Main Office**

219 West Main Street  
Carthage, MS 39051  
601.257.4525

**Phone Teller**

1.800.397.0344

**Crossroads Branch**

501 Hwy 35 south  
Carthage, MS 39051  
601.267.4525

**Madden Branch**

Highway 488  
Madden, MS 39109  
601.267.7366

**Sebastopol Branch**

24 Pine Street  
Sebastopol, MS 39359  
601.625.7447

**DeKalb Branch**

Corner of Main & Bell St.  
DeKalb, MS 39328  
601.743.2115

**Kosciusko Branch**

775 North Jackson Street  
Kosciusko, MS 39090  
662.289.4356

**Scooba Branch**

1048 Johnson Street  
Scooba, MS 39358  
662.476-8431

**Meridian Branch**

1825 Hwy 39 North  
Meridian, MS 39301  
601.693.8367

**Internet Banking**

<http://www.thecitizensbankphila.com>

**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 Branch**

100 East Main Street  
Louisville, MS 39339  
662.773.6261

**Noxapater Branch**

45 East Main Street  
Noxapater, MS 39346  
662.724.4261

**Industrial Branch**

803 South Church Street  
Louisville, MS 39339  
662.773.6261

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**FINANCIAL INFORMATION****CORPORATE HEADQUARTERS**

521 Main Street  
P.O. Box 209  
Philadelphia, MS 39350  
601.656.4692

**ANNUAL STOCKHOLDER MEETING**

The Annual Stockholder meeting of the Citizens Holding Company, Inc. will be held Tuesday, April 25, 2006, at 4:30P.M. at 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 Corporation's most recent Annual Report on Form 10-K, filed with the Securities and Exchange Commission, is available without charge to stockholder's 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

**601.656.4692**

[www.thecitizensbankphila.com](http://www.thecitizensbankphila.com)

**Exhibit 21 – Subsidiaries of the Registrant**

The following is a list of subsidiaries of the Company at December 31, 2005:

<u>Subsidiaries</u>	<u>Jurisdiction of Incorporation</u>	<u>Approximate Percentage of Voting Securities Owned</u>
The Citizens Bank of Philadelphia, Mississippi	Mississippi	97.86%

**[HORNE LLP LETTERHEAD]**

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in this Annual Report on Form 10-K of Citizens Holding Company for the year ended December 31, 2005 and in the Registration Statement on Form S-8 (No. 333-89680) of Citizens Holding Company of our reports dated March 7, 2005, relating to the financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting which appear in the 2005 Annual Report to Shareholders, which Annual Report to Shareholders is incorporated by reference in this Annual Report on Form 10-K of Citizens Holding Company for the year ended December 31, 2005.

/s/ HORNE LLP  
Jackson, Mississippi  
March 13, 2006

## CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Greg L. McKee, certify that:

1. I have reviewed this annual report on Form 10-K of The Citizens Holding Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's internal controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 7, 2006

by: /s/ Greg L. McKee  
Greg L. McKee  
Chief Executive Officer



## CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Robert T. Smith, certify that:

1. I have reviewed this annual report on Form 10-K of The Citizens Holding Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's internal controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 7, 2006

by: /s/ Robert T. Smith  
Robert T. Smith  
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of The Citizens Holding Company (the "Company") for the period ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Greg L. McKee, Chief Executive Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Date: March 7, 2006

by: /s/ Greg L. McKee  
Greg L. McKee  
Chief Executive Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report on Form 10-K of The Citizens Holding Company (the "Company") for the period ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert T. Smith, Chief Financial Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Date: March 7, 2006

by: /s/ Robert T. Smith  
Robert T. Smith  
Chief Financial Officer