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

FORM 10-Q

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

For the quarterly period ended March 31, 2020

or

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

For the transition period from _____ to _____

Commission File Number: 001-15375

CITIZENS HOLDING COMPANY

(Exact name of registrant as specified in its charter)

Mississippi
(State or other jurisdiction of
incorporation or organization)

64-0666512
(IRS Employer
Identification No.)

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

39350
(Zip Code)

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

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

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, \$0.20 par value	CIZN	NASDAQ Global Market

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

None

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller Reporting Company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Number of shares outstanding of each of the issuer's classes of common stock, as of May 6, 2020:

Title	Outstanding
Common Stock, \$0.20 par value	5,590,131

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS.

CITIZENS HOLDING COMPANY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(in thousands, except share data)

	March 31, 2020 (Unaudited)	December 31, 2019 (Audited)
ASSETS		
Cash and due from banks	\$ 19,610	\$ 15,937
Interest bearing deposits with other banks	61,909	58,557
Federal funds sold	—	1,600
Investment securities available for sale, at fair value	482,077	464,383
Loans, net of allowance for loan losses of \$3,816 in 2020 and \$3,755 in 2019	573,163	573,312
Premises and equipment, net	24,495	24,672
Other real estate owned, net	3,643	3,552
Accrued interest receivable	4,106	4,181
Cash surrender value of life insurance	25,220	25,088
Deferred tax assets, net	1,669	3,684
Other assets	20,219	20,468
TOTAL ASSETS	\$ 1,216,111	\$ 1,195,434
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing demand	\$ 195,843	\$ 190,406
Interest-bearing NOW and money market accounts	410,485	369,354
Savings deposits	87,422	83,065
Certificates of deposit	232,138	256,171
Total deposits	925,888	898,996
Securities sold under agreement to repurchase	159,442	170,410
Accrued interest payable	722	1,128
Deferred compensation payable	9,530	9,453
Other liabilities	1,785	2,647
Total liabilities	1,097,367	1,082,634
SHAREHOLDERS' EQUITY		
Common stock, \$0.20 par value, 22,500,000 shares authorized, 5,582,631 shares issued and outstanding at March 31, 2020 and 5,578,131 at December 31, 2019	1,117	1,116
Additional paid-in capital	18,009	17,883
Retained earnings	94,411	94,590
Accumulated other comprehensive loss, net of tax (expense) benefit of (\$1,731) at March 31, 2020 and \$262 at December 31, 2019	5,207	(789)
Total shareholders' equity	118,744	112,800
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,216,111	\$ 1,195,434

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

CITIZENS HOLDING COMPANY
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

	(Unaudited)	
	For the Three Months	
	Ended March 31,	
	2020	2019
INTEREST INCOME		
Interest and fees on loans	\$ 7,480	\$ 5,450
Interest on securities		
Taxable	1,657	2,082
Nontaxable	340	617
Other interest	232	235
Total interest income	9,709	8,384
INTEREST EXPENSE		
Deposits	1,969	1,729
Other borrowed funds	355	445
Total interest expense	2,324	2,174
NET INTEREST INCOME	7,385	6,210
PROVISION FOR LOAN LOSSES	314	195
NET INTEREST INCOME AFTER		
PROVISION FOR LOAN LOSSES	7,071	6,015
OTHER INCOME		
Service charges on deposit accounts	1,049	1,097
Other service charges and fees	773	684
Other operating income	559	266
Total other income	2,381	2,047
OTHER EXPENSES		
Salaries and employee benefits	4,435	3,547
Occupancy expense	1,659	1,423
Other expense	1,973	1,670
Total other expenses	8,067	6,640
INCOME BEFORE PROVISION		
FOR INCOME TAXES	1,385	1,422
PROVISION FOR INCOME TAXES	225	195
NET INCOME	\$ 1,160	\$ 1,227
NET INCOME PER SHARE -Basic	\$ 0.21	\$ 0.25
-Diluted	\$ 0.21	\$ 0.25
DIVIDENDS PAID PER SHARE	\$ 0.24	\$ 0.24

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

CITIZENS HOLDING COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(in thousands)

	For the Three Months Ended March 31,	
	2020	2019
Net income	\$ 1,160	\$ 1,227
Other comprehensive income		
Securities available-for-sale		
Unrealized holding gains	7,912	8,823
Income tax effect	(1,974)	(2,201)
	5,938	6,622
Reclassification adjustment for gains included in net income	77	—
Income tax effect	(19)	—
	58	—
Total other comprehensive income	5,996	6,622
Comprehensive income	<u>\$ 7,156</u>	<u>\$ 7,849</u>

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

CITIZENS HOLDING COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	For the Three Months Ended March 31,	
	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Net cash provided by operating activities	\$ 2,340	\$ 1,978
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and calls of securities available for sale	74,267	8,336
Proceeds from sale of investment securities	37,196	—
Purchases of investment securities available for sale	(122,722)	(63,403)
Purchases of bank premises and equipment	(70)	(45)
Decrease in federal funds sold	1,600	—
Increase in interest bearing deposits with other banks	(3,352)	(19,042)
Proceeds from sale of other real estate	—	—
Net increase in loans	(258)	(18,200)
Net cash used in investing activities	(13,339)	(92,354)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	26,892	83,938
(Decrease) increase in securities sold under agreement to repurchase	(10,968)	7,485
Proceeds from exercise of stock options	87	—
Payment of dividends	(1,339)	(1,177)
Net cash provided by financing activities	14,672	90,246
Net increase (decrease) in cash and due from banks	3,673	(130)
Cash and due from banks, beginning of period	15,937	12,592
Cash and due from banks, end of period	<u>\$ 19,610</u>	<u>\$ 12,462</u>

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

CITIZENS HOLDING COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
As of and for the three months ended March 31, 2020
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

These interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). However, these interim consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The interim consolidated financial statements are unaudited and reflect all adjustments and reclassifications, which, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition as of and for the interim periods presented. All adjustments and reclassifications are of a normal and recurring nature. Results for the period ended March 31, 2020 are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

The interim consolidated financial statements of Citizens Holding Company (the “Company”) include the accounts of its wholly-owned subsidiary, The Citizens Bank of Philadelphia (the “Bank” and collectively with the Company, the “Corporation”). In addition to full service commercial banking, the Bank offers title insurance services through its subsidiary, Title Services LLC. All significant intercompany transactions have been eliminated in consolidation.

For further information and significant accounting policies of the Corporation, see the Notes to Consolidated Financial Statements of Citizens Holding Company included in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2019, filed with the Securities and Exchange Commission on March 13, 2020.

Nature of Business

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. The Company is also subject to the regulations of the Federal Reserve. The area served by the Bank is east central and southern counties of Mississippi and the surrounding areas. Services are provided at several branch offices.

Estimates

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

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

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

Risks and Uncertainties

(in thousands, except for number of loans)

The outbreak of COVID-19 has adversely impacted a broad range of industries in which the Company's customers operate and could impair their ability to fulfill their financial obligations to the Company. The World Health Organization has declared COVID-19 to be a global pandemic indicating that almost all public commerce and related business activities must be, to varying degrees, curtailed with the goal of decreasing the rate of new infections. The spread of the outbreak has caused significant disruptions in the U.S. economy and has disrupted banking and other financial activity in the areas in which the Company operates. While there has been no material impact to the Company's employees to date, COVID-19 could also potentially create widespread business continuity issues for the Company.

Congress, the President, and the Federal Reserve have taken several actions designed to cushion the economic fallout. Most notably, the Coronavirus Aid, Relief and Economic Security ("CARES") Act was signed into law at the end of March 2020 as an over \$2 trillion legislative package. The goal of the CARES Act is to prevent a severe economic downturn through various measures, including direct financial aid to American families and economic stimulus to significantly impacted industry sectors. The package also includes extensive emergency funding for hospitals and providers. In addition to the general impact of COVID-19, certain provisions of the CARES Act as well as other recent legislative and regulatory relief efforts are expected to have a material impact on the Company's operations.

The Company's business is dependent upon the willingness and ability of its employees and customers to conduct banking and other financial transactions. If the global response to contain COVID-19 escalates further or is unsuccessful, the Company could experience a material adverse effect on its business, financial condition, results of operations and cash flows. While it is not possible to know the full extent that the impact of COVID-19, and resulting measures to curtail its spread, will have on the Company's operations, the Company is disclosing potentially material items of which it is aware.

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Financial position and results of operations

The Company's fee income could be reduced due to COVID-19. In keeping with guidance from regulators, the Company is actively working with COVID-19 affected customers to waive fees from a variety of sources, such as, but not limited to, insufficient funds and overdraft fees, ATM fees, account maintenance fees, etc. These reductions in fees are thought, at this time, to be temporary in conjunction with the length of the expected COVID-19 related economic crisis. At this time, the Company is unable to project the materiality of such an impact, but recognizes the breadth of the economic impact is likely to impact its fee income in future periods.

The Company's interest income could be reduced due to COVID-19. In keeping with guidance from regulators, the Company is actively working with COVID-19 affected borrowers to defer their payments and fees. While interest and fees will still accrue to income, through normal GAAP accounting, should eventual credit losses on these deferred payments emerge, interest income and fees accrued would need to be reversed. In such a scenario, interest income in future periods could be negatively impacted. At this time, the Company is unable to project the materiality of such an impact, but recognizes the breadth of the economic impact may affect its borrowers' ability to repay in future periods.

Capital and liquidity

While the Company believes that it has sufficient capital to withstand an extended economic recession brought about by COVID-19, its reported and regulatory capital ratios could be adversely impacted by further credit losses and loss of fee income.

The Company maintains access to multiple sources of liquidity. If an extended recession caused large numbers of the Company's deposit customers to withdraw their funds, the Company might become more reliant on volatile or more expensive sources of funding. Wholesale funding markets have remained open to us, but rates for short term funding have recently been volatile. If funding costs are elevated for an extended period of time, it could have an adverse effect on the Company's net interest margin.

Asset valuation

Currently, the Company does not expect COVID-19 to affect its ability to account timely for the assets on its consolidated statement of condition; however, this could change in future periods. While certain valuation assumptions and judgments will change to account for pandemic-related circumstances such as widening credit spreads, the Company does not anticipate significant changes in methodology used to determine the fair value of assets measured in accordance with GAAP.

COVID-19 could cause a further and sustained decline in the Company's stock price or the occurrence of what management would deem to be a triggering event that could, under certain circumstances, cause us to perform a goodwill impairment test and result in an impairment charge being recorded for that period. In the event that the Company concludes that all or a portion of its goodwill is impaired, a non-cash charge for the amount of such impairment would be recorded to earnings. Such a charge would have no impact on tangible capital or regulatory capital.

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Processes, controls and business continuity plan

The Company has invoked its Board approved Pandemic Preparedness Plan that includes a remote working strategy, among other measures. The Company does not anticipate incurring additional material cost related to its continued deployment of the remote working strategy. No material operational or internal control challenges or risks have been identified to date. The Company does not anticipate significant challenges to its ability to maintain its systems and controls in light of the measures the Company has taken to prevent the spread of COVID-19. The Company does not currently face any material resource constraint through the implementation of its business continuity plans.

Lending operations and accommodations to borrowers

In keeping with regulatory guidance to work with borrowers during this unprecedented situation and as outlined in the CARES Act, the Company is executing a payment deferral program for its commercial lending clients that are adversely affected by the pandemic. Depending on the demonstrated need of the client, the Company is deferring either the full loan payment or the principal component of the loan payment for 60 or 90 days. As of April 30, 2020, the Company has executed 309 of these deferrals on outstanding loan balances of \$148,120. In accordance with interagency guidance issued in March 2020, these short term deferrals are not considered troubled debt restructurings.

With the passage of the Paycheck Protection Program (“PPP”), administered by the Small Business Administration (“SBA”), the Company is actively participating in assisting its customers with applications for resources through the program. PPP loans have a two-year term and earn interest at 1%. The Company believes that the majority of these loans will ultimately be forgiven by the SBA in accordance with the terms of the program. As of April 30, 2020, the Company has closed 386 SBA PPP loans representing \$38,315 in funding. It is the Company’s understanding that loans funded through the PPP program are fully guaranteed by the U.S. government. Should those circumstances change, the Company could be required to establish additional allowance for credit loss through additional credit loss expense charged to earnings.

Further, in sensitivity and service to its communities during this unprecedented time, the Company is waiving late payment and overdraft fees and has temporarily suspended collection efforts on past due loans.

Credit

The Company is working with customers directly affected by COVID-19. The Company is prepared to offer short-term assistance in accordance with regulator guidelines. As a result of the current economic environment caused by the COVID-19 virus, the Company is engaging in more frequent communication with borrowers to better understand their situation and the challenges faced, allowing it to respond proactively as needs and issues arise. Should economic conditions worsen, the Company could experience further increases in its allowance for loan losses and record additional credit loss expense. It is possible that the Company’s asset quality measures could worsen at future measurement periods if the effects of COVID-19 are prolonged.

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Adoption of New Accounting Standards

In January 2017, the FASB issued ASU 2017-04, “*Intangibles—Goodwill and Other (Topic 350)—Simplifying the Test for Goodwill Impairment*” (“ASU 2017-04”). ASU 2017-04 simplifies the accounting for goodwill impairment for all entities by requiring impairment charges to be based on the first step in the previous two-step impairment test. Under the new guidance, if a reporting unit’s carrying amount exceeds its fair value, an entity will record an impairment charge based on that difference. The impairment charge will be limited to the amount of goodwill allocated to that reporting unit. The standard eliminates the prior requirement to calculate a goodwill impairment charge using Step 2, which requires an entity to calculate any impairment charge by comparing the implied fair value of goodwill with its carrying amount. ASU 2017-04 was effective for the Company on January 1, 2020 and did not have a material impact on the Company’s financial statements.

ASU 2019-13 “*Fair Value Measurement (Topic 820) – Changes in the Disclosure Requirements for Fair Value Measurement*” (“ASU 2019-13”) removes the requirement to disclose the amount of and reasons for transfers between Level 1 and Level 2 fair value measurement methodologies, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements. It also adds a requirement to disclose changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 measurements. For certain unobservable inputs, entities may disclose other quantitative information in lieu of the weighted average if the other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements. ASU 2019-13 is effective for annual and interim periods beginning after December 15, 2019. ASU 2019-13 was effective for the Company on January 1, 2020 and did not have a material impact on the Company’s financial statements.

In March 2020, various regulatory agencies, including the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, (“the agencies”) issued an interagency statement on loan modifications and reporting for financial institutions working with customers affected by COVID-19. The interagency statement was effective immediately and impacted accounting for loan modifications. Under Accounting Standards Codification 310-40, “*Receivables – Troubled Debt Restructurings by Creditors*,” (“ASC 310-40”), a restructuring of debt constitutes a troubled debt restructuring (“TDR”) if the creditor, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies confirmed with the staff of the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented. This interagency guidance is expected to have a material impact on the Company’s financial statements; however, this impact cannot be quantified at this time. See Note 8 of the condensed footnotes to the consolidated financial statements for disclosure of the impact to date.

Newly Issued, But Not Yet Effective Accounting Standards

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). ASU 2016-13 makes significant changes to the accounting for credit losses on financial instruments and disclosures about them. The new current expected credit loss (CECL) impairment model will require an estimate of expected credit losses, measured over the contractual life of an instrument, which considers reasonable and supportable forecasts of future economic conditions in addition to information about past events and current conditions. The standard provides significant flexibility and requires a high degree of judgment with regards to pooling financial assets with similar risk characteristics, determining the contractual terms of said financial assets and adjusting the relevant historical loss information in order to develop an estimate of expected lifetime losses. In addition, ASU 2016-13 amends the accounting for credit losses on debt securities and purchased financial assets with credit deterioration. The amendments in ASU 2016-13 are currently effective for fiscal years beginning after December 31, 2019, and interim periods within those years for public business entities that are SEC filers. However, in October 2019, the FASB approved deferral of the effective date for ASU 2016-13 for certain companies. The new effective date for the Company is January 1, 2023. ASU 2016-13 permits the use of estimation techniques that are practical and relevant to the Company’s circumstances, as long as they are applied consistently over time and faithfully estimate expected credit losses in accordance with the standard. The ASU lists several common credit loss methods that are acceptable such as a discounted cash flow method, loss-rate method and probability of default/loss given default (PD/LGD) method. Depending on the nature of each identified pool of financial assets with similar risk characteristics, the Company currently plans on implementing a PD/LGD method or a loss-rate method to estimate expected credit losses. The Company expects ASU 2016-13 to have a significant impact on the Company’s accounting policies, internal controls over financial reporting and footnote disclosures. The Company has assessed its data and system needs and has begun designing its financial models to estimate expected credit losses in accordance with the standard. Further development, testing and evaluation of said models is required to determine the impact that adoption of this standard will have on the financial condition and results of operations of the Company.

Note 2. Mergers and Acquisitions

(in thousands, except share data)

Merger with Charter Bank

Effective October 1, 2019, the Company completed its acquisition by merger of Charter Bank (“Charter”), in a transaction valued at approximately \$19.7 million. The Company issued 666,101 shares of common stock and paid approximately \$6.1 million in cash to Charter shareholders, excluding cash paid for fractional shares. At closing, Charter merged with and into the Bank, with the Bank being the surviving corporation in the merger. Operations of Charter will be included in the consolidated financial statements of the Corporation for periods subsequent to the acquisition date.

For further information regarding the merger with Charter, see the Notes to Consolidated Financial Statements of Citizens Holding Company included in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2019, filed with the Securities and Exchange Commission on March 13, 2020.

Note 3. Commitments and Contingent Liabilities

(in thousands)

In the ordinary course of business, the Corporation enters into commitments to extend credit to its customers. The unused portion of these commitments is not reflected in the accompanying financial statements. As of March 31, 2020, the Corporation had entered into loan commitments with certain customers with an aggregate unused balance of \$86,167 compared to an aggregate unused balance of \$94,009 at December 31, 2019. There were \$2,488 of letters of credit outstanding at March 31, 2020 and \$2,436 at December 31, 2019. The fair value of such commitments is not considered material because letters of credit and loan commitments often are not used in their entirety, if at all, before they expire. The balances of such letters and commitments should not be used to project actual future liquidity requirements. However, the Corporation does incorporate expectations about the utilization under its credit-related commitments into its asset and liability management program.

The Corporation is a party to lawsuits and other claims that arise in the ordinary course of business, all of which are being vigorously contested. In the regular course of business, management evaluates estimated losses or costs related to litigation, and provisions are made for anticipated losses whenever management believes that such losses are probable and can be reasonably estimated. At the present time, management believes, based on the advice of legal counsel, that the final resolution of pending legal proceedings will not likely have a material impact on the Corporation’s consolidated financial condition or results of operations.

Note 4. Net Income per Share

(in thousands, except share and per share data)

Net income per share - basic has been computed based on the weighted average number of shares outstanding during each period. Net income per share - diluted has been computed based on the weighted average number of shares outstanding during each period plus the dilutive effect of outstanding stock options and restricted stock using the treasury stock method. Net income per share was computed as follows:

	For the Three Months Ended March 31,	
	2020	2019
Basic weighted average shares outstanding	5,579,381	4,892,530
Dilutive effect of granted options	2,030	2,598
Diluted weighted average shares outstanding	5,581,411	4,895,128
Net income	\$ 1,160	\$ 1,227
Net income per share-basic	\$ 0.21	\$ 0.25
Net income per share-diluted	\$ 0.21	\$ 0.25

Note 5. Equity Compensation Plans

(in thousands, except per share data)

The Corporation has adopted the 2013 Incentive Compensation Plan (the "2013 Plan"), which the Corporation intends to use for future equity grants to employees, directors or consultants until the termination or expiration of the 2013 Plan.

Prior to the adoption of the 2013 Plan, the Corporation issued awards to directors from the 1999 Directors' Stock Compensation Plan (the "Directors' Plan"), which has expired.

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The following table is a summary of the stock option activity for the three months ended March 31, 2020:

	Directors' Plan		2013 Plan	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2019	40,500	\$ 21.49	—	\$ —
Granted	—	—	—	—
Exercised	(4,500)	19.18	—	—
Expired	—	—	—	—
Outstanding at March 31, 2020	<u>36,000</u>	<u>\$ 21.78</u>	<u>—</u>	<u>\$ —</u>

The intrinsic value of options outstanding under the Directors' Plan at March 31, 2020, was \$15,480. No options were outstanding under the 2013 Plan as of March 31, 2020.

During 2019, the Corporation's directors received restricted stock grants totaling 7,500 shares of common stock under the 2013 Plan. These grants vest over a one-year period ending April 23, 2020 during which time the recipients have rights to vote the shares and to receive dividends. The grant date fair value of these shares was \$161,475 and will be expensed ratably over the one-year vesting period.

Note 6. Income Taxes

(in thousands)

For the three months ended March 31, 2020 and 2019, the Company recorded a provision for income taxes totaling \$225 and \$195, respectively. The effective tax rate was 16.5% and 13.7% for the three months ending March 31, 2020 and 2019, respectively.

The provision for income taxes includes both federal and state income taxes and differs from the statutory rate due to favorable permanent differences primarily related to tax free municipal investments.

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(in thousands)

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2020				
Securities available-for-sale				
Obligations of U.S. Government agencies	\$ 44,574	\$ 191	\$ —	\$ 44,765
Mortgage backed securities	367,582	6,024	118	373,488
State, County, Municipals	62,484	931	94	63,321
Other Securities	500	3	—	503
Total	<u>\$475,140</u>	<u>\$ 7,149</u>	<u>\$ 212</u>	<u>\$482,077</u>
December 31, 2019				
Securities available-for-sale				
Obligations of U.S. Government agencies	\$ 97,400	\$ —	\$ 289	\$ 97,111
Mortgage backed securities	308,310	640	2,050	306,900
State, County, Municipals	59,724	708	60	60,372
Total	<u>\$465,434</u>	<u>\$ 1,348</u>	<u>\$ 2,399</u>	<u>\$464,383</u>

At March 31, 2020 and December 31, 2019, securities with a carrying value of \$418,632 and \$413,275, respectively, were pledged to secure government and public deposits and securities sold under agreement to repurchase.

The amortized cost and estimated fair value of securities by contractual maturity at March 31, 2020 and December 31, 2019 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay certain obligations.

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	March 31, 2020		December 31, 2019	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available-for-sale				
Due in one year or less	\$ 845	\$ 848	\$ 345	\$ 345
Due after one year through five years	38,070	38,117	89,920	89,681
Due after five years through ten years	17,681	18,019	18,678	18,808
Due after ten years	50,962	51,605	48,181	48,649
Residential mortgage backed securities	320,902	326,742	259,309	258,415
Commercial mortgage backed securities	46,680	46,746	49,001	48,485
Total	<u>\$475,140</u>	<u>\$482,077</u>	<u>\$465,434</u>	<u>\$464,383</u>

The tables below show the Corporation's gross unrealized losses and fair value of available-for-sale investments, aggregated by investment category and length of time that individual investments were in a continuous loss position at March 31, 2020 and December 31, 2019.

A summary of unrealized loss information for securities available-for-sale, categorized by security type follows:

March 31, 2020	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of Securities						
Obligations of U.S. government agencies	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Mortgage backed securities	25,319	93	5,566	25	30,885	118
State, County, Municipal	12,380	92	651	2	13,031	94
Total	<u>\$ 37,699</u>	<u>\$ 185</u>	<u>\$ 6,217</u>	<u>\$ 27</u>	<u>\$ 43,916</u>	<u>\$ 212</u>

December 31, 2019	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of Securities						
Obligations of U.S. government agencies	\$ 76,682	\$ 217	\$ 20,429	\$ 72	\$ 97,111	\$ 289
Mortgage backed securities	101,730	871	76,630	1,179	178,360	2,050
State, County, Municipal	8,280	37	3,731	23	12,011	60
Total	<u>\$186,692</u>	<u>\$ 1,125</u>	<u>\$100,790</u>	<u>\$ 1,274</u>	<u>\$287,482</u>	<u>\$ 2,399</u>

The Corporation's unrealized losses on its obligations of United States government agencies, mortgage backed securities and state, county and municipal bonds are the result of an upward trend in interest rates since purchase, mainly in the mid-term sector. None of the unrealized losses disclosed in the previous table are related to credit deterioration. The Corporation does not intend to sell any securities in an unrealized loss position that it holds and it is not more likely than not that the Corporation will be required to sell any such security prior to the recovery of its amortized cost basis, which may be at maturity. Furthermore, even though a number of these securities have been in a continuous unrealized loss position for greater than twelve months, the Corporation is collecting principal and interest payments as scheduled. The Corporation has determined that none of the securities in this classification were other-than-temporarily impaired at March 31, 2020 nor at December 31, 2019.

Note 8. Non Purchased Loans

(in thousands, except number of loans)

“Purchased” loans are those acquired in any of the Company’s previous acquisitions. “Non Purchased” loans include all of the Company’s other loans. For purposes of Note 8, all references to “loans” mean non purchased loans.

The composition of net loans at March 31, 2020 and December 31, 2019 was as follows:

	<u>March 31, 2020</u>	<u>December 31, 2019</u>
Real Estate:		
Land Development and Construction	\$ 78,059	\$ 66,428
Farmland	15,241	15,595
1-4 Family Mortgages	88,400	87,631
Commercial Real Estate	<u>207,453</u>	<u>207,604</u>
Total Real Estate Loans	389,153	377,258
Business Loans:		
Commercial and Industrial Loans	82,207	84,611
Farm Production and Other Farm Loans	649	683
Total Business Loans	<u>82,856</u>	<u>85,294</u>
Consumer Loans:		
Credit Cards	1,629	1,833
Other Consumer Loans	<u>11,445</u>	<u>12,060</u>
Total Consumer Loans	<u>13,074</u>	<u>13,893</u>
Total Gross Loans	485,083	476,445
Unearned Income	(5)	(8)
Allowance for Loan Losses	<u>(3,816)</u>	<u>(3,755)</u>
Loans, net	<u>\$ 481,262</u>	<u>\$ 472,682</u>

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

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

	<u>March 31, 2020</u>	<u>December 31, 2019</u>
Real Estate:		
Land Development and Construction	\$ 111	\$ 111
Farmland	230	232
1-4 Family Mortgages	2,054	2,160
Commercial Real Estate	8,966	9,082
Total Real Estate Loans	11,361	11,585
Business Loans:		
Commercial and Industrial Loans	512	338
Farm Production and Other Farm Loans	10	10
Total Business Loans	522	348
Consumer Loans:		
Other Consumer Loans	58	60
Total Consumer Loans	58	60
Total Nonaccrual Loans	<u>\$ 11,941</u>	<u>\$ 11,993</u>

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An aging analysis of past due loans, segregated by class, as of March 31, 2020, was as follows:

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
Real Estate:						
Land Development and Construction	\$ 567	\$ 111	\$ 678	\$ 77,381	\$ 78,059	\$ —
Farmland	376	—	376	14,865	15,241	—
1-4 Family Mortgages	2,263	496	2,759	85,641	88,400	—
Commercial Real Estate	18,676	2,890	21,566	185,887	207,453	—
Total Real Estate Loans	21,882	3,497	25,379	363,774	389,153	—
Business Loans:						
Commercial and Industrial Loans	531	296	827	81,380	82,207	12
Farm Production and Other Farm Loans	35	—	35	614	649	—
Total Business Loans	566	296	862	81,994	82,856	12
Consumer Loans:						
Credit Cards	34	2	36	1,593	1,629	2
Other Consumer Loans	117	44	161	11,284	11,445	—
Total Consumer Loans	151	46	197	12,877	13,074	2
Total Loans	\$ 22,599	\$ 3,839	\$ 26,438	\$458,645	\$485,083	\$ 14

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An aging analysis of past due loans, segregated by class, as of December 31, 2019 was as follows:

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
Real Estate:						
Land Development and Construction	\$ 736	\$ —	\$ 736	\$ 65,692	\$ 66,428	\$ —
Farmland	171	39	210	15,385	15,595	39
1-4 Family Mortgages	3,116	777	3,893	83,738	87,631	147
Commercial Real Estate	8,511	2,080	10,591	197,013	207,604	18
Total Real Estate Loans	12,534	2,896	15,430	361,828	377,258	204
Business Loans:						
Commercial and Industrial Loans	586	312	898	83,713	84,611	52
Farm Production and Other Farm Loans	17	—	17	666	683	—
Total Business Loans	603	312	915	84,379	85,294	52
Consumer Loans:						
Credit Cards	45	18	63	1,770	1,833	18
Other Consumer Loans	172	42	214	11,846	12,060	—
Total Consumer Loans	217	60	277	13,616	13,893	18
Total Loans	\$ 13,354	\$ 3,268	\$ 16,622	\$459,823	\$476,445	\$ 274

Loans are considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. In determining which loans to evaluate for impairment, management looks at all loans over \$100 that are past due loans, bankruptcy filings and any situation that might lend itself to cause a borrower to be unable to repay the loan according to the original agreement terms. If a loan is determined to be impaired and the collateral is deemed to be insufficient to fully repay the loan, a specific reserve will be established. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans or portions thereof, are charged-off when deemed uncollectible.

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Impaired loans as of March 31, 2020, segregated by class, were as follows:

	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Real Estate:						
Land Development and Construction	\$ 111	\$ 58	\$ 53	\$ 111	\$ 16	\$ 111
Farmland	250	250	—	250	—	\$ 251
1-4 Family Mortgages	805	795	10	805	8	\$ 822
Commercial Real Estate	11,463	6,011	3,736	9,747	559	\$ 9,768
Total Real Estate Loans	12,629	7,114	3,799	10,913	583	\$ 10,952
Business Loans:						
Commercial and Industrial Loans	433	233	200	433	94	\$ 289
Total Business Loans	433	233	200	433	94	\$ 289
Total Loans	<u>\$ 13,062</u>	<u>\$ 7,347</u>	<u>\$ 3,999</u>	<u>\$ 11,346</u>	<u>\$ 677</u>	<u>\$ 11,241</u>

Impaired loans as of December 31, 2019, segregated by class, were as follows:

	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Real Estate:						
Land Development and Construction	\$ 111	\$ 58	\$ 53	\$ 111	\$ 16	\$ 56
Farmland	252	252	—	252	—	\$ 261
1-4 Family Mortgages	839	740	99	839	28	\$ 996
Commercial Real Estate	11,506	5,949	3,840	9,789	566	\$ 9,337
Total Real Estate Loans	12,708	6,999	3,992	10,991	610	\$ 10,650
Business Loans:						
Commercial and Industrial Loans	144	—	144	144	72	\$ 72
Total Business Loans	144	—	144	144	72	\$ 72
Total Loans	<u>\$ 12,852</u>	<u>\$ 6,999</u>	<u>\$ 4,136</u>	<u>\$ 11,135</u>	<u>\$ 682</u>	<u>\$ 10,722</u>

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The following table presents troubled debt restructurings, segregated by class:

March 31, 2020	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate	<u>3</u>	<u>\$ 4,871</u>	<u>\$ 2,427</u>
Total	<u>3</u>	<u>\$ 4,871</u>	<u>\$ 2,427</u>

December 31, 2019	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate	<u>3</u>	<u>\$ 4,871</u>	<u>\$ 2,495</u>
Total	<u>3</u>	<u>\$ 4,871</u>	<u>\$ 2,495</u>

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

Totals at January 1, 2019	<u>Number of Loans</u>	<u>Recorded Investment</u>
	3	\$ 2,782
Reductions due to:		
Principal paydowns		<u>(287)</u>
Totals at January 1, 2020	3	\$ 2,495
Reductions due to:		
Principal paydowns		<u>(68)</u>
Total at March 31, 2020	<u>3</u>	<u>\$ 2,427</u>

The allocated allowance for loan losses attributable to restructured loans was \$-0- at March 31, 2020 and December 31, 2019. The Corporation had no commitments to lend additional funds on these troubled debt restructurings as of March 31, 2020.

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

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

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

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

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

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

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

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

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

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

These internally assigned grades are updated on a continual basis throughout the course of the year and represent management's most updated judgment regarding grades at March 31, 2020.

The following table details the amount of gross loans, segregated by loan grade and class, as of March 31, 2020:

	Satisfactory 1,2,3,4	Special Mention 5,6	Substandard 7	Doubtful 8	Loss 9	Total Loans
Real Estate:						
Land Development and Construction	\$ 75,338	\$ 2,099	\$ 622	\$ —	\$—	\$ 78,059
Farmland	14,163	327	751	—	—	15,241
1-4 Family Mortgages	79,860	2,346	6,168	—	26	88,400
Commercial Real Estate	169,660	20,874	16,919	—	—	207,453
Total Real Estate Loans	339,021	25,646	24,460	—	26	389,153
Business Loans:						
Commercial and Industrial Loans	77,968	275	3,951	13	—	82,207
Farm Production and Other Farm Loans	636	—	3	—	10	649
Total Business Loans	78,604	275	3,954	13	10	82,856
Consumer Loans:						
Credit Cards	1,593	—	36	—	—	1,629
Other Consumer Loans	11,295	45	59	41	5	11,445
Total Consumer Loans	12,888	45	95	41	5	13,074
Total Loans	\$ 430,513	\$ 25,966	\$ 28,509	\$ 54	\$ 41	\$ 485,083

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The following table details the amount of gross loans segregated by loan grade and class, as of December 31, 2019:

	Satisfactory 1,2,3,4	Special Mention 5,6	Substandard 7	Doubtful 8	Loss 9	Total Loans
Real Estate:						
Land Development and Construction	\$ 64,112	\$ 1,682	\$ 634	\$ —	\$ —	\$ 66,428
Farmland	14,533	331	731	—	—	15,595
1-4 Family Mortgages	79,068	1,917	6,646	—	—	87,631
Commercial Real Estate	169,270	21,266	17,068	—	—	207,604
Total Real Estate Loans	326,983	25,196	25,079	—	—	377,258
Business Loans:						
Commercial and Industrial Loans	80,289	128	4,194	—	—	84,611
Farm Production and Other Farm Loans	669	—	4	—	10	683
Total Business Loans	80,958	128	4,198	—	10	85,294
Consumer Loans:						
Credit Cards	1,770	—	63	—	—	1,833
Other Consumer Loans	11,907	59	53	41	—	12,060
Total Consumer Loans	13,677	59	116	41	—	13,893
Total Loans	\$421,618	\$25,383	\$ 29,393	\$ 41	\$ 10	\$476,445

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(in thousands)

For purposes of this Note 9, all references to “loans” means purchased loans.

The following is a summary of purchased loans:

	<u>March 31, 2020</u>	<u>December 31, 2019</u>
Real Estate:		
Land Development and Construction	\$ 13,029	\$ 14,722
Farmland	504	510
1-4 Family Mortgages	32,157	35,952
Commercial Real Estate	<u>30,789</u>	<u>32,436</u>
Total Real Estate Loans	76,479	83,620
Business Loans:		
Commercial and Industrial Loans	12,903	14,153
Farm Production and Other Farm Loans	871	884
Total Business Loans	<u>13,774</u>	<u>15,037</u>
Consumer Loans:		
Credit Cards	—	—
Other Consumer Loans	1,648	1,973
Total Consumer Loans	<u>1,648</u>	<u>1,973</u>
Total Purchased Loans	<u>\$ 91,901</u>	<u>\$ 100,630</u>

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An age analysis of past due loans, segregated by class of loans, as of March 31, 2020, is as follows:

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
Real Estate:						
Land Development and Construction	\$ 610	\$ —	\$ 610	\$12,419	\$13,029	\$ —
Farmland	167	—	167	337	504	—
1-4 Family Mortgages	189	53	242	31,915	32,157	—
Commercial Real Estate	17	4	21	30,768	30,789	—
Total Real Estate Loans	983	57	1,040	75,439	76,479	—
Business Loans:						
Commercial and Industrial Loans	74	—	74	12,829	12,903	—
Farm Production and Other Farm Loans	—	—	—	871	871	—
Total Business Loans	74	—	74	13,700	13,774	—
Consumer Loans:						
Credit Cards	—	—	—	—	—	—
Other Consumer Loans	32	—	32	1,616	1,648	—
Total Consumer Loans	32	—	32	1,616	1,648	—
Total Loans	\$ 1,089	\$ 57	\$ 1,146	\$90,755	\$91,901	\$ —

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An age analysis of past due loans, segregated by class of loans, as of December 31, 2019, is as follows:

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
Real Estate:						
Land Development and Construction	\$ 528	\$ —	\$ 528	\$14,194	\$ 14,722	\$ —
Farmland	—	—	—	510	510	—
1-4 Family Mortgages	444	—	444	35,508	35,952	—
Commercial Real Estate	603	—	603	31,833	32,436	—
Total Real Estate Loans	1,575	—	1,575	82,045	83,620	—
Business Loans:						
Commercial and Industrial Loans	379	3	382	13,771	14,153	—
Farm Production and Other Farm Loans	—	—	—	884	884	—
Total Business Loans	379	3	382	14,655	15,037	—
Consumer Loans:						
Credit Cards	—	—	—	—	—	—
Other Consumer Loans	49	8	57	1,916	1,973	—
Total Consumer Loans	49	8	57	1,916	1,973	—
Total Loans	\$ 2,003	\$ 11	\$ 2,014	\$98,616	\$100,630	\$ —

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The following table details the amount of gross loans by loan grade, which are consistent with the Company's loan grades, and class as of March 31, 2020:

	Satisfactory 1,2,3,4	Special Mention 5,6	Substandard 7	Doubtful 8	Loss 9	Total Loans
Real Estate:						
Land Development and Construction	\$ 12,163	\$ 780	\$ 86	\$ —	\$—	\$13,029
Farmland	504	—	—	—	—	504
1-4 Family Mortgages	29,975	1,516	666	—	—	32,157
Commercial Real Estate	28,956	1,546	287	—	—	30,789
Total Real Estate Loans	71,598	3,842	1,039	—	—	76,479
Business Loans:						
Commercial and Industrial Loans	11,999	588	316	—	—	12,903
Farm Production and Other Farm Loans	871	—	—	—	—	871
Total Business Loans	12,870	588	316	—	—	13,774
Consumer Loans:						
Credit Cards	—	—	—	—	—	—
Other Consumer Loans	1,615	33	—	—	—	1,648
Total Consumer Loans	1,615	33	—	—	—	1,648
Total Loans	\$ 86,083	\$4,463	\$ 1,355	\$ —	\$—	\$91,901

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The following table details the amount of gross loans by loan grade, which are consistent with the Company's loan grades, and class as of December 31, 2019:

	Satisfactory 1,2,3,4	Special Mention 5,6	Substandard 7	Doubtful 8	Loss 9	Total Loans
Real Estate:						
Land Development and Construction	\$ 13,890	\$ 789	\$ 43	\$ —	\$ —	\$ 14,722
Farmland	510	—	—	—	—	510
1-4 Family Mortgages	33,737	1,535	680	—	—	35,952
Commercial Real Estate	30,780	1,656	—	—	—	32,436
Total Real Estate Loans	78,917	3,980	723	—	—	83,620
Business Loans:						
Commercial and Industrial Loans	13,545	608	—	—	—	14,153
Farm Production and Other Farm Loans	884	—	—	—	—	884
Total Business Loans	14,429	608	—	—	—	15,037
Consumer Loans:						
Credit Cards	—	—	—	—	—	—
Other Consumer Loans	1,937	36	—	—	—	1,973
Total Consumer Loans	1,937	36	—	—	—	1,973
Total Loans	\$ 95,283	\$4,624	\$ 723	\$ —	\$ —	\$100,630

Loans purchased in business combinations that exhibited, at the date of acquisition, evidence of deterioration of the credit quality since origination, such that it was probable that all contractually required payments would not be collected, were as follows:

	March 31, 2020	December 31, 2019
Real Estate:		
Land Development and Construction	\$ 36	\$ 43
Farmland	—	—
1-4 Family Mortgages	692	706
Commercial Real Estate	4	—
Total Real Estate Loans	732	749
Total PCD Loans	\$ 732	\$ 749

Non-accrual loans of \$82 and \$33 are included in 1-4 Family Mortgages at March 31, 2020 and December 31, 2019 and \$4 are included in Commercial Real Estate at March 31, 2020.

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The following table presents the fair value of loans determined to be impaired at the time of acquisition:

	<u>Total Purchased Credit Deteriorated Loans</u>
Contractually-required principal	\$ 993
Nonaccretable difference	(68)
Cash flows expected to be collected	925
Accretable yield	(36)
Fair Value	<u>\$ 889</u>

Changes in the accretable yield of loans purchased with deteriorated credit quality were as follows:

Balance at January 1, 2020	\$ (16)
Additions through acquisition	—
Reclasses from nonaccretable difference	(13)
Accretion	5
Charge-off	—
Balance at March 31, 2020	<u>\$ (24)</u>

There were no loans classified as TDRs purchased as part of the acquisition of Charter.

The following table presents the fair value of loans purchased from Charter as of the October 1, 2019 acquisition date:

	<u>October 1, 2019</u>
At acquisition date:	
Contractually-required principal	\$ 104,127
Nonaccretable difference	(68)
Cash flows expected to be collected	104,059
Accretable yield	(394)
Fair Value	<u>\$ 103,665</u>

Note 10. Allowance for Loan Losses

(in thousands)

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

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

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

The following table details activity in the allowance for loan losses by portfolio segment for the three months ended March 31, 2020:

	Real Estate	Business Loans	Consumer	Total
March 31, 2020				
Beginning Balance, January 1, 2020	\$3,075	\$ 371	\$ 309	\$3,755
Provision for loan losses	184	3	127	314
Chargeoffs	222	23	55	300
Recoveries	14	24	9	47
Net (recoveries) chargeoffs	208	(1)	46	253
Ending Balance	<u>\$3,051</u>	<u>\$ 375</u>	<u>\$ 390</u>	<u>\$3,816</u>
Period end allowance allocated to:				
Loans individually evaluated for impairment	\$ 582	\$ 95	\$ —	\$ 677
Loans collectively evaluated for impairment	2,469	280	390	3,139
Ending Balance, March 31, 2020	<u>\$3,051</u>	<u>\$ 375</u>	<u>\$ 390</u>	<u>\$3,816</u>

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The following table details activity in the allowance for loan losses by portfolio segment for the three months ended March 31, 2019:

	Real Estate	Business Loans	Consumer	Total
March 31, 2019				
Beginning Balance, January 1, 2019	\$2,845	\$ 222	\$ 305	\$3,372
Provision for loan losses	(63)	99	159	195
Chargeoffs	—	12	25	37
Recoveries	12	4	14	30
Net (recoveries) chargeoffs	(12)	8	11	7
Ending Balance	<u>\$2,794</u>	<u>\$ 313</u>	<u>\$ 453</u>	<u>\$3,560</u>
Period end allowance allocated to:				
Loans individually evaluated for impairment	\$ 417	\$ 5	\$ —	\$ 422
Loans collectively evaluated for impairment	2,377	308	453	3,138
Ending Balance, March 31, 2019	<u>\$2,794</u>	<u>\$ 313</u>	<u>\$ 453</u>	<u>\$3,560</u>

The Corporation's recorded investment in loans as of March 31, 2020 and December 31, 2019 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Corporation's impairment methodology was as follows (in thousands):

	Real Estate	Business Loans	Consumer	Total
March 31, 2020				
Loans individually evaluated for specific impairment	\$ 10,913	\$ 433	\$ —	\$ 11,346
Loans collectively evaluated for general impairment	453,987	96,197	14,722	564,906
Acquired with deteriorated credit quality	732	—	—	732
	<u>\$465,632</u>	<u>\$ 96,630</u>	<u>\$14,722</u>	<u>\$576,984</u>
December 31, 2019				
Loans individually evaluated for specific impairment	\$ 10,991	\$ 144	\$ —	\$ 11,135
Loans collectively evaluated for general impairment	449,138	100,187	15,866	565,191
Acquired with deteriorated credit quality	749	—	—	749
	<u>\$460,878</u>	<u>\$100,331</u>	<u>\$15,866</u>	<u>\$577,075</u>

Note 11. Premises and Equipment

The Company leases certain premises and equipment under operating leases. At March 31, 2020, the Company had lease liabilities and ROU assets totaling \$690 thousand related to these leases. Lease liabilities and ROU assets are reflected in other liabilities and other assets, respectively. For the three months ended March 31, 2020, the weighted average remaining lease term for operating leases was 1.1 years and the weighted average discount rate used in the measurement of operating lease liabilities was 3.3%.

Lease costs were as follows:

	Three Months Ended March 31, 2020
<i>(in thousands)</i>	
Operating lease cost	\$ 92
Short-term lease cost	6
Variable lease cost	—
	<u>\$ 98</u>

There were no sale and leaseback transactions, leverage leases or lease transactions with related parties during the three months ended March 31, 2020.

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total operating lease liability is as follows:

	Three Months Ended March 31, 2020
<i>(in thousands)</i>	
Lease payments due:	
Within one year	\$ 348
After one year but within two years	306
After two years but within three years	60
After three year but within four years	—
After four years but within five years	—
After five years	—
Total undiscounted cash flows	<u>714</u>
Discount on cash flows	<u>(24)</u>
Total lease liability	<u>\$ 690</u>

Note 12. Goodwill and Other Intangible Assets*(in thousands)*

The carrying amount of goodwill for the three months ended March 31, 2020 were as follows:

	Total
Balance at January 1, 2020	<u>\$13,103</u>
Measurement period adjustment to goodwill from Charter acquisition	<u>27</u>
Balance at March 31, 2020	<u>\$13,130</u>

The following table provides a summary of finite-lived intangible assets as of the dates presented:

	March 31, 2020	December 31, 2019
Core deposit intangible	\$ 739	\$ 766
Accumulated amortization	(27)	(27)
Total finite-lived intangible assets	<u>\$ 712</u>	<u>\$ 739</u>

Core deposit intangible amortization expense for the three month periods ended March 31, 2020 and 2019 was \$27 and \$-0-, respectively. The estimated amortization expense of finite-lived intangible assets for the five succeeding fiscal years is summarized as follows:

Year ending December 31,	Amount
2020	\$ 82
2021	109
2022	109
2023	109
2024	109
Thereafter	194
	<u>\$ 712</u>

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(in thousands, except share data)

The following summarizes the activity in the capital structure of the Company:

	Number of Shares Issued	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance, January 1, 2020	5,578,131	\$ 1,116	\$ 17,883	\$ (789)	\$94,590	\$112,800
Net income	—	—	—	—	1,160	1,160
Dividends paid (\$0.24 per share)	—	—	—	—	(1,339)	(1,339)
Options exercised	4,500	1	86	—	—	87
Restricted stock granted	—	—	—	—	—	—
Stock compensation expense	—	—	40	—	—	40
Other comprehensive income, net	—	—	—	5,996	—	5,996
Balance, March 31, 2020	<u>5,582,631</u>	<u>\$ 1,117</u>	<u>\$ 18,009</u>	<u>\$ 5,207</u>	<u>\$94,411</u>	<u>\$118,744</u>
	Number of Shares Issued	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance, January 1, 2019	4,904,530	\$ 981	\$ 4,298	\$ (14,975)	\$93,562	\$83,866
Net income	—	—	—	—	1,227	1,227
Dividends paid (\$0.24 per share)	—	—	—	—	(1,177)	(1,177)
Options exercised	—	—	—	—	—	—
Restricted stock granted	—	—	—	—	—	—
Stock compensation expense	—	—	41	—	—	41
Other comprehensive income, net	—	—	—	6,622	—	6,622
Balance, March 31, 2019	<u>4,904,530</u>	<u>\$ 981</u>	<u>\$ 4,339</u>	<u>\$ (8,353)</u>	<u>\$93,612</u>	<u>\$90,579</u>

Note 14. Fair Value of Financial Instruments

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

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- Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 Inputs other than quoted prices in active markets for identical assets and liabilities included in Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active; or
- Level 3 Unobservable inputs for an asset or liability, such as discounted cash flow models or valuations.

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

The following table presents assets and liabilities that were measured at fair value on a recurring basis as of March 31, 2020:

	Quoted Prices in Active Markets for Identical Assets <u>(Level 1)</u>	Fair Value Measurements Using:		Totals
		Significant Other Observable Inputs <u>(Level 2)</u>	Significant Unobservable Inputs <u>(Level 3)</u>	
Securities available for sale				
Obligations of U.S.				
Government Agencies	\$ —	\$ 44,765	\$ —	\$ 44,765
Mortgage-backed securities	—	373,488	—	373,488
State, county and municipal obligations	—	63,321	—	63,321
Other securities	503	—	—	503
Total	<u>\$ 503</u>	<u>\$ 481,574</u>	<u>\$ —</u>	<u>\$482,077</u>

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The following table presents assets and liabilities that were measured at fair value on a recurring basis as of December 31, 2019:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements Using:		Totals
		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Securities available for sale				
Obligations of U.S. Government Agencies	\$ —	\$ 97,111	\$ —	\$ 97,111
Mortgage-backed securities	—	306,900	—	306,900
State, county and municipal obligations	—	60,372	—	60,372
Total	<u>\$ —</u>	<u>\$ 464,383</u>	<u>\$ —</u>	<u>\$464,383</u>

The Corporation recorded no gains or losses in earnings for the period ended March 31, 2020 or December 31, 2019 that were attributable to the change in unrealized gains or losses relating to assets still held at the reporting date.

Impaired Loans

Loans considered impaired are reserved for at the time the loan is identified as impaired taking into account the fair value of the collateral less estimated selling costs. Collateral may be real estate and/or business assets including but not limited to, equipment, inventory and accounts receivable. The fair value of real estate is determined based on appraisals by qualified licensed appraisers. The fair value of the business assets is generally based on amounts reported on the business's financial statements. Appraised and reported values may be adjusted based on management's historical knowledge, changes in market conditions from the time of valuation and management knowledge of the client and the client's business. Since not all valuation inputs are observable, these nonrecurring fair value determinations are classified Level 3. The unobservable inputs may vary depending on the individual assets with the fair value of real estate based on appraised value being the predominant approach. The Company reviews the certified appraisals for appropriateness and adjusts the value downward to consider selling, closing and liquidation costs, which typically approximates 25% of the appraised value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors previously identified.

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Other real estate owned

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

For assets measured at fair value on a nonrecurring basis during 2020 that were still held on the Corporation's balance sheet at March 31, 2020, the following table provides the hierarchy level and the fair value of the related assets:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Totals
Impaired loans	\$ —	\$ —	\$ 254	\$254
Total	\$ —	\$ —	\$ 254	\$254

The following table presents information as of March 31, 2020 about significant unobservable inputs (Level 3) used in the valuation of assets and liabilities measured at fair value on a nonrecurring basis:

Financial instrument	Fair Value	Valuation Technique	Significant Unobservable Inputs	Range of Inputs
Impaired loans	\$ 254	Appraised value of collateral less estimated costs to sell	Estimated costs to sell	25%

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For assets measured at fair value on a nonrecurring basis during 2019 that were still held on the Corporation's balance sheet at December 31, 2019, the following table provides the hierarchy level and the fair value of the related assets:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements Using:		Totals
		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Impaired loans	\$ —	\$ —	\$ 4,576	\$4,576
Total	\$ —	\$ —	\$ 4,576	\$4,576

Impaired loans with a carrying value of \$390 and \$5,003 had an allocated allowance for loan losses of \$136 and \$427 at March 31, 2020 and December 31, 2019, respectively. The allocated allowance is based on the carrying value of the impaired loan and the fair value of the underlying collateral less estimated costs to sell.

After monitoring the carrying amounts for subsequent declines or impairments after foreclosure, management determined that a fair value adjustment to OREO in the amount of \$-0- was necessary and recorded during the three-month period ended March 31, 2020 and the year ended December 31, 2019.

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

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The following represents the carrying value and estimated fair value of the Corporation's financial instruments at March 31, 2020:

March 31, 2020	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements Using:		Total Fair Value
			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Financial assets					
Cash and due from banks	\$ 19,610	\$ 19,610	\$ —	\$ —	\$ 19,610
Interest bearing deposits with banks	61,909	61,909	—	—	61,909
Securities available-for-sale	482,077	503	481,574	—	482,077
Net loans	573,163	—	—	566,944	566,944
Financial liabilities Deposits	\$925,888	\$ 693,750	\$ 234,138	\$ —	\$927,888
Securities sold under agreement to repurchase	159,442	159,442	—	—	159,442

The following represents the carrying value and estimated fair value of the Corporation's financial instruments at December 31, 2019:

December 31, 2019	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurements Using:		Total Fair Value
			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Financial assets					
Cash and due from banks	\$ 15,937	\$ 15,937	\$ —	\$ —	\$ 15,937
Federal funds sold	1,600	1,600	—	—	1,600
Interest bearing deposits with banks	58,557	58,557	—	—	58,557
Securities available-for-sale	464,383	—	464,383	—	464,383
Net loans	573,312	—	—	569,640	569,640
Financial liabilities Deposits	\$898,996	\$ 642,825	\$ 258,100	\$ —	\$900,925
Securities sold under agreement to repurchase	170,410	170,410	—	—	170,410

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

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q (the "Quarterly Report") contains statements that constitute forward-looking statements and information within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are based on management's beliefs, plans, expectations and assumptions and on information currently available to management. The words "may," "should," "expect," "anticipate," "intend," "plan," "continue," "believe," "seek," "estimate" and similar expressions used in this Quarterly 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 Quarterly Report. The Corporation notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements.

The risks and uncertainties that may affect the operation, performance, development and results of the business of Citizens Holding Company (the "Company") and the Company's wholly-owned subsidiary, The Citizens Bank of Philadelphia, Mississippi (the "Bank" and collectively with the Company, the "Corporation"), include, but are not limited to, the following:

- expectations about the movement of interest rates, including actions that may be taken by the Federal Reserve Board in response to changing economic conditions;
- adverse changes in asset quality and loan demand, and the potential insufficiency of the allowance for loan losses and our ability to foreclose on delinquent mortgages;
- the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Company operates including, but not limited to, the negative impacts and disruptions resulting from the recent outbreak of COVID-19;
- extensive regulation, changes in the legislative and regulatory environment that negatively impact the Company and the Bank through increased operating expenses and the potential for regulatory enforcement actions, claims, or litigation;
- increased competition from other financial institutions and the risk of failure to achieve our business strategies;
- events affecting our business operations, including the effectiveness of our risk management framework, the accuracy of our estimates, our reliance on third party vendors, the risk of security breaches and potential fraud, and the impact of technological advances;
- our ability to maintain sufficient capital and to raise additional capital when needed;
- our ability to maintain adequate liquidity to conduct business and meet our obligations;
- events affecting our ability to compete effectively and achieve our strategies, such as the risk of failure to achieve the revenue increases expected to result from our acquisitions, branch additions and in new product and service offerings, our ability to control expenses and our ability to attract and retain skilled people;

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- events that adversely affect our reputation, and the resulting potential adverse impact on our business operations;
- risks arising from owning our common stock, such as the volatility and trading volume, our ability to pay dividends, the regulatory limitations on stock ownership, and provisions in our governing documents that may make it more difficult for another party to obtain control of us; and
- other risks detailed from time-to-time in the Company's filings with the Securities and Exchange Commission.

Except as required by law, the Company does not undertake any obligation to update or revise any forward-looking statements subsequent to the date of this Quarterly Report, or if earlier, the date on which such statements were made.

Management's discussion and analysis is intended to provide greater insight into the results of operations and the financial condition of the Corporation. The following discussion should be read in conjunction with the consolidated financial statements and notes appearing elsewhere in this Quarterly Report.

OVERVIEW

The Company is a one-bank holding company incorporated under the laws of the State of Mississippi on February 16, 1982. The Company is the sole shareholder of the Bank. The Company does not have any direct subsidiaries other than the Bank.

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 March 31, 2020, the Bank was the largest bank headquartered in Neshoba County, Mississippi, with total assets of \$1,216 and total deposits of \$927,645. In addition to full service commercial banking, the Bank offers title insurance services through its subsidiary, Title Services LLC. All significant intercompany transactions have been eliminated in consolidation. 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.

LIQUIDITY

The Corporation has an asset and liability management program that assists management in maintaining net interest margins during times of both rising and falling interest rates and in maintaining sufficient liquidity. A measurement of liquidity is the ratio of net deposits and short-term liabilities divided by the sum of net cash, short-term investments and marketable assets. This measurement for liquidity of the Corporation at March 31, 2020, was 21.67% and at December 31, 2019, was 24.87%. The decrease was due to an increase in deposits at March 31, 2020. Management believes it maintains adequate liquidity for the Corporation's current needs.

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The Corporation's primary source of liquidity is customer deposits, which were \$925,888 at March 31, 2020, and \$898,996 at December 31, 2019. Other sources of liquidity include investment securities, the Corporation's line of credit with the Federal Home Loan Bank ("FHLB") and federal funds lines with correspondent banks. The Corporation had \$482,077 invested in available-for-sale investment securities at March 31, 2020, and \$464,383 at December 31, 2019. This increase was due to purchases coupled with an increase in the market value of the Corporation's investment securities portfolio in excess of paydowns, maturities, sales and calls.

The Corporation also had \$61,909 in interest bearing deposits at other banks at March 31, 2020 and \$58,557 at December 31, 2019. The Corporation had secured and unsecured federal funds lines with correspondent banks in the amount of \$45,000 at both March 31, 2020 and December 31, 2019. In addition, the Corporation has the ability to draw on its line of credit with the FHLB. At March 31, 2020, the Corporation had unused and available \$223,047 of its line of credit with the FHLB and at December 31, 2019, the Corporation had unused and available \$177,592 of its line of credit with the FHLB. The increase in the amount available under the Corporation's line of credit with the FHLB from the end of 2019 to March 31, 2020, was the result of an increase in the amount of loans eligible for the collateral pool securing the Corporation's line of credit with the FHLB. The Corporation had federal funds purchased of \$-0- as of March 31, 2020 and December 31, 2019. The Corporation may purchase federal funds from correspondent banks on a temporary basis to meet short term funding needs.

When the Corporation has more funds than it needs for its reserve requirements or short-term liquidity needs, the Corporation increases its investment portfolio, increases the balances in interest bearing due from bank accounts or sells federal funds. It is management's policy to maintain an adequate portion of its portfolio of assets and liabilities on a short-term basis to insure rate flexibility and to meet loan funding and liquidity needs. When deposits decline or do not grow sufficiently to fund loan demand, management will seek funding either through federal funds purchased or advances from the FHLB.

CAPITAL RESOURCES

Total shareholders' equity was \$118,744 at March 31, 2020, as compared to \$112,800 at December 31, 2019. The increase in shareholders' equity was the result of a decrease in the accumulated other comprehensive loss brought about by the investment securities market value adjustment partially offset by dividends paid in excess of earnings. The market value adjustment, which was an increase due to general market conditions, specifically the decrease in medium term interest rates, caused an increase in the market price of the Corporation's investment portfolio.

The Corporation paid aggregate cash dividends in the amount of \$1,339, or \$0.24 per share, during the three-month period ended March 31, 2020 compared to \$1,177, or \$0.24 per share, for the same period in 2019.

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Quantitative measures established by federal regulations to ensure capital adequacy require the Corporation to maintain minimum amounts and ratios of Total and Tier 1 capital (primarily common stock and retained earnings, less goodwill) to risk weighted assets, and of Tier 1 capital to average assets. Management believes that as of March 31, 2020, the Corporation meets all capital adequacy requirements to which it is subject and according to these requirements the Corporation is considered to be well capitalized.

	Actual		Minimum Capital Requirement to be Well Capitalized		Minimum Capital Requirement to be Adequately Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2020						
Citizens Holding Company Tier 1 leverage ratio	\$ 98,695	8.30%	\$59,432	5.00%	\$47,546	4.00%
Common Equity tier 1 capital ratio	98,695	13.82%	77,262	6.50%	53,489	4.50%
Tier 1 risk-based capital ratio	98,695	13.82%	57,147	8.00%	42,861	6.00%
Total risk-based capital ratio	102,510	14.35%	71,434	10.00%	57,147	8.00%
December 31, 2019						
Citizens Holding Company Tier 1 leverage ratio	\$ 98,733	8.33%	\$59,270	5.00%	\$47,416	4.00%
Common Equity tier 1 capital ratio	98,733	13.86%	77,051	6.50%	53,343	4.50%
Tier 1 risk-based capital ratio	98,733	13.86%	56,972	8.00%	42,729	6.00%
Total risk-based capital ratio	102,488	14.39%	71,215	10.00%	56,972	8.00%

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

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

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

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

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

Management believes that, as of March 31, 2020, the Company and the Bank met all capital adequacy requirements under Basel III. The changes to the calculation of risk-weighted assets required by Basel III did not have a material impact on the Corporation's capital ratios as presented.

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RESULTS OF OPERATIONS

The following table sets forth for the periods indicated, certain items in the consolidated statements of income of the Corporation and the related changes between those periods:

	For the Three Months Ended March 31,	
	2020	2019
Interest Income, including fees	\$ 9,709	\$ 8,384
Interest Expense	2,324	2,174
Net Interest Income	7,385	6,210
Provision for loan losses	314	195
Net Interest Income after Provision for loan losses	7,071	6,015
Other Income	2,381	2,047
Other Expense	8,067	6,640
Income Before Provision For Income Taxes	1,385	1,422
Provision for Income Taxes	225	195
Net Income	\$ 1,160	\$ 1,227
Net Income Per share - Basic	\$ 0.21	\$ 0.25
Net Income Per Share - Diluted	\$ 0.21	\$ 0.25

See Note 4 to the Corporation's Consolidated Financial Statements for an explanation regarding the Corporation's calculation of Net Income Per Share - basic and - diluted.

Annualized return on average equity ("ROE") was 4.11% for the three months ended March 31, 2020, and 5.70% for the corresponding period in 2019. The decrease in ROE for the three months ended March 31, 2020 was caused by the increase in equity balances and a decrease in net income compared to the same period in 2019.

Book value per share increased to \$21.27 at March 31, 2020, compared to \$20.22 at December 31, 2019. The increase in book value per share reflects an increase in the fair value of the Corporation's investment securities partially offset by dividends in excess of earnings. Average assets for the three months ended March 31, 2020 were \$1,202,483 compared to \$1,164,570 for the year ended December 31, 2019. This increase was due mainly to an increase in investment securities.

NET INTEREST INCOME / NET INTEREST MARGIN

One component of the Corporation's earnings is net interest income, which is the difference between the interest and fees earned on loans and investments and the interest paid for deposits and borrowed funds. The net interest margin is net interest income expressed as a percentage of average earning assets.

The annualized net interest margin was 2.72% for the three months ended March 31, 2020 compared to 2.74% for the corresponding period of 2019. The decrease in net interest margin for the three months ended March 31, 2020, when compared to the same period in 2019, was overall minimal as yields on earning assets and rates on interest bearing liabilities decreased proportionally, as detailed below. Earning assets averaged \$1,109,562 for the three months ended March 31, 2020. This represents an increase of \$179,885, or 19.3%, over average earning assets of \$929,677 for the three months ended March 31, 2019.

Interest bearing deposits averaged \$731,470 for the three months ended March 31, 2020. This represents an increase of \$97,486, or 15.4%, from the average of interest-bearing deposits of \$633,984 for the three months ended March 31, 2019. This was due to an increase in interest-bearing NOW and money market accounts, savings and certificates of deposit.

Other borrowed funds averaged \$158,424 for the three months ended March 31, 2020. This represents an increase of \$51,635, or 48.4%, over the other borrowed funds of \$106,789 for the three months ended March 31, 2019. This increase in other borrowed funds was due to an increase in securities sold under agreements to repurchase for the three months ended March 31, 2020, when compared to the three months ended March 31, 2019.

Net interest income was \$7,385 for the three months ended March 31, 2020, an increase of \$1,175 from \$6,210 for the three months ended March 31, 2019, primarily due to an increase in the loan volume from the same period in 2019. The changes in volume in earning assets, deposits and borrowed funds are discussed above. As for changes in interest rates in the three months ended March 31, 2020, the yields on earning assets decreased and the rates paid on deposits decreased from the same period in 2019. The yield on all interest-bearing assets decreased 11 basis points to 3.56% in the three months ended March 31, 2020 from 3.67% for the same period in 2019. At the same time, the rate paid on all interest-bearing liabilities for the three months ended March 31, 2020 decreased 14 basis points to 1.05% from 1.19% in the same period in 2019. As longer term interest-bearing assets and liabilities mature and reprice, management believes that the yields on interest bearing assets and rates on interest bearing liabilities will both increase.

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

	For the Three Months Ended March 31,	
	2020	2019
Interest and Fees	\$ 7,480	\$ 5,450
Average Gross Loans	574,755	435,070
Annualized Yield	5.21%	5.01%

CREDIT LOSS EXPERIENCE

As a natural corollary to the Corporation's lending activities, some loan losses are to be expected. The risk of loss varies with the type of loan being made and the overall creditworthiness of the borrower over the term of the loan. The degree of perceived risk is taken into account in establishing the structure of, and interest rates and security for, specific loans and for various types of loans. The Corporation attempts to minimize its credit risk exposure by use of thorough loan application and approval procedures.

The Corporation maintains a program of systematic review of its existing loans. Loans are graded for their overall quality. Those loans, which management determines require further monitoring and supervision, are segregated and reviewed on a regular basis. Significant problem loans are reviewed monthly by the Corporation's management and Board of Directors.

The Corporation charges off that portion of any loan that the Corporation's management and Board of Directors has determined to be a loss. A loan is generally considered by management to represent a loss, in whole or in part, when exposure beyond the collateral value is apparent, servicing of the unsecured portion has been discontinued or collection is not anticipated based on the borrower's financial condition. The general economic conditions in the borrower's industry influence this determination. The principal amount of any loan that is declared a loss is charged against the Corporation's allowance for loan losses.

The Corporation's allowance for loan losses is designed to provide for loan losses that can be reasonably anticipated. The allowance for loan losses is established through charges to operating expenses in the form of provisions for loan losses. Actual loan losses or recoveries are charged or credited to the allowance for loan losses. The Board of Directors determines the amount of the allowance. Among the factors considered in determining the allowance for loan losses are the current financial condition of the Corporation's borrowers and the value of security, if any, for their loans. Estimates of future economic conditions and their impact on various industries and individual borrowers are also taken into consideration, as are the Corporation's historical loan loss experience and reports of banking regulatory authorities. As these estimates, factors and evaluations are primarily judgmental, no assurance can be given as to whether the Corporation will sustain loan losses in excess or below its allowance or that subsequent evaluation of the loan portfolio may not require material increases or decreases in such allowance.

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The following table summarizes the Corporation's allowance for loan losses for the dates indicated:

	Quarter Ended March 31, 2020	Year Ended December 31, 2019	Amount of Increase (Decrease)	Percent of Increase (Decrease)
BALANCES:				
Gross Loans	\$ 576,984	\$ 577,075	\$ (91)	-0.02%
Allowance for Loan Losses	3,816	3,755	61	1.62%
Nonaccrual Loans	11,941	11,993	(52)	-0.43%
Ratios:				
Allowance for loan losses to gross loans	0.66%	0.65%		
Net loans charged off (recovered) to allowance for loan losses	6.63%	5.06%		

The provision for loan losses for the three months ended March 31, 2020 was \$314, an increase of \$119 from the provision for loan losses of \$195 for the same period in 2019. The change in the Corporation's loan loss provisions for the three months ended March 31, 2020 is a result of management's assessment of inherent loss in the loan portfolio, including the impact caused by current local, national and international economic conditions coupled with an increase in loan demand. As a result of the COVID-19 virus, the Corporation increased the allowance for loan losses qualitatively, specifically related to exposures that we felt were more "at-risk" than others, including hotels, restaurants and retail real estate. The Corporation's model used to calculate the provision is based on the percentage of historical charge-offs, increased for certain qualitative factors within the regulatory framework, applied to the current loan balances by loan segment and specific reserves applied to certain impaired loans. Nonaccrual loans decreased during this period due to payments received and loans charged off in excess of new loans being added to nonaccrual status.

For the three months ended March 31, 2020, net loan losses charged to the allowance for loan losses totaled \$253, an increase of \$246 from the \$7 charged off in the same period in 2019. The decrease was primarily due to one significant charge-off during the first quarter of 2020.

Management reviews quarterly with the Corporation's Board of Directors the adequacy of the allowance for loan losses. The loan loss provision is adjusted when specific items reflect a need for such an adjustment. Management believes that there were no material loan losses during the three months ended March 31, 2020 that have not been charged off. Management also believes that the Corporation's allowance will be adequate to absorb probable losses inherent in the Corporation's loan portfolio. However, it remains possible that additional provisions for loan loss may be required. We are working with customers directly affected by COVID-19. We have been and continue to be prepared to offer short-term assistance in accordance with regulator guidelines. As a result of the current economic environment caused by the COVID-19 virus, we are engaging in more frequent communications with borrowers to better understand their situation and challenges faced, allowing us to proactively respond as needs and issues arise.

OTHER INCOME

Other income includes service charges on deposit accounts, wire transfer fees, safe deposit box rentals and other revenue not derived from interest on earning assets. Other income for the three months ended March 31, 2020 was \$2,381, an increase of \$334, or 16.3%, from \$2,047 in the same period in 2019. Service charges on deposit accounts were \$1,049 in the three months ended March 31, 2020, compared to \$1,097 for the same period in 2019. Other service charges and fees increased by \$89, or 13.0%, to \$773 in the three months ended March 31, 2020, compared to \$684 for the same period in 2019. Other operating income not derived from service charges or fees increased \$293, or 110.2% to \$559 in the three months ended March 31, 2020, compared to \$266 for the same period in 2019. This increase was primarily due to two reasons, (1) an increase in gains from security sales due to strategic investment decisions and (2) an increase in mortgage loan origination income due to a decrease in long-term mortgage rates.

The following is a detail of the other major income classifications that were included in other operation income on the income statement:

<u>Other operating income</u>	For the Three Months Ended March 31,	
	2020	2019
BOLI Income	\$ 106	\$ 126
Mortgage Loan Origination Income	247	48
Income from security sales, net	77	—
Other Income	129	92
Total Other Income	<u>\$ 559</u>	<u>\$ 266</u>

OTHER EXPENSES

Other expenses include salaries and employee benefits, occupancy and equipment, and other operating expenses. Aggregate non-interest expenses for the three months ended March 31, 2020 and 2019 were \$8,067 and \$6,640, respectively, an increase of \$1,426 or 21.5%. Salaries and benefits increased to \$4,435 for the three months ended March 31, 2020, from \$3,547 for the same period in 2019. Occupancy expense increased by \$236, or 16.6%, to \$1,659 for the three months ended March 31, 2020, compared to \$1,423 for the same period of 2019. Other operating expenses increased by \$302, or 18.1%, to \$1,973 for the three months ended March 31, 2020, compared to \$1,670 for the same period of 2019. This increase was mainly due to an increase in legal and consulting fees, advertising, office supplies and telephone expense.

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

Other Operating Expense	For the Three Months Ended March 31,	
	2020	2019
Advertising	\$ 204	\$ 179
Office Supplies	292	217
Professional Fees	258	133
Telephone expense	158	112
Postage and Freight	141	149
Loan Collection Expense	23	8
Regulatory and related expense	66	84
Debit Card/ATM expense	135	121
Travel and Convention	53	37
Other expenses	643	630
Total Other Expense	<u>\$ 1,973</u>	<u>\$ 1,670</u>

The Corporation's efficiency ratio for the three months ended March 31, 2020 was 84.74%, compared to 76.34% for the same period in 2019. The efficiency ratio is the ratio of non-interest expenses divided by the sum of net interest income (on a fully tax equivalent basis) and non-interest income.

BALANCE SHEET ANALYSIS

	March 31, 2020	December 31, 2019	Amount of Increase (Decrease)	Percent of Increase (Decrease)
Cash and Due From Banks	\$ 19,610	\$ 15,937	\$ 3,673	23.05%
Interest Bearing deposits with Other Banks	61,909	58,557	3,352	5.72%
Investment Securities	482,077	464,383	17,694	3.81%
Loans, net	573,163	573,312	(149)	-0.03%
Premises and Equipment	24,495	24,672	(177)	-0.72%
Total Assets	1,216,111	1,195,434	20,677	1.73%
Total Deposits	925,888	898,996	26,892	2.99%
Total Shareholders' Equity	118,744	112,800	5,944	5.27%

CASH AND CASH EQUIVALENTS

Cash and due from banks, which consist of cash, balances at correspondent banks and items in process of collection, balance at March 31, 2020 was \$19,610, which was an increase of \$3,673 from the balance of \$15,937 at December 31, 2019. The increase was due to an increase in the balances being held at the Company's branches due to uncertainty around the COVID-19 pandemic.

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INVESTMENT SECURITIES

The Corporation's investment securities portfolio primarily consists of United States agency debentures, mortgage-backed securities and obligations of states, counties and municipalities. The Corporation's investment securities portfolio at March 31, 2020 increased by \$17,694, or 3.8%, to \$482,077 from \$464,383 at December 31, 2019. This increase was due to sales, maturities, paydowns and calls in excess of purchases and increases in the market value of the Corporation's investment securities portfolio.

LOANS

The Corporation's loan balance decreased by \$149, or 0.3%, during the three months ended March 31, 2020, to \$573,163 from \$573,312 at December 31, 2019. Loan demand, especially in land development and construction, commercial and industrial, and commercial real estate categories, remained strong during the three months ended March 31, 2020 but competition for available loans continued to be strong during that period. Additionally, the uncertainty surrounding the COVID-19 pandemic has put a lot of projects on hold in the near term. No material changes were made to the loan products offered by the Corporation during this period.

PREMISES AND EQUIPMENT

During the three months ended March 31, 2020, the Corporation's premises and equipment decreased by \$177, or 0.7%, to \$24,495 from \$24,672 at December 31, 2019. The increase was due to the purchase of a piece of property for expansion partially offset by depreciation expense.

DEPOSITS

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

	March 31, 2020	December 31, 2019	Amount of Increase (Decrease)	Percent of Increase (Decrease)
Noninterest-Bearing Deposits	\$195,843	\$ 190,406	\$ 5,437	2.86%
Interest-Bearing Deposits	410,485	369,354	41,131	11.14%
Savings Deposits	87,422	83,065	4,357	5.25%
Certificates of Deposit	232,138	256,171	(24,033)	-9.38%
Total deposits	<u>\$925,888</u>	<u>\$ 898,996</u>	<u>\$ 26,892</u>	<u>2.99%</u>

Noninterest-bearing, interest-bearing and savings accounts increased during the three months ended March 31, 2020 while certificates of deposit decreased slightly. Management continually monitors the interest rates on loan and deposit products to ensure that the Corporation is in line with the rates dictated by the market and our asset and liability management objectives. These rate adjustments impact deposit balances.

OFF-BALANCE SHEET ARRANGEMENTS

Please refer to Note 3 to the consolidated financial statements included in this Quarterly Report for a discussion of the nature and extent of the Corporation's off-balance sheet arrangements, which consist solely of commitments to fund loans and letters of credit.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Asset/Liability Management and Interest Rate Risk

The principal objective of our asset and liability management function is to evaluate the interest rate risk within the balance sheet and pursue a controlled assumption of interest rate risk while maximizing net income and preserving adequate levels of liquidity and capital. The Board of Directors of the Bank has oversight of our asset and liability management function, which is managed by our Chief Financial Officer. Our Chief Financial Officer meets with our senior executive management team regularly to review, among other things, the sensitivity of our assets and liabilities to market rate changes, local and national market conditions and market interest rates. That group also reviews our liquidity, capital, deposit mix, loan mix and investment positions.

As a financial institution, our primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of our assets and liabilities, and the fair value of all interest earning assets and interest-bearing liabilities, other than those which have a short term to maturity. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair values.

We manage our exposure to interest rates primarily by structuring our balance sheet in the ordinary course of business. We do not typically enter into derivative contracts for the purpose of managing interest rate risk, but we may elect to do so should the situation warrant. Based upon the nature of our operations, we are not subject to material foreign exchange or commodity price risk. We do not own any trading assets.

We use an interest rate risk simulation model to test the interest rate sensitivity of net interest income and the balance sheet. Instantaneous parallel rate shift scenarios are modeled and utilized to evaluate risk and establish exposure limits for acceptable changes in projected net interest margin. These scenarios, known as rate shocks, simulate an instantaneous change in interest rates and use various assumptions, including, but not limited to, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment and replacement of asset and liability cash flows. We also analyze the economic value of equity as a secondary measure of interest rate risk. This is a complementary measure to net interest income where the calculated value is the result of the fair value of assets less the fair value of liabilities. The economic value of equity is a longer-term view of interest rate risk because it measures the present value of all future cash flows. The impact of changes in interest rates on this calculation is analyzed for the risk to our future earnings and is used in conjunction with the analyses on net interest income.

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The following table summarizes the simulated change in net interest income assuming a static balance sheet versus unchanged rates as of March 31, 2020 and December 31, 2019:

	March 31, 2020		December 31, 2019	
	Following 12 months	Months 13-24	Following 12 months	Months 13-24
+400 basis points	24.4%	32.7%	6.4%	20.9%
+300 basis points	22.3%	27.6%	6.3%	17.5%
+200 basis points	18.3%	20.7%	5.7%	13.3%
+100 basis points	11.8%	11.4%	3.0%	7.0%
Flat rates	—	—	—	—
-100 basis points	-7.0%	-7.4%	-7.3%	-7.5%
-200 basis points	-8.0%	-7.5%	-14.5%	-15.1%

The following table presents the change in our economic value of equity as of March 31, 2020 and December 31, 2019, assuming immediate parallel shifts in interest rates:

	Economic Value of Equity at Risk (%)	
	March 31, 2020	December 31, 2019
+400 basis points	30.9%	7.1%
+300 basis points	32.4%	8.0%
+200 basis points	29.6%	7.8%
+100 basis points	17.9%	5.4%
Flat rates	—	—
-100 basis points	-27.1%	-18.5%
-200 basis points	-46.7%	-42.3%

Many assumptions are used to calculate the impact of interest rate fluctuations. Actual results may be significantly different than our projections due to several factors, including the timing and frequency of rate changes, market conditions and the shape of the yield curve. The computations of interest rate risk shown above do not include actions that our management may undertake to manage the risks in response to anticipated changes in interest rates, and actual results may also differ due to any actions taken in response to the changing rates.

As part of our asset/liability management strategy, our management has emphasized the origination of shorter duration loans as well as variable rate loans to limit the negative exposure to a rate increase. We also desire to acquire deposit transaction accounts, particularly noninterest or low interest bearing non-maturity deposit accounts, whose cost is less sensitive to changes in interest rates.

ITEM 4. CONTROLS AND PROCEDURES.

The management of the Company, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures in ensuring that the information required to be disclosed in our filings under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, including ensuring that such information is accumulated and communicated to the Company's management as appropriate to allow timely decision regarding required disclosure. Based on such evaluation, our principal executive officer and principal financial officer have concluded that such disclosure controls and procedures were effective as of March 31, 2020 (the end of the period covered by this Quarterly Report).

There were no changes to the Company's internal control over financial reporting that occurred in the three months ended March 31, 2020, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

The Corporation is a party to lawsuits and other claims that arise in the ordinary course of business, all of which are being vigorously contested. In the regular course of business, management evaluates estimated losses or costs related to litigation, and provisions are made for anticipated losses whenever management believes that such losses are probable and can be reasonably estimated. At the present time, management believes, based on the advice of legal counsel, that the final resolution of pending legal proceedings will not likely have a material impact on the Corporation's consolidated financial condition or results of operations.

ITEM 1A. RISK FACTORS.

The Corporation's business, future financial condition and results of operations are subject to a number of factors, risks and uncertainties, which are disclosed in Item 1A, "Risk Factors," in Part I of our Annual Report on Form 10-K for the year ended December 31, 2019, which the Corporation filed with the Securities and Exchange Commission on March 13, 2020. Additional information regarding some of those risks and uncertainties is contained in the notes to the condensed consolidated financial statements appearing in Part I, Item 1 of this Quarterly Report, in "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing in Part I, Item 2 of this Quarterly Report and in "Quantitative and Qualitative Disclosures About Market Risk" appearing in Part I, Item 3 of this Quarterly Report. The risks and uncertainties disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2019, the Corporation's quarterly reports on Form 10-Q and other reports and forms filed with the SEC are not necessarily all of the risks and uncertainties that may affect the Corporation's business, financial condition and results of operations in the future.

The outbreak of the novel coronavirus ("COVID-19") could adversely affect the Corporation's business, financial condition, and results of operations.

The ongoing COVID-19 global and national health emergency has caused significant disruption in the international and United States economies and financial markets. As a result, the COVID-19 pandemic could have an adverse effect on the Corporation's business, financial condition and results of operations. The spread of COVID-19 has caused illness, quarantines, reduction in business activity and financial transactions, supply chain interruptions and overall economic and financial market instability. Additionally, in response to the COVID-19 pandemic, the state government of Mississippi, where all of the Bank's branch offices and the Corporation's principal executive office are located, and the governments of most other states, have taken preventative or protective actions, such as imposing restrictions on travel and business operations, advising or requiring individuals to limit or forego activities outside of their homes, and ordering temporary closures of businesses that have been deemed to be non-essential. These restrictions and other consequences of the pandemic have resulted in a significant number of layoffs and furloughs of employees nationwide and in the regions in which the Bank operates. The ultimate effects of COVID-19 on the broader economy and the markets that the Bank serves are not known. Moreover, the Federal Reserve has taken action to lower the Federal Funds rate, which may negatively affect the Corporation's interest income and, therefore, earnings, financial condition and results of operation. Additional impacts of COVID-19 on the Corporation's business could be widespread and material, and may include, or exacerbate, among other consequences, the following:

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- employees contracting COVID-19;
- a work stoppage, forced quarantine, or other interruption of the Corporation's business;
- unavailability of key personnel necessary to conduct the Corporation's business activities;
- sustained closures of the Bank's branch lobbies or the offices of the Bank's customers;
- declines in demand for loans and other banking services and products;
- reduced consumer spending due to both job losses and other effects attributable to the pandemic;
- unprecedented volatility in United States financial markets;
- volatile performance of the Corporation's investment securities portfolio;
- decline in the credit quality of the Bank's loan portfolio, owing to the effects of COVID-19 in the markets the Bank serves, leading to a need to increase the Corporation's allowance for loan losses;
- declines in value of collateral for loans, including real estate collateral;
- declines in the net worth and liquidity of borrowers and loan guarantors, impairing their ability to honor commitments to us; and
- declines in demand resulting from businesses being deemed to be "non-essential" by governments in the markets the Bank serves, and from "non-essential" and "essential" businesses suffering adverse effects from reduced levels of economic activity in the Corporation's markets.

These factors, together or in combination with other events or occurrences that may not yet be known or anticipated, may materially and adversely affect the Company's business, financial condition and results of operations.

The ongoing COVID-19 pandemic has resulted in meaningfully lower stock prices for many companies, as well as the trading prices for many other securities. The further spread of the COVID-19 outbreak, as well as ongoing or new governmental, regulatory and private sector responses to the pandemic, may materially disrupt banking and other economic activity generally and in the areas in which the Bank operates. This could result in further decline in demand for the Bank's banking products and services, and could negatively impact, among other things, our liquidity, regulatory capital and growth strategy of the Corporation.

The Corporation is taking precautions to protect the safety and well-being of its employees and customers. However, no assurance can be given that the steps being taken will be adequate or deemed to be appropriate, nor can the Corporation predict the level of disruption which will occur to employee's ability to provide customer support and service. If the Corporation is unable to recover from a business disruption on a timely basis, its business, financial condition and results of operations could be materially and adversely affected. The Corporation may also incur additional costs to remedy damages caused by such disruptions, which could further adversely affect its business, financial condition and results of operations.

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Since the Bank is a participating lender in the SBA Paycheck Protection Program (“PPP”), the Company and the Bank are subject to additional risks of litigation from the Bank’s clients or other parties regarding the Bank’s processing of loans for the PPP.

On March 27, 2020, President Trump signed the CARES Act, which included a \$349 billion loan program administered through the SBA referred to as the PPP. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. The Bank is participating as a lender in the PPP. The PPP opened on April 3, 2020; however, because of the short timeframe between the passing of the CARES Act and the opening of the PPP, there is some ambiguity in the laws, rules and guidance regarding the operation of the PPP, which exposes the Company to risks relating to noncompliance with the PPP. Since the opening of the PPP, several other larger banks have been subject to litigation regarding the process and procedures that such banks used in processing applications for the PPP. The Company and the Bank may be exposed to the risk of litigation, from both clients and non-clients that approached the Bank regarding PPP loans, regarding its process and procedures used in processing applications for the PPP. If any such litigation is filed against the Company or the Bank and is not resolved in a manner favorable to the Company or the Bank, it may result in significant financial liability or adversely affect the Company’s reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP related litigation could have a material adverse impact on our business, financial condition and results of operations.

ITEM 6. EXHIBITS.

Exhibits

- 31(a) [Certification of the Chief Executive Officer pursuant to Rule 13a-14\(a\)/15d-14\(a\).](#)
- 31(b) [Certification of the Chief Financial Officer pursuant to Rule 13a-14\(a\)/15d-14\(a\).](#)
- 32(a) [Certification of the Chief Executive Officer pursuant to 18 U.S.C. § 1350.](#)
- 32(b) [Certification of the Chief Financial Officer pursuant to 18 U.S.C. § 1350.](#)
- 101 Financial Statements submitted in XBRL format.

SIGNATURES

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

CITIZENS HOLDING COMPANY

BY: /s/ Greg L. McKee

Greg L. McKee
President and Chief Executive Officer
(Principal Executive Officer)

BY: /s/ Robert T. Smith

Robert T. Smith
Treasurer and Chief Financial Officer
(Principal Financial Officer and Chief
Accounting Officer)

DATE: May 8, 2020

**Certification of Chief Executive Officer
Pursuant to Rule 13a-14(a)/15d-14(a)**

I, Greg L. McKee, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 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(s) 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 disclosure 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(s) 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 the 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: May 8, 2020

/s/ Greg L. McKee

Greg L. McKee

President and Chief Executive Officer

**Certification of Chief Financial Officer
Pursuant to Rule 13a-14(a)/15d-14(a)**

I, Robert T. Smith, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 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(s) 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 disclosure 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(s) 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 the 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: May 8, 2020

/s/ Robert T. Smith

Robert T. Smith

Treasurer and Chief Financial Officer

Certification of Chief Executive Officer
Pursuant to 18 U.S.C. § 1350

In connection with the Quarterly Report on Form 10-Q for the quarter ended March 31, 2020, of Citizens Holding Company (the "Company"), as filed with the Securities Exchange Commission on the date hereof (the "Report"), I, Greg L. McKee, certify, pursuant to 18 U.S.C. § 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 operations of the Company.

Date: May 8, 2020

/s/ Greg L. McKee

Greg L. McKee
President and Chief Executive Officer

Certification of Chief Financial Officer
Pursuant to 18 U.S.C. § 1350

In connection with the Quarterly Report on Form 10-Q for the quarter ended March 31, 2020, of Citizens Holding Company (the "Company"), as filed with the Securities Exchange Commission on the date hereof (the "Report"), I, Robert T. Smith, certify, pursuant to 18 U.S.C. § 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 operations of the Company.

Date: May 8, 2020

/s/ Robert T. Smith

Robert T. Smith
Treasurer and Chief Financial Officer