

CITIZENS HOLDING CO /MS/  
Form 10-Q  
November 07, 2018  
Table of Contents

**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 September 30, 2018**

**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)**

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 November 5, 2018:

Title	Outstanding
Common Stock, \$0.20 par value	4,904,530



**Table of Contents**

CITIZENS HOLDING COMPANY

TABLE OF CONTENTS

PART I.	<u>FINANCIAL INFORMATION</u>	1
Item 1.	<u>Consolidated Financial Statements.</u>	1
	<u>Consolidated Statements of Financial Condition, as of September 30, 2018 (Unaudited) and December 31, 2017 (Audited)</u>	1
	<u>Consolidated Statements of Income for the Three and nine months ended September 30, 2018 (Unaudited) and 2017 (Unaudited)</u>	2
	<u>Consolidated Statements of Comprehensive (Loss) Income for the Three and nine months ended September 30, 2018 (Unaudited) and 2017 (Unaudited)</u>	3
	<u>Consolidated Statements of Cash Flows for the Nine months ended September 30, 2018 (Unaudited) and 2017 (Unaudited)</u>	4
	<u>Notes to Consolidated Financial Statements</u>	5
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	31
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk.</u>	44
Item 4.	<u>Controls and Procedures.</u>	47
PART II.	<u>OTHER INFORMATION</u>	48
	<u>Item 1. Legal Proceedings.</u>	48
	<u>Item 1A. Risk Factors.</u>	48
	Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.*	
	Item 3. Defaults Upon Senior Securities.*	
	Item 4. Mine Safety Disclosures.*	
	Item 5. Other Information.*	
Item 6.	<u>Exhibits.</u>	49
*	None or Not Applicable.	
	<u>SIGNATURES</u>	50

**Table of Contents**

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS.

## CITIZENS HOLDING COMPANY CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	September 30, 2018 (Unaudited)	December 31, 2017 (Audited)
<b>ASSETS</b>		
Cash and due from banks	\$ 12,609,437	\$ 17,962,990
Interest bearing deposits with other banks	1,351,745	1,532,420
Investment securities available for sale, at fair value	449,254,631	505,046,377
Loans, net of allowance for loan losses of \$3,172,943 in 2018 and \$3,019,228 in 2017	431,433,287	402,390,574
Premises and equipment, net	19,868,597	20,571,551
Other real estate owned, net	3,413,734	3,980,127
Accrued interest receivable	3,946,179	4,450,723
Cash surrender value of life insurance	25,134,668	24,612,779
Deferred tax assets, net	8,326,417	5,362,750
Other assets	7,629,251	7,185,537
<b>TOTAL ASSETS</b>	<b>\$ 962,967,946</b>	<b>\$ 993,095,828</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing demand	\$ 162,832,452	\$ 159,291,356
Interest-bearing NOW and money market accounts	327,991,524	306,047,053
Savings deposits	81,085,547	77,784,876
Certificates of deposit	185,470,810	177,562,214
Total deposits	757,380,333	720,685,499
Securities sold under agreement to repurchase	88,908,916	142,497,938
Federal funds purchased	6,500,000	1,500,000
Federal Home Loan Bank advances	20,000,000	30,000,000
Accrued interest payable	245,839	198,183
Deferred compensation payable	8,923,577	8,620,890
Other liabilities	1,214,779	1,142,278
Total liabilities	883,173,444	904,644,788
<b>SHAREHOLDERS EQUITY</b>		
Common stock; \$0.20 par value, 22,500,000 shares authorized, 4,904,530 shares issued and outstanding at September 30, 2018 and 4,894,705 shares issued and outstanding at December 31, 2017	980,906	978,941
Additional paid-in capital	4,257,155	4,103,139

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

Retained earnings	93,022,796	91,594,379
Accumulated other comprehensive loss, net of tax benefit of \$6,139,049 in 2018 and \$2,734,500 in 2017	(18,466,355)	(8,225,419)
Total shareholders equity	79,794,502	88,451,040
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 962,967,946	\$ 993,095,828

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

**Table of Contents**

## CITIZENS HOLDING COMPANY

## CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>INTEREST INCOME</b>				
Loans, including fees	\$ 5,166,554	\$ 4,585,668	\$ 14,867,465	\$ 14,017,718
Investment securities	2,696,474	2,892,063	8,253,586	8,643,750
Other interest	24,291	66,633	144,635	194,266
Total interest income	7,887,319	7,544,364	23,265,686	22,855,734
<b>INTEREST EXPENSE</b>				
Deposits	709,985	471,049	1,726,700	1,434,694
Other borrowed funds	458,039	353,968	1,062,505	1,027,587
Total interest expense	1,168,024	825,017	2,789,205	2,462,281
NET INTEREST INCOME	6,719,295	6,719,347	20,476,481	20,393,453
PROVISION FOR (REVERSAL OF) LOAN LOSSES	288,576	(73,808)	140,765	(254,614)
NET INTEREST INCOME AFTER PROVISION FOR (REVERSAL OF) LOAN LOSSES	6,430,719	6,793,155	20,335,716	20,648,067
<b>OTHER INCOME</b>				
Service charges on deposit accounts	1,170,956	1,115,474	3,381,809	3,176,877
Other service charges and fees	761,935	702,686	2,147,452	1,992,929
Other operating income	287,683	308,012	870,153	1,013,818
Total other income	2,220,574	2,126,172	6,399,414	6,183,624
<b>OTHER EXPENSES</b>				
Salaries and employee benefits	3,668,012	3,744,831	11,011,291	11,154,068
Occupancy expense	1,486,232	1,335,676	4,373,233	3,984,549
Other operating expense	1,739,780	1,806,713	5,505,070	5,768,370
Total other expenses	6,894,024	6,887,220	20,889,594	20,906,987
INCOME BEFORE PROVISION FOR INCOME TAXES	1,757,269	2,032,107	5,845,536	5,924,704
PROVISION FOR INCOME TAXES	260,475	424,638	888,215	1,096,457
NET INCOME	\$ 1,496,794	\$ 1,607,469	\$ 4,957,321	\$ 4,828,247
NET INCOME PER SHARE -Basic	\$ 0.31	\$ 0.33	\$ 1.01	\$ 0.99

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

-Diluted	\$	0.31	\$	0.33	\$	1.01	\$	0.99
DIVIDENDS PAID PER SHARE	\$	0.24	\$	0.24	\$	0.72	\$	0.72

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



Table of Contents

## CITIZENS HOLDING COMPANY

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$ 1,496,794	\$ 1,607,469	\$ 4,957,321	\$ 4,828,247
Other comprehensive (loss) income				
Securities available-for-sale				
Unrealized holding (losses) gains	(3,006,277)	(2,137,839)	(13,656,532)	8,378,246
Income tax effect	747,310	797,413	3,407,305	(3,125,086)
	(2,258,967)	(1,340,426)	(10,249,227)	5,253,160
Rclassification adjustment for gains included in net income	11,047	15,612	11,047	104,708
Income tax effect	(2,756)	(5,823)	(2,756)	(39,056)
	8,291	9,789	8,291	65,652
Total other comprehensive (loss) income	(2,250,676)	(1,330,637)	(10,240,936)	5,318,812
Comprehensive (loss) income	\$ (753,882)	\$ 276,832	\$ (5,283,615)	\$ 10,147,059

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

**Table of Contents**

CITIZENS HOLDING COMPANY  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Nine Months Ended September 30,	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net cash provided by operating activities	\$ 8,832,306	\$ 8,034,077
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from maturities and calls of securities available for sale	32,579,774	31,045,728
Proceeds from sale of investment securities	17,609,890	114,060,844
Purchases of investment securities available for sale	(10,550,000)	(160,967,616)
Purchases of bank premises and equipment	(268,708)	(2,844,102)
Sales of bank premises and equipment	264,000	
Decrease in interest bearing deposits with other banks	180,675	18,962,673
Purchase of Federal Home Loan Bank stock		(498,700)
Proceeds from sale of other real estate	802,372	127,722
Net (increase) decrease in loans	(29,407,770)	829,450
Net cash provided by investing activities	11,210,233	715,999
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase (decrease) in deposits	36,694,834	(5,386,374)
Net change in securities sold under agreement to repurchase	(53,589,022)	(830,963)
Increase in federal funds purchased	5,000,000	
Repayment of Federal Home Loan Bank advances	(10,000,000)	
Proceeds from exercise of stock options	27,000	92,625
Payment of dividends	(3,528,904)	(3,522,327)
Net cash used in financing activities	(25,396,092)	(9,647,039)
Net decrease in cash and due from banks	(5,353,553)	(896,963)
Cash and due from banks, beginning of period	17,962,990	21,688,557
Cash and due from banks, end of period	\$ 12,609,437	\$ 20,791,594

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

**Table of Contents**

CITIZENS HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the nine months ended September 30, 2018

(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 September 30, 2018 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 ). 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, 2017, filed with the Securities and Exchange Commission on March 15, 2018.

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

## Table of Contents

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.

## Revenue from Contracts with Customers

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers* ( Topic 606 ). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous or future periods.

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers.

## Adoption of New Accounting Standards

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-09, *Revenue from Contracts with Customers* ( ASU 2014-09 ), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Company on January 1, 2018. Adoption of ASU 2014-09 did not have a material impact on the Company's consolidated

---

**Table of Contents**

financial statements and related disclosures as the Company's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Company's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of OREO, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption however, periods prior to the date of adoption will not be retrospectively revised as the impact of the ASU on uncompleted contracts at the date of adoption was not material.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities* (ASU 2016-01). The guidance affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements of financial instruments. ASU 2016-01 was effective for the Company on January 1, 2018 and did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company does not hold any equity securities that are within the scope of ASU 2016-01. ASU 2016-01 also eliminates the disclosure of assumptions used to estimate fair value for financial instruments measured at amortized cost and requires disclosure of an exit price notion in determining the fair value of certain financial instruments prior to its changing to the exit price upon adoption of this standard in the first quarter of 2018. This ASU did not have any other implications to the Company at the time of adoption.

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

In January 2017, FASB issued ASU 2017-01, *Business Combinations (Topic 805), Clarifying the Definition of a Business* (ASU 2017-01), that changes the definition of a business when evaluating whether transactions should be accounted for as the acquisition of assets or the acquisition of a business. ASU 2017-01 requires an entity to evaluate if substantially all of the fair value of the assets acquired are concentrated in a single asset or a group of similar identifiable assets; if so, the acquired assets or group of similar identifiable assets is not considered a business. In addition, the guidance requires that, to be considered a business, the acquired assets must include an input and a substantive process that together significantly

**Table of Contents**

contribute to the ability to create output. The ASU removes the evaluation of whether a market participant could replace any of the missing elements. ASU 2017-01 was effective for the Company on January 1, 2018 and is to be applied under a prospective approach. The Company expects the adoption of this new guidance to impact the determination of whether future acquisitions are considered business combinations.

In February 2018, FASB issued ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220)* ( ASU 2018-02 ). The amendments in ASU 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings to eliminate the stranded tax effects in accumulated other comprehensive income resulting from the Tax Cuts and Jobs Act. ASU 2018-02 will be effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period, for public companies for reporting periods for which financial statements have not yet been issued. The Company early adopted ASU 2018-02 as of December 31, 2017 and, as a result, reclassified \$1,588,198 from accumulated other comprehensive income to retained earnings as of December 31, 2017. The reclassification impacted the Consolidated Statements of Financial Condition and the Consolidated Statements of Changes in Shareholders' Equity as of and for the twelve months ended December 31, 2017.

**Newly Issued, But Not Yet Effective Accounting Standards**

On September 16, 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* ( ASU 2016-13 ). The update will significantly change the way entities recognize impairment on many financial assets by requiring immediate recognition of estimated credit losses expected to occur over the asset's remaining life. The FASB describes this impairment recognition model as the current expected credit loss ( CECL ) model and believes the CECL model will result in more timely recognition of credit losses since the CECL model incorporates expected credit losses versus incurred credit losses. The scope of FASB's CECL model would include loans, held-to-maturity debt instruments, lease receivables, loan commitments and financial guarantees that are not accounted for at fair value. For public business entities, this update becomes effective for interim and annual periods beginning after December 15, 2019. Management is currently evaluating the impact this ASU will have on the Company's consolidated financial statements and will continue to monitor FASB's progress on this topic.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* ( ASU 2016-02 ). ASU 2016-02 amends the accounting model and disclosure requirements for leases. The current accounting model for leases distinguishes between capital leases, which are recognized on-balance sheet, and operating leases, which are not. Under the new standard, the lease classifications are defined as finance leases, which are similar to capital leases under current GAAP, and operating leases. Further, a lessee will recognize a lease liability and a right-of-use asset for all leases with a term greater than 12 months on its balance sheet regardless of the lease's classification, which may significantly increase reported assets and liabilities. The accounting model and disclosure requirements for lessors remains substantially unchanged from current GAAP. ASU 2016-02 is effective for annual and interim periods in fiscal years beginning after December 15, 2018. Management is currently evaluating the impact ASU 2016-02 will have on the Company's financial position and results of operations.

---

**Table of Contents**

In March 2017, the FASB issued ASU No. 2017-08, *Receivables- Nonrefundable Fees and Other Costs (Subtopic 310-20)* ( ASU 2017-08 ). ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium. Specifically, amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this update more closely align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities due to market participants pricing securities to the call date that produces the worst yield when the coupon is above current market rates, and pricing securities to maturity when the coupon is below market rates in anticipation that the borrower will act in its economic best interest. Therefore, the amendments more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument. ASU 2017-08 is effective for annual and interim periods in fiscal years beginning after December 15, 2018. Management is currently evaluating the impact ASU 2017-08 will have on the Company's financial position and results of operations.

ASU 2018-13 *Fair Value Measurement (Topic 820) Changes in the Disclosure Requirements for Fair Value Measurement* ( ASU 2018-13 ) 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 2018-13 is effective for annual and interim periods beginning after December 15, 2019. Management is currently evaluating the impact this ASU will have on the Company's financial statements.

**Table of Contents****Note 2. Commitments and Contingent Liabilities**

In the ordinary course of business, the Corporation enters into commitments to extend credit to its customers. The unused portion of these commitments is not reflected in the accompanying financial statements. As of September 30, 2018, the Corporation had entered into loan commitments with certain customers with an aggregate unused balance of \$55,982,175 compared to an aggregate unused balance of \$46,405,869 at December 31, 2017. There were \$2,516,810 of letters of credit outstanding at September 30, 2018 and \$2,842,010 at December 31, 2017. 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 and 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 3. Net Income per Share**

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Basic weighted average shares outstanding	4,899,520	4,882,705	4,888,372	4,877,338
Dilutive effect of granted options	5,093	10,443	9,586	17,412
Diluted weighted average shares outstanding	4,904,613	4,893,148	4,897,958	4,894,750
Net income	\$ 1,496,794	\$ 1,607,469	\$ 4,957,321	\$ 4,828,247
Net income per share-basic	\$ 0.31	\$ 0.33	\$ 1.01	\$ 0.99
Net income per share-diluted	\$ 0.31	\$ 0.33	\$ 1.01	\$ 0.99

**Note 4. Equity Compensation Plans**

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



**Table of Contents**

Prior to the adoption of the 2013 Plan, the Corporation utilized two stock-based compensation plans, the 1999 Directors Stock Compensation Plan (the Directors Plan ) for directors, and the 1999 Employees Long-Term Incentive Plan (the Employees Plan ) for employees, both of which have expired.

The following table is a summary of the stock option activity for the nine months ended September 30, 2018:

	Directors Plan	2013 Plan
	Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2017	63,000	\$ 20.96
Granted		
Exercised	(6,000)	18.00
Expired	(4,500)	18.00
Outstanding at September 30, 2018	52,500	\$ 21.55

The intrinsic value of options outstanding under the Directors Plan at September 30, 2018, was \$131,820. No options were outstanding under the 2013 Plan or the Employees Plan as of September 30, 2018.

During the quarter ended June 30, 2018, 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 25, 2019 during which time the recipients have rights to vote the shares and to receive dividends. The grant date fair value of these shares was \$165,375 and will be recognized over the one-year vesting period at a cost of \$13,781 per month less deferred taxes of \$3,438 per month.

**Note 5. Income Taxes**

The Tax Cuts and Jobs Act (the Tax Act ), enacted on December 22, 2017, among other things, permanently lowered the statutory federal corporate tax rate from 34% to 21%, effective for tax years including or beginning January 1, 2018. Under the guidance of ASC 740, Income Taxes ( ASC 740 ), the Company revalued its net deferred tax assets on the date of enactment based on the reduction in the overall future tax benefit expected to be realized at the lower tax rate implemented by the new legislation, the Company's revaluation of its net deferred tax assets was \$2,558,859, which was included in Provision for Income Taxes in the Consolidated Statements of Income at December 31, 2017. Although in the normal course of business the Company is required to make estimates and assumptions for certain tax items which cannot be fully determined at period end, the Company did not identify items for which the income tax effects of the Tax Act had not been completed as of December 31, 2017 and, therefore, considered its accounting for the tax effects of the Tax Act on its net deferred tax asset to have been completed as of December 31, 2017.

**Table of Contents**

The effective tax rate for the three and nine months ended September 30, 2018 and 2017 differ from the statutory federal income tax rates of 21% and 34%, respectively, due primarily to state income taxes offset by tax exempt interest income.

**Note 6. Securities**

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

September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Securities available-for-sale</b>				
Obligations of U.S. Government agencies	\$ 99,367,877	\$	\$ 4,515,549	\$ 94,852,328
Mortgage backed securities	268,468,752	6,116	14,361,628	254,113,240
State, County, Municipals	106,023,406	52,086	5,786,429	100,289,063
<b>Total</b>	<b>\$ 473,860,035</b>	<b>\$ 58,202</b>	<b>\$ 24,663,606</b>	<b>\$ 449,254,631</b>

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Securities available-for-sale</b>				
Obligations of U.S. Government agencies	\$ 180,647,580	\$	\$ 4,199,022	\$ 176,448,558
Mortgage backed securities	213,707,125	43,197	5,327,265	208,423,057
State, County, Municipals	118,786,297	849,364	2,535,126	117,100,535
Other investments	2,865,294	208,933		3,074,227
<b>Total</b>	<b>\$ 516,006,296</b>	<b>\$ 1,101,494</b>	<b>\$ 12,061,413</b>	<b>\$ 505,046,377</b>

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

At September 30, 2018 and December 31, 2017, securities with a carrying value of \$247,691,420 and \$222,326,856, respectively, were pledged to secure government and public deposits. Securities with a carrying value of \$88,515,589 and \$151,629,948, respectively, were pledged as collateral for customers who are under repurchase agreements.

The amortized cost and estimated fair value of securities by contractual maturity at September 30, 2018 and December 31, 2017 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay certain obligations.



**Table of Contents**

	September 30, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available-for-sale				
Due in one year or less	\$ 2,020,810	\$ 2,023,462	\$ 3,398,727	\$ 3,421,576
Due after one year through five years	91,951,412	88,193,981	70,836,435	69,594,014
Due after five years through ten years	31,859,642	30,351,244	55,691,854	54,740,055
Due after ten years	79,559,419	74,572,704	81,519,845	80,184,001
Residential mortgage backed securities	194,336,400	183,779,806	213,707,125	208,423,057
Commercial mortgage backed securities	74,132,352	70,333,434	90,852,310	88,683,674
<b>Total</b>	<b>\$ 473,860,035</b>	<b>\$ 449,254,631</b>	<b>\$ 516,006,296</b>	<b>\$ 505,046,377</b>

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 September 30, 2018 and December 31, 2017.

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

September 30, 2018	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	\$	\$	\$ 94,852,328	\$ 4,515,549	\$ 94,852,328	\$ 4,515,549
Mortgage backed securities	17,492,984	367,341	236,430,049	13,994,287	253,923,033	14,361,628
State, County, Municipal	25,438,651	1,149,633	64,401,928	4,636,796	89,840,579	5,786,429
<b>Total</b>	<b>\$ 42,931,635</b>	<b>\$ 1,516,974</b>	<b>\$ 395,684,305</b>	<b>\$ 23,146,632</b>	<b>\$ 438,615,940</b>	<b>\$ 24,663,606</b>

December 31, 2017	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	\$ 15,681,866	\$ 223,534	\$ 160,766,691	\$ 3,975,488	\$ 176,448,557	\$ 4,199,022
Mortgage backed securities	88,499,852	1,613,091	116,753,236	3,714,174	205,253,088	5,327,265
State, County, Municipal	7,117,600	59,041	66,973,174	2,476,085	74,090,774	2,535,126
<b>Total</b>	<b>\$ 111,299,318</b>	<b>\$ 1,895,666</b>	<b>\$ 344,493,101</b>	<b>\$ 10,165,747</b>	<b>\$ 455,792,419</b>	<b>\$ 12,061,413</b>

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, 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 September 30, 2018 nor at December 31, 2017.

**Table of Contents****Note 7. Loans**

The composition of net loans (in thousands) at September 30, 2018 and December 31, 2017 was as follows:

	September 30, 2018	December 31, 2017
<b>Real Estate:</b>		
Land Development and Construction	\$ 41,937	\$ 25,923
Farmland	15,541	16,905
1-4 Family Mortgages	88,448	95,925
Commercial Real Estate	197,235	191,736
<b>Total Real Estate Loans</b>	<b>343,161</b>	<b>330,489</b>
<b>Business Loans:</b>		
Commercial and Industrial Loans	75,842	58,204
Farm Production and Other Farm Loans	966	922
<b>Total Business Loans</b>	<b>76,808</b>	<b>59,126</b>
<b>Consumer Loans:</b>		
Credit Cards	1,492	1,310
Other Consumer Loans	13,214	14,680
<b>Total Consumer Loans</b>	<b>14,706</b>	<b>15,990</b>
<b>Total Gross Loans</b>	<b>434,675</b>	<b>405,605</b>
Unearned Income	(69)	(195)
Allowance for Loan Losses	(3,173)	(3,019)
<b>Loans, net</b>	<b>\$ 431,433</b>	<b>\$ 402,391</b>

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

**Table of Contents**

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

	September 30, 2018	December 31, 2017
<b>Real Estate:</b>		
Land Development and Construction	\$	\$
Farmland	264	366
1-4 Family Mortgages	1,929	2,131
Commercial Real Estate	7,719	4,891
<b>Total Real Estate Loans</b>	<b>9,912</b>	<b>7,388</b>
<b>Business Loans:</b>		
Commercial and Industrial Loans	60	78
Farm Production and Other Farm Loans	31	32
<b>Total Business Loans</b>	<b>91</b>	<b>110</b>
<b>Consumer Loans:</b>		
Other Consumer Loans	98	84
<b>Total Consumer Loans</b>	<b>98</b>	<b>84</b>
<b>Total Nonaccrual Loans</b>	<b>\$ 10,101</b>	<b>\$ 7,582</b>

**Table of Contents**

An aging analysis of past due loans (in thousands), segregated by class, as of September 30, 2018, 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
<b>Real Estate:</b>						
Land Development and Construction	\$ 1,383	\$	\$ 1,383	\$ 40,554	\$ 41,937	\$
Farmland	327	37	364	15,177	15,541	
1-4 Family Mortgages	1,756	166	1,922	86,526	88,448	
Commercial Real Estate	1,785	2,074	3,859	193,376	197,235	
<b>Total Real Estate Loans</b>	<b>5,251</b>	<b>2,277</b>	<b>7,528</b>	<b>335,633</b>	<b>343,161</b>	
<b>Business Loans:</b>						
Commercial and Industrial Loans	338		338	75,504	75,842	
Farm Production and Other Farm Loans				966	966	
<b>Total Business Loans</b>	<b>338</b>		<b>338</b>	<b>76,470</b>	<b>76,808</b>	
<b>Consumer Loans:</b>						
Credit Cards	47		47	1,445	1,492	
Other Consumer Loans	205	88	293	12,921	13,214	
<b>Total Consumer Loans</b>	<b>252</b>	<b>88</b>	<b>340</b>	<b>14,366</b>	<b>14,706</b>	
<b>Total Loans</b>	<b>\$ 5,841</b>	<b>\$ 2,365</b>	<b>\$ 8,206</b>	<b>\$ 426,469</b>	<b>\$ 434,675</b>	<b>\$</b>



**Table of Contents**

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

Loans are considered impaired when, based on current information and events, it is probable 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 \$100,000 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.

**Table of Contents**

Impaired loans (in thousands) as of September 30, 2018, 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
<b>Real Estate:</b>						
Land Development and Construction	\$	\$	\$	\$	\$	\$ 111
Farmland	269	269		269		261
1-4 Family Mortgages	1,215	1,019	196	1,215	29	1,280
Commercial Real Estate	9,021	5,179	3,842	9,021	380	7,411
<b>Total Real Estate Loans</b>	<b>10,505</b>	<b>6,467</b>	<b>4,038</b>	<b>10,505</b>	<b>409</b>	<b>9,062</b>
<b>Business Loans:</b>						
Farm Production and Other Farm Loans						25
<b>Total Business Loans</b>						<b>25</b>
<b>Total Loans</b>	<b>\$ 10,505</b>	<b>\$ 6,467</b>	<b>\$ 4,038</b>	<b>\$ 10,505</b>	<b>\$ 409</b>	<b>\$ 9,087</b>

Impaired loans (in thousands) as of December 31, 2017, 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
<b>Real Estate:</b>						
Land Development and Construction	\$ 222	\$	\$ 222	\$ 222	\$	\$ 111
Farmland	252	252		252		126
1-4 Family Mortgages	1,344	1,141	203	1,344	46	906
Commercial Real Estate	5,801	1,763	4,038	5,801	397	4,994
<b>Total Real Estate Loans</b>	<b>7,619</b>	<b>3,156</b>	<b>4,463</b>	<b>7,619</b>	<b>443</b>	<b>6,137</b>
<b>Business Loans:</b>						
Farm Production and Other Farm Loans	50	50		50		25
<b>Total Business Loans</b>	<b>50</b>	<b>50</b>		<b>50</b>		<b>25</b>
<b>Total Loans</b>	<b>\$ 7,669</b>	<b>\$ 3,206</b>	<b>\$ 4,463</b>	<b>\$ 7,669</b>	<b>\$ 443</b>	<b>\$ 6,162</b>

**Table of Contents**

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

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
September 30, 2018			
Commercial real estate	3	\$ 4,871	\$ 2,963
Total	3	\$ 4,871	\$ 2,963

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

Changes in the Corporation's troubled debt restructurings (in thousands, except for number of loans) are set forth in the table below:

	Number of Loans	Recorded Investment
Totals at January 1, 2018	3	\$ 3,047
Reductions due to:		
Principal paydowns		(84)
Total at September 30, 2018	3	\$ 2,963

The allocated allowance for loan losses attributable to restructured loans was \$174,274 at September 30, 2018 and December 31, 2017. The Corporation had no remaining availability under commitments to lend additional funds on these troubled debt restructurings as of September 30, 2018.

**Table of Contents**

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.

**Table of Contents**

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 September 30, 2018.

The following table details the amount of gross loans (in thousands), segregated by loan grade and class, as of September 30, 2018:

	Satisfactory 1,2,3,4	Special Mention 5,6	Substandard 7	Doubtful 8	Loss 9	Total Loans
<b>Real Estate:</b>						
Land Development and Construction	\$ 40,644	\$ 720	\$ 573	\$	\$	\$ 41,937
Farmland	14,170	356	1,015			15,541
1-4 Family Mortgages	79,176	1,770	7,502			88,448
Commercial Real Estate	154,868	17,891	24,476			197,235
<b>Total Real Estate Loans</b>	<b>288,858</b>	<b>20,737</b>	<b>33,566</b>			<b>343,161</b>
<b>Business Loans:</b>						
Commercial and Industrial Loans	73,460	122	2,260			75,842
Farm Production and Other Farm Loans	931	2	33			966
<b>Total Business Loans</b>	<b>74,391</b>	<b>124</b>	<b>2,293</b>			<b>76,808</b>
<b>Consumer Loans:</b>						
Credit Cards	1,492					1,492
Other Consumer Loans	13,000	65	91	58		13,214
<b>Total Consumer Loans</b>	<b>14,492</b>	<b>65</b>	<b>91</b>	<b>58</b>		<b>14,706</b>
<b>Total Loans</b>	<b>\$ 377,741</b>	<b>\$ 20,926</b>	<b>\$ 35,950</b>	<b>\$ 58</b>	<b>\$</b>	<b>\$ 434,675</b>

**Table of Contents**

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

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

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.

**Table of Contents**

The following table details activity in the allowance for loan losses by portfolio segment for the nine months ended September 30, 2018:

<b>September 30, 2018</b>	Real Estate	Business Loans	Consumer	Total
Beginning Balance, January 1, 2018	\$ 2,151,715	\$ 346,781	\$ 520,732	\$ 3,019,228
Provision for (reversal of) loan losses	615,927	(289,894)	(185,268)	140,765
Chargeoffs	202,352	31,236	117,401	350,989
Recoveries	91,071	203,777	69,091	363,939
Net chargeoffs (recoveries)	111,281	(172,541)	48,310	(12,950)
Ending Balance	\$ 2,656,361	\$ 229,428	\$ 287,154	\$ 3,172,943
Period end allowance allocated to:				
Loans individually evaluated for impairment	\$ 409,496	\$	\$	\$ 409,496
Loans collectively evaluated for impairment	2,246,865	229,428	287,154	2,763,447
Ending Balance, September 30, 2018	\$ 2,656,361	\$ 229,428	\$ 287,154	\$ 3,172,943

The following table details activity in the allowance for loan losses by portfolio segment for the nine months ended September 30, 2017:

<b>September 30, 2017</b>	Real Estate	Business Loans	Consumer	Total
Beginning Balance, January 1, 2017	\$ 3,117,134	\$ 257,554	\$ 528,108	\$ 3,902,796
(Reversal of) provision for loan losses	(482,980)	199,355	29,011	(254,614)
Chargeoffs	126,757	146,139	41,788	314,684
Recoveries	26,188	754	43,493	70,435
Net chargeoffs (recoveries)	100,569	145,385	(1,705)	244,249
Ending Balance	\$ 2,533,585	\$ 311,524	\$ 558,824	\$ 3,403,933
Period end allowance allocated to:				
Loans individually evaluated for impairment	\$ 537,897	\$	\$	\$ 537,897
Loans collectively evaluated for impairment	1,995,688	311,524	558,824	2,866,036
Ending Balance, September 30, 2017	\$ 2,533,585	\$ 311,524	\$ 558,824	\$ 3,403,933

**Table of Contents**

The Corporation's recorded investment in loans as of September 30, 2018 and December 31, 2017 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
<b>September 30, 2018</b>				
Loans individually evaluated for specific impairment	\$ 10,505	\$	\$	\$ 10,505
Loans collectively evaluated for general impairment	332,656	76,808	14,706	424,170
	\$ 343,161	\$ 76,808	\$ 14,706	\$ 434,675
<b>December 31, 2017</b>				
Loans individually evaluated for specific impairment	\$ 7,669	\$	\$	\$ 7,669
Loans collectively evaluated for general impairment	322,820	59,126	15,990	397,936
	\$ 330,489	\$ 59,126	\$ 15,990	\$ 405,605



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

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

Level 1 Quoted prices (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 September 30, 2018:

	Fair Value Measurements Using:			Totals
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Securities available for sale				
Obligations of U.S. Government Agencies	\$	\$ 94,852,328	\$	\$ 94,852,328
Mortgage-backed securities		254,113,240		254,113,240
State, county and municipal obligations		100,289,063		100,289,063
<b>Total</b>	<b>\$</b>	<b>\$ 449,254,631</b>	<b>\$</b>	<b>\$ 449,254,631</b>

**Table of Contents**

The following table presents assets and liabilities that were measured at fair value on a recurring basis as of December 31, 2017:

	Fair Value Measurements Using:			Totals		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)			
Securities available for sale						
Obligations of U.S. Government Agencies	\$	\$ 176,448,558	\$	\$ 176,448,558		
Mortgage-backed securities		208,423,057		208,423,057		
State, county and municipal obligations		117,100,535		117,100,535		
Other investments			3,074,227	3,074,227		
Total	\$	\$ 501,972,150	\$ 3,074,227	\$ 505,046,377		

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

	Fair Value Measurements Using: Significant Unobservable Inputs (Level 3)	
	Structured Financial Product	
	As of September 30, 2018	2017
Beginning Balance	\$ 3,074,227	\$ 2,971,106
Sales	(2,865,294)	
Principal payments received		(5,067)
Unrealized (loss) gains included in other comprehensive income	(208,933)	39,303
Ending Balance	\$	\$ 3,005,342

The Corporation recorded no gains or losses in earnings for the period ended September 30, 2018 or December 31, 2017 that were attributable to the change in unrealized gains or losses relating to assets still held at the reporting date.

**Table of Contents**

For assets measured at fair value on a nonrecurring basis during 2018 that were still held on the Corporation's balance sheet at September 30, 2018, the following table provides the hierarchy level and the fair value of the related assets:

	Fair Value Measurements Using:			Totals		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)			
					\$	\$
Impaired loans	\$	\$	\$ 3,254,784	\$ 3,254,784		
Total	\$	\$	\$ 3,254,784	\$ 3,254,784		

The following table presents information as of September 30, 2018 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	\$ 3,254,784	Appraised value of collateral less estimated costs to sell	Estimated costs to sell	25%

For assets measured at fair value on a nonrecurring basis during 2017 that were still held on the Corporation's balance sheet at December 31, 2017, the following table provides the hierarchy level and the fair value of the related assets:

	Fair Value Measurements Using:			Totals		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)			
					\$	\$
Impaired loans	\$	\$	\$ 544,502	\$ 544,502		
Other real estate owned			1,307,250	1,307,250		
Total	\$	\$	\$ 1,851,752	\$ 1,851,752		

Impaired loans with a carrying value of \$10,504,831 and \$7,668,908 had an allocated allowance for loan losses of \$409,496 and \$442,589 at September 30, 2018 and December 31, 2017, respectively. The allocated allowance is based on the carrying value of the impaired loan and the fair value of the underlying collateral less estimated costs to sell.

**Table of Contents**

Real estate acquired through foreclosure or deed in lieu, sometimes referred to as other real estate owned ( OREO ), during the nine-month period ended September 30, 2018, and recorded at fair value, less costs to sell, was \$223,859. There were no writedowns during the period on properties owned. OREO acquired during 2017 and recorded at fair value, less costs to sell, was \$88,579. There were \$413,740 in additional writedowns during 2017 on OREO acquired in previous years.

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.

**Table of Contents**

The following represents the carrying value and estimated fair value of the Corporation's financial instruments at September 30, 2018:

September 30, 2018	Carrying Value	Fair Value Measurements Using:			Total Fair Value
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Financial assets</b>					
Cash and due from banks	\$ 12,609,437	\$ 12,609,437	\$	\$	\$ 12,609,437
Interest bearing deposits with banks	1,351,745	1,351,745			1,351,745
Securities available-for-sale	449,254,631		449,254,631		449,254,631
Net loans	431,433,287			425,805,759	425,805,759
<b>Financial liabilities</b>					
Deposits	\$ 757,380,333	\$	\$ 757,335,191	\$	\$ 757,335,191
Federal Funds Purchased	6,500,000	6,500,000			6,500,000
Federal Home Loan Bank advances	20,000,000		20,000,000		20,000,000
Securities Sold under Agreement to Repurchase	88,908,916		88,908,916		88,908,916

**Table of Contents**

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

December 31, 2017	Carrying Value	Fair Value Measurements Using:			Total Fair Value
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Financial assets</b>					
Cash and due from banks	\$ 17,962,990	\$ 17,962,990	\$	\$	\$ 17,962,990
Interest bearing deposits with banks	1,532,420	1,532,420			1,532,420
Securities available-for-sale	505,046,377		501,972,150	3,074,227	505,046,377
Net loans	402,390,574			401,706,081	401,706,081
<b>Financial liabilities</b>					
Deposits	\$ 720,685,499	\$ 543,123,284	\$	\$ 177,698,280	\$ 720,821,564
Federal Home Loan Bank advances	30,000,000			30,005,541	30,005,541
Securities Sold under Agreement to Repurchase	142,497,938	142,497,938			142,497,938



**Table of Contents**

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 words 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"), 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;

the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Company operates;

extensive regulation, changes in the legislative and regulatory environment that negatively impact the Company and the Bank through increased operating expenses and the potential for regulatory enforcement actions, claims, and 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, 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 that adversely affect our reputation, and the resulting potential adverse impact on our business operations;

expectations about overall economic strength and the performance of the economy in the Company's market area;

risks arising from owning our common stock, such as volatility and trading volume, our ability to pay dividends, the regulatory limitations on stock ownership, and the provisions in our governing documents that may make it more difficult for another party to obtain control of us; and

## **Table of Contents**

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

Except as required by law, the Corporation 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 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 September 30, 2018, the Bank was the largest bank headquartered in Neshoba County, Mississippi, with total assets of \$962.968 million and total deposits of \$757.380 million.

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 September 30, 2018, was 23.67% and at December 31, 2017, was 28.59%. The decrease was due to a decrease in short term marketable assets at September 30, 2018. Management believes it maintains adequate liquidity for the Corporation's current needs.

The Corporation's primary source of liquidity is customer deposits, which were \$757,380,333 at September 30, 2018, and \$720,685,499 at December 31, 2017. 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 \$449,254,631 invested in available-for-sale investment securities at September 30, 2018, and \$505,046,377 at December 31, 2017. This decrease was due to maturities, paydowns, sales and calls in excess of purchases and decreases in the market value of the Corporation's investment securities portfolio.

---

**Table of Contents**

The Corporation also had \$1,351,745 in interest bearing deposits at other banks at September 30, 2018 and \$1,532,420 at December 31, 2017. The Corporation had secured and unsecured federal funds lines with correspondent banks in the amount of \$45,000,000 at both September 30, 2018 and December 31, 2017. In addition, the Corporation has the ability to draw on its line of credit with the FHLB. At September 30, 2018, the Corporation had unused and available \$147,138,402 of its line of credit with the FHLB and at December 31, 2017, the Corporation had unused and available \$169,925,797 of its line of credit with the FHLB. The decrease in the amount available under the Corporation's line of credit with the FHLB from the end of 2017 to September 30, 2018, was the result of a decrease 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 \$6,500,000 as of September 30, 2018 and \$1,500,000 as of December 31, 2017. 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 \$79,794,502 at September 30, 2018, as compared to \$88,451,040 at December 31, 2017. The decrease 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 the increase in earnings in excess of dividends paid. The market value adjustment, which was a decrease was due to general market conditions, specifically the increase in medium term interest rates, caused a decrease in the market price of the Corporation's investment portfolio.

The Corporation paid aggregate cash dividends in the amount of \$3,528,904, or \$0.72 per share, during the nine-month period ended September 30, 2018 compared to \$3,522,327, or \$0.72 per share, for the same period in 2017.

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 September 30, 2018, 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.

**Table of Contents**

	Actual		Minimum Capital Requirement to be Well Capitalized		Minimum Capital Requirement to be Adequately Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>September 30, 2018</b>						
Citizens Holding Company						
Tier 1 leverage ratio	\$ 95,111	9.93%	\$ 47,914	5.00%	\$ 38,331	4.00%
Common Equity tier 1 capital ratio	95,111	9.93%	62,288	6.50%	43,123	4.50%
Tier 1 risk-based capital ratio	95,111	17.15%	44,358	8.00%	33,268	6.00%
Total risk-based capital ratio	98,284	17.73%	55,447	10.00%	44,358	8.00%
<b>December 31, 2017</b>						
Citizens Holding Company						
Tier 1 leverage ratio	\$ 93,527	9.17%	\$ 51,005	5.00%	\$ 40,804	4.00%
Common Equity tier 1 capital ratio	93,527	9.17%	66,307	6.50%	45,905	4.50%
Tier 1 risk-based capital ratio	93,527	17.93%	41,737	8.00%	31,303	6.00%
Total risk-based capital ratio	96,546	18.51%	52,171	10.00%	41,737	8.00%

The 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 will replace the existing regulatory capital rules for all banks, savings associations and U.S. bank holding companies with greater than \$500 million in total assets, and all savings and loan holding companies.

Beginning January 1, 2015, the Company and the Bank were required to comply with the final Basel III rules, although the rules will not be fully phased-in until January 1, 2019. Among other things, the final Basel III rules will impact regulatory capital ratios of banking organizations in the following manner, when fully phased-in:

Create a new requirement to maintain a ratio of common equity Tier 1 capital to total risk-weighted assets of not less than 4.5%;

Increase the minimum leverage 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%.

In addition, the final Basel III rules, when fully phased-in, will subject a banking organization to certain limitations on capital distributions and discretionary bonus payments to executive officers if the organization did not maintain a

capital conservation buffer of common equity Tier 1 capital in an amount greater than 2.5% of its total risk-weighted assets. The effect of the capital conservation buffer, when fully phased-in, will be to increase 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.

**Table of Contents**

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 September 30, 2018, the Company and the Bank would meet all capital adequacy requirements under Basel III and the banking agencies' proposals on a fully phased-in basis, if such requirements were currently effective. 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. Management will continue to monitor these and any future proposals submitted by the Corporation's and Bank's regulators.

**Table of Contents****RESULTS OF OPERATIONS**

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

	For the Three Months		For the Nine Months	
	Ended September 30, 2018	2017	Ended September 30, 2018	2017
Interest Income, including fees	\$ 7,887,319	\$ 7,544,364	\$ 23,265,686	\$ 22,855,734
Interest Expense	1,168,024	825,017	2,789,205	2,462,281
Net Interest Income	6,719,295	6,719,347	20,476,481	20,393,453
Provision for (reversal of) loan losses	288,576	(73,808)	140,765	(254,614)
Net Interest Income after Provision for (reversal of) loan losses	6,430,719	6,793,155	20,335,716	20,648,067
Other Income	2,220,574	2,126,172	6,399,414	6,183,624
Other Expense	6,894,024	6,887,220	20,889,594	20,906,987
Income Before Provision For Income Taxes	1,757,269	2,032,107	5,845,536	5,924,704
Provision for Income Taxes	260,475	424,638	888,215	1,096,457
Net Income	\$ 1,496,794	\$ 1,607,469	\$ 4,957,321	\$ 4,828,247
Net Income Per share - Basic	\$ 0.31	\$ 0.33	\$ 1.01	\$ 0.99
Net Income Per Share-Diluted	\$ 0.31	\$ 0.33	\$ 1.01	\$ 0.99

See Note 3 to the Corporation's Consolidated Financial Statements for an explanation regarding the Corporation's calculation of Net Income Per Share - basic and - diluted.

Annualized return on average equity ( ROE ) was 7.31% for the three months ended September 30, 2018, and 7.42% for the corresponding period in 2017. For the nine months ended September 30, 2018, ROE was 7.81% compared to 7.18% for the nine months ended September 30, 2017. The decrease in ROE for the three months ended September 30, 2018 was caused by a decrease in net income for the period partially offset by a decrease in equity balances. The increase in ROE for the nine months ended September 30, 2018 was caused by the decrease in equity balances and an increase in net income compared to the same period in 2017.

Book value per share decreased to \$16.27 at September 30, 2018, compared to \$18.07 at December 31, 2017. The decrease in book value per share reflects earnings in excess of dividends offset by an increase in other comprehensive loss due to the decrease in fair value of the Corporation's investment securities. Average assets for the nine months ended September 30, 2018, were \$973,552,832 compared to \$996,266,145 for the year ended December 31, 2017. This decrease was due mainly to a decrease in available-for-sale securities and interest bearing due from bank accounts partially offset by an increase in loans.





---

**Table of Contents****NET INTEREST INCOME / NET INTEREST MARGIN**

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

The annualized net interest margin was 3.07% for the quarter ended September 30, 2018 compared to 2.98% for the corresponding period of 2017. For the nine months ended September 30, 2018, annualized net interest margin was 3.10% compared to 3.03% for the nine months ended September 30, 2017. The increase in net interest margin for the three and nine months ended September 30, 2018, when compared to the same period in 2017, was the result of the increase in yields on earning assets in excess of the increase in rates paid on deposits and borrowed funds, as detailed below. Earning assets averaged \$882,576,323 for the three months ended September 30, 2018. This represents a decrease of \$51,631,253, or 5.5%, over average earning assets of \$934,204,576 for the three months ended September 30, 2017. For the nine months ended September 30, 2018, earning assets averaged \$894,031,031. This represents a decrease of \$37,115,781 or 4.0%, over average earning assets of \$931,146,812 for the nine months ended September 30, 2017. The decrease in average earning assets for the three and nine months ended September 30, 2018, is the result of a decrease in investment securities and interest bearing due from bank accounts partially offset by an increase in loans.

Interest bearing deposits averaged \$595,613,872 for the three months ended September 30, 2018. This represents a decrease of \$17,942,852, or 2.9%, from the average of interest bearing deposits of \$613,556,724 for the three months ended September 30, 2017. This was due, in large part, to a decrease in interest-bearing NOW accounts and certificates of deposit partially offset by an increase in savings and money market accounts.

Other borrowed funds averaged \$110,281,373 for the three months ended September 30, 2018. This represents a decrease of \$33,745,137, or 23.4%, over the other borrowed funds of \$144,026,510 for the three months ended September 30, 2017. This decrease in other borrowed funds was due to a decrease in the securities sold under agreements to repurchase partially offset by the increase in federal funds purchased for the three months ended September 30, 2018, when compared to the three months ended September 30, 2017.

Interest bearing deposits averaged \$600,863,780 for the nine months ended September 30, 2018. This represents a decrease of \$18,213,420 or 2.9%, from the average of interest bearing deposits of \$619,077,200 for the nine months ended September 30, 2017. This was due, in large part, to a decrease in interest-bearing NOW accounts and certificates of deposit partially offset by an increase in money market and savings accounts.

Other borrowed funds averaged \$113,333,145 for the nine months ended September 30, 2018. This represents a decrease of \$28,912,845, or 20.3%, over the other borrowed funds of \$142,245,990 for the nine months ended September 30, 2017. This decrease in other borrowed funds was due to a decrease in the securities sold under agreements to repurchase partially offset by the increase in federal funds purchased for the nine months ended September 30, 2018, when compared to the nine months ended September 30, 2017.

**Table of Contents**

Net interest income was \$6,719,295 for the three months ended September 30, 2018, a decrease of \$52 from \$6,719,347 for the three months ended September 30, 2017, primarily due to a decrease in earning assets. The changes in volume in earning assets and in deposits and in borrowed funds are discussed above. As for changes in interest rates in the three months ended September 30, 2018, the yields on earning assets increased and the rates paid on deposits and borrowed funds increased from the same period in 2017. The yield on all interest-bearing assets increased 25 basis points to 3.58% in the three months ended September 30, 2018 from 3.33% for the same period in 2017. At the same time, the rate paid on all interest-bearing liabilities for the three months ended September 30, 2018 increased 22 basis points to 0.66% from 0.44% in the same period in 2017. 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.

Net interest income was \$20,476,481 for the nine months ended September 30, 2018, an increase of \$83,028 from \$20,393,453 for the nine months ended September 30, 2017, primarily due to an increase in yields on earning assets in excess of the increase in rates paid on deposits and borrowed funds. The changes in volume in earning assets and in deposits and in borrowed funds are discussed above. As for changes in interest rates in the nine months ended September 30, 2018, the yields on earning assets increased and the rates paid on deposits and borrowed funds increased from the same period in 2017. The yield on all interest-bearing assets increased 12 basis points to 3.50% in the nine months ended September 30, 2018 from 3.38% for the same period in 2017. At the same time, the rate paid on all interest-bearing liabilities for the nine months ended September 30, 2018 increased 9 basis point to 0.52% from 0.43% in the same period in 2017. 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.

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

	For the Three Months		For the Nine Months	
	Ended September 30, 2018	2017	Ended September 30, 2018	2017
Interest and Fees	\$ 5,166,554	\$ 4,585,668	\$ 14,867,465	\$ 14,017,718
Average Gross Loans	422,551,745	392,016,275	413,851,534	394,201,872
Annualized Yield	4.89%	4.68%	4.79%	4.74%

**Table of Contents**

**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.

**Table of Contents**

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

	Quarter Ended	Year Ended	Amount of	Percent of
	September 30,	December 31,	Increase	Increase
	2018	2017	(Decrease)	(Decrease)
<b>BALANCES:</b>				
Gross Loans	\$ 434,675,184	\$ 405,605,542	\$ 29,069,642	7.17%
Allowance for Loan Losses	3,172,943	3,019,228	153,715	5.09%
Nonaccrual Loans	10,101,197	7,582,017	2,519,180	33.23%
<b>Ratios:</b>				
Allowance for loan losses to gross loans	0.73%	0.74%		
Net loans charged off to allowance for loan losses	-0.41%	11.28%		

The provision for loan losses for the three months ended September 30, 2018 was \$288,576, an increase of \$362,384 from the negative \$73,808 provision for the same period in 2017. The provision for loan losses for the nine months ended September 30, 2018, was \$140,765, an increase of \$395,379 from the negative \$254,614 for the same period in 2017. The change in the Corporation's loan loss provisions for the three and nine months ended September 30, 2018 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. The Corporation's model used to calculate the provision is based on the percentage of historical charge-offs applied to the current loan balances by loan segment and specific reserves applied to certain impaired loans. Nonaccrual loans increased during this period due to new loans being added to nonaccrual status in excess of the amount of payments received and loans charged off.

For the three months ended September 30, 2018, net loan losses charged to the allowance for loan losses totaled \$144,015, an increase of \$115,750 from the \$28,265 charged off in the same period in 2017. The increase was primarily due to a several significant charge-offs during the third quarter of 2018.

For the nine months ended September 30, 2018, net loan losses charged to the allowance for loan losses totaled negative \$12,950, a decrease of \$257,199 from the \$244,249 charged off in the same period in 2017. The increase was primarily due to an unexpected significant recovery on a previously charged off loan.

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 nine months ended September 30, 2018 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.

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

Other income includes service charges on deposit accounts, wire transfer fees, safe deposit box rentals and other revenue not derived from interest on earning assets. Other income for the three months ended September 30, 2018 was \$2,220,574, an increase of \$94,402, or 4.4%, from \$2,126,172 in the same period in 2017. Service charges on deposit accounts were \$1,170,956 in the three months ended September 30, 2018, compared to \$1,115,474 for the same period in 2017. Other service charges and fees increased by \$59,249, or 8.4%, to \$761,935 in the three months ended September 30, 2018, compared to \$702,686 for the same period in 2017. Other operating income not derived from service charges or fees decreased \$20,329, or 6.6% to \$287,683 in the three months ended September 30, 2018, compared to \$308,012 for the same period in 2017. This decrease was due mainly to a decrease in income from security sales and a reduction in other income partially offset by an increase in mortgage loan origination income from long-term mortgage loans originated for sale to the secondary market and income on bank owned life insurance.

Other income for the nine months ended September 30, 2018 was \$6,399,414, an increase of \$215,790, or 3.5%, from \$6,183,624 the same period in 2017. Service charges on deposit accounts were \$3,381,809 in the nine months ended September 30, 2018, compared to \$3,176,877 for the same period in 2017. Other service charges and fees increased by \$154,523, or 7.8%, to \$2,147,452 in the nine months ended September 30, 2018, compared to \$1,992,929 for the same period in 2017. Other operating income not derived from service charges or fees decreased \$143,665, or 14.2% to \$870,153 in the nine months ended September 30, 2018, compared to \$1,013,818 for the same period in 2017. This decrease was due mainly to a decrease in income from security sales and a reduction in other income partially offset by an increase in mortgage loan origination income from long-term mortgage loans originated for sale to the secondary market and income on bank owned life insurance.

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

	Three months		Nine months	
	Ended September 30,		Ended September 30,	
	2018	2017	2018	2017
Other operating income				
BOLI Income	\$ 124,666	\$ 120,000	\$ 375,101	\$ 360,000
Mortgage Loan Origination Income	101,077	87,069	273,367	249,435
Income from security sales, net		15,612	11,047	104,708
Other Income	61,940	85,331	210,638	299,675
<b>Total Other Income</b>	<b>\$ 287,683</b>	<b>\$ 308,012</b>	<b>\$ 870,153</b>	<b>\$ 1,013,818</b>

**Table of Contents****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 September 30, 2018 and 2017 were \$6,894,024 and \$6,887,220, respectively, an increase of \$6,804 or 0.1%. Salaries and benefits decreased to \$3,668,012 for the three months ended September 30, 2018, from \$3,744,831 for the same period in 2017. Occupancy expense increased by \$150,556, or 11.3%, to \$1,486,232 for the three months ended September 30, 2018, compared to \$1,335,676 for the same period of 2017. Other operating expenses decreased by \$66,933, or 3.7%, to \$1,739,780 for the three months ended September 30, 2018, compared to \$1,806,713 for the same period of 2017.

Aggregate non-interest expenses for the nine months ended September 30, 2018 and 2017 were \$20,889,594 and \$20,906,987, respectively, a decrease of \$17,393 or 0.1%. Salaries and benefits decreased to \$11,011,291 for the nine months ended September 30, 2018, from \$11,154,068 for the same period in 2017. Occupancy expense increased by \$388,684, or 9.8%, to \$4,373,233 for the nine months ended September 30, 2018, compared to \$3,984,549 for the same period of 2017. Other operating expenses decreased by \$263,300, or 4.6%, to \$5,505,070 for the nine months ended September 30, 2018, compared to \$5,768,370 for the same period of 2017.

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	Three months		Nine months	
	Ended September 30, 2018	2017	Ended September 30, 2018	2017
Advertising	\$ 108,140	\$ 142,032	\$ 434,657	\$ 532,292
Office Supplies	245,248	290,110	736,630	712,397
Legal and Audit Fees	181,036	135,403	425,905	400,483
Telephone expense	124,490	124,112	401,496	399,926
Postage and Freight	136,285	133,251	425,353	396,042
Loan Collection Expense	5,819	106,947	22,641	149,355
Other Losses	546	12,039	233,972	213,606
Regulatory and related expense	84,084	107,932	277,437	322,104
Debit Card/ATM expense	121,434	103,240	343,817	307,069
Travel and Convention	54,745	54,198	166,759	197,318
Other expenses	677,953	597,449	2,036,403	2,137,778
Total Other Expense	\$ 1,739,780	\$ 1,806,713	\$ 5,505,070	\$ 5,768,370

The Corporation's efficiency ratio for the three months ended September 30, 2018 was 75.25%, compared to 75.67% for the same period in 2017. For the nine months ended September 30, 2018 and 2017, the Corporation's efficiency ratio was 75.79% and 76.35%, respectively. The efficiency ratio is the ratio of non-interest expenses divided by the sum of net interest income (on a fully tax equivalent basis) and non-interest income.

**Table of Contents****BALANCE SHEET ANALYSIS**

	September 30, 2018	December 31, 2017	Amount of Increase (Decrease)	Percent of Increase (Decrease)
Cash and Due From Banks	\$ 12,609,437	\$ 17,962,990	\$ (5,353,553)	-29.80%
Interest Bearing deposits with Other Banks	1,351,745	1,532,420	(180,675)	-11.79%
Investment Securities	449,254,631	505,046,377	(55,791,746)	-11.05%
Loans, net	431,433,287	402,390,574	29,042,713	7.22%
Premises and Equipment	19,868,597	20,571,551	(702,954)	-3.42%
Total Assets	962,967,946	993,095,828	(30,127,882)	-3.03%
Total Deposits	757,380,333	720,685,499	36,694,834	5.09%
Total Shareholders Equity	79,794,502	88,451,040	(8,656,538)	-9.79%

**CASH AND CASH EQUIVALENTS**

Cash and cash equivalents, which consist of cash, balances at correspondent banks and items in process of collection, balance at September 30, 2018 was \$12,609,437, which was a decrease of \$5,353,553 from the balance of \$17,962,990 at December 31, 2017. The decrease was due to a decrease in the balances at correspondent banks due to a decrease in the amount of checks drawn on other banks in the normal process of clearing funds between these banks.

**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 September 30, 2018, decreased by \$55,791,746, or 11.1%, to \$449,254,631 from \$505,046,377 at December 31, 2017. This decrease was due to maturities, paydowns, sales and calls in excess of purchases and decreases in the market value of the Corporation's investment securities portfolio.

**LOANS**

The Corporation's loan balance increased by \$29,042,713, or 7.2%, during the nine months ended September 30, 2018, to \$431,433,287 from \$402,390,574 at December 31, 2017. Loan demand, especially in land development and construction, commercial and industrial, and commercial real estate categories, strengthened during the nine months ended September 30, 2018 but competition for available loans continued to be strong during that period. No material changes were made to the loan products offered by the Corporation during this period.



**Table of Contents****PREMISES AND EQUIPMENT**

During the nine months ended September 30, 2018, the Corporation's premises and equipment decreased by \$702,954, or 3.4%, to \$19,868,597 from \$20,571,551 at December 31, 2017. The decrease was due to depreciation expense exceeding the amount of property and equipment purchased during the period.

**DEPOSITS**

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

	September 30, 2018	December 31, 2017	Amount of Increase (Decrease)	Percent of Increase (Decrease)
Noninterest-Bearing Deposits	\$ 162,832,452	\$ 159,291,356	\$ 3,541,096	2.22%
Interest-Bearing Deposits	327,991,524	306,047,053	21,944,471	7.17%
Savings Deposits	81,085,547	77,784,876	3,300,671	4.24%
Certificates of Deposit	185,470,810	177,562,214	7,908,596	4.45%
<b>Total deposits</b>	<b>\$ 757,380,333</b>	<b>\$ 720,685,499</b>	<b>\$ 36,694,834</b>	<b>5.09%</b>

Non-interest-bearing, interest-bearing, savings and certificates of deposits increased during the nine months ended September 30, 2018. 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 2 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.

**CONTRACTUAL OBLIGATIONS**

There have been no material changes outside of the ordinary course of the Corporation's business to the contractual obligations set forth in Note 12 to the Corporation's financial statements contained in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2017.

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

The following discussion of operations outlines specific risks that could affect the Corporation's ability to compete, change the Corporation's risk profile or eventually impact the Corporation's financial condition or results. The risks the Corporation faces generally are similar to those experienced, to varying degrees, by all financial services companies.



## Table of Contents

The Corporation's strategies and its management's ability to react to changing competitive and economic environments have historically enabled the Corporation to compete effectively and manage risks to acceptable levels. The Corporation has outlined potential risks below that it presently believes could be important; however, other risks may prove to be important in the future. New risks may emerge at any time and the Corporation cannot predict with certainty all potential developments that could affect the Corporation's financial condition or results of operation. The following discussion highlights potential risks, which could intensify over time or shift dynamically in a way that might change the Corporation's risk profile.

### Competition Risks

The market in which the Corporation competes is saturated with community banks seeking to provide a service-oriented banking experience to individuals and businesses compared with what the Corporation believes is the more rigid and less friendly environment found in larger banks. This requires the Corporation to offer most, if not all, of the products and conveniences that are offered by the larger banks, but with a service differentiation. In doing so, it is imperative that the Corporation identify the lines of business that the Corporation can excel in, prudently utilize the Corporation's available capital to acquire the people and platforms required thereof, and execute on these strategies.

### Credit Risks

Like all lenders, the Corporation faces the risk that the Corporation's customers may not repay their loans and that the realizable value of collateral may be insufficient to avoid a loss of principal. In the Corporation's business, some level of credit loss is unavoidable and overall levels of credit loss can vary over time. The Corporation's ability to manage credit risk depends primarily upon the Corporation's ability to assess the creditworthiness of customers and the value of collateral, including real estate. The Corporation controls credit risk by diversifying the Corporation's loan portfolio and managing its composition, and by recording and managing an allowance for expected loan losses in accordance with applicable accounting rules. At the end of September 30, 2018, the Corporation had approximately \$3.2 million of available reserves to cover such losses. The models and approaches the Corporation uses to originate and manage loans are regularly reviewed, if necessary or advisable, updated to consider changes in the competitive environment, in real estate prices and other collateral values, and in the economy, among other things, based on the Corporation's experience originating loans and servicing loan portfolios.

### Financing, Funding and Liquidity Risks

One of the most important aspects of management's efforts to sustain long-term profitability for the Corporation is the management of interest rate risk. Management's goal is to maximize net interest income within acceptable levels of interest-rate risk and liquidity.

## Table of Contents

The Corporation's assets and liabilities are principally financial in nature and the resulting earnings thereon are subject to significant variability due to the timing and extent to which the Corporation can reprice the yields on interest-earning assets and the costs of interest bearing liabilities as a result of changes in market interest rates. Interest rates in the financial markets affect the Corporation's decisions on pricing its assets and liabilities, which impacts net interest income, an important cash flow stream for the Corporation. As a result, a substantial part of the Corporation's risk-management activities are devoted to managing interest-rate risk. Currently, the Corporation does not have any significant risks related to foreign currency exchange, commodities or equity risk exposures.

### Interest Rate and Yield Curve Risks

A significant portion of the Corporation's business involves borrowing and lending money. Accordingly, changes in interest rates directly impact the Corporation's revenues and expenses, and potentially could compress the Corporation's net interest margin. The Corporation actively manages its balance sheet to control the risks of a reduction in net interest margin brought about by ordinary fluctuations in rates.

Like all financial services companies, the Corporation faces the risk of abnormalities in the yield curve. The yield curve shows the interest rates applicable to short and long term debt. The curve is steep when short-term rates are much lower than long-term rates, it is flat when short-term rates are equal, or nearly equal, to long-term rates, and it is inverted when short-term rates exceed long-term rates. Historically, the yield curve has been positively sloped. A flat or inverted yield curve tends to decrease net interest margin, as funding costs increase relative to the yield on assets. Currently, the yield curve is flat.

### Regulatory and Legal Risks

The Corporation operates in a heavily regulated industry and therefore is subject to many banking, deposit, and consumer lending laws as well as the rules and regulations promulgated by the FDIC, FRB, Securities and Exchange Commission and the NASDAQ stock market. Failure to comply with applicable regulations could result in financial or operational penalties. In addition, efforts to comply with applicable regulations may increase the Corporation's costs and/or limit the Corporation's ability to pursue certain business opportunities. Federal and state regulations significantly limit the types of activities in which the Corporation, as a financial institution, may engage. In addition, the Corporation is subject to a wide array of other regulations that govern other aspects of how the Corporation conducts business, such as in the areas of employment and intellectual property. Federal and state legislative and regulatory authorities occasionally consider changing these regulations or adopting new ones. Such actions could limit the amount of interest or fees the Corporation can charge, could restrict the Corporation's ability to collect loans or realize on collateral or could materially affect us in other ways. Additional federal and state consumer protection regulations could also expand the privacy protections afforded to customers of financial institutions, restricting the Corporation's ability to share or receive customer information and increasing the Corporation's costs. In addition, changes in accounting rules can significantly affect how the Corporation records and reports assets, liabilities, revenues, expenses and earnings.

## Table of Contents

The Corporation also faces litigation risks from customers (individually or in class actions) and from federal or state regulators. Litigation is an unavoidable part of doing business, and the Corporation manages those risks through internal controls, personnel training, insurance, litigation management, the Corporation's compliance and ethics processes and other means. However, the commencement, outcome and magnitude of litigation cannot be predicted or controlled with any certainty.

## Accounting Estimate Risks

The preparation of the Corporation's consolidated financial statements in conformity with GAAP requires management to make significant estimates that affect the financial statements. The Corporation's most critical estimate is the level of the allowance for credit losses. However, other estimates occasionally become highly significant, especially in volatile situations such as litigation and other loss contingency matters. Estimates are made at specific points in time as actual events unfold, estimates are adjusted accordingly. Due to the inherent nature of these estimates, it is possible that, at some time in the future, the Corporation may significantly increase the allowance for credit losses or sustain credit losses that are significantly higher than the provided allowance, or the Corporation may make some other adjustment that will differ materially from the estimates that the Corporation previously made.

## Expense Control

Expenses and other costs directly affect the Corporation's earnings. The Corporation's ability to successfully manage expenses is important to its long-term profitability. Many factors can influence the amount of the Corporation's expenses, as well as how quickly they grow. As the Corporation's businesses change or expand, additional expenses can arise from asset purchases, structural reorganization, evolving business strategies, and changing regulations, among other things. The Corporation manages expense growth and risk through a variety of means, including actual versus budget management, imposition of expense authorization, and procurement coordination and processes.

## ITEM 4. CONTROLS AND PROCEDURES.

The management of the Corporation, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures in ensuring that the information required to be disclosed in our filings under the Securities Exchange Act of 1934, 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 Corporation's management as appropriate to allow timely decision regarding required disclosure. Based on such evaluation, our principal executive officer and principal financial officer have concluded that such disclosure controls and procedures were effective as of September 30, 2018 (the end of the period covered by this Quarterly Report).

There were no changes to the Corporation's internal control over financial reporting that occurred in the three months ended September 30, 2018, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 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, 2017, which the Corporation filed with the Securities and Exchange Commission on March 15, 2018. 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, 2017, the Corporation's quarterly reports on Form 10-Q and other reports 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.

There have been no material changes to the risk factors as disclosed in the Corporation's Annual Report on Form 10-K for the Corporation's year ended December 31, 2017.

**Table of Contents**

ITEM 6. EXHIBITS.

Exhibits

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

Table of Contents

SIGNATURES

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

CITIZENS HOLDING COMPANY

BY: /s/ Greg L. McKee  
Greg L. McKee  
President and Chief Executive Officer  
(Principal Executive Officer)

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

DATE: November 7, 2018