CITIZENS HOLDING CO /MS/
Form 10-K
March 15, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______ to ______

Commission file number: 001-15375

CITIZENS HOLDING COMPANY

(Exact Name of Registrant as Specified in Its Charter)

MISSISSIPPI	**64-0666512**
(State or Other Jurisdiction of Incorporation or Organization)	**(IRS Employer Identification Number)**
521 Main Street, Philadelphia, MS	**39350**
(Address of Principal Executive Office)	**(Zip Code)**

Registrant s Telephone Number, Including Area Code: (601) 656-4692

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $.20 par value	NASDAQ Global Market

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities

Act.   Yes   No

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes   No

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller Reporting Company

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

As of June 30, 2016, the aggregate market value of the registrant s common stock, $.20 par value, held by non-affiliates of the registrant was $97,194,045 based on the closing sale price as reported on the NASDAQ Global Market for such date (the exchange on which the registrant s common stock was listed on June 30, 2016).

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

Class	Outstanding at March 8, 2017
Common stock, $.20 par value	4,882,579 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Citizens Holding Company s Annual Report to Shareholders for the fiscal year ended December 31, 2016 are incorporated by reference into Part II of this Annual Report on Form 10-K.

Portions of Citizens Holding Company s Definitive Proxy Statement with respect to its 2017 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

In addition to historical information, this report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are based on management s beliefs, plans, expectations, assumptions and on information currently available to management. The words may, should, expect, anticipate, intend, plan, continue, estimate and similar expressions used in this report that do not relate to historical facts are intended to identify forward-looking statements. These statements appear in a number of places in this report, including, but not limited to, statements found in Item 1, Business, and in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations. Citizens Holding Company (the Company) notes that a variety of factors could cause its actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of the business of the Company and the Company s wholly-owned subsidiary, The Citizens Bank of Philadelphia, Mississippi (the Bank), include, but are not limited to, the following:

- expectations about the movement of interest rates, including actions that may be taken by the Federal Reserve Board in response to changing economic conditions;
- adverse changes in asset quality and loan demand, 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, or litigation;
- increased competition from other financial institutions and the risk of failure to achieve our business strategies;
- events affecting our business operations, including the effectiveness of our risk management framework, 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

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

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

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The Company undertakes no obligation to update or revise any forward-looking statements subsequent to the date on which they are made. Please also refer to Item 1A, Risk Factors, for a detailed discussion of the risks related to the Company, the Bank in particular, and the banking industry generally.

Except as otherwise indicated herein, the information presented in this Annual Report on Form 10-K is as of March 8, 2017.

ITEM 1. BUSINESS.

BACKGROUND

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 Citizens Bank of Philadelphia (the Bank). The Company does not have any subsidiaries other than the Bank. The Company, we, or our, as used herein, includes the Bank, unless the context otherwise requires.

The Bank was opened on February 8, 1908 as The First National Bank of Philadelphia. In 1917, the Bank surrendered its national charter and obtained a state charter, at which time the name of the Bank was changed to The Citizens Bank of Philadelphia, Mississippi. At December 31, 2016, the Bank was the largest bank headquartered in Neshoba County, Mississippi, with total assets of $1.025 billion and total deposits of $760.152 million. For more information regarding the assets, revenue and profits of the Company, refer to the Consolidated Financial Statements of the Company contained in Item 8, Financial Statements and Supplementary Data. The Company s only reportable segment is the assets and cash flow of the Bank, resulting in revenues of $37,747,661, operating profit of $6,949,153 and total assets of $1,024,898,099 for the Company as of December 31, 2016.

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.

OPERATIONS

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

Revenues from the Company s lending activities constitute the largest component of the Company s operating revenues. Revenue from loan interest and fees made up 50.2% of gross revenues in 2016, 51.0% in 2015 and 50.8% in 2014. Loan demand has improved but increased competition that results in lower loan yields along with an increased investment portfolio have caused this percentage to remain relatively flat over the last three years. Such lending activities include commercial, real estate, installment (direct and indirect) and credit card loans. The Company s primary lending area is East Central and South Mississippi, specifically Neshoba, Newton, Leake, Lamar, Forrest, Scott, Attala, Lauderdale, Oktibbeha, Rankin, Harrison, Jackson, Winston and Kemper counties and contiguous counties. In 2008, the Company entered the southern Mississippi market with the opening of a branch office in Hattiesburg, Mississippi, which is located in Lamar County. In 2009, the Company opened a Loan Production Office in Biloxi, Mississippi to serve the Mississippi Gulf Coast and in April 2014 converted this office to a full service branch and at the same time opened another branch in Biloxi. In 2011, the Company opened a branch in

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Flowood, Mississippi. In December 2016, the Company opened a loan production office (LPO) in Oxford to offer commercial loans to the people in North Mississippi. On a very limited basis, the Company extends out-of-area credit only to borrowers who are considered to be low risk, as defined within the Bank s lending policy. The Company is not dependent upon any single customer or small group of customers, and it has no foreign operations.

The Company s market area is mainly rural, with Hattiesburg, population 50,233, Biloxi, population 50,644, and Meridian, population 38,314, being the largest markets. Agriculture and some light industry comprise a significant portion of the economy of this area. The largest employer in the Company s service area is the Mississippi Band of Choctaw Indians. Its schools, manufacturing plants and main source of income, The Pearl River Resort (the Resort), generate a significant number of jobs in the area. The Resort and its related services employ approximately 2,400 people within the Company s market. For more information regarding revenue from external customers for the last three fiscal years, attributed by geographic region, please refer to Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, which is included in the Company s Annual Report and attached as an exhibit hereto.

The Company has historically made, and intends to continue to make, most types of real estate loans, including, but not limited to, single and multi-family housing, farm, residential and commercial construction, and commercial real estate loans. At December 31, 2016, approximately 81.2% of the Company s loan portfolio was attributed to real estate lending, 14.0% of the Company s loan portfolio was comprised of commercial, industrial and agricultural production loans, and consumer loans made up the remaining 4.8% of the Company s total loan portfolio.

The Company s loan personnel have the authority to extend credit under guidelines established and approved by the Company s Board of Directors. Any aggregate credit that exceeds the authority of the loan officer is forwarded to the Board s loan committee for approval. The loan committee is composed of certain independent Company directors. All aggregate credits that exceed the loan committee s lending authority are presented to the Board of Directors for ultimate approval or denial. The loan committee not only acts as an approval body to ensure consistent application of the Company s loan policies, but also provides valuable insight through the communication and pooling of knowledge, judgment and experience of its members.

All loans in the Company s portfolio are subject to risk based on the state of both the local and national economy. The local economy has weathered the recent downturn in the national economy with a minimum effect on employment and production. It is still uncertain how the weakness in the local, state and national economy will affect the Company in the future.

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

EXECUTIVE OFFICERS OF THE COMPANY

Greg L. McKee, 55, has been employed by the Bank since 1984. He was named President and Chief Executive Officer of the Company and Chief Executive Officer of the Bank in January 2003.

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He has served as President of the Bank since January 2002 and served as Chief Operating Officer of the Bank from January 2002 until December 31, 2002. He has also been a member of the Board of Directors of both the Company and the Bank since 2001. Mr. McKee served as Executive Vice-President of the Bank from 2001 to 2002, Senior Vice-President of the Bank from 2000 to 2001, Vice-President of the Bank from 1992 to 2000, Assistant Vice-President of the Bank from 1989 to 1992, and Assistant Cashier of the Bank from 1984 to 1989.

Robert T. Smith, 65, has been employed by the Bank since 1986. He has served as Senior Vice-President and Chief Financial Officer of the Bank since January 2001. Prior to January 2001, Mr. Smith held the title of Vice-President and Controller of the Bank from 1987 until 2001 and Assistant Vice-President of the Bank from 1986 to 1987. In addition to his position with the Bank, Mr. Smith has served as Treasurer of the Company since February 1996 and Treasurer and Chief Financial Officer since January 2001.

EMPLOYEES

The Company has no employees other than three Bank officers who provide services to the Company. These officers receive no compensation from the Company for their services to it as their compensation is paid by the Bank. At December 31, 2015, the Bank employed 240 full-time employees and 24 part-time employees. The Bank is not a party to any collective bargaining agreements, and employee relations are considered to be good.

SUPERVISION AND REGULATION

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

General.

The current regulatory environment for financial institutions includes substantial enforcement activity by the federal and state banking agencies, and other state and federal law enforcement agencies, reflecting an increase in activity over prior years. This environment entails significant increases in compliance requirements and associated costs. The FRB requires the Company to maintain certain levels of capital and to file an annual report with the FRB. The FRB also has the authority to conduct examinations of the Company and the Bank and to take enforcement action against any bank holding company that engages in any unsafe or unsound practice or that violates certain laws, regulations, or conditions imposed in writing by the FRB.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, as amended, (Dodd-Frank Act) affects financial institutions in numerous ways, including the creation of a new Financial Stability Oversight Council responsible for monitoring and managing systemic risk, granting additional authority to the FRB to regulate certain types of nonbank financial companies, granting new authority to the FDIC as liquidator and receiver, abolishing the Office of Thrift Supervision, changing the manner in which insurance deposit assessments are made, requiring the regulators to modify capital standards, establishing a new Bureau of Consumer Financial Protection to regulate compliance with consumer laws and regulations, cap interchange fees which banks charge merchants for debit card transactions, and imposing new requirements on mortgage lenders. There are many provisions in the Dodd-Frank Act mandating regulators to adopt new regulations and conduct studies upon which future regulation may be based. A number of regulations issued by the CFPB affect the origination, administration, and servicing of mortgage loans, and it is anticipated that these rules and enforcement by the Bank s regulators will continue to evolve through regulatory amendments, informal interpretations, and enhanced enforcement in the future. Congress and the President have announced proposed reforms and changes to the Dodd-Frank Act, and it is uncertain how the Dodd-Frank Act provisions may be modified or the ultimate impact any such modifications may have to our business operations.

Capital Standards.

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

A banking organization s risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance sheet items. Since December 31, 1992, the federal banking agencies have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance sheet items of 4%. At December 31, 2016, the Company s ratio of qualifying total capital to risk-adjusted assets and off-balance sheet items was 18.67%, and its ratio of Tier 1 capital to risk-adjusted assets and off-balance sheet items was 17.92%.

In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 4%. The Company s leverage ratio at December 31, 2016 was 9.22%.

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

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Beginning January 1, 2015 the Bank began to comply with the 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 ratio to 4% for all banking organizations (currently 3% for certain banking organizations);
- Increase the minimum Tier 1 risk-based capital ratio from 4% to 6%; and
- Maintain the minimum total risk-based capital ratio at 8%.

In addition, the Basel III rules, 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.

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

Management believes that, as of December 31, 2016, 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. Management will continue to monitor these and any future proposals submitted by the Company s and Bank s regulators.

Prompt Corrective Action and Other Enforcement Mechanisms.

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

Safety and Soundness Standards.

FDICIA also implemented certain specific restrictions on transactions and required the regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation, and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, the use of

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brokered deposits and the aggregate extension of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions and for deposits by certain employee benefits accounts.

Restrictions on Dividends and Other Distributions.

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

The approval of the Mississippi Department of Banking and Consumer Finance is also required prior to the Bank paying dividends. The department s regulations limit dividends to earned surplus in excess of three times the Bank s capital stock. At December 31, 2016, the maximum amount available for transfer from the Bank to the Company in the form of a dividend was approximately $81.4 million, or 98.1% of the Bank s consolidated net assets.

FRB regulations limit the amount the Bank may loan to the Company unless those loans are collateralized by specific obligations. At December 31, 2016, the maximum amount available for transfer from the Bank in the form of loans was $8.3 million, or 10% of the Bank s consolidated net assets. The Bank does not have any outstanding loans with the Company.

FDIC Insurance Assessments.

The FDIC maintains the Deposit Insurance Fund (DIF) by assessing depository institutions an insurance premium. The amount each institution is assessed is based upon statutory factors that include the balance of insured deposits as well as the degree of risk the institution poses to the DIF. The Dodd-Frank Act permanently raised the FDIC insurance coverage limit per depositor to $250,000. On May 20, 2016, the FDIC amended its rule to refine the deposit insurance assessment system for small insured depository institutions that have been federally insured for at least five years that became effective on July 1, 2016. The deposit insurance assessment system is mandated by the Dodd-Frank Act. The rule, which applies to banks with less than $10 billion in assets, would take effect when the Deposit Insurance Fund reaches 1.15% of insured deposits. FDIC released a statement confirming that as of second quarter of 2016, our DIF reserve ratio had reached 1.17%. As a result, the calculation adopted in the final rule for Small Bank FDIC Assessments was reflected in the third quarter of 2016 accruals. The assessment rate schedule was also revised to a range of 3 to 30 basis points annually, and fully adjusted rates will range from 1.5 to 40 basis points annually.

Other BHC Act Provisions.

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

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

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

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

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

Community Reinvestment Act.

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

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The FDIC examined the Bank on July 12, 2016 for its performance under the CRA. The Bank was rated Satisfactory during this examination. No discriminatory practices or illegal discouragement of applications were found.

Anti-Money Laundering Efforts.

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

Corporate Governance.

The Sarbanes-Oxley Act of 2002 (Sarbanes Act) requires publicly traded companies, such as the Company, to adhere to several directives designed to prevent corporate misconduct. As a result, additional duties have been placed on officers, directors, auditors and attorneys of public companies. The Sarbanes Act requires certifications regarding financial statement accuracy and internal control adequacy by the chief executive officer and the chief financial officer to accompany periodic reports filed with the Securities and Exchange Commission (SEC). The Sarbanes Act also accelerates insider reporting obligations under Section 16 of the Securities Exchange Act of 1934, as amended, restricts certain executive officer and director transactions, imposes new obligations on corporate audit committees and provides for enhanced review by the SEC.

The Dodd-Frank Act mandated a number of new requirements with respect to corporate governance. The legislation requires publicly traded companies to give stockholders a non-binding vote on executive compensation at least every three years and on so-called golden parachute payments in connection with approvals of mergers and acquisitions. The Dodd-Frank Act also authorizes the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company s proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Impact of Monetary Policies.

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

Future Legislation

Various legislation affecting financial institutions and the financial industry is from time to time introduced in Congress. Such legislation may change banking statutes and our operating environment in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending upon whether any of this potential legislation will be enacted, and if enacted, the effect that it or any implementing regulations, would have on the financial condition or our results of operations. With the proposals to alter the Dodd-Frank Act and the evolution of the CFPB, the nature and extent of future legislative and regulatory changes affecting financial institutions continues to be very unpredictable.

COMPETITION

The banking business is highly competitive. The Company s market consists principally of Neshoba, Newton, Leake, Lamar, Forrest, Scott, Attala, Lafayette, Lauderdale, Oktibbeha, Rankin, Harrison, Jackson, Winston and Kemper and contiguous counties in Mississippi. In 2008, the Company entered the southern Mississippi market with the opening of a branch office in Hattiesburg, Mississippi, which is located in Lamar County, and in 2009, opened a loan production office in Biloxi, Mississippi, which in April 2014, was converted into a full service branch. In 2011, the Company opened a branch in Flowood, Mississippi. In 2014, the Company established an additional branch in Biloxi to better serve the Gulf Coast. In 2016, the Company entered North Mississippi with the establishment of a loan production office in Oxford, Mississippi. The Company competes with local, regional and national financial institutions in these counties and in surrounding counties in Mississippi in obtaining deposits, lending activities and providing many types of financial services. The Company also competes with larger regional banks for the business of companies located in the Company s market area.

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

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

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Currently, there are approximately thirty different financial institutions in the Company s market competing for the same customer base. According to the FDIC s Summary of Deposits that is collected as of June 30 each year, the Company s market share in its market area was approximately 6.00% at June 30, 2016. The Company competes in its market for loan and deposit products, along with many of the other services required by today s banking customer, on the basis of availability, quality and pricing. The Company believes it is able to compete favorably in its markets, in terms of both the rates the Company offers and the level of service that the Company provides to its customers.

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AVAILABILITY OF INFORMATION

The Company s Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments thereto, along with other information about the Company, are available, free of charge, on our website, http://www.citizensholdingcompany.com. The information contained on our website is not incorporated into this report. Upon request, the Company will provide to any record holder or beneficial holder of its shares a copy of such reports without charge. Requests should be made to Robert T. Smith, Treasurer and Chief Financial Officer, Citizens Holding Company, 521 Main Street, Philadelphia, Mississippi 39350.

ITEM 1A. RISK FACTORS.

In addition to the other information contained in or incorporated by reference into this report and the exhibits hereto, the following risk factors should be considered carefully in evaluating the Company s business. The risks disclosed below, either alone or in combination, could materially adversely affect the business, prospects, financial condition or results of operations of the Company and/or the Bank. Additional risks not presently known to the Company, or that the Company currently deems immaterial, may also adversely affect the Company s business, financial condition or results of operations.

Risks Related To The Company s Business and Industry

The Company is subject to interest rate risk.

One of the most important aspects of management s efforts to sustain long-term profitability for the Company 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.

The Company 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 Company 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 Company s decisions on pricing its assets and liabilities, which impacts net interest income, an important cash flow stream for the Company. As a result, a substantial part of the Company s risk-management activities is devoted to managing interest-rate risk. Currently, the Company does not have any significant risks related to foreign currency exchange, commodities or equity risk exposures.

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

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the results of operations of the Company, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company s financial condition and results of operations. For the reasons set forth above, an increase in interest rates generally as a result of such a credit rating downgrade could adversely affect out net interest income levels, thereby resulting in reduced earnings, and reduce loan demand. Volatility in interest rates may also result in disintermediation, which is the flow of funds away from financial institutions into direct investments, such as United States Government and Agency securities and other investment vehicles, including mutual funds, which generally pay higher rates of return than financial institutions because of the absence of federal insurance premiums and reserve requirements. Disintermediation could also result in material adverse effects on the Company s financial condition and results of operations.

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

The Company is subject to lending risk.

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

As of December 31, 2016, approximately 70.2% of the Company s loan portfolio consisted of commercial, construction and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans due primarily to the large amounts loaned to individual borrowers. Because the loan portfolio contains a significant number of commercial, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on the Company s financial condition and results of operations.

Delays in the Company s ability to foreclose on delinquent mortgage loans may negatively impact our business.

Because the Bank originates loans secured by real estate, the Bank may have to foreclose on the collateral property to protect its investment and may thereafter own and operate such property,

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in which case the Company is exposed to the risks inherent in the ownership of real estate. The amount realized after a default is dependent upon factors outside of the Company s control, including, but not limited to:

- general or local economic conditions;
- environmental cleanup liability;
- neighborhood values;
- interest rates;
- real estate tax rates;
- operating expenses of the mortgaged properties;
- supply of and demand for rental units or properties;
- ability to obtain and maintain adequate occupancy of the properties;
- zoning laws;
- governmental rules, regulations and fiscal policies; and
- natural disasters.

Certain expenses associated with the ownership of real estate, principally real estate taxes, insurance, and maintenance costs, may adversely affect the net proceeds received from the real estate, if any. The ability to mitigate the losses on defaulted loans depends upon the ability to promptly foreclose upon the collateral after an appropriate cure period. In some states, the large number of mortgage foreclosures that have occurred has resulted in significant delays in foreclosing. Any delay in the foreclosure process adversely affects us by increasing the expenses related to carrying such real estate and exposes us to losses as a result of potential additional declines in the value of such collateral. As a result, the increased cost of owning and operating such real estate may exceed the rental income earned from the real estate (if any), the Company may have to advance additional funds to protect our investment or the Company may be required to dispose of the real estate at a loss.

The allowance for possible loan losses may be insufficient.

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

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

The Company depends on the accuracy and completeness of information about customers and counterparties.

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

The Company is subject to environmental liability risk associated with lending activities.

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

The Company is subject to risk from adverse economic conditions.

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

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The FRB has implemented significant economic strategies that have impacted interest rates, inflation, asset values, and the shape of the yield curve, and currently is transitioning from many years of easing to what may be a new period of tightening.

In recent years, the FRB has begun to gradually unwind the remaining domestic monetary policy initiatives as the economy continues to recover. In December 2015, the Federal Reserve raised the target federal funds rate after a prolonged period of no change by 25 bps and did so again by 25 bps a year later in December 2016. These developments, along with the U. S. government s credit and deficit concerns, the European sovereign debt crisis and the economic slowdown in China, could cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms. Other significant monetary strategies could be implemented in the future including, in particular, so-called tightening strategies. FRB strategies can, and often are intended to, affect the domestic money supply, inflation, interest rates, and the shape of the yield curve. Effects on the yield curve often are most pronounced at the short end of the curve, which is of particular importance to us and other banks. Among other things, easing strategies are intended to lower interest rates, flatten the yield curve, expand the money supply, and stimulate economic activity, while tightening strategies are intended to increase interest rates, steepen the yield curve, tighten the money supply, and restrain economic activity. All things being equal, the current transition from easing to possible tightening should tend to diminish or reverse downward pressure on rates, and to diminish or eventually end the stimulus effect that low rates tend to have on the economy. Many external factors may interfere with the effects of these plans or cause them to be changed unexpectedly. Such factors include significant economic trends or events as well as significant international monetary policies and events. Risks associated with interest rates and the yield curve are discussed in this Item 1A under the caption The Company is subject to interest rate risk. Such strategies also can affect the United States. and world-wide financial systems in ways that may be difficult to predict.

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

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

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The Company is subject to extensive government regulation and supervision.

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

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

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

Failure to comply with laws, regulations or policies could also result in sanctions by regulatory agencies and/or civil money penalties, which could have a material adverse effect on the Company s business, prospects, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, it cannot assure that such violations will be prevented. The information under the heading Supervision and Regulation in Item 1, Business, and Note 16, Regulatory Matters to the Consolidated Financial Statements of the Company in Item 8, Financial Statements and Supplementary Data, provides more information regarding the regulatory environment in which the Company and the Bank operate.

We are subject to claims and litigation.

From time to time, customers and others make claims and take legal action pertaining to our performance of our responsibilities. Whether customer claims and legal action related to our performance of our responsibilities are founded or unfounded, or if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services, as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

The Company operates in a highly competitive industry and market area.

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

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

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

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets.

- the ability to expand the Company s market position.

- the scope, relevance and pricing of products and services offered to meet customer needs and demands.

- the rate at which the Company introduces new products and services relative to its competitors.

- customer satisfaction with the Company s and the Bank s level of service.

industry and general economic trends.

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

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We are subject to a variety of operational risks, including the risk of fraud or theft by employees, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including liquidity risk, credit risk, market risk, interest rate risk, legal and compliance risk, strategic risk, information security risk, and reputational risk. We are also reliant upon our employees, and our operations are subject to the risk of fraud, theft or malfeasance by our employees. We have established processes and procedures intended to identify, measure, monitor, report and analyze these risks, however, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated, monitored or identified. If our risk management framework proves ineffective, we could suffer unexpected losses, we may have to expend resources detecting and correcting the failure in our systems and we may be subject to potential claims from third parties and government agencies. We may also suffer severe reputational damage. Any of these consequences could adversely affect our bus