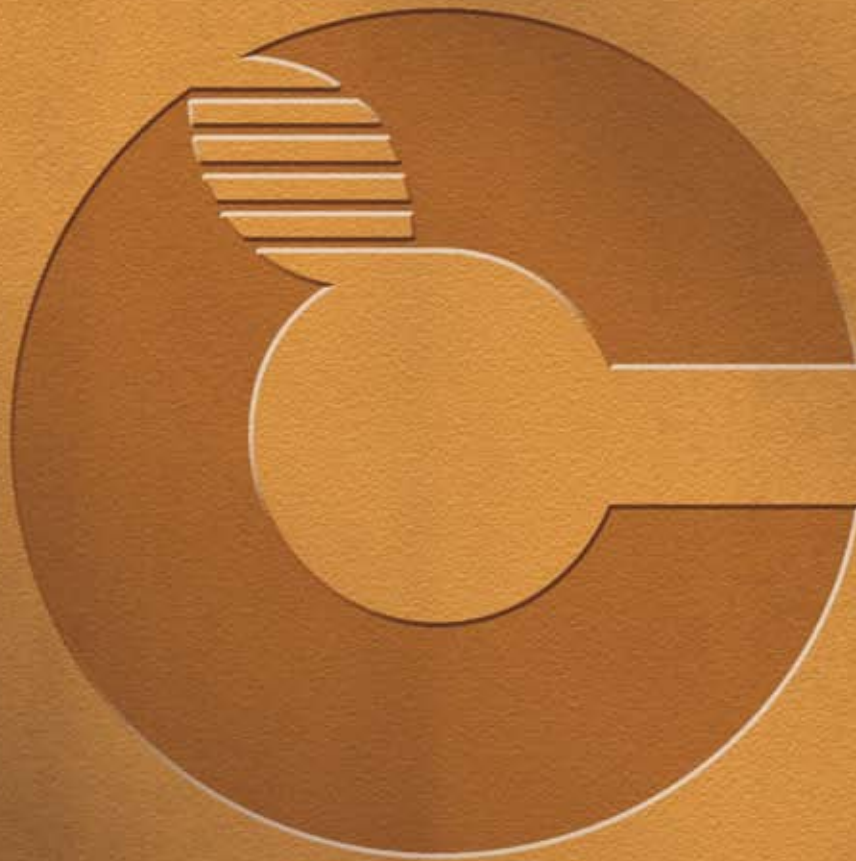


A TRADITION OF
STRENGTH AND STABILITY



2 0 0 8 A N N U A L R E P O R T

Resolution of the Board of Directors

**CITIZENS NATIONAL BANK
OF PAINTSVILLE, KY**



O.T. Dorton

WHEREAS, Oscar Trigg "O.T." Dorton was a resident of Paintsville, Kentucky; a Director Emeritus of Citizens National Bank; and member of First United Methodist Church, Paintsville, Kentucky;

WHEREAS, "O.T." Dorton was past President and CEO, past Board Chairman of Citizens National Bank and Citizens National Corporation; Kentucky Bankers Association, Kentucky Chamber of Commerce; a founding member of Big Sandy Community Action Program, and past Director of the Cincinnati Branch of the Cleveland Federal Reserve Bank;

WHEREAS, "O.T." Dorton served the Paintsville Independent School Board, Pikeville College Board, Lindsey Wilson College Board, Big Sandy Community and Technical College Board, and Development Board of the University of Kentucky;

WHEREAS, "O.T." Dorton departed this life February 19, 2009 and leaves behind his loving wife of sixty-four years, Betty Marie Reynolds Dorton; two children Dennis Trigg Dorton (Jean Marie Mollett Dorton) of Paintsville, KY; and Lynn Dorton Mullins (William Charles Mullins) of Paintsville, KY; one sister, Norma Jean Maggard; his three grandchildren Andrew Trigg Dorton (Stephanie Stumbo), Meredith Lynn Mullins, and Macy Marie Covington (Trey Covington); and two great grandsons Tristan Andrew Dorton and Ashton Warren Dorton;

RESOLVED by the Board of Citizens National Bank, that the family having lost a devoted husband, father, grandfather and great grandfather and the community in which he resided an honored citizen whose many lifelong interests benefited from his leadership and generosity, we deeply sympathize with and share the grief and bereavement of the family in the great loss sustained by the death of Mr. Oscar Trigg "O.T." Dorton;

RESOLVED FURTHER, that this Resolution be spread at large upon the appropriate records of this bank, and a copy be tendered to his family as a humble expression of the Board's heartfelt sympathy in its bereavement, and that it be published in local papers and in *Kentucky Banker Magazine*.

Unanimously adopted by the Board of Directors of Citizens National Bank of Paintsville, Kentucky, on March 17, 2009.

Gregory Meade, Chairman
Sharon A. Collins, Secretary

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Vision & Philosophy

OUR VISION

Citizens National Bank will be the preferred high-performing, independent community bank in Kentucky. We partner with growing businesses and consumers to build lasting relationships. We do this by providing financial products and services valued by our customers, delivered by committed employees who really mean it!

OUR PHILOSOPHY

At Citizens National Bank, the customer experience is our first priority. We will provide convenient branch and ATM locations as well as the 24/7 access of online and telephone banking. We will continue to offer our customers the latest in superior financial products and services. Citizens National Bank pledges to provide accurate, timely and personal service and when an error or problem does arise, we will work to resolve it to our customer's total satisfaction. We will strive to be responsive, thoughtful and friendly. Finally, we at Citizens National Bank promise that we will never lose sight of the fact that our customers are our greatest asset.

Letter to Shareholders

A TRADITION OF STRENGTH & STABILITY



A SAFE HAVEN

In a year wrought with financial uncertainty, Citizens National Bank is proud to provide a safe, stable haven for those who want more from their bank. It is times like these in which truly solid companies like Citizens shine the brightest. Despite the worst economic climate since World War II, sound practices have helped us weather the storm and kept us able to fulfill our commitment to our shareholders and to the legacy of personal service that our competitors simply cannot match.

A GROWING PRESENCE

2008 has seen great expansion for Citizens National Corporation. The new Lexington Loan Processing Office has allowed us to bring Citizens Mortgage Services to another market, while the new South Ashland Branch has significantly increased our presence in the Ashland area. Moving forward, Ashland, Pike and Fayette counties will be major expansion priorities.

MANAGING FOR THE LONG RUN

A new addition to CNC, our Wealth Management program is off to a strong start. The opportunity to partner with customers to help them holistically manage their wealth, both in short-term solutions and long-term planning, helps Citizens more fully realize the goal of becoming our customers' life-long banking partner.

PARTNERS IN BUSINESS BANKING

In maintaining our commitment to service and constantly seeking out a competitive edge, Citizens continues to offer state-of-the-art products and services. Online Business Banking and Cash Management have added great ease and convenience for our business customers while the success of Health Care Banking stands as a testament to Citizens' ability to learn our clients' businesses and tailor solutions to them. And once again, the Third Annual Business Symposium was well received as Mitch Barnhart gave his address and Citizens further cemented its position as eastern Kentucky's business banking partner.

I am privileged to work with the entire CNC-CNB team in fulfilling our commitment to shareholders and customers in every economic environment. It is a commitment we have kept for nearly 100 years, and one that we look forward to continuing for a hundred more.

Dennis T. Dorton
PRESIDENT/CHIEF EXECUTIVE OFFICER

Strategic Plan Progress Report



We continue to make significant progress toward achieving the goals and objectives outlined in our strategic plan, first developed by the senior management team and the Board in 2005. As we do each year, in the fall of 2008 the senior management team and the Board spent two days in Ashland and thoroughly discussed and reviewed our existing plan, making the necessary modifications. I'd like to take this opportunity to highlight some of our strategic initiatives and accomplishments.

In 2005, we stated that we would like to reach \$500 million in total assets by our 100th anniversary in 2010. We are currently at \$574 million. Most of this growth came as a result of the Heritage Bank of Ashland and Kentucky National Bank of Pikeville acquisitions. Both acquisitions were in markets we identified in our 2005 strategic plan as potential growth markets for Citizens. Each acquisition was very different and complex. Heritage was a financially struggling bank which had a negative impact on our profitability ratios. Conversely, Kentucky National Bank was a highly profitable bank and had a positive impact on our profitability ratios, but needed some infrastructure enhancements like debit cards,

online banking and bill payment capabilities, as well as a website for their customers. The Ashland and Pikeville markets present tremendous growth opportunities due to our low market share in these areas. We amended our total asset goal to \$1 billion by 2013.

The development of a Wealth Management line of business, consisting of trust, brokerage and insurance services, was another key strategic initiative. In 2006 we hired a senior manager, Ed Neely, to be responsible for the growth and development of this line of business. In late 2007, we hired Jim Moore to be our retail brokerage and business development officer. CNC Insurance Services was already in existence. Despite the worst economy and market conditions in nearly 40 years, the Wealth Management business generated \$197,000 of non-interest income, a 51.9 percent increase over 2007. In addition to being a new source of revenue for the bank, the Wealth Management business also complements our relationship banking initiative, allowing us to provide a broader range of financial services to our customers.

Another strategic goal was to change our mix of portfolio loans to include more profitable commercial and business loans with less emphasis on residential mortgage loans. I am pleased to report that we have made significant progress on this initiative. We have developed a few specialty lending products and services to create a niche for our lenders, including Health Care Banking and natural gas-based lending.

In addition, we have implemented a robust and technically advanced online banking system for our business customers. This service has given us a competitive edge as our business customers are becoming more and more savvy when it comes to cash flow and money management.

Last, but not least, we continue to focus on "WOW" customer service. We recognize that customer service is essentially the only differentiator between banks. We cannot grow the bank if we open three new relationships, but lose another four due to poor customer service. We continually emphasize to our employees the importance of "WOW" customer service and the effects it can have on the long-term performance of the bank.

These are just a few examples of the many strategic initiatives we have been developing and executing. I can assure you that the employees of Citizens National Bank are committed to the success of the bank, our shareholders and our customers. We look forward to another successful year in 2009 and beyond.

Mark J. Wiete

EXECUTIVE VICE PRESIDENT/CHIEF OPERATING OFFICER

Financial Highlights

Year Ended December 31

| | 2008 | 2007 | % Change |
|-----------------------|---------------|---------------|----------|
| Net Income | \$ 3,938,000 | \$ 3,341,000 | 17.9% |
| Net Interest Income | \$ 16,721,000 | \$ 14,644,000 | 14.2% |
| Common Dividends Paid | \$ 645,000 | \$ 626,000 | 3.0% |

Per Share*

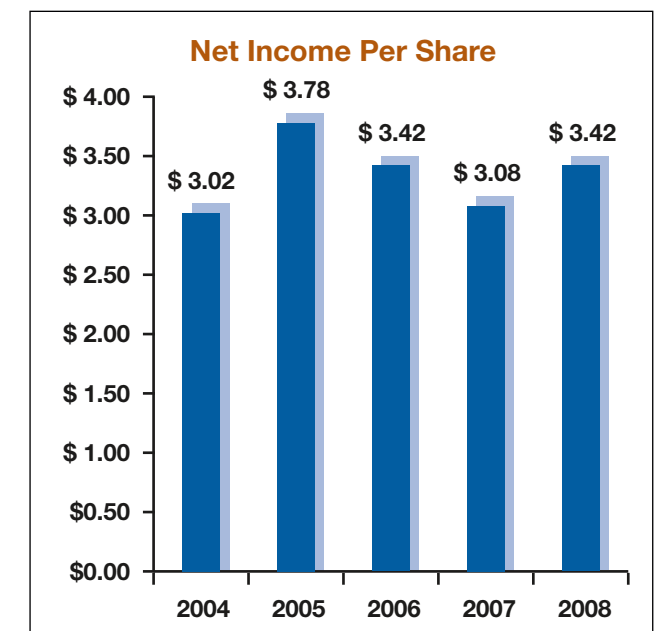
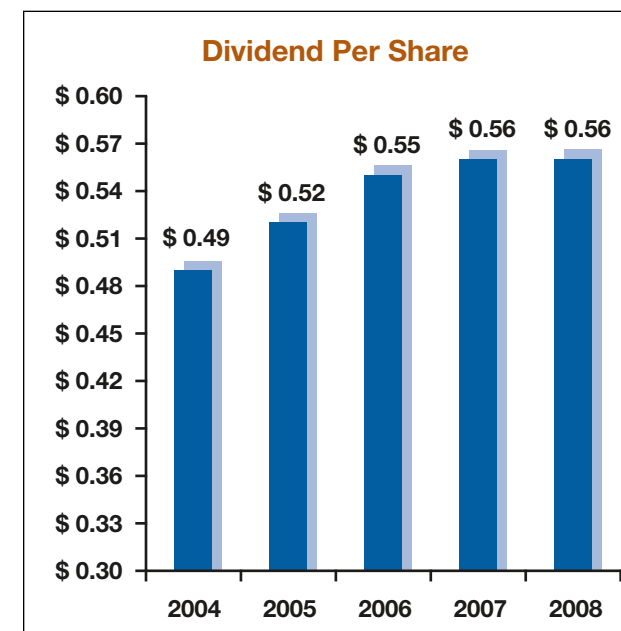
| | | | |
|---------------------------------|----------|----------|-------|
| Basic Earnings Per Common Share | \$ 3.42 | \$ 3.08 | 11.0% |
| Dividend Per Common Share | \$ 0.56 | \$ 0.56 | 0.0% |
| Book Value Per Common Share | \$ 39.98 | \$ 37.48 | 6.7% |

At Year End

| | | | |
|----------------------|----------------|----------------|-------|
| Total Assets | \$ 574,152,000 | \$ 549,930,000 | 4.4% |
| Total Deposits | \$ 431,400,000 | \$ 436,188,000 | -1.1% |
| Net Loans | \$ 359,575,000 | \$ 335,964,000 | 7.0% |
| Stockholders' Equity | \$ 45,934,000 | \$ 43,270,000 | 6.2% |

Performance Ratios

| | | |
|----------------------------|--------|--------|
| Return on Average Assets | 0.71% | 0.68% |
| Return on Average Equity | 8.93% | 8.79% |
| Capital Ratios | | |
| Tier 1 Leverage Ratio | 7.34% | 6.80% |
| Tier 1 Risk-Based | 10.14% | 9.60% |
| Total Risk-Based | 11.44% | 11.40% |
| Loan Loss Reserve to Loans | 0.98% | 1.26% |



*Per Share data is restated to reflect a 2-for-1 stock split during 2007.

Report of Independent Auditors



Board of Directors and Shareholders
Citizens National Corporation
Paintsville, Kentucky

We have audited the accompanying consolidated balance sheets of Citizens National Corporation as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citizens National Corporation as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP
Louisville, Kentucky
March 12, 2009

Consolidated Balance Sheets

December 31

(Dollar amounts in thousands, except share and par amounts)

| | 2008 | 2007 |
|----------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| ASSETS | | |
| Cash and due from financial institutions | \$ 20,447 | \$ 16,875 |
| Interest bearing deposits in other financial institutions | 3,577 | - |
| Securities available for sale | 131,160 | 142,129 |
| Loans held for sale | - | 1,318 |
| Loans, net | 359,575 | 335,964 |
| Restricted stock | 3,546 | 3,056 |
| Premises and equipment, net | 14,242 | 13,644 |
| Goodwill | 15,604 | 15,604 |
| Core deposit intangible | 1,711 | 2,022 |
| Bank-owned life insurance | 11,505 | 6,433 |
| Accrued interest receivable and other assets | 12,785 | 12,885 |
| | <u>\$ 574,152</u> | <u>\$ 549,930</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits | | |
| Non-interest bearing | \$ 92,756 | \$ 79,695 |
| Interest bearing | 338,644 | 356,493 |
| Total deposits | 431,400 | 436,188 |
| Federal funds purchased | - | 11,223 |
| Repurchase agreements | 24,311 | 16,854 |
| Federal Home Loan Bank advances (FHLB) | 49,062 | 17,596 |
| Subordinated debentures | 16,000 | 16,000 |
| Notes payable | 1,500 | 3,000 |
| Accrued interest payable and other liabilities | 5,945 | 5,799 |
| Total liabilities | 528,218 | 506,660 |
| Commitments and contingencies (Note 10) | | |
| Shareholders' equity | | |
| Common stock, no par value; 3,000,000 shares authorized; 1,148,879 and 1,154,336 shares outstanding in 2008 and 2007 | - | - |
| Additional paid-in capital | 12,375 | 12,639 |
| Retained earnings | 32,196 | 29,200 |
| Accumulated other comprehensive income | 1,363 | 1,431 |
| Total shareholders' equity | 45,934 | 43,270 |
| | <u>\$ 574,152</u> | <u>\$ 549,930</u> |

See accompanying notes.

Consolidated Statements of Income

December 31

(Dollar amounts in thousands, except share and par amounts)

| | 2008 | 2007 |
|------------------------------------------------------------|-----------------|-----------------|
| Interest income | | |
| Loans, including fees | \$ 23,948 | \$ 23,079 |
| Taxable securities | 4,937 | 5,337 |
| Tax-exempt securities | 1,385 | 1,248 |
| Federal funds sold and other | 268 | 564 |
| | <u>30,538</u> | <u>30,228</u> |
| Interest expense | | |
| Deposits | 10,440 | 12,975 |
| Federal Home Loan Bank advance | 1,564 | 934 |
| Repurchase agreements and federal funds purchased | 682 | 726 |
| Subordinated debentures | 1,016 | 809 |
| Note payable | 115 | 140 |
| | <u>13,817</u> | <u>15,584</u> |
| Net interest income | 16,721 | 14,644 |
| Provision for loan losses | 600 | 360 |
| Net interest income after provision for loan losses | 16,121 | 14,284 |
| Non-interest income | | |
| Service charge on deposit accounts | 5,165 | 4,155 |
| Gain on sale of mortgage loans | 332 | 433 |
| Earnings on bank-owned life insurance | 273 | 235 |
| Other | 802 | 1,079 |
| | <u>6,572</u> | <u>5,902</u> |
| Non-interest expense | | |
| Salaries and employee benefits | 8,378 | 7,561 |
| Occupancy and equipment | 2,242 | 2,289 |
| Data processing | 1,470 | 1,463 |
| Core deposit amortization | 311 | 293 |
| Advertising | 382 | 378 |
| Net loss on sale of assets | 23 | 251 |
| Other | 5,168 | 4,334 |
| | <u>17,974</u> | <u>16,569</u> |
| Income before income taxes | 4,719 | 3,617 |
| Income tax expense | 781 | 276 |
| Net income | <u>\$ 3,938</u> | <u>\$ 3,341</u> |
| Basic earnings per share | <u>\$ 3.42</u> | <u>\$ 3.08</u> |

See accompanying notes.

Consolidated Statements of Changes in Shareholders' Equity

Years ended December 31, 2008 and 2007

(Dollar amounts in thousands)

| | Common Stock | Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---------------------------------------------------------------------------------------------------------|--------------|------------------|-------------------|-----------------------------------------------|----------------------------|
| Balance, January 1, 2007 | \$ 2,545 | \$ 5,297 | \$ 26,485 | \$ 269 | \$ 34,596 |
| Comprehensive income: | | | | | |
| Net income | - | - | 3,341 | - | 3,341 |
| Change in net unrealized gain on securities available for sale, net of reclassification and tax effects | - | - | - | 1,162 | 1,162 |
| Total comprehensive income | <u>-</u> | <u>-</u> | <u>-</u> | <u>1,162</u> | <u>1,162</u> |
| Transfer from common stock to additional paid-in capital, no par value | (2,545) | 2,545 | - | - | - |
| Issuance of 137,589 no par value common stock | - | 4,849 | - | - | 4,849 |
| Cash dividends declared | - | - | (626) | - | (626) |
| Redemption of 1,235 shares of common stock | <u>-</u> | <u>(52)</u> | <u>-</u> | <u>-</u> | <u>(52)</u> |
| Balances, December 31, 2007 | - | 12,639 | 29,200 | 1,431 | 43,270 |
| Comprehensive income: | | | | | |
| Net income | - | - | 3,938 | - | 3,938 |
| Change in net unrealized loss on securities available for sale, net of reclassification and tax effects | - | - | - | (68) | (68) |
| Total comprehensive income | <u>-</u> | <u>-</u> | <u>-</u> | <u>(68)</u> | <u>(68)</u> |
| Record post retirement death benefit liability under EITF 06-4 | - | - | (297) | - | (297) |
| Cash dividends declared | - | - | (645) | - | (645) |
| Redemption of 5,457 shares of common stock | <u>-</u> | <u>(264)</u> | <u>-</u> | <u>-</u> | <u>(264)</u> |
| Balances, December 31, 2008 | <u>\$ -</u> | <u>\$ 12,375</u> | <u>\$ 32,196</u> | <u>\$ 1,363</u> | <u>\$ 45,934</u> |

See accompanying notes.

Consolidated Statements of Cash Flows

Years ended December 31
(Dollar amounts in thousands)

| | <u>2008</u> | <u>2007</u> |
|---------------------------------------------------------------------------|-----------------|-----------------|
| Cash flows from operating activities | | |
| Net income | \$ 3,938 | \$ 3,341 |
| Adjustments to reconcile net income to net cash from operating activities | | |
| Depreciation and amortization | 1,026 | 985 |
| Net amortization (accretion) of securities | 124 | (52) |
| Intangible amortization | 311 | 293 |
| Provision for loan losses | 600 | 360 |
| Net loss on sale of assets | 23 | 251 |
| Gain on sale of mortgage loans | (332) | (433) |
| Increase in cash surrender value of life insurance | (272) | (235) |
| Net change in: | | |
| Loans held for sale | 1,650 | 147 |
| Interest receivable and other assets | (579) | (2,063) |
| Interest payable and other liabilities | (115) | 544 |
| Net cash from operating activities | <u>6,374</u> | <u>3,138</u> |
| Cash flows from investing activities | | |
| Change in interest-bearing deposits | (3,577) | 300 |
| Activity in available-for-sale securities: | | |
| Purchases | (30,357) | (54,363) |
| Sales | - | 5,617 |
| Maturities, calls and principal reductions | 41,098 | 49,867 |
| Purchase of restricted stock | (490) | (193) |
| Purchases of bank-owned life insurance | (4,800) | - |
| Loan originations and payments, net | (23,532) | (11,459) |
| Property and equipment expenditures, net | (1,647) | (5,662) |
| Net cash paid for acquisition | - | (19,266) |
| Net cash from investing activities | <u>(23,305)</u> | <u>(35,159)</u> |

Continued

Consolidated Statements of Cash Flows

Years ended December 31
(Dollar amounts in thousands)

| | <u>2008</u> | <u>2007</u> |
|--------------------------------------------------------------|------------------|------------------|
| Cash flows from financing activities | | |
| Net change in deposits | \$ (4,788) | \$ 2,511 |
| Net change in securities sold under agreements to repurchase | 7,457 | 3,841 |
| Net change in Federal funds purchased | (11,223) | 11,223 |
| Proceeds from note payable | - | 3,000 |
| Repayment of note payable | (1,500) | - |
| Repayment of Federal Home Loan advances | (3,034) | (3,484) |
| Proceeds on Federal Home Loan Bank borrowings | 34,500 | - |
| Proceeds from issuance of subordinate debentures | - | 10,000 |
| Proceeds received from issuance of common stock | - | 4,849 |
| Redemption of common stock | (264) | (52) |
| Common stock dividends paid | (645) | (626) |
| Net cash from financing activities | <u>20,503</u> | <u>31,262</u> |
| Net change in cash and cash equivalents | 3,572 | (759) |
| Beginning cash and cash equivalents | <u>16,875</u> | <u>17,634</u> |
| Ending cash and cash equivalents | <u>\$ 20,447</u> | <u>\$ 16,875</u> |
| Supplemental cash flow information | | |
| Interest paid | \$ 14,219 | \$ 15,319 |
| Income taxes paid | 693 | 311 |
| Supplemental noncash disclosures | | |
| Transfer from loans to other real estate | \$ 679 | \$ 498 |

See accompanying notes.

Notes to Financial Statements

December 31

(Dollar amounts in thousands, except share and par amounts)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The consolidated financial statements include the accounts of Citizens National Corporation and its wholly-owned subsidiaries, Citizens National Bank (Citizens) and CNC Insurance Agency. Citizens National Bank has one subsidiary, CNC Development Foundation. Citizens is a nationally chartered commercial bank. Inter-company transactions and balances have been eliminated in consolidation.

The Corporation, through its bank subsidiary, provides financial services through its offices in Eastern Kentucky. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially, all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses and the fair values of financial instruments are particularly subject to change.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, federal funds purchased and securities sold under agreements to repurchase transactions.

Interest-Bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

Securities: Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in accumulated other comprehensive income, net of tax. Restricted securities include Federal Home Loan Bank and Federal Reserve Bank stock and are carried at cost.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Notes to Financial Statements

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregated cost or market, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held for sale are generally sold servicing released.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Purchased Loans: In 2006 and 2007, the Company acquired loan portfolios through whole bank acquisitions. Purchased loans that show evidence of credit deterioration since origination are recorded at the amount paid (or allocated fair value in a purchase business combination), such that there is no carryover of the seller's allowance for loan losses. After acquisition, incurred losses are recognized by an increase in the allowance for loan losses.

Purchased loans are accounted for individually or aggregated into pools of loans based on common risk characteristics (e.g., credit score, loan type, and date of origination). The Company estimates the amount and timing of expected cash flows for each purchased loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

Continued on following page.

Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Premises and Equipment: Land is carried at cost. Premises and equipment are reported at cost less accumulated depreciation. Depreciation is calculated on the straight-line and accelerated methods over asset useful lives.

Federal Home Loan Bank Stock (FHLB): The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as long term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Bank-Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. In accordance with EITF 06-4, bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Goodwill and Other Intangible Assets: Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified.

Core deposit intangible assets arise from whole bank acquisitions. They are initially measured at fair value and then are amortized on an accelerated method over their estimated useful life, which is 7-8 years.

Long-Term Assets: Premises and equipment, core deposit and other intangible assets and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Notes to Financial Statements

Repurchase Agreements: Substantially, all repurchase agreement liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. Deferred tax assets are recognized for net operating losses that expire primarily in 2025 because the benefit is more likely than not to be realized.

Earnings Per Share: Basic earnings per common share are net income divided by the weighted average number of common shares outstanding during the period. The Corporation does not present diluted earnings per share because there are no potential dilutive common shares outstanding. During 2007, the Company declared a 2-1 stock split. Earnings per share are restated for all stock splits and dividends through the date of issue of the financial statements.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which is also recognized as a separate component of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Retirement Plans: Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

Equity: Stock dividends in excess of 20% are reported by transferring the par value of the stock issued from retained earnings to common stock. Stock dividends for 20% or less are reported by transferring the fair value, as of the ex-dividend date, of the stock issued from retained earnings to common stock and additional paid-in capital. Fractional share amounts are paid in cash with a reduction in retained earnings. During 2007, the Company amended its by-laws, changing common stock from a \$5 par value to a no par value.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the holding company or by the holding company to shareholders.

Continued on following page.

Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications: Some items in the prior year consolidated financial statements were reclassified to conform with the current presentation.

Adoption of New Accounting Standards: In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (FAS 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard was effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position (FSP) 157-2, *Effective Date of FASB Statement No. 157*. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The impact of adoption was not material. In October 2008, the FASB issued Staff Position (FSP) 157-3, *Determining the Fair Value of a Financial Asset when the Market for That Asset Is Not Active*. This FSP clarifies the application of FAS 157 in a market that is not active. The impact of adoption was not material.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard was effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. This issue was effective for fiscal years beginning after December 15, 2007. The impact of adoption resulted in a charge to retained earnings of \$297.

Notes to Financial Statements

NOTE 2 - SECURITIES

The fair value of available for sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

| | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses |
|-----------------------------------------------------------------------|---------------------|------------------------------|-------------------------------|
| 2008 | | | |
| U.S. Government and federal agencies States and municipals | \$ 49,964 34,446 | \$ 1,898 227 | \$ - (643) |
| Collateralized mortgage obligations and mortgage backed securities | 39,139 | 684 | (187) |
| Other securities | <u>7,611</u> | <u>252</u> | <u>(166)</u> |
| Total | <u>\$ 131,160</u> | <u>\$ 3,061</u> | <u>\$ (996)</u> |
| 2007 | | | |
| U.S. Government and federal agencies States and municipals | \$ 63,159 37,442 | \$ 1,216 249 | \$ (32) (184) |
| Collateralized mortgage obligations and mortgage backed securities | 33,087 | 306 | (290) |
| Other securities | <u>8,441</u> | <u>909</u> | <u>(7)</u> |
| Total | <u>\$ 142,129</u> | <u>\$ 2,680</u> | <u>\$ (513)</u> |

There were no sales of available for sale securities in 2008. Proceeds from sales of available for sale securities were \$5,617, with a gross gain of \$1 and no gross losses in 2007.

The fair value of debt securities and carrying amount, if different, at year-end 2008 by contractual maturities were as follows. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

| | Fair Value |
|-----------------------------------------------------------------------|-------------------|
| Due in one year or less | \$ 2,523 |
| Due after one year through five years | 19,969 |
| Due after five years through ten years | 25,816 |
| Due after ten years | <u>43,713</u> |
| | 92,021 |
| Collateralized mortgage obligations and mortgage backed securities | <u>39,139</u> |
| | <u>\$ 131,160</u> |

Continued on following page.

Notes to Financial Statements

NOTE 2 - SECURITIES (Continued)

Securities with a carrying value of \$101,822 and \$98,217 at year-end 2008 and 2007 were pledged to secure public deposits, trust deposits, and for other purposes.

Securities with unrealized losses at year-end 2008 and 2007, aggregated by investment category and length of time that individual security have been in a continuous unrealized loss position, are as follows:

| Description | Less than 12 Months | | 12 Months or More | | Total | |
|-------------------------------------------------------------------|---------------------|-----------------|-------------------|-----------------|-----------------|-----------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| 2008 | | | | | | |
| States and municipals | \$18,525 | \$ (602) | \$ 295 | \$ (41) | \$18,820 | \$ (643) |
| Collateralized mortgage obligations and mortgage based securities | 4,952 | (152) | 2,734 | (35) | 7,686 | (187) |
| Other securities | 834 | (166) | - | - | 834 | (166) |
| Total temporarily impaired | <u>\$24,311</u> | <u>\$ (920)</u> | <u>\$ 3,029</u> | <u>\$ (76)</u> | <u>\$27,340</u> | <u>\$ (996)</u> |
| 2007 | | | | | | |
| U.S. Government and federal agencies | \$ - | \$ - | \$ 7,968 | \$ (32) | \$ 7,968 | \$ (32) |
| States and municipals | 8,263 | (135) | 5,872 | (49) | 14,135 | (184) |
| Collateralized mortgage obligations and mortgage based securities | 4,305 | (55) | 6,488 | (235) | 10,793 | (290) |
| Other securities | - | - | 993 | (7) | 993 | (7) |
| Total temporarily impaired | <u>\$12,568</u> | <u>\$ (190)</u> | <u>\$21,321</u> | <u>\$ (323)</u> | <u>\$33,889</u> | <u>\$ (513)</u> |

Unrealized losses on securities have not been recognized into income because the securities are of high credit quality, management has the intent and ability to hold for the foreseeable future, and the decline in fair value is largely due to fluctuations in market interest rates. The fair value is expected to recover as the bonds approach their maturity and/or market rates change.

Notes to Financial Statements

NOTE 3 - LOANS

Loans at year-end were as follows:

| | 2008 | 2007 |
|------------------------------------|-------------------|-------------------|
| Commercial | \$ 191,541 | \$ 178,336 |
| Real estate, primarily residential | 127,675 | 123,438 |
| Consumer | 43,502 | 37,665 |
| Other | 629 | 1,101 |
| Subtotal | 363,347 | 340,540 |
| Less: Allowance for loan losses | (3,541) | (4,270) |
| Net deferred loan fees | (231) | (306) |
| Loans, net | <u>\$ 359,575</u> | <u>\$ 335,964</u> |

Activity in the allowance for loan losses was as follows:

| | 2008 | 2007 |
|-------------------------------------|-----------------|-----------------|
| Beginning balance | \$ 4,270 | \$ 3,836 |
| Addition resulting from acquisition | - | 567 |
| Provision for loan losses | 600 | 360 |
| Loans charged off | (1,567) | (865) |
| Recoveries | 238 | 372 |
| Ending balance | <u>\$ 3,541</u> | <u>\$ 4,270</u> |

Impaired loans were as follows:

| | 2008 | 2007 |
|------------------------------------------------------------|------------------|------------------|
| Year-end loans with no allocated allowance for loan losses | \$ - | \$ - |
| Year-end loans with allocated allowance for loan losses | 16,632 | 16,545 |
| Total | <u>\$ 16,632</u> | <u>\$ 16,545</u> |
| Amount of the allowance for loan losses allocated | \$ 1,338 | \$ 1,058 |
| Average of impaired loans during the year | 16,136 | 14,210 |
| Interest income recognized during impairment | 85 | 145 |
| Cash-basis interest income recognized | 50 | 127 |
| Loans past due over 90 days still on accrual | 724 | 220 |
| Nonaccrual loans | 4,704 | 6,431 |

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. Some loans classified as impaired are still accruing interest.

Loans to executive officers and directors, including loans to affiliated companies of these individuals, totaled approximately \$2,202 and \$1,321 at year-end 2008 and 2007.

Continued on following page.

Notes to Financial Statements

NOTE 3 - LOANS (Continued)

Purchased Loans subject to SOP 03-3:

The Company has purchased loans, all which were obtained through its acquisition of Heritage Bank in 2006 and Kentucky National Bank in 2007. At acquisition, there was evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. Information about these loans follows:

Contractually required payments receivable of loans purchased

| | 2008 | 2007 |
|----------------------------------------------------|---------------|---------------|
| Commercial | \$ 180 | \$ 240 |
| Real estate | 455 | 599 |
| Total | <u>\$ 635</u> | <u>\$ 839</u> |
| Carrying amount, net of allowance of \$0 | <u>\$ 495</u> | <u>\$ 670</u> |
| Cash flows expected to be collected at acquisition | \$ 1,238 | \$ 1,238 |
| Basis in acquired loans at acquisition | 1,238 | 1,238 |

The Company has not increased the allowance for loan losses for these loans, nor was there any reversal of the allowance for loan losses for loans.

NOTE 4 - PREMISES AND EQUIPMENT

Year-end premises and equipment were as follows:

| | 2008 | 2007 |
|--------------------------------|------------------|------------------|
| Land | \$ 3,078 | \$ 2,798 |
| Buildings and improvements | 13,614 | 12,997 |
| Furniture and equipment | 7,857 | 7,084 |
| | <u>24,549</u> | <u>22,879</u> |
| Less: Accumulated depreciation | <u>(10,307)</u> | <u>(9,235)</u> |
| | <u>\$ 14,242</u> | <u>\$ 13,644</u> |

Depreciation expense was \$1,026 and \$919 for the years ended 2008 and 2007. Rent expense was \$260 and \$356 for the years ended 2008 and 2007.

NOTE 5 - GOODWILL AND INTANGIBLE ASSETS

Goodwill

The change in balance for goodwill during the year is as follows:

| | 2008 | 2007 |
|-------------------|------------------|------------------|
| Beginning of year | \$ 15,604 | \$ 3,012 |
| Acquired goodwill | - | 12,592 |
| | <u>\$ 15,604</u> | <u>\$ 15,604</u> |

Notes to Financial Statements

Acquired Intangible Assets

Acquired intangible assets were as follows at year end:

| | 2008 | | 2007 | |
|------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets: | | | | |
| Core deposit intangibles | \$ 4,194 | \$ 2,483 | \$ 4,194 | \$ 2,172 |
| Total | <u>\$ 4,194</u> | <u>\$ 2,483</u> | <u>\$ 4,194</u> | <u>\$ 2,172</u> |

Aggregate amortization expense was \$311 and \$293 for 2008 and 2007.

Estimated amortization expense for each of the next five years:

| | |
|------|--------|
| 2009 | \$ 311 |
| 2010 | 311 |
| 2011 | 311 |
| 2012 | 311 |
| 2013 | 311 |

NOTE 6 - TIME DEPOSITS AND TIME REPURCHASE AGREEMENTS

Time deposits of \$100 or more were \$85,460 and \$91,909 at year-end 2008 and 2007.

Scheduled maturities of time deposits and term repurchase agreements for the next five years were as follows:

| | Time Deposits |
|------|---------------|
| 2009 | \$ 117,966 |
| 2010 | 47,662 |
| 2011 | 25,549 |
| 2012 | 2,202 |
| 2013 | 1,378 |

Deposits from principal officers, directors, and their affiliates at year-end 2008 and 2007 were \$3,238 and \$4,058.

NOTE 7 - FEDERAL HOME LOAN BANK ADVANCES

At year-end, advances from the Federal Home Loan Bank were as follows:

| | 2008 | 2007 |
|--------------------------------------------------------------------------------------------------------------|-----------|--------|
| Maturities from August 2009 through November 2017, fixed rates at rates from 2.35% to 5.12%, averaging 4.2%. | \$ 49,062 | \$ - |
| Maturities from March 2008 through December 2016, fixed rates from 4.07% to 4.83%, averaging 4.4% | - | 17,596 |

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances are collateralized by first mortgage loans under a blanket lien arrangement.

The advances have required repayments of \$1,234 in 2009, \$2,036 in 2010, \$10,038 in 2011, \$5,254 in 2012, \$14,000 in 2013, and \$16,500 thereafter.

Notes to Financial Statements

NOTE 8 - SUBORDINATED DEBENTURES

In June 2006 and 2007, CZNL Statutory Trust I and Trust II, trusts formed by the Company, closed a pooled private offering of 6,000 and 10,000 trust preferred securities with a liquidation amount of \$1 per security. The Company issued \$6,186 and \$10,310 of subordinated debentures to the trusts in exchange for ownership of all of the common security of the trusts and the proceeds of the preferred securities sold by the trusts. In accordance with FASB Interpretation 46R, the trusts are not consolidated with the Company's financial statements, but rather the subordinated debentures are shown as a liability. The Company's investment in the common stock of the trusts was \$186 and \$310 and is included in other assets.

The Company may redeem the subordinated debentures, in whole or in part, in a principal amount with integral multiples of \$1, on or after June 2011 for Trust I and June 2012 for Trust II at 100% of the principal amount, plus accrued and unpaid interest. The subordinated debentures mature on June 2036 for Trust I and June 2037 for Trust II. The subordinated debentures are also redeemable in whole or in part from time to time, upon the occurrence of specific events defined within the trust indentures. The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years for Trust I and Trust II.

The subordinated debentures may be included in Tier I capital (with certain limitations applicable) under current regulatory guidelines and interpretations. The subordinated debentures for Trust I have a variable rate of interest equal of the three month London Interbank Offered Rate (LIBOR) plus 1.50%, which was 3.5% at year-end 2008. The subordinated debentures for Trust II have a fixed rate of 7.31% for five years and convert to a variable rate of LIBOR plus 1.63% in 2012.

NOTE 9 - EMPLOYEE BENEFIT PLANS

Citizens National Bank provides a 401(k) retirement plan for their employees which matches employee contributions up to 50% of a maximum of 6% of salary. Expense for the 401(k) plan was \$152 and \$142 for 2008 and 2007.

Deferred Compensation Plans – The Corporation maintains a deferred compensation plan for its directors and executive officers.

Under the director plan, the directors may elect to defer their compensation until termination of service. The fees deferred are invested by the Bank at the discretion of the director. Upon termination of service, Citizens National Bank pays the director, or their beneficiary, the amount deferred (plus or minus accumulated earnings or losses) over 10 years. The expense incurred for the director plan for each of the last two years was \$33 and \$32, and resulted in deferred compensation assets and liabilities of \$631 and \$628 as of year end 2008 and 2007.

The executive plan covers four executives and provides for salary continuation for a period of 19 years following their retirement. The cost of this plan is being accrued over the executive's service period such that the liability will be fully accrued upon their retirement. The expense incurred for the executive plan for each of the last two years was \$274 and \$204 and resulted in a liability of \$1,660 and \$1,386 as of year end 2008 and 2007.

Notes to Financial Statements

NOTE 10 - INCOME TAXES

The income tax expense was as follows:

| | <u>2008</u> | <u>2007</u> |
|----------|---------------|---------------|
| Current | \$ 501 | \$ 588 |
| Deferred | 280 | (312) |
| Total | <u>\$ 781</u> | <u>\$ 276</u> |

The difference between the recorded income tax expense and the amount computed by applying the effective federal income tax rate of 34% is primarily attributable to interest income from securities exempt from federal taxation, non-taxable earnings of cash, surrender value of certain life insurance policies, new market tax credits, and qualified zone academy bond credits.

Deferred tax assets and liabilities at year-end consist of:

| | <u>2008</u> | <u>2007</u> |
|-------------------------------------------------------------------|-----------------|-----------------|
| Deferred tax assets: | | |
| Loan loss provisions | \$ 721 | \$ 915 |
| Core deposit intangible and other purchase accounting adjustments | 299 | 319 |
| Deferred compensation | 750 | 654 |
| Net operating loss carryforward | 1,466 | 1,552 |
| Nonaccrual loan interest | 95 | 126 |
| OREO writedowns | - | 101 |
| Accrued expenses | - | 51 |
| Credit carryforward | 138 | - |
| Other | 27 | 14 |
| | <u>3,496</u> | <u>3,732</u> |
| Deferred tax liabilities: | | |
| Premises and equipment | (420) | (365) |
| Accretion on securities | (16) | (25) |
| Federal Home Loan Bank stock dividends | (291) | (263) |
| Unrealized gain on available for sale securities | (702) | (736) |
| Other | (70) | (100) |
| | <u>(1,499)</u> | <u>(1,489)</u> |
| Net deferred tax asset/(liability) | <u>\$ 1,997</u> | <u>\$ 2,243</u> |

No valuation allowance for deferred tax assets is considered necessary. At year end 2008, the Company had net operations loss carryovers from a previous acquisition of approximately \$4,312 which expire beginning in 2023. The utilization of the net operating loss carryforward is limited to \$254 annually under code section 382.

Notes to Financial Statements

NOTE 11 – LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off-balance-sheet risk was as follows at year-end:

| | 2008 | 2007 |
|----------------------------------------------|-----------|-----------|
| Commitments to make loans | \$ 19,461 | \$ 21,170 |
| Unused lines of credit and letters of credit | 12,644 | 11,089 |

At year-end 2008 and 2007, reserves of \$7,341 and \$8,167 were required as deposits with the Federal Reserve or as cash on hand.

Letters of credit are financial instruments considered financial guarantees under FASB Interpretation 45 (FIN45). The Company also sold loans totaling \$305 that have recourse provisions. These instruments are carried at fair value and are immaterial to the financial statements as defined under FIN 45.

NOTE 12 – EARNINGS PER SHARE

Basic earning per share was computed as follows.

| | 2008 | 2007 |
|--------------------------------------------------|----------|----------|
| Net income | \$ 3,938 | \$ 3,341 |
| Average common shares outstanding (in thousands) | 1,153 | 1,085 |
| Basic earnings per share | \$ 3.42 | \$ 3.08 |

NOTE 13 – CAPITAL REQUIREMENTS AND RESTRICTIONS ON RETAINED EARNINGS

Banks and bank holding are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes as of December 31, 2008, the Company and Bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2008 and 2007, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Notes to Financial Statements

Actual and required capital amounts (in millions) and ratios are presented below at year-end.

| | Actual | | Required For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Regulations | |
|-----------------------------------------------|---------|-------|----------------------------------------------|-------|----------------------------------------------------------------------------|-------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| 2008 | | | | | | |
| Total Capital to risk weighted assets | | | | | | |
| Consolidated | \$ 45.4 | 11.4% | \$ 31.7 | 8.0% | N/A | N/A |
| Bank | 45.9 | 11.6 | 31.7 | 8.0 | \$ 39.6 | 10.0% |
| Tier 1 (Core) Capital to risk weighted assets | | | | | | |
| Consolidated | \$ 40.3 | 10.1% | \$ 15.9 | 4.0% | N/A | N/A |
| Bank | 42.3 | 10.7 | 15.9 | 4.0 | \$ 23.8 | 6.0% |
| Tier 1 (Core) Capital to average assets | | | | | | |
| Consolidated | \$ 40.3 | 7.3% | \$ 21.9 | 4.0% | N/A | N/A |
| Bank | 42.3 | 7.7 | 21.9 | 4.0 | \$ 27.4 | 5.0% |
| 2007 | | | | | | |
| Total Capital to risk weighted assets | | | | | | |
| Consolidated | \$ 42.6 | 11.4% | \$ 29.8 | 8.0% | N/A | N/A |
| Bank | 44.6 | 12.0 | 29.8 | 8.0 | \$ 37.3 | 10.0% |
| Tier 1 (Core) Capital to risk weighted assets | | | | | | |
| Consolidated | \$ 35.8 | 9.6% | \$ 14.9 | 4.0% | N/A | N/A |
| Bank | 40.3 | 10.8 | 14.9 | 4.0 | \$ 22.4 | 6.0% |
| Tier 1 (Core) Capital to average assets | | | | | | |
| Consolidated | \$ 35.8 | 6.8% | \$ 20.9 | 4.0% | N/A | N/A |
| Bank | 40.3 | 7.8 | 20.7 | 4.0 | \$ 25.9 | 5.0% |

Dividends Restrictions – The Company's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During 2009, the Bank could, without prior approval, declare dividends of approximately equal to any 2009 net profits retained to the date of the dividend declaration.

Notes to Financial Statements

NOTE 14 - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

| | Fair Value Measurements at December 31, 2008 Using | | |
|-------------------------------|------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level One) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | |
| Available for sale securities | \$ - | \$ 131,160 | \$ - |

Carrying amount and estimated fair values of financial instruments not previously presented were as follows at year-end:

| | 2008 | | 2007 | |
|-----------------------------|-------------------|---------------|-------------------|---------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Financial assets | | | | |
| Cash and cash equivalents | \$ 20,447 | \$ 20,447 | \$ 16,875 | \$ 16,875 |
| Loans held for sale | - | - | 1,318 | 1,318 |
| Loans, net | 359,575 | 365,291 | 335,964 | 349,824 |
| Restricted securities | 3,456 | N/A | 3,056 | N/A |
| Accrued interest receivable | 2,582 | 2,582 | 2,996 | 2,996 |

Notes to Financial Statements

| | 2008 | | 2007 | |
|----------------------------------------------------------------------|-------------------|---------------|-------------------|---------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Financial liabilities | | | | |
| Deposits | \$ 431,400 | \$ 435,199 | \$ 436,188 | \$ 436,754 |
| Federal funds purchased, repurchase agreement and note payable | 25,811 | 25,828 | 31,077 | 31,452 |
| FHLB borrowings | 49,062 | 54,058 | 17,596 | 17,832 |
| Subordinated debt | 16,000 | 10,075 | 16,000 | 13,924 |
| Accrued interest payable | 839 | 839 | 1,240 | 1,240 |
| Off-balance-sheet items | | | - | - |

The methods and assumptions used to estimate fair value are described as follows. The carrying value is considered to estimate fair value for cash and cash equivalents, accrued interest receivable and payable, demand and savings deposits, short-term borrowings and variable rate loans and deposits that reprice fully and frequently. It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value for loans and certificates of deposits are based on estimates of discounted cash flow analysis using current market rates for the estimated life and credit risk. Fair value of loans held for sale approximate cost. The fair value of debt is based on current rates for similar financing. The fair value of off-balance-sheet items is not considered material.

NOTE 15 - COMPREHENSIVE INCOME

Other comprehensive income components were as follows:

| | 2008 | 2007 |
|-------------------------------------------------------------------------------------|---------|----------|
| Unrealized holding gains and losses on available-for-sale securities, net of tax | \$ (68) | \$ 1,162 |
| Reclassification adjustments for losses later recognized in income, net of tax | - | - |
| Other comprehensive income | \$ (68) | \$ 1,162 |

Executive Officers

Dennis T. Dorton
President/Chief Executive Officer

Mark J. Wiete
Executive Vice President/Chief Operating Officer

Charles L. Patton
Senior Vice President/Chief Financial Officer

Corporate Secretary

Sharon Collins
Executive Secretary

Officers

Michael McCoy
Market President Pikeville Region

Ed Neely
Market President Ashland Region/Head of Wealth Management

Pam Butcher
Vice President/Retail Banking

Paula Chandler
Vice President/Compliance Officer

Michael L. Hill
Vice President/Senior Credit Officer

Kathy M. Kinner
Vice President/Human Resources

Greg Lee
Vice President/Mortgage Lending

Ronnie Newsome
Vice President/Business Development Officer

Toni C. Spradlin
Vice President/Trust Officer

Ben D. Tackett, Jr.
Vice President/Business Banking

Rose M. Wheeler
Vice President/Information Systems & Operations Manager

Patty D. Adams
Assistant Vice President/Branch Operations Manager

Donna R. Cassell
Assistant Vice President/Human Resources Specialist

Chris Castle
Assistant Vice President/Business Banking

Kimberly J. Dalton
Assistant Vice President/Marketing Officer

April Damron
Assistant Vice President/Branch Manager

Todd Dials
Assistant Vice President/Information Systems Manager

Judy L. Frazier
Assistant Vice President/Branch Manager

Hilma Harned
Assistant Vice President/Branch Manager

Johnene Holbrook
Assistant Vice President/Auditor

Paula Howard
Assistant Vice President/Branch Manager

Terry Kidd
Assistant Vice President/Branch Manager

Joyce C. Lemaster
Assistant Vice President/Branch Manager

Leischa Maynard
Assistant Vice President/Controller

Ronnie Merrill
Assistant Vice President/Electronic Banking Manager

Nancy Osborne
Assistant Vice President/Mortgage Underwriter

Beverly A. Oxford
Assistant Vice President/Credit Manager

Sandra Pelphrey
Assistant Vice President/Customer Data Center Manager

Jeff Ramey
Assistant Vice President/Branch Manager

Stephanie A. Salyer
Assistant Vice President/Customer Service Manager

Dave Simpson
Assistant Vice President/Security Officer

Misty Turner
Assistant Vice President/Branch Manager

Grady A. Underwood
Assistant Vice President/Branch Manager

Beth Waugh
Assistant Vice President/Branch Manager

Michael C. Caudill
Branch Manager

Tammy Hall
Branch Manager

Earlene Nelson
Branch Manager

Zachary Vallance
Branch Manager

Jonathan Conwell
Business Banking Officer

Shareholder Information

Annual Shareholders' Meeting

Citizens National Corporation
620 Broadway
Paintsville, KY 41240
Tuesday, April 21, 2008
10:30 a.m.

How to Buy Stock

Prospective investors, securities analysts, portfolio managers and representatives of financial institutions seeking information about the purchase of Citizens National Corporation stock may contact:

Morgan Keegan and Co. Inc.
Van Thompson, Broker
489 East Main Street
Lexington, KY 40507
Telephone: 800.937.0161

Citizens National Corporation stock is listed on the NASDAQ stock exchange under symbol CZNL

Shareholder Inquiries

Communications regarding stock holdings, stock certificates, dividend payments, changes of address, transfer of ownership, or other stock matters may be directed to Citizens National Corporation.

Transfer Agent
Citizens National Corporation
620 Broadway
Paintsville, KY 41240
Telephone: 606.789.4001 ext 13026
Email: scollins@cnbonline.com

Investor Relations

Citizens National Corporation's Annual Report and current stock price information are available by contacting the company or by visiting www.cnbonline.com. Prospective investors, securities analysts, portfolio managers and representatives of financial institutions seeking these reports or other information regarding the Company may contact:

Charles L. Patton, Sr. VP & CFO
Citizens National Corporation
620 Broadway
PO Box 1488
Paintsville, KY 41240-5488
Telephone: 606.789.4001 ext 13055
Fax: 606.789.4440
Email: cpatton@cnbonline.com

Common Stock

Citizens National Corporation has approximately 220 shareholders. Quarterly dividends on Citizens National Corporation common stock, when declared by the Board of Directors, are paid on or about March 31, June 30, September 30 and December 31. The Company does not currently offer a dividend reinvestment program.

Board of Directors



Gregory Meade

Chairman of the Board. Elected to the CNC Board on April 15, 1991, Meade is President of Gregory J Meade Insurance, Inc., of Paintsville. He is the Chairman of the Johnson County Soil Conservation District, Chairman of the Johnson County Extension District, Secretary and Treasurer of the Johnson County Farm Bureau, and past member of the

Paintsville/Prestonsburg Airport Board.



Paul David Brown, Jr.

Elected to the board of directors in 2008, Paul David is the CEO of Redd, Brown & Williams Real Estate Services where he has been employed since 1980. He is married to Cathy Thomas Brown and they have two children, Jennifer and Rachael. Paul David is a Certified General Appraiser, Real Estate Broker, and Auctioneer.

He has been certified by the AQB as a Uniform Standards of Professional Appraisal Practice Instructor. He is a real estate and appraisal instructor, has a BBA from Eastern Kentucky University, and is a member of St. Michael's Catholic Church where he serves on the Finance Council and the Buildings and Ground Committee.



Larry Conley

A CNC Board member since August 1992, Conley has been a sports announcer for various stations including CBS, NBC, ABC, Fox Television and ESPN. He was also a former manager for both General Electric Credit and Converse Rubber Co. He played basketball for the University of Kentucky Basketball program and played

professionally for the Kentucky Colonels.



Robin Cooper

A member of the CNC Board since April 1983, Robin is a former Mayor of the City of Paintsville. During his tenure he was elected President of the Kentucky League of Cities and served as Chairman of the Kentucky Law Enforcement Council for several years. He retired from the periodical and newspaper business in 1998 and is currently employed as the

Chief Member Services officer for the Kentucky League of Cities.



Dennis T. Dorton

Dorton joined Citizens in 1970, became a member of the CNC Board in April 1982 and was named President/CEO in 1986. He is President/CEO of Citizens National Bank, CNC Insurance Agency, LLC and CNC Development Foundation, Inc. He is a Member of Highlands Regional Medical Center Board of Trustees and a member of the Board of Consolidated Health,

Chairman of the Big Sandy Regional Industrial Development Authority Board, Treasurer and Board Member of Paintsville-Johnson County Chamber of Commerce, Chairman of the Big Sandy Area Chapter of the American Red Cross, 2007-2008 Chairman of Kentucky Bankers Association, and past KBA Chair.



Barrett Frederick

A member of the CNC Board since April 1986, Frederick is President of Rifle Coal Company, a highway contracting company. He holds a Juris Doctorate degree from the University of Louisville and practiced law from 1974 until 1980 in the West Liberty area. He is also on the Board of Commercial Bank and a member of the Morgan

County ARH Advisory Committee.



Bob Hutchison

A Board Member since April 1991, Hutchison currently co-owns and operates 14 McDonald's restaurants throughout Eastern Kentucky. He is a member of the First United Methodist Church in Paintsville, Vice Chairperson of Christian Appalachian Project, Chairman of Johnson County School System and is Executive Board Member of the Bluegrass

Council for Boy Scouts of America. He is also a member of Leadership Kentucky, of Johnson, Floyd, Morgan and Pike County Chambers of Commerce and is President of the Rockhouse Volunteer Fire Department.



Lynn Dorton Mullins

Board Member since April 1994. Mullins is a partner in Crigger/Mullins Speech Therapy Services, providing speech therapy services throughout eastern Kentucky. She received her BA and MA from the University of Kentucky in Speech Pathology. She is a member of the American Speech and Hearing Association and the Kentucky Speech-Language

Hearing Association. Mullins is a member of the First United Methodist Church in Paintsville where she has served on the board and is a member of the Wesleyan Service Guild. She is also a member of Beta Sigma Phi Service Sorority.



Marvin Butch Walker

Elected board member in 2005, Walker is an attorney and registered professional engineer. He currently works as a consultant with his wife, Kathy E. Walker, who owns and operates Elm Street Resources, Inc. Walker was previously with the law firm of Wells, Porter, Schmitt, and Walker of Paintsville (now Porter, Schmitt, Banks & Baldwin). He is a long-standing

member of the Board of Education of the Paintsville Independent School System.



Harold D. Ward

Elected to the CNC Board in October 1998. He is retired from Rainbow Homes where he was owner, President and CEO.

Directors Emeriti

W G Bailey

was Senior Vice President of CNB where he served for over 42 years. He was elected to the Board in April 1972 and retired in April 1996.

Paul D. Brown

was elected to the Board of Directors April 1970, where he served for 38 years before retiring in April 2008.



SENIOR MANAGEMENT TEAM & EXECUTIVE COMMITTEE

First row left to right: Rose M. Wheeler, Mark J. Wieta, Kathy M. Kinner, Charles L. Patton, Pam Butcher

Second row left to right: Greg Lee, Michael McCoy, Ben D. Tackett, Jr., Dennis T. Dorton, Michael L. Hill, Ed Neely

Citizens National Bank Market Advisory Board

Southern

Gary Branham

Randy Clark

John Duvall Elliott

Paul P. Hughes

Greg Johnson

Paul E. Preston

Jack C. Sykes

Northern

Tracy Hillman

Todd Skaggs

Cheryl Spriggs

Richard Stai

Subsidiaries

CNC Insurance

Focus on Communities

Citizens continues to give back to the community today as it has for nearly a hundred years, and expansion has given us the opportunity to serve even more communities. Whether donating time, money or both, Citizens National Bank and its employees contribute almost daily to the well-being of the people and communities within the seven counties we serve. Citizens National Bank supports a variety of organizations in education, historical preservation, the arts, our youth, health care and economic development. Here are some of those that have benefited from our contributions over the past year.

History & the Arts

- Appalachian Artisan Center
- Arts Council of Northeast Kentucky
- Jenny Wiley Theatre
- Kentucky Historical Society
- Mountain Arts Center
- Paramount Arts Center
- Paramount Women's Association

Youth & Education

- Alice Lloyd College Scholarship Fund
- Big Sandy Community and Technical College Scholarships
- Book Donations to elementary schools in Magoffin, Johnson, Floyd and Pike counties
- Boy Scouts of America
- East Kentucky Science Center
- 4-H
- Girl Scouts of America
- July Jam
- Kentucky Governor's Scholars
- Leadership East Kentucky
- Leadership Kentucky
- Morehead State University
- MVP High School Scholarship Program
- Paul B. Hall Scholarship Fund
- Pikeville College
- Project Proms
- School Sports Sponsorships
- UNITE Program
- University of Kentucky

Economic Development

- Ashland Alliance
- Big Sandy Area Development District
- Floyd County Chamber of Commerce
- Grayson Chamber of Commerce
- Magoffin County Foundation
- Main Street Associations
- Paintsville/Johnson County Chamber of Commerce
- Pike County Chamber of Commerce



Above: Sign unveiling new South Ashland location

Community & Health

- American Cancer Society
- Christian Appalachian Project
- East Kentucky Fair
- Employer Support of The National Guard and Reserve
- Habitat for Humanity
- Highlands Regional Medical Center
- Kiwanis
- Our Lady of Bellefonte Hospital
- Pike County Humane Society
- Pike County YMCA
- Rotary
- United Way
- Westcare Homeless Shelter

3rd Annual Business Symposium



Left: Mitch Barnhart
Right: Mitch Barnhart, Mark Wiete with Students from Alice Lloyd College

American Cancer Society Relay for Life Challenge Event – Relay Mowing

Left: Citizens Camp
Center: Dennis T. Dorton
Right: Mark Wiete



Big Sandy Community & Technical College



Left: Girls Camp
Right: Dennis T. Dorton with Girls Camp attendees

2008 Annual Shareholders' Meeting

Left: Greg Meade
Right: Lynn Dorton Mullins, Jean Dorton



 **Citizens** NATIONAL BANK

 **Citizens**
INSURANCE SERVICES

620 Broadway

Paintsville, Kentucky 41240

www.cnbonline.com

Member
FDIC