CITIZENS FINANCIAL CORP /KY/
Form 10-Q
May 14, 2001

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2001

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 0-20148

CITIZENS FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Kentucky 61-1187135
(State of Incorporation) (I.R.S. Employer Identification No.)

12910 Shelbyville Road, Louisville, Kentucky, 40243
(Address of principal executive offices)

(502) 244-2420
(Registrant's telephone number)

Check whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Exchange Act 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 ~~X~~ No ~~~~~~

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Class A Stock - 1,758,215 as of May 11, 2001.

The date of this Report is May 14, 2001.

Part I - Financial Information; Item 1 - Financial Statements

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

Three Months Ended March 31	2001
Revenues:	
Premiums and other considerations	$7,030,087
Premiums ceded	(311,532)
Net premiums earned	6,718,555
Net investment income	1,684,933
Net realized investment gains, net of expenses	171,896
Other income	49,945
Total Revenues	8,625,329
Policy Benefits and Expenses:	
Policyholder benefits	4,700,975
Policyholder benefits ceded	(283,840)
Net benefits	4,417,135
Increase in net benefit reserves	830,063
Interest credited on policyholder deposits	195,546
Commissions	1,758,343
General expenses	1,623,807
Interest expense	171,651
Policy acquisition costs deferred	(1,058,813)
Amortization of deferred policy acquisition costs, value of insurance acquired, and goodwill	496,152
Total Policy Benefits and Expenses	8,433,884
Income before Income Tax Expense	191,445
Income Tax Expense	88,000
Income before cumulative effect of a change in accounting principle	103,445
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	(311,211)
Net Income (Loss)	$ (207,766)
Per Share Amounts:	
Income before cumulative effect of a change in accounting principle	$ 0.06
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	(0.18)
Net Income (Loss)	$ (0.12)

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	March 31, 2001
ASSETS	(Unaudited)
Investments:	
Securities available for sale, at fair value:	
Fixed maturities (amortized cost of $68,529,362 and $72,516,172 in 2001 and 2000 respectively)	$ 69,384,080
Equity securities (cost of $11,998,741 and $13,677,303 in 2001 and 2000, respectively)	8,720,604
Investment real estate	3,476,329
Mortgage loans on real estate	156,000
Policy loans	4,228,439
Short-term investments	610,379
Total Investments	86,575,831
Cash and cash equivalents	26,947,109
Accrued investment income	1,234,587
Reinsurance recoverable	2,656,524
Premiums receivable	256,840
Property and equipment	2,918,564
Deferred policy acquisition costs	7,288,421
Value of insurance acquired	4,748,709
Goodwill	823,292
Federal income tax receivable	204,759
Deferred federal income tax	1,922,942
Other assets	544,925
Total Assets	$136,122,503

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	March 31, 2001
LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)
Liabilities:	
Policy Liabilities:	
Future policy benefits	$ 84,582,481
Policyholder deposits	16,283,200
Policy and contract claims	1,693,906
Unearned premiums	176,602
Other	258,331
Total Policy Liabilities	102,994,520
Notes payable	7,800,000
Accrued expenses and other liabilities	2,198,586
Total Liabilities	112,993,106
Commitments and Contingencies	
Shareholders' Equity:	
Common stock, 6,000,000 shares authorized; 1,758,215 shares issued and outstanding in 2001 and 2000, respectively	1,758,215
Additional paid-in capital	7,640,988
Accumulated other comprehensive income	(1,510,240)
Retained earnings	15,240,434
Total Shareholders' Equity	23,129,397
Total Liabilities and Shareholders' Equity	$136,122,503

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

Three Months Ended March 31	2001
Cash Flows from Operations:	

Net income (loss)	$ (207,766)
Adjustments to reconcile net income to cash from operations:	
Increase in benefit reserves	1,136,702
Decrease in claim liabilities	(123,041)
Decrease in reinsurance recoverable	30,223
Interest credited on policyholder deposits	195,546
Provision for amortization and depreciation, net of deferrals	(473,114)
Amortization of premium and accretion of discount on Securities purchased, net	(14,340)
Net realized investment gains	(171,896)
(Increase) decrease in accrued investment income	93,904
Change in other assets and liabilities	(135,152)
Increase (decrease) in deferred federal income tax liability	173,000
Decrease in federal income taxes receivable	1,159,743
Cumulative effect of change in accounting principle	311,211
Net Cash provided by Operations	1,975,020
Cash Flows from Investment Activities:	
Cost of securities acquired	(2,992,896)
Investments sold or matured	8,457,895
Investment management fees and margin interest	(151,753)
Additions to property and equipment, net	(18,311)
Other investing activities, net	76,973
Net Cash provided by Investment Activities	5,371,908
Cash Flows from Financing Activities:	
Policyholder deposits	255,335
Policyholder withdrawals	(548,928)
Payments on notes payable - bank	(200,000)
Brokerage account advances, net	---
Repurchase of common stock	---
Net Cash used in Financing Activities	(493,593)
Net Increase in Cash and Cash Equivalents	6,853,335
Cash and Cash Equivalents at Beginning of Period	20,093,774
Cash and Cash Equivalents at End of Period	$ 26,947,109

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q in conformity with accounting principles generally accepted in the United States. The accompanying unaudited condensed financial statements reflect all adjustments which are, in the opinion of management, necessary to a fair presentation of the results for the interim periods. All such adjustments are of a normal recurring nature. For further information, refer to the December 31, 2000 consolidated financial statements and footnotes included in the Company's annual report on Form 10-K.

Note 2 - COMPREHENSIVE INCOME

The components of comprehensive income, net of related tax, for the three months ended March 31, 2001 and 2000 are as follows:

	Three Months Ended March 31,	
COMPREHENSIVE INCOME:	2001	2000
Net Income (Loss)	$ (207,766)	$2,908,718
Net unrealized gains on securities	63,054	2,246,732
Comprehensive Income (Loss)	$ (144,712)	$5,155,450

Note 3 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Effective January 1, 2001, the Company adopted Financial Accounting Standards Board Statement (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS Nos. 137 and 138. This statement requires that all derivatives be recognized as either assets or liabilities in the balance sheet at their fair value, and sets forth the manner in which gains or losses thereon are to be recorded. The treatment of such gains and losses is dependent upon the type of exposure, if any, for which the derivative is designed as a hedge. Currently, the Company has not designated any derivatives as hedges. In accordance with SFAS 133, as of January 1, 2001, the Company recorded a $311,211 transition adjustment loss. This adjustment represents the cumulative market value change (since January 1, 1999) of options embedded within convertible bonds, along with a recalculation of discount accretion for the related host bonds and corresponding income tax impacts. The net transition adjustment includes a $539,090 gross market value decline, $67,558 of discount accretion, and a $160,321 income tax benefit.

Note 4 - NET REALIZED INVESTMENT GAINS, NET OF EXPENSES

The Company recorded pretax reductions to the carrying value of available for sale securities totaling $7,145 and $2,820,000 for the three months ended March 31, 2001 and 2000, respectively, relating to declines in value which were considered by management to be other than temporary. These amounts are reported as reductions of net realized investment gains. The Company also nets certain direct, incremental investment management fees and margin loan interest cost against net realized investment gains presented in the Condensed Consolidated Statements of Income. Such costs are based directly on or, are primarily associated with, realized capital gains. Costs netted against realized investment gains total $26,889 and $714,641 for the three months ended March 31, 2001 and 2000, respectively.

Part I; Item 1 (continued)

Note 5 - INCOME TAXES

Current taxes are provided based on estimates of the projected effective annual tax rate. Deferred taxes reflect the net effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Note 6 - SEGMENT INFORMATION

The Company's operations are managed along five principal insurance product lines: Home Service Life, Broker Life, Preneed Life, Dental, and Other Health. Products in all five lines are sold through independent agency operations. Home Service Life consists primarily of traditional life insurance coverage sold in amounts of $10,000 and under to middle and lower income individuals. This distribution channel is characterized by a significant amount of agent contact with customers throughout the year. Broker Life product sales consist primarily of simplified issue and graded-benefit policies in amounts of $10,000 and under. Other products in this segment which are not aggressively marketed include: group life, universal life, annuities and participating life coverages. Preneed Life products are sold to individuals in connection with prearrangement of their funeral and include single premium and multi-pay policies with coverages generally in amounts of $10,000 and less. These policies are generally sold to older individuals at increased premium rates. Dental products are term coverages generally sold to small and intermediate size employer groups. Other Health products include various accident and health coverages sold to individuals and employer groups. Segment information as of March 31, 2001 and 2000, and for the periods then ended is as follows:

	Three Months Ended March 31,	
REVENUE:	2001	2000
Home Service Life	$ 2,338,761	$ 2,366,416
Broker Life	1,489,060	1,494,958
Preneed Life	2,137,321	1,051,969
Dental	2,099,652	1,885,303
Other Health	388,639	393,171
Segment Totals	8,453,433	7,191,817
Realized investment gains, net of expenses	171,896	4,793,958
Total Revenue	$ 8,625,329	$11,985,775

Below are the net investment income amounts which are included in the revenue totals above.

	Three Months Ended March 31,	
INVESTMENT INCOME:	2001	2000
Home Service Life	$ 563,048	$ 491,728
Broker Life	712,522	595,735
Preneed Life	374,771	307,777
Dental	9,965	8,645

Other Health	24,627	20,698
Segment Totals	$1,684,933	$1,424,583

Part I; Item 1 (continued)

The Company evaluates performance based on several factors, of which the primary financial measure is segment profit. Segment profit represents pretax earnings, except net realized investment gains and interest expense are excluded. The majority of the Company's realized investment gains are generated from investments in equity securities. The equities portfolio averaged (on a cost basis) approximately $12,838,000 and $19,721,000 during the three months ended March 31, 2001 and 2000, respectively. If these funds had been invested in fixed-maturities yielding 7%, realized investment gains would have changed and the three month segment profit totals below would have increased by approximately $166,000 and $223,000 in 2001 and 2000, respectively.

	Three Months Ended March 31,	
SEGMENT PROFIT (LOSS):	2001	2000
Home Service Life	$169,668	$ 42,240
Broker Life	214,447	134,971
Preneed Life	(311,936)	(326,652)
Dental	95,498	121,511
Other Health	23,523	27,912
Segment Totals	191,200	(18)
Realized investment gains, net of expenses	171,896	4,793,958
Interest expense	171,651	185,222
Income before Federal Income Tax	$191,445	$4,608,718

Depreciation and amortization amounts below consist of amortization of the value of insurance acquired, deferred policy acquisition costs and goodwill, along with depreciation expense.

	Three Months Ended March 31,	
DEPRECIATION AND AMORTIZATION:	2001	2000
Home Service Life	$177,635	$149,369
Broker Life	158,680	163,105
Preneed Life	214,790	78,640
Dental	18,000	13,598
Other Health	16,594	7,582
Segment Totals	$585,699	$412,294

Segment asset totals are determined based on policy liabilities outstanding in each segment.

ASSETS:	March 31, 2001	December 31, 2000
Home Service Life	$45,479,233	$45,577,255
Broker Life	57,037,822	57,721,008
Preneed Life	30,929,528	29,421,677
Dental	727,911	799,496
Other Health	1,948,009	2,018,570
Segment Totals	$136,122,503	$135,538,006

Part I; Item 1 (continued)

Note 7 - LITIGATION

During June 2000, the Company was informed of an action filed against its subsidiary, United Liberty Life Insurance Company ("United") by two policyholders. The Company acquired United in May, 1998. The complaint in the action refers to a particular class of life insurance policies that United issued over a period of years ending around 1971. The complaint alleges that United's dividend payments on these policies from 1993 through 1999 were less than the required amount. The complaint does not specify the amount of the alleged underpayment but implies a maximum of about $1 million. The plaintiffs also allege that United is liable to pay punitive damages, also in an unspecified amount, for breach of an implied covenant of good faith and fair dealing to the plaintiffs in relation to the dividends. The plaintiffs are seeking to have the action certified as a class action on behalf of all other policyholders whose policies were still in force in 1993. United has filed its answer denying the material allegations of the complaint and intends to defend the action vigorously. The Company has engaged in pre-trial discovery proceedings, in relation both to the plaintiffs' underlying allegations and their request for class action certification. At this early stage of the litigation, the Company is unable to determine whether an unfavorable outcome of the action is likely to occur or, alternatively, whether the chance of such an outcome is remote. Therefore, at this time, management has no basis for estimating potential losses, if any.

Part I; Item 2 - Management's Discussion and Analysis

FINANCIAL POSITION. Shareholders' equity totaled approximately $23,129,000 and $33,140,000 at March 31, 2001 and 2000, respectively. These balances reflect an approximate 1% decrease and a 18% increase for the respective quarters then ended. As described above, comprehensive income (loss) totaled approximately $(145,000) and $5,155,000 for the three months ended March 31, 2001 and 2000, respectively. A significant portion of comprehensive income (loss) is attributable to changes in the value of the Company's equity portfolios. Equity securities comprised approximately 6% and 20% of the Company's total assets as of March 31, 2001 and 2000, respectively. Accordingly, as also described below, the Company's financial position can be significantly affected by movements in the equities markets. Equity portfolio positions decreased $1,679,000 on a cost basis and $3,857,000 on a market value basis, during the first three months of 2001. Fixed maturity portfolio positions decreased $3,987,000 on an amortized cost basis and decreased $2,020,000 on a market value basis during the same period. However, as described in Note 3 above, $497,000 of the change between cost and market values during 2001 is attributable to the SFAS 133 transition adjustment recorded at January 1, 2001. Cash and cash equivalent positions also increased approximately $6,853,000 during the quarter ended March 31, 2001.

OPERATIONS. Net premiums and other considerations increased approximately $996,000, or 17% during the first three months of 2001 compared to the first three months of 2000. Preneed Life and Dental premium increases were approximately $1,017,000 and $213,000, respectively, while Home Service and Broker Life each experienced modest decreases. The Preneed Life segment growth is attributable primarily to competitive marketing agreements signed with certain independent agency groups during late 2000. Dental premium growth is also primarily attributable to a key additional independent marketing arrangement signed during 2000. The Other Health segment represents less that 6% of total premium.

Pretax earnings (before the cumulative effect of a change in accounting principle) decreased approximately 96% to $191,000 for the three months ended March 31, 2001, primarily due to an approximate $4,622,000 decrease in realized investment gains, net of expenses. Pretax Segment Profit (excluding realized investment gains and interest expense) for the first three months of 2001 was approximately $191,000, compared to an approximate break-even result for the first three months of 2000. This increase resulted primarily from improved Home Service Life persistency and additional investment income generated by higher yields on real estate and short-term investments, along with a reduction in lower yielding equity investment positions.

The Company's higher effective income tax rate is due to the lack of tax loss carryback potential for a portion of the Company's operations.

CASH FLOW AND LIQUIDITY. Cash flow from operations totaled $1,975,000 for the three months ended March 31, 2001 compared to $180,000 for the same period in the prior year. This increase is primarily attributable to growth in the Preneed Life business. The $5,372,000 of cash provided by investing activities for the three months ended March 31, 2001 resulted primarily from retaining the net proceeds from equity investment sales as cash. The $493,000 of cash used in financing activities during the first three months of 2001 is primarily attributable to annuity and Universal Life account withdrawals.

Part I; Item 2 - Management's Discussion and Analysis (continued)

FORWARD-LOOKING INFORMATION.

All statements, trend analyses and other information contained in this report relative to markets for the Company's products and trends in the Company's operations or financial results, as well as other statements including words such as "anticipate", "believe", "plan", "estimate", "expect", "intend", and other similar expressions, constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors which may cause actual results to be materially different from those contemplated by the forward-looking statements. Such factors include, among other things:

- |X| the market value of the Company' s investments, including stock market performance and prevailing interest rate levels;
- |X| customer and agent response to new products, distribution channels and marketing initiatives, including exposure to unrecoverable advanced commissions;
- |X| mortality, morbidity, lapse rates, and other factors which may affect the profitability of the Company's insurance products;
- |X| regulatory changes or actions, including those relating to regulation of insurance products and insurance companies;
- |X| ratings assigned to the Company and its subsidiaries by independent rating organizations which the Company believes are important to the sale of its products;
- |X| general economic conditions and increasing competition which may affect the Company's ability to sell its products;
- |X| the Company's ability to achieve anticipated levels of operating efficiencies and meet cash requirements based upon projected liquidity sources;
- |X| unanticipated adverse litigation outcomes; and
- |X| changes in the Federal income tax laws and regulations which may affect the relative tax advantages of some of the Company's products.

There can be no assurance that other factors not currently anticipated by management will not also materially and adversely affect the Company's results of operations.

Part II - Other Information

Item 6. Exhibits and Reports on Form 8-K.

a). Exhibit 11. Statement re: computation of per share earnings.

b). none

SIGNATURES

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

CITIZENS FINANCIAL CORPORATION

BY: /s/ Darrell R. Wells

Darrell R. Wells
President and Chief Executive Officer

BY: /s/ Brent L. Nemec

Brent L. Nemec
Treasurer and Principal Accounting Officer

Date: May 14, 2001

EXHIBIT INDEX

Exhibit No.	Description
11	Statement re: computation of per share earnings

EXHIBIT 11

Citizens Financial Corporation and Subsidiaries
Computation of Per Share Earnings
(Unaudited)

Three Months Ended March 31	2001
Numerator(s):	
Income before cumulative effect of a change in accounting principle	$ 103,445
Cumulative effect of change in accounting principle	(311,211)
Net Income (Loss)	$ (207,766)

Denominator:	
Weighted average common shares	1,758,215
Earnings Per Share:	
Income before cumulative effect of a change in accounting principle	$ 0.06
Cumulative effect of change in accounting principle	$ (0.18)
Net Income (Loss)	$ (0.12)