

CITIZENS INC  
Form 10-Q  
May 06, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2014

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: 000-16509

CITIZENS, INC.

(Exact name of registrant as specified in its charter)

Colorado

84-0755371

(State or other jurisdiction of incorporation or  
organization)

(I.R.S. Employer Identification No.)

400 East Anderson Lane, Austin, TX  
(Address of principal executive offices)  
(512) 837-7100

78752  
(Zip Code)

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of May 1, 2014, the Registrant had 49,080,114 shares of Class A common stock, no par value, outstanding and 1,001,714 shares of Class B common stock outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Financial Position

(In thousands)

	March 31, 2014 (Unaudited)	December 31, 2013
Assets		
Investments:		
Fixed maturities available-for-sale, at fair value (cost: \$621,480 and \$595,944 in 2014 and 2013, respectively)	\$644,759	605,256
Fixed maturities held-to-maturity, at amortized cost (fair value: \$225,087 and \$223,533 in 2014 and 2013, respectively)	223,586	227,696
Equity securities available-for-sale, at fair value (cost: \$48,133 and \$45,883 in 2014 and 2013, respectively)	49,845	47,259
Mortgage loans on real estate	659	671
Policy loans	50,288	48,868
Real estate held for investment (less \$1,465 and \$1,429 accumulated depreciation in 2014 and 2013, respectively)	8,403	8,440
Other long-term investments	44	45
Total investments	977,584	938,235
Cash and cash equivalents	52,307	54,593
Accrued investment income	12,803	12,251
Receivable for securities	1,707	—
Reinsurance recoverable	4,614	4,394
Deferred policy acquisition costs	148,443	146,691
Cost of customer relationships acquired	25,488	23,374
Goodwill	17,160	17,160
Other intangible assets	976	851
Property and equipment, net	6,688	6,662
Due premiums, net (less \$1,312 and \$1,429 allowance for doubtful accounts in 2014 and 2013, respectively)	10,387	11,209
Prepaid expenses	1,311	95
Other assets	741	765
Total assets	\$1,260,209	1,216,280

(Continued)

See accompanying notes to consolidated financial statements.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Financial Position

(In thousands, except share amounts)

	March 31, 2014 (Unaudited)	December 31, 2013
Liabilities and Stockholders' Equity		
Liabilities:		
Policy liabilities:		
Future policy benefit reserves:		
Life insurance	\$856,915	834,269
Annuities	55,833	55,485
Accident and health	1,221	1,250
Dividend accumulations	14,129	13,662
Premiums paid in advance	34,037	32,560
Policy claims payable	10,120	9,488
Other policyholders' funds	7,498	7,982
Total policy liabilities	979,753	954,696
Commissions payable	2,238	2,562
Federal income tax payable	2,107	590
Deferred federal income tax	6,621	1,704
Payable for securities in process of settlement	2,977	—
Other liabilities	10,333	10,919
Total liabilities	1,004,029	970,471
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Class A, no par value, 100,000,000 shares authorized, 52,215,852 shares issued and outstanding in 2014 and 2013, including shares in treasury of 3,135,738 in 2014 and 2013	259,383	259,383
Class B, no par value, 2,000,000 shares authorized, 1,001,714 shares issued and outstanding in 2014 and 2013	3,184	3,184
Accumulated deficit	(11,345	) (12,542
Accumulated other comprehensive income:		
Unrealized gains on securities, net of tax	15,969	6,795
Treasury stock, at cost	(11,011	) (11,011
Total stockholders' equity	256,180	245,809
Total liabilities and stockholders' equity	\$1,260,209	1,216,280

See accompanying notes to consolidated financial statements.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIE

## Consolidated Statements of Comprehensive Income

Three Months Ended March 31,

(In thousands, except per share amounts)

(Unaudited)

	2014		2013
Revenues:			
Premiums:			
Life insurance	\$41,397		39,414
Accident and health insurance	351		349
Property insurance	1,265		1,177
Net investment income	9,906		8,389
Realized investment gains (losses), net	(56	)	31
Other income	169		186
Total revenues	53,032		49,546
Benefits and expenses:			
Insurance benefits paid or provided:			
Claims and surrenders	16,457		14,806
Increase in future policy benefit reserves	17,698		16,959
Policyholders' dividends	2,102		2,074
Total insurance benefits paid or provided	36,257		33,839
Commissions	9,910		9,058
Other general expenses	6,502		6,699
Capitalization of deferred policy acquisition costs	(7,068	)	(6,362
Amortization of deferred policy acquisition costs	5,209		4,626
Amortization of cost of customer relationships acquired	531		578
Total benefits and expenses	51,341		48,438
Income before federal income tax	1,691		1,108
Federal income tax expense	494		252
Net income	1,197		856
Per Share Amounts:			
Basic earnings per share of Class A common stock	\$0.02		0.02
Basic earnings per share of Class B common stock	0.01		0.01
Diluted earnings per share of Class A common stock	0.02		0.02
Diluted earnings per share of Class B common stock	0.01		0.01
Other comprehensive income:			
Unrealized gains on available-for-sale securities:			
Unrealized holding gains arising during period	14,096		96
Reclassification adjustment for gains (losses) included in net income	32		(31
Unrealized gains on available-for-sale securities, net	14,128		65
Income tax expense on unrealized gains on available-for-sale securities	4,954		27
Other comprehensive income	9,174		38
Comprehensive income	\$10,371		894
See accompanying notes to consolidated financial statements.			



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Cash Flows

Three Months Ended March 31,

(In thousands)

(Unaudited)

	2014	2013	
Cash flows from operating activities:			
Net income	\$1,197	856	
Adjustments to reconcile net income to net cash provided by operating activities:			
Realized gains (losses) on sale of investments and other assets	56	(31	)
Net deferred policy acquisition costs	(1,859	)	(1,736
Amortization of cost of customer relationships acquired	531	578	)
Depreciation	323	320	
Amortization of premiums and discounts on investments	2,230	2,297	
Deferred federal income tax benefit	(1,023	)	(1,148
Change in:			
Accrued investment income	(471	)	(608
Reinsurance recoverable	(220	)	2,822
Due premiums	822	296	
Future policy benefit reserves	17,697	14,504	
Other policyholders' liabilities	2,053	1,345	
Federal income tax receivable	1,496	1,400	
Commissions payable and other liabilities	(1,030	)	(1,408
Other, net	(1,293	)	(1,410
Net cash provided by operating activities	20,509	18,077	
Cash flows from investing activities:			
Sale of fixed maturities, available-for-sale	—	58	
Maturities and calls of fixed maturities, available-for-sale	16,900	15,851	
Maturities and calls of fixed maturities, held-to-maturity	9,292	18,465	
Purchase of fixed maturities, available-for-sale	(36,161	)	(64,046
Purchase of fixed maturities, held-to-maturity	(6,347	)	—
Calls of equity securities, available-for-sale	100	200	
Principal payments on mortgage loans	12	133	
Increase in policy loans, net	(1,420	)	(1,879
Sale of other long-term investments	1	1	
Purchase of other long-term investments	—	(42	)
Purchase of property and equipment	(283	)	(181
Purchase of short-term investments	—	(531	)
Net cash used in acquisition	(4,810	)	—
Net cash provided by (used in) investing activities	(22,716	)	(31,971



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Cash Flows, Continued

Three Months Ended March 31,

(In thousands)

(Unaudited)

	2014	2013	
Cash flows from financing activities:			
Annuity deposits	1,489	1,242	
Annuity withdrawals	(1,568	) (1,039	)
Net cash provided (used in) by financing activities	(79	) 203	
Net decrease in cash and cash equivalents	(2,286	) (13,691	)
Cash and cash equivalents at beginning of year	54,593	56,299	
Cash and cash equivalents at end of period	\$52,307	42,608	
Supplemental disclosures of operating activities:			
Cash paid (received) during the period for income taxes, net	\$—	—	

## Supplemental Disclosures of Non-Cash Investing Activities:

None.

See accompanying notes to consolidated financial statements.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements

March 31, 2014

(Unaudited)

(1) Financial Statements

Basis of Presentation and Consolidation

The accompanying consolidated financial statements of Citizens, Inc. and its wholly-owned subsidiaries have been prepared in conformity with U.S. generally accepted accounting principles ("U.S. GAAP").

The consolidated financial statements include the accounts and operations of Citizens, Inc. ("Citizens"), a Colorado corporation, and its wholly-owned subsidiaries, CICA Life Insurance Company of America ("CICA"), Security Plan Life Insurance Company ("SPLIC"), Security Plan Fire Insurance Company ("SPFIC"), Citizens National Life Insurance Company ("CNLIC"), Magnolia Guaranty Life Insurance Company ("MGLIC"), Computing Technology, Inc. ("CTI") and Insurance Investors, Inc. ("III"). Citizens and its wholly-owned subsidiaries are collectively referred to as "the Company," "we," "us" or "our."

The consolidated statements of financial position for March 31, 2014, and the consolidated statements of comprehensive income and cash flows for the three-month periods ended March 31, 2014 and 2013, have been prepared by the Company without audit. In the opinion of management, all adjustments to present fairly the financial position, results of operations, and changes in cash flows at March 31, 2014 and for comparative periods have been made. The consolidated financial statements have been prepared in accordance with U.S. GAAP accounting principles for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required for complete financial statements and should be read in conjunction with the Company's consolidated financial statements, and notes thereto, for the year ended December 31, 2013. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

We provide primarily life insurance and a small amount of health insurance policies through our insurance subsidiaries: CICA, SPLIC, MGLIC and CNLIC. CICA and CNLIC issue ordinary whole-life policies, credit life and disability, burial insurance, pre-need policies, and accident and health related policies, throughout the Midwest and southern United States. CICA also issues ordinary whole-life policies to non-U.S. residents. SPLIC offers final expense and home service life insurance in Louisiana, Arkansas and Mississippi and SPFIC, a wholly-owned subsidiary of SPLIC, writes a limited amount of property insurance in Louisiana. MGLIC provides industrial life policies through independent funeral homes in Mississippi.

CTI provides data processing systems and services, as well as furniture and equipment, to the Company. III provides aviation transportation to the Company.

In accordance with our purchase agreement dated October 7, 2013, we finalized the MGLIC stock acquisition on March 7, 2014 for approximately \$5.2 million in cash consideration. The assets recorded as of March 31, 2014 were \$11.9 million, liabilities of \$6.6 million and stockholders equity of \$5.3 million. We believe the goodwill will be minimal relative to this company purchase. We are continuing to finalize the actuarial estimates and intangibles which may result in changes from the amounts reported in this quarterly report on Form 10-Q. This entity will be reported as part of our home service segment business and is a wholly owned subsidiary of SPLIC.

Use of Estimates

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

The most significant estimates include those used in the evaluation of other-than-temporary impairments on debt and equity securities and valuation allowances on investments, actuarially determined assets and liabilities and assumptions, goodwill impairment, valuation allowance on deferred tax assets, and contingencies relating to litigation and regulatory matters. Certain

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

of these estimates are particularly sensitive to market conditions, and deterioration and/or volatility in the worldwide debt or equity markets could have a material impact on the Consolidated Financial Statements.

Reclassification

Reclassifications have been made in the current year related to certain prior year reported amounts to provide consistent presentation. No individual amounts were material.

Significant Accounting Policies

For a description of significant accounting policies, see Note 1 of the Notes to Consolidated Financial Statements included in our 2013 Form 10-K Annual Report, which should be read in conjunction with these accompanying Consolidated Financial Statements.

(2) Accounting Pronouncements

Accounting Standards Recently Adopted

On January 1, 2014, we adopted Accounting Standards Update (ASU) ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" to eliminate diversity in practice. This ASU requires that companies net their unrecognized tax benefits against all same-jurisdiction net operating losses or tax credit carryforwards that would be used to settle the position with a tax authority. The adoption of this ASU did not have an effect on our consolidated financial statements.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

## (3) Segment Information

The Company has three reportable segments: Life Insurance, Home Service Insurance, and Other Non-Insurance Enterprises. The accounting policies of the segments are in accordance with U.S. GAAP and are the same as those used in the preparation of the consolidated financial statements. The Company evaluates profit and loss performance based on U.S. GAAP income before federal income taxes for its three reportable segments.

The Company has no reportable differences between segments and consolidated operations.

	Three Months Ended March 31, 2014			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$31,811	11,202	—	43,013
Net investment income	6,283	3,287	336	9,906
Realized investment gains (losses), net	(64	) 8	—	(56
Other income	143	1	25	169
Total revenue	38,173	14,498	361	53,032
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	10,815	5,642	—	16,457
Increase in future policy benefit reserves	16,976	722	—	17,698
Policyholders' dividends	2,086	16	—	2,102
Total insurance benefits paid or provided	29,877	6,380	—	36,257
Commissions	6,238	3,672	—	9,910
Other general expenses	2,840	3,169	493	6,502
Capitalization of deferred policy acquisition costs	(5,659	) (1,409	) —	(7,068
Amortization of deferred policy acquisition costs	4,407	802	—	5,209
Amortization of cost of customer relationships acquired	171	360	—	531
Total benefits and expenses	37,874	12,974	493	51,341
Income (loss) before income tax expense	\$299	1,524	(132	) 1,691

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

	Three Months Ended March 31, 2013			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$30,117	10,823	—	40,940
Net investment income	4,904	3,180	305	8,389
Realized investment gains, net	—	30	1	31
Other income	63	90	33	186
Total revenue	35,084	14,123	339	49,546
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	9,338	5,468	—	14,806
Increase in future policy benefit reserves	16,042	917	—	16,959
Policyholders' dividends	2,059	15	—	2,074
Total insurance benefits paid or provided	27,439	6,400	—	33,839
Commissions	5,579	3,479	—	9,058
Other general expenses	2,852	3,266	581	6,699
Capitalization of deferred policy acquisition costs	(5,086)	(1,276)	—	(6,362)
Amortization of deferred policy acquisition costs	3,985	641	—	4,626
Amortization of cost of customer relationships acquired	167	411	—	578
Total benefits and expenses	34,936	12,921	581	48,438
Income (loss) before income tax expense	\$148	1,202	(242)	1,108

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

## (4) Earnings Per Share

The following tables set forth the computation of basic and diluted earnings per share.

	Three Months Ended	
	March 31, 2014	March 31, 2013
	(In thousands, except per share amounts)	
Basic and diluted earnings per share:		
Numerator:		
Net income	\$1,197	856
Net income allocated to Class A common stock	\$1,185	848
Net income allocated to Class B common stock	12	8
Net income	\$1,197	856
Denominator:		
Weighted average shares of Class A outstanding - basic	49,080	49,080
Weighted average shares of Class A outstanding - diluted	49,080	49,080
Weighted average shares of Class B outstanding - basic and diluted	1,002	1,002
Basic earnings per share of Class A common stock	\$0.02	0.02
Basic earnings per share of Class B common stock	0.01	0.01
Diluted earnings per share of Class A common stock	0.02	0.02
Diluted earnings per share of Class B common stock	0.01	0.01

## (5) Investments

The Company invests primarily in fixed maturity securities, which totaled 84.3% of total investments and cash and cash equivalents at March 31, 2014.

	March 31, 2014		December 31, 2013		
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value	
	(In thousands)		(In thousands)		
Fixed maturity securities	\$868,345	84.3	% \$832,952	83.9	%
Equity securities	49,845	4.8	% 47,259	4.8	%
Mortgage loans	659	0.1	% 671	0.1	%
Policy loans	50,288	4.9	% 48,868	4.8	%
Real estate and other long-term investments	8,447	0.8	% 8,485	0.9	%
Cash and cash equivalents	52,307	5.1	% 54,593	5.5	%
Total cash, cash equivalents and investments	\$1,029,891	100.0	% \$992,828	100.0	%

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

The following tables represent the cost, gross unrealized gains and losses and fair value for fixed maturities and equity securities as of the periods indicated.

	March 31, 2014			
	Cost or Amortized Cost (In thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed maturities:				
Available-for-sale:				
U.S. Treasury securities	\$ 10,101	2,539	—	12,640
U.S. Government-sponsored enterprises States and political subdivisions	43,076	1,718	30	44,764
Foreign governments	355,633	10,529	6,242	359,920
Corporate	104	27	—	131
Commercial mortgage-backed	208,740	14,883	440	223,183
Residential mortgage-backed	432	10	—	442
Total available-for-sale securities	3,394	287	2	3,679
Held-to-maturity securities:	621,480	29,993	6,714	644,759
U.S. Government-sponsored enterprises States and political subdivisions	5,846	249	—	6,095
Corporate	183,868	3,975	3,400	184,443
Total held-to-maturity securities	33,872	853	176	34,549
Total fixed maturities	223,586	5,077	3,576	225,087
Equity securities:	\$ 845,066	35,070	10,290	869,846
Stock mutual funds	\$ 10,463	1,737	—	12,200
Bond mutual funds	35,080	29	318	34,791
Common stock	810	10	7	813
Preferred stock	1,780	269	8	2,041
Total equity securities	\$ 48,133	2,045	333	49,845



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

	December 31, 2013			
	Cost or	Gross	Gross	Fair
	Amortized	Unrealized	Unrealized	Value
	Cost	Gains	Losses	
	(In thousands)			
Fixed maturities:				
Available-for-sale securities:				
U.S. Treasury securities	\$10,115	2,348	—	12,463
U.S. Government-sponsored enterprises	53,587	1,209	228	54,568
States and political subdivisions	341,673	6,242	11,449	336,466
Foreign governments	104	23	—	127
Corporate	186,671	12,289	1,399	197,561
Commercial mortgage-backed	300	9	—	309
Residential mortgage-backed	3,494	270	2	3,762
Total available-for-sale securities	595,944	22,390	13,078	605,256
Held-to-maturity securities:				
U.S. Government-sponsored enterprises	8,877	197	3	9,071
States and political subdivisions	181,246	1,633	6,412	176,467
Corporate	37,573	771	349	37,995
Total held-to-maturity securities	227,696	2,601	6,764	223,533
Total fixed maturity securities	\$823,640	24,991	19,842	828,789
Equity securities:				
Stock mutual funds	\$10,463	1,506	—	11,969
Bond mutual funds	35,080	—	417	34,663
Common stock	17	—	5	12
Preferred stock	323	292	—	615
Total equity securities	\$45,883	1,798	422	47,259

At March 31, 2014, the Company had \$3.8 million of mortgage-backed security holdings based on amortized cost, of which \$3.4 million, or 89.5%, were residential U.S. Government-sponsored issues. Mortgage-backed securities are also referred to as securities not due at a single maturity date throughout this report. The majority of the Company's equity securities are diversified stock and bond mutual funds.

## Valuation of Investments in Fixed Maturity and Equity Securities

Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

The Company monitors all debt and equity securities on an on-going basis relative to changes in credit ratings, market prices, earnings trends and financial performance, in addition to specific region or industry reviews. The assessment of whether impairments have occurred is based on a case-by-case evaluation of underlying reasons for the decline in fair value. The Company determines other-than-temporary impairment by reviewing relevant evidence related to the specific security issuer as well as the Company's intent to sell the security, or if it is more likely than not that the Company would be required to sell a security before recovery of its amortized cost.

When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is recognized in earnings equal to the

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the following: (a) the amount representing the credit loss; and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value.

The Company evaluates whether a credit impairment exists for debt securities by considering primarily the following factors: (a) changes in the financial condition of the security's underlying collateral; (b) whether the issuer is current on contractually obligated interest and principal payments; (c) changes in the financial condition, credit rating and near-term prospects of the issuer; (d) the length of time to which the fair value has been less than the amortized cost of the security; and (e) the payment structure of the security. The Company's best estimate of expected future cash flows used to determine the credit loss amount is a quantitative and qualitative process. Quantitative review includes information received from third party sources such as financial statements, pricing and rating changes, liquidity and other statistical information. Qualitative factors include judgments related to business strategies, economic impacts on the issuer and overall judgment related to estimates and industry factors. The Company's best estimate of future cash flows involves assumptions including, but not limited to, various performance indicators, such as historical and projected default and recovery rates, credit ratings, and current delinquency rates. These assumptions require the use of significant management judgment and include the probability of issuer default and estimates regarding timing and amount of expected recoveries, which may include estimating the underlying collateral value. In addition, projections of expected future debt security cash flows may change based upon new information regarding the performance of the issuer.

The primary factors considered in evaluating whether an impairment exists for an equity security include, but are not limited to: (a) the length of time and the extent to which the fair value has been less than the cost of the security; (b) changes in the financial condition, credit rating and near-term prospects of the issuer; (c) whether the issuer is current on contractually obligated payments; and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery.

The Company did not recognize any other-than-temporary impairments ("OTTI") during the three months ended March 31, 2014 and 2013.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

The following tables present the fair values and gross unrealized losses of fixed maturities and equity securities that have remained in a continuous unrealized loss position for the periods indicated.

	March 31, 2014								
	Less than 12 months			Greater than 12 months			Total		
	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities
(In thousands, except for # of securities)									
Fixed maturities:									
Available-for-sale securities:									
U.S.									
Government-sponsored enterprises	\$1,285	9	6	830	21	1	2,115	30	7
States and political subdivisions	128,340	5,149	137	21,095	1,093	23	149,435	6,242	160
Corporate	38,641	286	34	2,623	154	2	41,264	440	36
Residential mortgage-backed	61	1	5	40	1	1	101	2	6
Total available-for-sale securities	168,327	5,445	182	24,588	1,269	27	192,915	6,714	209
Held-to-maturity securities:									
States and political subdivisions	74,114	3,031	87	11,710	369	18	85,824	3,400	105
Corporate	5,395	176	4	—	—	—	5,395	176	4
Total held-to-maturity securities	79,509	3,207	91	11,710	369	18	91,219	3,576	109
Total fixed maturities	\$247,836	8,652	273	36,298	1,638	45	284,134	10,290	318
Equity securities:									
Bond mutual funds	\$27,682	318	3	—	—	—	27,682	318	3
Common stocks	136	3	1	13	4	1	149	7	2
Preferred stocks	338	8	8	—	—	—	338	8	8
Total equities	\$28,156	329	12	13	4	1	28,169	333	13

As of March 31, 2014, the Company had 27 available-for-sale securities and 18 held-to-maturity securities that were in an unrealized loss position for greater than 12 months. We reported 1 common stock holding in an unrealized loss position as of March 31, 2014.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

	December 31, 2013								
	Less than 12 months			Greater than 12 months			Total		
	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities
	(In thousands, except for # of securities)								
Fixed maturities:									
Available-for-sale securities:									
U.S.									
Government-sponsored enterprises	\$ 14,032	228	12	—	—	—	14,032	228	12
States and political subdivisions	183,280	9,872	203	15,673	1,577	16	198,953	11,449	219
Corporate	35,789	1,048	25	2,426	351	2	38,215	1,399	27
Residential mortgage-backed	57	1	3	42	1	1	99	2	4
Total available-for-sale securities	233,158	11,149	243	18,141	1,929	19	251,299	13,078	262
Held-to-maturity securities:									
U.S.									
Government-sponsored enterprises	2,997	3	1	—	—	—	2,997	3	1
States and political subdivisions	100,153	5,236	118	14,797	1,176	17	114,950	6,412	135
Corporate	5,225	349	4	—	—	—	5,225	349	4
Total held-to-maturity securities	108,375	5,588	123	14,797	1,176	17	123,172	6,764	140
Total fixed maturities	\$ 341,533	16,737	366	32,938	3,105	36	374,471	19,842	402
Equity securities:									
Bond mutual funds	\$ 34,663	417	7	—	—	—	34,663	417	7
Common stock	12	5	1	—	—	—	12	5	1
Total equities	\$ 34,675	422	8	—	—	—	34,675	422	8

We have reviewed these securities for the periods ended March 31, 2014 and December 31, 2013 and determined that no other-than-temporary impairment exists based on our evaluation of the credit worthiness of the issuers and the fact that we do not intend to sell the investments nor is it likely that we will be required to sell the securities before recovery of their amortized cost bases which may be maturity. We continue to monitor all securities on an on-going basis, and future information may become available which could result in impairments being recorded.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

The amortized cost and fair value of fixed maturity securities at March 31, 2014 by contractual maturity are shown in the table below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date have been reflected based upon final stated maturity.

	March 31, 2014	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale securities:		
Due in one year or less	\$ 15,507	15,818
Due after one year through five years	117,719	125,050
Due after five years through ten years	104,920	108,876
Due after ten years	383,334	395,015
Total available-for-sale securities	621,480	644,759
Held-to-maturity securities:		
Due in one year or less	10,453	10,515
Due after one year through five years	31,897	32,581
Due after five years through ten years	43,214	44,633
Due after ten years	138,022	137,358
Total held-to-maturity securities	223,586	225,087
Total fixed maturities	\$845,066	869,846

The Company uses the specific identification method of the individual security to determine the cost basis used in the calculation of realized gains and losses related to security sales. Proceeds and gross realized gains from sales of securities for the three months ended March 31, 2014 and 2013 are summarized as follows.

	Fixed Maturities, Available-for-sale		Equity Securities	
	Three Months Ended		Three Months Ended	
	March 31,	2013	March 31,	2013
	(In thousands)			
Proceeds	\$—	58	—	—
Gross realized gains	\$—	1	—	—
Gross realized losses	\$—	—	—	—

There were no securities sold at a loss during the three month period ended March 31, 2014 or 2013. There were no securities sold from the held-to-maturity portfolio for the three months ended March 31, 2014 or 2013.

## (6) Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We hold available-for-sale fixed maturity securities and equity securities, which are carried at fair value.

Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our view of market assumptions in

the absence of observable market information. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

unobservable inputs. All assets and liabilities carried at fair value are required to be classified and disclosed in one of the following three categories:

Level 1 - Quoted prices for identical instruments in active markets.

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs or whose significant value drivers are observable.

Level 3 - Instruments whose significant value drivers are unobservable.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as U.S. Treasury securities and actively traded mutual fund and stock investments.

Level 2 includes those financial instruments that are valued by independent pricing services or broker quotes. These models are primarily industry-standard models that consider various inputs, such as interest rates, credit spreads and foreign exchange rates for the underlying financial instruments. All significant inputs are observable, or derived from observable information in the marketplace or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category primarily include corporate securities, U.S.

Government-sponsored enterprise securities, municipal securities and certain mortgage and asset-backed securities.

Level 3 is comprised of financial instruments whose fair value is estimated based on non-binding broker prices utilizing significant inputs not based on or corroborated by readily available market information. This category consists of two private placement mortgage-backed securities.

The following tables set forth our assets and liabilities that are measured at fair value on a recurring basis as of the dates indicated.

	March 31, 2014			Total Fair Value
	Level 1	Level 2	Level 3	
Available-for-sale investments				
	(In thousands)			
Financial assets:				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$12,640	44,764	—	57,404
States and political subdivisions	—	359,920	—	359,920
Corporate	—	223,183	—	223,183
Commercial mortgage-backed	—	152	290	442
Residential mortgage-backed	—	3,679	—	3,679
Foreign governments	—	131	—	131
Total fixed maturities	12,640	631,829	290	644,759
Equity securities:				
Stock mutual funds	12,200	—	—	12,200
Bond mutual funds	34,791	—	—	34,791
Common stock	813	—	—	813
Preferred stock	2,041	—	—	2,041
Total equity securities	49,845	—	—	49,845



Total financial assets	\$62,485	631,829	290	694,604
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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

Available-for-sale investments	December 31, 2013			Total Fair Value
	Level 1	Level 2	Level 3	
	(In thousands)			
Financial assets:				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$ 12,463	54,568	—	67,031
States and political subdivisions	—	336,466	—	336,466
Corporate	—	197,561	—	197,561
Commercial mortgage-backed	—	—	309	309
Residential mortgage-backed	—	3,762	—	3,762
Foreign governments	—	127	—	127
Total fixed maturities	12,463	592,484	309	605,256
Equity securities:				
Stock mutual funds	11,969	—	—	11,969
Bond mutual funds	34,663	—	—	34,663
Common stock	12	—	—	12
Preferred stock	615	—	—	615
Total equity securities	47,259	—	—	47,259
Total financial assets	\$ 59,722	592,484	309	652,515

## Financial Instruments Valuation

Fixed maturity securities, available-for-sale. At March 31, 2014, our fixed maturity securities, valued using a third-party pricing source, totaled \$631.8 million for Level 2 assets and comprised 91.0% of total reported fair value of our financial assets. The Level 1 and Level 2 valuations are reviewed and updated quarterly through random testing by comparisons to separate pricing models, other third-party pricing services, and back tested to recent trades. In addition, we obtain information relative to the third-party pricing models and review model parameters for reasonableness. Fair values for Level 3 assets are based upon unadjusted broker quotes that are non-binding, and consist of two private placement mortgage-backed securities with a total value of \$0.3 million. Our Level 3 assets are current relative to principal and interest payments and are considered immaterial to our financial statements. For the three months ended March 31, 2014, there were no material changes to the valuation methods or assumptions used to determine fair values, and no broker or third party prices were changed from the values received.

Equity securities, available-for-sale. Our available-for-sale equity securities are classified as Level 1 assets as their fair values are based upon quoted market prices.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

The following table presents additional information about fixed maturity securities measured at fair value on a recurring basis that are classified as Level 3 assets and for which we have utilized significant unobservable inputs to determine fair value.

	March 31, 2014 (In thousands)	December 31, 2013
Balance at beginning of period	\$309	387
Total realized and unrealized gains (losses)		
Included in net income	—	—
Included in other comprehensive income	—	(7 )
Principal paydowns	(19 )	(71 )
Transfer in and (out) of Level 3	—	—
Balance at end of period	\$290	309

We review the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets. Such reclassifications are reported as transfers in and out of Level 3 at the beginning fair value for the reporting period in which the changes occur. There were no transfers in or out of Level 1 or 2.

## Financial Instruments not Carried at Fair Value

Estimates of fair values are made at a specific point in time, based on relevant market prices and information about the financial instruments. The estimated fair values of financial instruments presented below are not necessarily indicative of the amounts the Company might realize in actual market transactions.

The carrying amount and fair value for the financial assets and liabilities on the consolidated balance sheets not otherwise disclosed for the periods indicated are as follows:

	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities, held-to-maturity	\$223,586	225,087	227,696	223,533
Mortgage loans	659	684	671	695
Policy loans	50,288	50,288	48,868	48,868
Cash and cash equivalents	52,307	52,307	54,593	54,593
Financial liabilities:				
Annuity - investment contracts	39,650	43,086	39,469	44,960

Fair values for fixed income securities, which are characterized as Level 2 assets in the fair value hierarchy, are based on quoted market prices for the same or similar securities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other assumptions, including a discount rate and estimates of future cash flows.

Mortgage loans are secured principally by residential and commercial properties. Weighted average interest rates for these loans were approximately 6.4% as of March 31, 2014 and December 31, 2013, with maturities ranging from 1 to 30 years. Management estimated the fair value using an annual interest rate of 6.25% at March 31, 2014. Our mortgage loans are considered Level 3 assets in the fair value hierarchy.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

Policy loans had a weighted average annual interest rate of 7.7% as of March 31, 2014 and December 31, 2013, and no specified maturity dates. The aggregate fair value of policy loans approximates the carrying value reflected on the consolidated balance sheets. These loans typically carry an interest rate that is tied to the crediting rate applied to the related policy and contract reserves. Policy loans are an integral part of the life insurance policies we have in force, cannot be valued separately and are not marketable. Therefore, the fair value of policy loans approximates the carrying value and policy loans are considered Level 3 assets in the fair value hierarchy.

The fair value of short-term investments approximate carrying value due to their short-term nature. Our short-term investments are considered Level 2 assets in the fair value hierarchy.

The fair value of cash and cash equivalents approximate carrying value and are characterized as Level 1 assets in the fair value hierarchy.

The fair value of the Company's liabilities under annuity contract policies, which are considered Level 3 assets, was estimated at March 31, 2014 using discounted cash flows based upon a swap rate curve with interest rates ranging from 0.24% to 4.03% based upon swap rates adjusted for various risk adjustments. The fair value of liabilities under all insurance contracts are taken into consideration in the overall management of interest rate risk, which seeks to minimize exposure to changing interest rates through the matching of investment maturities with amounts due under insurance contracts.

(7) Commitments and Contingencies

We are a defendant in a lawsuit filed on August 6, 1999, in the Texas District Court, Austin, Texas, now styled Delia Bolanos Andrade, et al., Plaintiffs, v. Citizens Insurance Company of America, et al., Defendants in which a class was originally certified by the trial court and reversed by the Texas Supreme Court in 2007 with an order to the trial court to conduct further proceedings consistent with its ruling. The underlying lawsuit alleged that certain life insurance policies CICA made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. On December 9, 2009, the trial court denied the recertification of the class after conducting additional proceedings in accordance with the Texas Supreme Court's ruling. The remaining plaintiffs must now proceed individually, and not as a class, if they intend to pursue their claims against us. Since the December 9, 2009 trial court ruling, no individual cases have been further pursued by the plaintiffs. The probability of the plaintiffs further pursuing their cases individually remains unknown. An estimate of any possible loss or range of losses cannot be made at this time in regard to individuals pursuing claims. However, should the plaintiffs further pursue their claims individually, we intend to vigorously defend any proceedings.

The Company is currently performing an internal audit related to unclaimed property for all legal reporting entities. Based upon internal findings to date our exposure appears to be primarily in the state of Louisiana, related to conversion processes surrounding the SPLIC acquisition. The Company had been informed by the Louisiana Department of Treasury, Arkansas Auditor of State and the Texas State Comptroller, that they authorized an audit of Citizens, Inc. and its affiliates for compliance with unclaimed property laws. This audit is being conducted by Verus Financial LLC on behalf of the states.

These internal and external audits may result in additional payments to beneficiaries, additional escheatment of funds deemed abandoned under state laws, administrative penalties, interest, and changes to the Company's procedures for the identification and escheatment of abandoned property. At this time, the Company is not able to estimate any of these possible amounts, but such costs could be substantial for a company our size.

We defend all claims vigorously. However, in doing so, we could incur significant defense costs, including attorneys' fees, other direct litigation costs and the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of litigation claims, it could have a material adverse effect on our business, results of operations and financial condition.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

March 31, 2014

(Unaudited)

(8) Income Taxes

The effective tax rate was 29.2% and 22.7% for the first quarter of 2014 and 2013, respectively. In periods where our effective tax rate is lower than the statutory tax rate of 35%, the difference is primarily due to tax-exempt state and local bonds. The effective tax rate is higher in the current year compared to 2013 primarily due to higher book income in the current period compared to the prior period but approximately the same amount of tax-exempt income in both periods.

(9) Related Party Transactions

The Company has various routine related party transactions in conjunction with our holding company structure, such as a management service agreement related to costs incurred, a tax sharing agreement between entities, and inter-company dividends and capital contributions. There were no changes related to these relationships during the three months ended March 31, 2014. See our Annual Report on Form 10-K as of December 31, 2013 for a comprehensive discussion of related party transactions.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

March 31, 2014

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

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q are not statements of historical fact and constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act (the "Act"), including, without limitation, statements specifically identified as forward-looking statements within this document. Many of these statements contain risk factors as well. In addition, certain statements in future filings by the Company with the Securities and Exchange Commission, in press releases, and in oral and written statements made by us or with the approval of the Company, which are not statements of historical fact, constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or non-payment of dividends, capital structure, and other financial items, (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services, (iii) statements of future economic performance and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "assumes," "estimates," "plans," "projects," "could," "expects," "intends," "targeted," "may," "will" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that could cause the Company's future results to differ materially from expected results include, but are not limited to:

- Changes in foreign and U.S. general economic, market, and political conditions, including the performance of financial markets and interest rates;
- Changes in consumer behavior, which may affect the Company's ability to sell its products and retain business;
- The timely development of and acceptance of new products of the Company and perceived overall value of these products and services by existing and potential customers;
- Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing and actuarial valuation of the Company's products;
- The performance of our investment portfolio, which may be adversely affected by changes in interest rates, adverse developments and ratings of issuers whose debt securities we may hold, and other adverse macroeconomic events;
- Results of litigation we may be involved in;
- Changes in assumptions related to deferred acquisition costs and the value of any businesses we may acquire;
- Regulatory, accounting or tax changes that may affect the cost of, or the demand for, the Company's products or services;
-