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

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

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 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)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 ~~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 - 1,733,715 as of November 2, 2001.

The date of this Report is November 7, 2001.

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Part I - Financial Information; Item 1 - Financial Statements

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

Nine Months Ended September 30	2001
Revenues:	
Premiums and other considerations	$22,151,658
Premiums ceded	(868,582)
Net premiums earned	21,283,076
Net investment income	4,948,968
Net realized investment gains (losses), net of expenses	(6,398,998)
Other income	196,669
Total Revenues	20,029,715
Policy Benefits and Expenses:	
Policyholder benefits	13,459,724
Policyholder benefits ceded	(869,942)
Net benefits	12,589,782
Increase in net benefit reserves	4,567,024
Interest credited on policyholder deposits	643,148
Commissions	4,903,230
General expenses	4,922,102
Interest expense	442,205
Policy acquisition costs deferred	(2,687,885)
Amortization of deferred policy acquisition costs, value of insurance acquired, and goodwill	1,606,003
Total Policy Benefits and Expenses	26,985,609
Income (Loss) before income tax and cumulative effect of a change in accounting principle	(6,955,894)
Income Tax Expense (Benefit)	(1,643,000)
Income (Loss) before cumulative effect of a change in accounting principle	(5,312,894)
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	(311,211)
Net Income (Loss)	$(5,624,105)
Per Share Amounts:	
Income (Loss) before cumulative effect of a change in accounting principle	$(3.04)
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	(0.18)
Net Income (Loss)	$(3.22)

Part I, Item 1 (continued)

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

Three Months Ended September 30	2001
Revenues:	
Premiums and other considerations	$7,652,167
Premiums ceded	(297,187)
Net premiums earned	7,354,980
Net investment income	1,607,471
Net realized investment losses, net of expenses	(3,100,898)
Other income	77,399
Total Revenues	5,938,952
Policy Benefits and Expenses:	
Policyholder benefits	4,248,273
Policyholder benefits ceded	(318,854)
Net benefits	3,929,419
Increase in net benefit reserves	1,793,317
Interest credited on policyholder deposits	229,739
Commissions	1,489,252
General expenses	1,590,419
Interest expense	127,504
Policy acquisition costs deferred	(657,524)
Amortization of deferred policy acquisition costs, value of insurance acquired, and goodwill	692,002
Total Policy Benefits and Expenses	9,194,128
Loss before Income Tax	(3,255,176)
Income Tax Benefit	(786,000)
Net Loss	$(2,469,176)
Net Loss Per Common Share	$(1.42)

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	September 30, 2001
ASSETS	(Unaudited)
Investments:	
Securities available for sale, at fair value:	
Fixed maturities (amortized cost of $73,878,918 and $72,516,172 in 2001 and 2000 respectively)	$ 74,694,965
Equity securities (cost of $5,808,613 and $13,677,303 in 2001 and 2000, respectively)	5,829,761
Investment real estate	3,527,984
Mortgage loans on real estate	156,000
Policy loans	4,226,290
Short-term investments	610,379
Total Investments	89,045,379
Cash and cash equivalents	22,672,850
Accrued investment income	1,366,930
Reinsurance recoverable	2,533,774
Premiums receivable	341,835
Property and equipment	2,851,619
Deferred policy acquisition costs	8,382,514
Value of insurance acquired	4,360,154
Goodwill	778,285
Federal income tax receivable	2,067,933
Deferred federal income tax	670,839
Other assets	555,434
Total Assets	$135,627,546

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	September 30, 2001
LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)

Liabilities:	
Policy Liabilities:	
Future policy benefits	$ 88,334,132
Policyholder deposits	16,153,350
Policy and contract claims	1,351,667
Unearned premiums	165,307
Other	307,283
Total Policy Liabilities	106,311,739
Notes payable	7,400,000
Accrued expenses and other liabilities	2,367,840
Total Liabilities	116,079,579
Commitments and Contingencies	
Shareholders' Equity:	
Common stock, 6,000,000 shares authorized; 1,733,715 and 1,758,215 shares issued and outstanding in 2001 and 2000, respectively	1,733,715
Additional paid-in capital	7,419,263
Accumulated other comprehensive income (loss)	570,894
Retained earnings	9,824,095
Total Shareholders' Equity	19,547,967
Total Liabilities and Shareholders' Equity	$135,627,546

Part I; Item 1 (continued)

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

Nine Months Ended September 30	2001
Cash Flows from Operations:	
Net income (loss)	$(5,624,105)
Adjustments to reconcile net income to cash from operations:	
Increase in benefit reserves	4,891,473
Decrease in claim liabilities	(465,280)
Decrease in reinsurance recoverable	152,973
Interest credited on policyholder deposits	643,148
Provision for amortization and depreciation, net of deferrals	(813,185)
Amortization of premium and accretion of discount on securities purchased, net	(129,103)
Net realized investment (gains) losses	6,398,998
Increase in accrued investment income	(38,440)
Change in other assets and liabilities	(210,473)

(Increase) decrease in deferred federal income tax asset	353,000
(Increase) decrease in federal income taxes receivable	(703,431)
Cumulative effect of a change in accounting principle	311,211
Net Cash provided by (used in) Operations	4,766,786
Cash Flows from Investment Activities:	
Cost of securities acquired	(20,797,466)
Investments sold or matured	20,603,453
Net cash received on block of insurance business acquired	---
Investment management fees and margin interest	(173,389)
Additions to property and equipment, net	(182,171)
Other investing activities, net	79,122
Net Cash provided by (used in) Investment Activities	(470,451)
Cash Flows from Financing Activities:	
Policyholder deposits	725,417
Policyholder withdrawals	(1,596,451)
Payments on notes payable - bank	(600,000)
Repurchase of common stock	(246,225)
Brokerage account advances, net	---
Net Cash used in Financing Activities	(1,717,259)
Net Increase (Decrease) in Cash and Cash Equivalents	2,579,076
Cash and Cash Equivalents at Beginning of Period	20,093,774
Cash and Cash Equivalents at End of Period	$22,672,850

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 and nine months ended September 30, 2001 and 2000 are as follows:

COMPREHENSIVE INCOME:	Three Months Ended September 30, 2001	2000	Nine Months Ended 2001
Net Income (Loss)	$(2,469,176)	$ (1,184,479)	$(5,624,104)
Net unrealized gains (losses) on securities	(227,430)	(2,000,020)	2,144,188
Comprehensive Loss	$(2,696,606)	$ (3,184,499)	$(3,479,916)

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 $2,634,000 and $5,063,000 for the nine months ended September 30, 2001 and 2000, respectively, relating to declines in value which were considered by management to be other than temporary. These amounts are reported as additional realized investment losses. Changes in the fair value of derivative instruments are also reported as realized gains (losses). The Company also nets certain direct, incremental investment management fees against net realized investment gains (losses) presented in the Condensed Consolidated Statements of Operations. Such costs are based directly on or, are primarily associated with, realized capital gains (losses). Costs netted against realized investment gains (losses) total $54,000 and $211,000 for the nine months ended September 30, 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 September 30, 2001 and 2000, and for the periods then ended is as follows:

	Three Months Ended September 30,		Nine Months Ende
REVENUE:	2001	2000	2001
Home Service Life	$ 2,346,090	$ 2,252,559	$ 7,029,071
Broker Life	1,684,895	1,609,712	4,776,334
Preneed Life	2,763,516	1,595,490	7,430,929
Dental	1,884,305	1,993,461	6,057,285
Other Health	361,044	351,742	1,135,094
Segment Totals	9,039,850	7,802,964	26,428,713
Realized investment gain (loss), net	(3,100,898)	(1,664,106)	(6,398,998)
Total Revenue	$ 5,938,952	$ 6,138,858	$20,029,715

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

	Three Months Ended September 30,		Nine Months Ended
INVESTMENT INCOME:	2001	2000	2001
Home Service Life	$ 526,394	$ 524,942	$1,638,758
Broker Life	661,800	702,021	2,060,052
Preneed Life	388,358	336,452	1,150,634
Dental	7,907	8,996	27,694
Other Health	23,012	23,111	71,830

Segment Totals	$1,607,471	$1,595,522	$4,948,968

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 (losses) and interest

Part I; Item 1 (continued)

expense are excluded. The majority of the Company's realized investment gains and losses are generated from investments in equity securities. The equities portfolio averaged (on a cost basis) approximately $10,887,000 and $20,508,000 during the nine months ended September 30, 2001 and 2000, respectively. If these funds had been invested in fixed-maturities yielding 7%, realized investment gains (losses) would have changed and the nine month segment profit totals below would have increased by approximately $365,000 and $763,000 in 2001 and 2000, respectively.

	Three Months Ended September 30,		Nine Months Ende
SEGMENT PROFIT (LOSS):	2001	2000	2001
Home Service Life	$ 42,374	$ (17,494)	$ 215,862
Broker Life	181,013	63,395	192,515
Preneed Life	(260,289)	(274,706)	(647,508)
Dental	81,070	47,080	165,768
Other Health	(70,942)	(10,213)	(41,328)
Segment Totals	(26,774)	(191,938)	(114,691)
Realized investment gain (loss), net	(3,100,898)	(1,664,106)	(6,398,998)
Interest expense	127,504	196,435	442,205
Income (Loss) before income tax and cumulative effect of a change in accounting principle	$(3,255,176)	$ (2,052,479)	$(6,955,894)

Depreciation and amortization amounts below consist of amortization of the value of insurance ac costs and goodwill, along with depreciation expense.

	Three Months Ended September 30,		Nine Months E
DEPRECIATION AND AMORTIZATION:	2001	2000	2001
Home Service Life	$ 352,726	$ 233,834	$ 645,492

Broker Life	158,360	160,873	488,787
Preneed Life	241,809	77,434	643,320
Dental	18,005	13,818	54,011
Other Health	10,677	13,257	43,089
Segment Totals	$ 781,577	$ 499,216	$1,874,699

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

ASSETS:	September 30, 2001	December 31, 2000
Home Service Life	$ 44,498,472	$ 45,577,255
Broker Life	55,107,256	57,721,008
Preneed Life	33,462,095	29,421,677
Dental	643,914	799,496
Other Health	1,915,809	2,018,570
Segment Totals	$135,627,546	$135,538,006

Part I; Item 1 (continued)

Note 7 - LITIGATION

United Liberty Life Insurance Company ("United"), which the Company acquired in 1998, is defending an action in an Ohio state court brought by two policyholders. The Complaint refers to a particular class of life insurance policies that United issued over a period of years ending around 1971. It alleges that United's dividend payments on these policies from 1993 through 1999 were less than the required amount. It does not specify the amount of the alleged underpayment but implies a maximum of about $850,000. 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 action has been certified as a class action on behalf of all policyholders residing in Ohio whose policies were still in force in 1993. United has denied the material allegations of the Complaint and is defending the action vigorously. Pre-trial discovery is continuing and will be followed by motions to dismiss or narrow the plaintiffs' claims. 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.

Note 8 - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after

December 15, 2001. Under the new rules, goodwill will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the nonamortization provisions of the Statement is expected to result in an increase in net income of $90,000 ($0.05 per share) per year. During 2002, the Company will perform the first of the required impairment tests of goodwill as of January 1, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

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

FINANCIAL POSITION. Shareholders' equity totaled approximately $19,548,000 and $23,274,000 at September 30, 2001 and December 31, 2000, respectively. These balances reflect a decrease of approximately 16% for the nine months ended September 30, 2001. As described above, the comprehensive loss totaled approximately $3,480,000 for the nine months ended September 30, 2001. A significant portion of the comprehensive loss is attributable to securities trading and changes in the value of the Company's equity portfolios. Equity portfolio positions decreased $7,869,000 (57%) on a cost basis and $6,748,000 (54%) on a market value basis, during the first nine months of 2001. Accordingly, equity securities comprised approximately 4% and 9% of the Company's total assets as of September 30, 2001 and December 31, 2000, respectively. Fixed maturity portfolio positions increased $1,363,000 on an amortized cost basis and $3,291,000 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 $2,579,000 during the nine months ended September 30, 2001.

The reduced equity positions described above have significantly decreased the Company's gross quantitative equity market risk. However, with the accompanying reductions in shareholders' equity, there is a somewhat lesser decline in relative equity market risk. As a result of this activity, A. M. Best Company recently revised the rating for the Company's principal insurance subsidiary, Citizens Security Life Insurance Company ("CSLIC"), from B to B-. In addition CSLIC reached agreement with its principal state insurance regulator concerning the carrying value of its subsidiaries. For statutory reporting purposes, CSLIC is now permitted to carry its inactive property and casualty insurance subsidiary at its full statutory value, provided CSLIC complies with additional planning and reporting requests.

OPERATIONS. Net premiums and other considerations increased approximately $3,863,000, or 22% during the first nine months of 2001 compared to the first nine months of 2000. Preneed Life, Dental, Home Service Life and Broker Life premium increases were approximately $3,876,000, $228,000, $144,000 and $75,000, respectively. The Preneed Life segment growth is attributable primarily to competitive marketing agreements signed with certain independent agency groups during late 2000 and continued expansion into independently owned funeral homes. Dental premium growth is also primarily attributable to a key additional independent marketing arrangement signed during 2000 and inflationary growth, net of cancellations. The Other Health segment represents less that 6% of total premium. Net premiums and other considerations for the three months ended September 30, 2001 increased approximately $1,217,000 or 20% compared to the three months ended September 30, 2000. Preneed Life, Dental, Home Service Life and Broker Life premium increases (decreases) were approximately $1,112,000, $(108,000), $90,000 and $114,000 respectively

Pretax earnings (loss) [before the cumulative effect of a new accounting principle] totaled approximately $(6,956,000) for the nine months ended September 30, 2001, compared to $3,825,000 for the nine months ended September 30, 2000. Pretax (loss) for the three months ending September 30, 2001 totaled approximately $(3,255,000) compared to $(2,052,000) for three months ended September 30, 2000. The majority of these changes resulted from realized investment losses. Pretax Segment (Loss) (excluding realized investment gains and losses and interest expense) for the first nine months of 2001 was approximately $(115,000), compared to $(260,000) for the first nine months of 2000. This change resulted primarily from improving sales volume and mortality for Preneed Life and Home Service Life, partially offset by higher Broker Life and Dental claims. The Pretax Segment (Loss) for the three months ended September 30, 2001 was $(27,000) compared to $(192,000) for the three months ended September 30, 2000.

The Company's lower effective income tax (benefit) rate for the nine months ended September 30, 2001 is due to the effect of the small life insurance company deduction on taxes paid in prior years, for which loss carrybacks are available.

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

CASH FLOW AND LIQUIDITY. Cash flow from operations totaled $4,767,000 for the nine months ended September 30, 2001 compared to $(1,190,000) for the same period in the prior year. This increase is primarily attributable to growth in the Preneed Life business. The $1,717,000 of cash used in financing activities during the first nine months of 2001 is primarily attributable to annuity and Universal Life account withdrawals and bank loan principal repayments.

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 I; Item 3 - Quantitative and Qualitative Disclosures about Market Risk

The primary changes in quantitative market risks during the nine months ended September 30, 2001 are discussed in Part I, Item 2 above.

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: November 7, 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)

Nine Months Ended September 30	2001
Numerator(s):	
Income (Loss) before cumulative effect of a change in accounting principle	$(5,312,894)
Cumulative effect of a change in accounting principle	(311,211)
Net Income (Loss)	$ (5,624,105)
Denominator:	
Weighted average common shares	1,747,087
Earnings Per Share:	
Income (Loss) before cumulative effect of a change in accounting principle	$ (3.04)
Cumulative effect of a change in accounting principle	(0.18)
Net Income (Loss)	$ (3.22)

Three Months Ended September 30	2001	
Numerator:		
Net Income (Loss)	$(2,469,176)	$
Denominator:		
Weighted average common shares	1,733,715	
Earnings Per Share:		
Net Income (Loss)	$ (1.42)	