

CITIZENS INC
Form 10-Q
November 05, 2014

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 September 30, 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 November 3, 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)

	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Investments:		
Fixed maturities available-for-sale, at fair value (cost: \$647,257 and \$595,944 in 2014 and 2013, respectively)	\$681,591	605,256
Fixed maturities held-to-maturity, at amortized cost (fair value: \$236,165 and \$223,533 in 2014 and 2013, respectively)	230,297	227,696
Equity securities available-for-sale, at fair value (cost: \$53,906 and \$45,883 in 2014 and 2013, respectively)	55,643	47,259
Mortgage loans on real estate	641	671
Policy loans	52,575	48,868
Real estate held for investment (less \$1,539 and \$1,429 accumulated depreciation in 2014 and 2013, respectively)	8,174	8,440
Other long-term investments	136	45
Total investments	1,029,057	938,235
Cash and cash equivalents	56,986	54,593
Accrued investment income	13,262	12,251
Reinsurance recoverable	4,330	4,394
Deferred policy acquisition costs	153,737	146,691
Cost of customer relationships acquired	24,182	23,374
Goodwill	17,306	17,160
Other intangible assets	976	851
Property and equipment, net	6,380	6,662
Due premiums, net (less \$1,292 and \$1,429 allowance for doubtful accounts in 2014 and 2013, respectively)	10,027	11,209
Prepaid expenses	1,152	95
Other assets	1,104	765
Total assets	\$1,318,499	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)

	September 30, 2014 (Unaudited)	December 31, 2013
Liabilities and Stockholders' Equity		
Liabilities:		
Policy liabilities:		
Future policy benefit reserves:		
Life insurance	\$894,885	834,269
Annuities	58,741	55,485
Accident and health	1,205	1,250
Dividend accumulations	15,381	13,662
Premiums paid in advance	37,432	32,560
Policy claims payable	8,534	9,488
Other policyholders' funds	6,892	7,982
Total policy liabilities	1,023,070	954,696
Commissions payable	2,563	2,562
Federal income tax payable	813	590
Deferred federal income tax	10,309	1,704
Payable for securities in process of settlement	3,787	—
Other liabilities	11,185	10,919
Total liabilities	1,051,727	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	(7,871	) (12,542
Accumulated other comprehensive income:		
Unrealized gains on securities, net of tax	23,087	6,795
Treasury stock, at cost	(11,011	) (11,011
Total stockholders' equity	266,772	245,809
Total liabilities and stockholders' equity	\$1,318,499	1,216,280

See accompanying notes to consolidated financial statements.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Three Months Ended September 30,

(In thousands, except per share amounts)

(Unaudited)

	2014		2013	
Revenues:				
Premiums:				
Life insurance	\$45,234		42,091	
Accident and health insurance	394		380	
Property insurance	1,295		1,276	
Net investment income	10,384		9,570	
Realized investment gains (losses), net	(222	)	30	
Other income	145		269	
Total revenues	57,230		53,616	
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	17,326		16,763	
Increase in future policy benefit reserves	19,307		17,398	
Policyholders' dividends	2,573		2,362	
Total insurance benefits paid or provided	39,206		36,523	
Commissions	11,116		9,940	
Other general expenses	6,029		6,163	
Capitalization of deferred policy acquisition costs	(8,126	)	(7,067)
Amortization of deferred policy acquisition costs	5,276		4,758	
Amortization of cost of customer relationships acquired	453		681	
Total benefits and expenses	53,954		50,998	
Income before federal income tax	3,276		2,618	
Federal income tax expense	952		794	
Net income	2,324		1,824	
Per Share Amounts:				
Basic earnings per share of Class A common stock	\$0.04		\$0.03	
Basic earnings per share of Class B common stock	0.03		0.02	
Diluted earnings per share of Class A common stock	0.04		0.03	
Diluted earnings per share of Class B common stock	0.03		0.02	
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding losses arising during period	(1,628	)	(4,128)
Reclassification adjustment for (gains) losses included in net income	227		(84)
Unrealized gains (losses) on available-for-sale securities, net	(1,401	)	(4,212)
Income tax benefit on unrealized losses on available-for-sale securities	(490	)	(1,474)
Other comprehensive loss	(911	)	(2,738)
Comprehensive income (loss)	\$1,413		(914)
See accompanying notes to consolidated financial statements.				

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Nine Months Ended September 30,

(In thousands, except per share amounts)

(Unaudited)

	2014		2013
Revenues:			
Premiums:			
Life insurance	\$131,298		123,728
Accident and health insurance	1,135		1,135
Property insurance	3,832		3,658
Net investment income	30,373		27,224
Realized investment gains (losses), net	(351	)	143
Other income	477		882
Total revenues	166,764		156,770
Benefits and expenses:			
Insurance benefits paid or provided:			
Claims and surrenders	50,451		48,229
Increase in future policy benefit reserves	56,984		52,253
Policyholders' dividends	7,087		6,671
Total insurance benefits paid or provided	114,522		107,153
Commissions	31,429		29,427
Other general expenses	19,979		20,204
Capitalization of deferred policy acquisition costs	(22,617	)	(21,101
Amortization of deferred policy acquisition costs	15,378		13,747
Amortization of cost of customer relationships acquired	1,598		1,819
Total benefits and expenses	160,289		151,249
Income before federal income tax	6,475		5,521
Federal income tax expense	1,804		1,534
Net income	4,671		3,987
Per Share Amounts:			
Basic earnings per share of Class A common stock	\$0.09		\$0.08
Basic earnings per share of Class B common stock	0.05		0.04
Diluted earnings per share of Class A common stock	0.09		0.08
Diluted earnings per share of Class B common stock	0.05		0.04
Other comprehensive income (loss):			
Unrealized gains (losses) on available-for-sale securities:			
Unrealized holding gains (losses) arising during period	24,764		(29,576
Reclassification adjustment for (gains) losses included in net income	332		(188
Unrealized gains (losses) on available-for-sale securities, net	25,096		(29,764
Income tax expense (benefit) on unrealized gains (losses) on available-for-sale securities	8,804		(10,400
Other comprehensive income (loss)	16,292		(19,364
Comprehensive income (loss)	\$20,963		(15,377
See accompanying notes to consolidated financial statements.			

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Cash Flows

Nine Months Ended September 30,

(In thousands)

(Unaudited)

	2014	2013	
Cash flows from operating activities:			
Net income	\$4,671	3,987	
Adjustments to reconcile net income to net cash provided by operating activities:			
Realized (gains) losses on sale of investments and other assets	351	(143)
Net deferred policy acquisition costs	(7,239	)	(7,354
Amortization of cost of customer relationships acquired	1,598	1,819)
Depreciation	964	955	
Amortization of premiums and discounts on investments	7,014	6,228	
Deferred federal income tax benefit	(1,140	)	(2,384
Change in:			
Accrued investment income	(915	)	(1,436
Reinsurance recoverable	64	5,161)
Due premiums	1,182	533	
Future policy benefit reserves	56,932	47,989	
Other policyholders' liabilities	4,282	(84)
Federal income tax receivable	201	685	
Commissions payable and other liabilities	264	(1,045)
Other, net	(1,373	)	(581
Net cash provided by operating activities	66,856	54,330)
Cash flows from investing activities:			
Sale of fixed maturities, available-for-sale	680	317	
Maturities and calls of fixed maturities, available-for-sale	38,658	41,054	
Maturities and calls of fixed maturities, held-to-maturity	10,523	37,213	
Purchase of fixed maturities, available-for-sale	(88,860	)	(71,818
Purchase of fixed maturities, held-to-maturity	(12,158	)	(75,386
Sale of equity securities, available-for-sale	15,029	—)
Calls of equity securities, available-for-sale	200	400	
Purchase of equity securities, available-for-sale	(21,285)	—
Principal payments on mortgage loans	30	829	
Increase in policy loans, net	(3,707	)	(4,366
Sale of other long-term investments	1	1)
Purchase of other long-term investments	(4	)	(86
Sale of property and equipment	5	—)
Purchase of property and equipment	(388	)	(386
Maturity of short-term investments	531	2,841	
Purchase of short-term investments	(531	)	(531
Net cash used in acquisition	(4,810)	—
Net cash provided by (used in) investing activities	(66,086)	(69,918

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Cash Flows, Continued

Nine Months Ended September 30,

(In thousands)

(Unaudited)

	2014	2013	
Cash flows from financing activities:			
Annuity deposits	\$5,479	4,293	
Annuity withdrawals	(3,856	) (3,317)
Net cash provided by financing activities	1,623	976	
Net increase (decrease) in cash and cash equivalents	2,393	(14,612)
Cash and cash equivalents at beginning of year	54,593	56,299	
Cash and cash equivalents at end of period	\$56,986	41,687	
Supplemental disclosures of operating activities:			
Cash paid during the period for income taxes, net	\$2,721	3,232	

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

September 30, 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 September 30, 2014, and the consolidated statements of comprehensive income for the three and nine months ended September 30, 2014 and 2013 and cash flows for the nine-month periods ended September 30, 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 September 30, 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 and endowment 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 acquisition were \$12.0 million, liabilities of \$6.8 million and stockholders equity of \$5.2 million. We recorded goodwill of \$0.1 million related to this purchase. This entity is reported as part of our home service segment business with total revenues of \$1.7 million and net income of \$0.2 million as of September 30, 2014, and is a wholly owned subsidiary of SPLIC. We have converted the policy inforce data to our policy administration system and we are continuing the process of data validation and therefore our initial accounting is provisional. We anticipate the completion of our conversion

efforts and final accounting will be reflected in our year end reporting.

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.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

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 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.

Accounting Standards Not Yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, using one of two retrospective application methods. Early application is not permitted. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 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 September 30, 2014			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$35,359	11,564	—	46,923
Net investment income	6,660	3,389	335	10,384
Realized investment losses, net	(159	) (63	) —	(222
Other income	130	3	12	145
Total revenue	41,990	14,893	347	57,230
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	12,205	5,121	—	17,326
Increase in future policy benefit reserves	18,314	993	—	19,307
Policyholders' dividends	2,560	13	—	2,573
Total insurance benefits paid or provided	33,079	6,127	—	39,206
Commissions	7,351	3,765	—	11,116
Other general expenses	2,464	3,227	338	6,029
Capitalization of deferred policy acquisition costs	(6,708	) (1,418	) —	(8,126
Amortization of deferred policy acquisition costs	4,449	827	—	5,276
Amortization of cost of customer relationships acquired	163	290	—	453
Total benefits and expenses	40,798	12,818	338	53,954
Income before income tax expense	\$1,192	2,075	9	3,276

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	Nine Months Ended September 30, 2014			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$ 101,739	34,526	—	136,265
Net investment income	19,409	9,958	1,006	30,373
Realized investment gains (losses), net	(271	) (81	) 1	(351
Other income	406	7	64	477
Total revenue	121,283	44,410	1,071	166,764
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	34,183	16,268	—	50,451
Increase in future policy benefit reserves	54,139	2,845	—	56,984
Policyholders' dividends	7,043	44	—	7,087
Total insurance benefits paid or provided	95,365	19,157	—	114,522
Commissions	20,073	11,356	—	31,429
Other general expenses	8,269	9,895	1,815	19,979
Capitalization of deferred policy acquisition costs	(18,215	) (4,402	) —	(22,617
Amortization of deferred policy acquisition costs	13,061	2,317	—	15,378
Amortization of cost of customer relationships acquired	454	1,144	—	1,598
Total benefits and expenses	119,007	39,467	1,815	160,289
Income (loss) before income tax expense	\$ 2,276	4,943	(744) 6,475

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	Three Months Ended September 30, 2013			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$32,800	10,947	—	43,747
Net investment income	5,924	3,309	337	9,570
Realized investment gains, net	23	2	5	30
Other income	261	(7	) 15	269
Total revenue	39,008	14,251	357	53,616
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	11,249	5,514	—	16,763
Increase in future policy benefit reserves	16,756	642	—	17,398
Policyholders' dividends	2,343	19	—	2,362
Total insurance benefits paid or provided	30,348	6,175	—	36,523
Commissions	6,282	3,658	—	9,940
Other general expenses	2,780	3,205	178	6,163
Capitalization of deferred policy acquisition costs	(5,685	) (1,382	) —	(7,067
Amortization of deferred policy acquisition costs	3,947	811	—	4,758
Amortization of cost of customer relationships acquired	171	510	—	681
Total benefits and expenses	37,843	12,977	178	50,998
Income before income tax expense	\$1,165	1,274	179	2,618

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

	Nine Months Ended September 30, 2013			
	Life Insurance	Home Service Insurance	Other Non-Insurance Enterprises	Consolidated
	(In thousands)			
Revenues:				
Premiums	\$95,767	32,754	—	128,521
Net investment income	16,412	9,830	982	27,224
Realized investment gains, net	104	33	6	143
Other income	675	129	78	882
Total revenue	112,958	42,746	1,066	156,770
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	32,016	16,213	—	48,229
Increase in future policy benefit reserves	49,845	2,408	—	52,253
Policyholders' dividends	6,618	53	—	6,671
Total insurance benefits paid or provided	88,479	18,674	—	107,153
Commissions	18,558	10,869	—	29,427
Other general expenses	8,560	9,696	1,948	20,204
Capitalization of deferred policy acquisition costs	(16,941)	(4,160)	—	(21,101)
Amortization of deferred policy acquisition costs	11,802	1,945	—	13,747
Amortization of cost of customer relationships acquired	492	1,327	—	1,819
Total benefits and expenses	110,950	38,351	1,948	151,249
Income (loss) before income tax expense	\$2,008	4,395	(882)	5,521

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

(4) Earnings Per Share

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

	Three Months Ended	
	September 30, 2014	September 30, 2013
	(In thousands, except per share amounts)	
Basic and diluted earnings per share:		
Numerator:		
Net income	\$2,324	1,824
Net income allocated to Class A common stock	\$2,301	1,806
Net income allocated to Class B common stock	23	18
Net income	\$2,324	1,824
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	\$0.04	0.03
Basic earnings per share of Class B common stock	0.03	0.02
Diluted earnings per share of Class A common stock	0.04	0.03
Diluted earnings per share of Class B common stock	0.03	0.02
	Nine Months Ended	
	September 30, 2014	September 30, 2013
	(In thousands, except per share amounts)	
Basic and diluted earnings per share:		
Numerator:		
Net income	\$4,671	3,987
Net income allocated to Class A common stock	\$4,624	3,947
Net income allocated to Class B common stock	47	40
Net income	\$4,671	3,987
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	\$0.09	0.08
Basic earnings per share of Class B common stock	0.05	0.04
Diluted earnings per share of Class A common stock	0.09	0.08
Diluted earnings per share of Class B common stock	0.05	0.04

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

(5) Investments

The Company invests primarily in fixed maturity securities, which totaled 84.0% of total cash, cash equivalents and investments at September 30, 2014.

	September 30, 2014		December 31, 2013			
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value		
	(\$ In thousands)					
Fixed maturity securities	\$911,888	84.0	% \$832,952	83.9	%	
Equity securities	55,643	5.1	% 47,259	4.8	%	
Mortgage loans	641	0.1	% 671	0.1	%	
Policy loans	52,575	4.8	% 48,868	4.8	%	
Real estate and other long-term investments	8,310	0.8	% 8,485	0.9	%	
Cash and cash equivalents	56,986	5.2	% 54,593	5.5	%	
Total cash, cash equivalents and investments	\$1,086,043	100.0	% \$992,828	100.0	%	

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 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.

	September 30, 2014			
	Cost or Amortized Cost (In thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed maturities:				
Available-for-sale:				
U.S. Treasury securities	\$10,071	2,656	—	12,727
U.S. Government-sponsored enterprises States and political subdivisions	38,539	1,817	1	40,355
Foreign governments	384,239	15,344	2,422	397,161
Corporate	104	29	—	133
Commercial mortgage-backed	210,715	17,063	417	227,361
Residential mortgage-backed	243	8	—	251
Total available-for-sale securities	3,346	260	3	3,603
Held-to-maturity securities:	647,257	37,177	2,843	681,591
U.S. Government-sponsored enterprises States and political subdivisions	5,783	212	—	5,995
Corporate	189,125	6,072	1,098	194,099
Total held-to-maturity securities	35,389	924	242	36,071
Total fixed maturities	230,297	7,208	1,340	236,165
Equity securities:	\$877,554	44,385	4,183	917,756
Stock mutual funds	\$15,738	1,801	30	17,509
Bond mutual funds	35,704	—	280	35,424
Common stock	723	21	11	733
Preferred stock	1,741	236	—	1,977
Total equity securities	\$53,906	2,058	321	55,643

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 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

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 entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

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 recognized other-than-temporary impairments during the three and nine months ended September 30, 2014 of \$0.3 million based upon the fact that there is no longer an intent to hold these securities. No other-than-temporary impairments were recognized during the three and nine months ended in 2013.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 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.

	September 30, 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	\$159	1	1	—	—	—	159	1	1
States and political subdivisions	46,146	508	50	58,380	1,914	50	104,526	2,422	100
Corporate	22,950	324	21	2,681	93	2	25,631	417	23
Residential mortgage-backed	169	2	7	82	1	2	251	3	9
Total available-for-sale securities	69,424	835	79	61,143	2,008	54	130,567	2,843	133
Held-to-maturity securities:									
States and political subdivisions	14,143	93	13	43,699	1,005	45	57,842	1,098	58
Corporate	2,368	178	2	2,958	64	2	5,326	242	4
Total held-to-maturity securities	16,511	271	15	46,657	1,069	47	63,168	1,340	62
Total fixed maturities	\$85,935	1,106	94	107,800	3,077	101	193,735	4,183	195
Equity securities:									
Stock mutual funds	\$1,970	30	2	—	—	—	1,970	30	2
Bond mutual funds	15,720	280	2	—	—	—	15,720	280	2
Common stocks	—	—	—	6	11	1	6	11	1
Preferred stocks	—	—	—	—	—	—	—	—	—
Total equities	\$17,690	310	4	6	11	1	17,696	321	5

As of September 30, 2014, the Company had 54 available-for-sale securities and 47 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 for greater than 12 months as of September 30, 2014.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 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 September 30, 2014 and December 31, 2013 and determined that no other-than-temporary impairment exists that have not been recognized 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

September 30, 2014

(Unaudited)

The amortized cost and fair value of fixed maturity securities at September 30, 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.

	September 30, 2014	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale securities:		
Due in one year or less	\$35,959	36,529
Due after one year through five years	112,116	118,976
Due after five years through ten years	92,456	97,519
Due after ten years	406,726	428,567
Total available-for-sale securities	647,257	681,591
Held-to-maturity securities:		
Due in one year or less	18,069	18,198
Due after one year through five years	24,252	24,927
Due after five years through ten years	56,641	58,762
Due after ten years	131,335	134,278
Total held-to-maturity securities	230,297	236,165
Total fixed maturities	\$877,554	917,756

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 and losses from sales of securities for the three and nine months ended September 30, 2014 and 2013 are summarized as follows.

	Fixed Maturities Available-for-Sale				Equity Securities			
	Three Months Ended September 30,		Nine Months Ended September 30,		Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013	2014	2013	2014	2013
	(In thousands)							
Proceeds	\$100	259	680	317	3,924	—	15,029	—
Gross realized gains	\$5	7	26	8	55	—	118	—
Gross realized losses	\$—	1	—	1	—	—	169	—

There was 1 equity bond mutual fund sold at a loss during the nine month period ended September 30, 2014 as higher yielding bond mutual fund alternatives became more attractive than these U.S. Government backed funds as circumstances changed in the current environment. There were no sales for the three and nine month periods in 2013. There were no securities sold from the held-to-maturity portfolio for the three and nine months ended September 30, 2014 or 2013.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

(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 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.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

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

Available-for-sale investments	September 30, 2014			Total Fair Value
	Level 1	Level 2	Level 3	
	(In thousands)			
Financial assets:				
Fixed maturities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$ 12,727	40,355	—	53,082
States and political subdivisions	—	397,161	—	397,161
Corporate	—	227,361	—	227,361
Commercial mortgage-backed	—	—	251	251
Residential mortgage-backed	—	3,603	—	3,603
Foreign governments	—	133	—	133
Total fixed maturities	12,727	668,613	251	681,591
Equity securities:				
Stock mutual funds	17,509	—	—	17,509
Bond mutual funds	35,424	—	—	35,424
Common stock	733	—	—	733
Preferred stock	1,977	—	—	1,977
Total equity securities	55,643	—	—	55,643
Total financial assets	\$68,370	668,613	251	737,234
	December 31, 2013			
Available-for-sale investments	Level 1	Level 2	Level 3	Total Fair Value
	(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

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

Financial Instruments Valuation

Fixed maturity securities, available-for-sale. At September 30, 2014, our fixed maturity securities, valued using a third-party pricing source, totaled \$668.6 million for Level 2 assets and comprised 90.7% 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 nine months ended September 30, 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.

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.

	September 30, 2014	December 31, 2013
	(In thousands)	
Balance at beginning of period	\$ 309	387
Total realized and unrealized gains (losses)		
Included in net income	—	—
Included in other comprehensive income	(1	) (7
Principal paydowns	(57	) (71
Transfer in and (out) of Level 3	—	—
Balance at end of period	\$ 251	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.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

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:

	September 30, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(In thousands)			
Financial assets:				
Fixed maturities, held-to-maturity	\$230,297	236,165	227,696	223,533
Mortgage loans	641	664	671	695
Policy loans	52,575	52,575	48,868	48,868
Cash and cash equivalents	56,986	56,986	54,593	54,593
Financial liabilities:				
Annuity - investment contracts	42,112	45,202	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 6.3% as of September 30, 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 September 30, 2014. Our mortgage loans are considered Level 3 assets in the fair value hierarchy.

Policy loans had a weighted average annual interest rate of 7.7% as of September 30, 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 September 30, 2014 using discounted cash flows based upon a swap rate curve with interest rates ranging from 1.02% to 4.88% 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

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

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Notes to Consolidated Financial Statements, Continued

September 30, 2014

(Unaudited)

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. The Company believes additional escheatment of funds in Arkansas or Texas will not be material to our financial condition or results. However, additional escheatment of funds in Louisiana, which may subsequently be deemed abandoned under the Louisiana Department of Treasury's audit, could be substantial for SPLIC if the Louisiana Department of Treasury chooses to disregard recent unclaimed property litigation in favor of the insurance industry. At this time, the Company is not able to estimate any of these possible amounts. For more information about the risks related to these external unclaimed property audits please see the Risk Factor in Item 1A titled "We are a defendant in lawsuits, which may adversely affect our financial condition and detract from the time our management is able to devote to our business, and we are subject to risks related to litigation and regulatory matters."

From time to time we are subject to legal and regulatory actions relating to our business. We defend all claims vigorously. As a result, we incur defense costs, including attorneys' fees, other direct litigation costs and the expenditure of management time that otherwise would be devoted to our business. For more information about the risks related to the Company's litigation, please see "Item 1 Legal Proceedings" and the risk factor titled "We are a defendant in lawsuits, which may adversely affect our financial condition and detract from the time our management is able to devote to our business, and we are subject to risks related to litigation and regulatory matters." in Item 1A. Risk Factors.

(8) Income Taxes

The effective tax rate was 29.1% and 30.3% for the three months and 27.9% and 27.8% for the nine months 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 has remained relatively flat from year to year.

(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 nine months ended September 30, 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

September 30, 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;
- Our concentration of business from persons residing in Latin America and the Pacific Rim;
- Changes in tax laws;
- Effects of acquisitions and restructuring, including possible difficulties in integrating and realizing the projected results of acquisitions;
- Changes in statutory or U.S. GAAP accounting principles, policies or practices; and
- Our success at managing risks involved in the foregoing; and
- The risk factors discussed in "Part II. - Item 1A - Risk Factors." of this report

Such forward-looking statements speak only as of the date on which such statements are made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

We make available, free of charge, through our Internet website (<http://www.citizensinc.com>), our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Section 16 Reports filed by officers and directors, news releases, and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2014

Exchange Act of 1934, as soon as reasonably practicable after we electronically file such reports with, or furnish such reports to, the Securities and Exchange Commission. We are not including any of the information contained on our website as part of, or incorporating it by reference into, this Quarterly Report on Form 10-Q.

Overview

Citizens is an insurance holding company serving the life insurance needs of individuals in the United States since 1969 and internationally since 1975. Through our insurance subsidiaries, we pursue a strategy of offering traditional insurance products in niche markets where we believe we are able to achieve competitive advantages. As of September 30, 2014, we had approximately \$1.3 billion of total assets and approximately \$5.0 billion of insurance in force. Our core insurance operations include issuing and servicing:

U.S. Dollar-denominated ordinary whole life insurance and endowment policies predominantly to high net worth, high income residents of foreign countries, principally in Latin America and the Pacific Rim through independent marketing consultants;
ordinary whole life insurance policies to middle income households concentrated in the Midwest and southern United States through independent marketing consultants; and
final expense and limited liability property policies to middle and lower income households in Louisiana, Arkansas and Mississippi through employee and independent agents in our home service distribution channel and funeral homes.

We were formed in 1969 by our Chairman, Harold E. Riley. Prior to our formation, Mr. Riley had many years of experience in the international and domestic life insurance business. Our Company has experienced significant growth through acquisitions in the domestic market and through market expansion in the international market. We seek to capitalize on the experience of our management team in marketing and operations as we strive to generate bottom line return using knowledge of our niche markets and our well-established distribution channels. We believe our underwriting processes, policy terms, pricing practices and proprietary administrative systems enable us to be competitive in our current markets, while protecting our shareholders and servicing our policyholders.

Current Financial Highlights

Financial highlights for the three and nine month periods ended September 30, 2014, compared to the same periods in 2013 were:

Insurance premiums rose for the three and nine month periods ended September 30, 2014 to \$46.9 million and \$136.3 million in 2014 from \$43.7 million and \$128.5 million for the corresponding periods in 2013, an increase of 7.3% and 6.0% driven primarily from first year and renewal premiums in our life insurance segment.

Net investment income increased 8.5% and 11.6% for the three and nine month periods ended September 30, 2014 compared to the corresponding periods in 2013. The average yield on the consolidated portfolio as of the nine months ended September 30, 2014 increased to an annualized rate of 4.22% up from 4.10% for the same period in 2013.

Claims and surrenders expense increased 3.4% and 4.6% for the three and nine months ended in 2014 compared to 2013 as surrender benefits reported in both insurance segments increased in the current year compared to 2013 levels.

Changes in reserves resulted in liability increases due to the increased sales of endowment products that build up reserves at a faster pace than whole life longer-term mortality based products.

We completed the acquisition of MGLIC in the first quarter and the related results have been included in our financial results for September 30, 2014. MGLIC is now a wholly owned subsidiary of SPLIC and is reported with the home service segment.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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Our Operating Segments

Our business is comprised of three operating business segments, as detailed below.

☒ Life Insurance

☒ Home Service Insurance

○ Other Non-Insurance Enterprises

Our insurance operations are the primary focus of the Company, as those operations generate the majority of our income. See the discussion under Segment Operations for detailed analysis. The amount of insurance, number of policies, and average face amounts of ordinary life policies issued during the periods indicated are shown below.

	Nine Months Ended September 30, 2014			2013		
	Amount of Insurance Issued	Number of Policies Issued	Average Policy Face Amount Issued	Amount of Insurance Issued	Number of Policies Issued	Average Policy Face Amount Issued
Life	\$272,101,881	4,546	\$59,855	\$262,191,318	4,418	\$59,346
Home Service	146,472,655	21,830	6,710	141,523,143	20,617	6,864

Note: All discussions below compare or state results for the three and nine-month periods ended September 30, 2014 compared to the three and nine-month periods ended September 30, 2013.

Consolidated Results of Operations

A discussion of consolidated results is presented below, followed by a discussion of segment operations and financial results by segment.

Revenues

Revenues are generated primarily by insurance premiums and investment income on invested assets.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Revenues:				
Premiums:				
Life insurance	\$45,234	42,091	\$131,298	123,728
Accident and health insurance	394	380	1,135	1,135
Property insurance	1,295	1,276	3,832	3,658
Net investment income	10,384	9,570	30,373	27,224
Realized investment gains (losses), net	(222	) 30	(351	) 143
Other income	145	269	477	882
Total revenues	\$57,230	53,616	\$166,764	156,770

Premium Income. Premium income derived from life, accident and health, and property insurance sales increased 7.3% and 6.0% for the three and nine month periods ended September 30, 2014 compared to the same periods ended September 30, 2013. The increase is generated primarily from an increase in the life segment first year and renewal business and premium income of \$1.4 million recorded due to the acquisition of MGLIC.

Net investment income performance is summarized as follows.

	September 30, 2014	December 31, 2013	September 30, 2013	
	(In thousands, except for %)			
Net investment income, annualized	\$40,498	36,597	36,299	
Average invested assets, at amortized cost	960,266	891,215	886,157	
Annualized yield on average invested assets	4.22	% 4.11	% 4.10	%

Yields have been slowly rising as we reinvest calls and new premium money into higher yielding bonds compared to the historically low rates experienced over the past several years.

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Investment income from debt securities accounted for approximately 85.3% of total investment income for the nine months ended September 30, 2014.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Gross investment income:				
Fixed maturity securities	\$9,189	8,634	\$27,317	24,330
Equity securities	510	420	1,356	1,345
Mortgage loans	10	10	32	58
Policy loans	1,049	956	3,080	2,660
Long-term investments	73	60	218	170
Other investment income	12	12	36	50
Total investment income	10,843	10,092	32,039	28,613
Investment expenses	(459	) (522	) (1,666	) (1,389
Net investment income	\$10,384	9,570	\$30,373	27,224

The consolidated invested asset portfolio has increased approximately 9.7% from year end 2013 to September 30, 2014 with, primarily, investments in the fixed maturity securities portfolio accounting for the most significant increase in investment income. Bond mutual funds are the primary source of dividend income in the equity securities holdings. In addition, the increase in policy loans, which represents policyholders utilizing their accumulated policy cash value, contributed to the increase to investment income.

Realized Investment Gains (Losses), Net. Losses of \$0.3 million were recorded in the current three month period due to other than temporary impairments that were recognized related to 2 short-term bond mutual fund issues that we anticipate disposing of in the near future if interest rates rise. In addition, we have sold three bond mutual fund issues totaling \$15.0 million that resulted in a net loss of \$51,000 for the nine months ended September 30, 2014. In addition, the nine month results in 2014 also include sinking par calls on bonds purchased at a premium which resulted in a loss. The losses are offset by issuer calls and redemptions that result in gains.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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Benefits and Expenses

	Three Months Ended September 30, 2014		2013		Nine Months Ended September 30, 2014		2013	
	(In thousands)							
Benefits and expenses:								
Insurance benefits paid or provided:								
Claims and surrenders	\$17,326	16,763	\$50,451	48,229				
Increase in future policy benefit reserves	19,307	17,398	56,984	52,253				
Policyholders' dividends	2,573	2,362	7,087	6,671				
Total insurance benefits paid or provided	39,206	36,523	114,522	107,153				
Commissions	11,116	9,940	31,429	29,427				
Other general expenses	6,029	6,163	19,979	20,204				
Capitalization of deferred policy acquisition costs	(8,126)	(7,067)	(22,617)	(21,101)				
Amortization of deferred policy acquisition costs	5,276	4,758	15,378	13,747				
Amortization of cost of customer relationships acquired	453	681	1,598	1,819				
Total benefits and expenses	\$53,954	50,998	\$160,289	151,249				

Claims and Surrenders. A detail of claims and surrender benefits is provided below.

	Three Months Ended September 30, 2014		2013		Nine Months Ended September 30, 2014		2013	
	(In thousands)							
Death claims	\$5,039	5,494	\$16,581	16,418				
Surrender benefits	7,091	6,028	18,141	16,525				
Endowments	4,023	3,927	12,110	11,515				
Property claims	439	613	1,153	1,582				
Accident and health benefits	111	117	386	284				
Other policy benefits	623	584	2,080	1,905				
Total claims and surrenders	\$17,326	16,763	\$50,451	48,229				

Death claims decreased 8.3% and increased slightly for the three and nine months ended September 30, 2014 as we experienced favorable claims development in the current quarter for both the life and home service segments.

Mortality experience is closely monitored by the Company and the activity is within expected levels.

Surrenders increased by 17.6% and 9.8% in the three and nine periods primarily due to activity in the life segment.

Increase in Future Policy Benefit Reserves. The increase in future policy benefit reserves for the three and nine months ended September 30, 2014, is due to continued growth in new sales of endowment products, which require higher initial reserve levels than whole life products. Endowments have been our top selling products for the last several years as policyholders favor the guaranteed values of this product.

Policyholder Dividends. The majority of our international policies are participating, and the dividends are factored into the premium rates charged. As policy provisioned dividend rates generally increase each year that a policy is in force, dividend expense is expected to increase as this block of insurance becomes more seasoned.

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Commissions. Commission expense is directly related to new and renewal insurance premium fluctuations and production levels by agents and associates. Commission expense for the three and nine months ended September 30, 2014 fluctuated directly in relation to the decrease and increase of first year and renewal premiums in the life segment compared to premium levels for the three and nine months ended September 30, 2013.

Capitalized and Amortized Deferred Policy Acquisition Costs. Costs capitalized under current accounting guidance include certain commissions, policy issuance costs, and underwriting and agency expenses that relate to successful sales efforts for insurance contracts. The increase for the three and nine months ended September 30, 2014, compared to the same periods in 2013 was the result of an increase in first year premium production in the current periods, which increased capitalized amounts. Though premium revenue increased in 2014, it was primarily related to an increase in renewal premiums compared to the prior year. Commissions paid on renewal premiums are significantly lower than those paid on first year business.

Amortization for the three and nine months ended September 30, 2014, increased compared to the same periods in 2013. Amortization of deferred policy acquisition costs is impacted by persistency and may fluctuate from year to year.

Federal Income Tax. The effective tax rate was 29.1% and 30.3% for the three months and 27.9% and 27.8% for the nine months ended September 30, 2014 and 2013, respectively. Differences between our effective tax rate and the statutory tax rate result from income and expense items that are treated differently for financial reporting and tax purposes. See Note 8 - Income Taxes in the consolidated financial statements for further discussion.

Segment Operations

The Company has three reportable segments: Life Insurance, Home Service Insurance and Other Non-Insurance Enterprises. These segments are reported in accordance with U.S. GAAP. The Company evaluates profit and loss performance of its segments based on net income or loss before income taxes.

	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
	(In thousands)			
Life Insurance	\$1,192	1,165	\$2,276	2,008
Home Service Insurance	2,075	1,274	4,943	4,395
Other Non-Insurance Enterprises	9	179	(744	) (882
Total	\$3,276	2,618	\$6,475	5,521

Life Insurance

Our Life Insurance segment issues ordinary whole life insurance domestically and U.S. Dollar-denominated ordinary whole-life policies to foreign residents. These contracts are designed to provide a fixed amount of insurance coverage over the life of the insured. Additionally, the Company issues endowment contracts, which are principally accumulation contracts that incorporate an element of life insurance protection. For the majority of our business, we retain only the first \$100,000 of risk on any one life. We operate this segment through our CICA and CNLIC insurance subsidiaries.

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International Sales

We focus our sales of U.S. Dollar-denominated ordinary whole life insurance and endowment policies to high net worth, high income residents in Latin America and the Pacific Rim. We have successfully participated in the foreign marketplace since 1975, and we continue to seek opportunities for expansion of our foreign operations. We believe positive attributes of our international insurance business include:

- larger face amount policies typically issued when compared to our U.S. operations, which results in lower underwriting and administrative costs per unit of coverage;
- premiums typically paid annually rather than monthly or quarterly, which reduces our administrative expenses, accelerates cash flow and results in lower policy lapse rates than premiums with more frequently scheduled payments; and
- comparable persistency levels and mortality rates as experienced with U.S. policies.

International Products

We offer several ordinary whole life insurance and endowment products designed to meet the needs of our non-U.S. policyowners. These policies have been structured to provide:

- U.S. Dollar-denominated cash values that accumulate, beginning in the first policy year, to a policyholder during his or her lifetime;
- premium rates that are competitive with or better than most foreign local companies;
- a hedge against local currency inflation;
- protection against devaluation of foreign currency;
- capital investment in the United States' more secure economic environment; and
- lifetime income guarantees for an insured or for surviving beneficiaries.

Our international products have living benefit features. Every policy contains guaranteed cash values and most are participating (i.e., provides for cash dividends as apportioned by the board of directors). Once a policyowner pays the annual premium and the policy is issued, we immediately pay the owner a cash dividend as well as an annual guaranteed endowment, if elected. The policyowner has several options with regard to the dividend and annual guaranteed endowments, including the right to assign policy values to our stock investment plan, registered under the Securities Act of 1933 (the "Securities Act") and administered in the United States by our unaffiliated transfer agent.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

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The following table sets forth, by country, our direct premiums from our international life insurance business for the periods indicated.

Country	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	2013	2013	2013	2013
	(In thousands)			
Venezuela	\$7,984	6,590	\$22,523	20,363
Colombia	7,268	6,291	20,065	17,908
Taiwan	3,392	3,182	11,460	10,771
Ecuador	3,559	3,607	11,077	10,812
Argentina	2,226	2,464	6,270	6,654
Other Non-U.S.	9,362	8,898	26,049	24,381
Total	\$33,791	31,032	\$97,444	90,889

We continue to report increased sales from our top producing countries as noted above. Our international business and premium collections could be impacted by future changes relative to laws, regulations or economic events in the countries from which we accept applications.

Domestic Sales

In the Midwest, Mountain West and the southern United States, we seek to serve middle income households through the sale of cash accumulation ordinary whole life insurance products. The majority of our inforce business results from blocks of business of insurance companies we have acquired over the past fifteen years.

Domestic Products

Our domestic life insurance products focus primarily on living needs and provide benefits focused toward accumulating money for living benefits while providing a modest death benefit for the policyowner. The features of our domestic life insurance products include:

- cash accumulation/living benefits;
- tax-deferred annuity interest earnings;
- guaranteed lifetime income or monthly income options for the policyowner or surviving family members;
- accidental death benefit coverage options; and
- an option to waive premium payments in the event of disability.

Our life insurance products are principally designed to address the insured's concern about outliving his or her monthly income, while at the same time providing death benefits. The primary purpose of our product portfolio is to help the insured create capital for needs such as retirement income, children's higher education funds, business opportunities, emergencies and extraordinary health care needs.

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The following table sets forth our direct premiums by state for the periods indicated.

State	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Texas	\$564	703	\$ 1,746	2,041
Indiana	353	401	1,040	1,099
Kentucky	107	108	337	350
Florida	166	145	429	401
Missouri	80	127	330	412
Other States	612	(12	) 1,582	1,388
Total	\$1,882	1,472	\$ 5,464	5,691

A number of domestic life insurance companies we acquired had blocks of accident and health insurance policies, which we did not consider to be a core part of our business. We have ceded the majority of our accident and health insurance business to Puritan Life Insurance Company ("Puritan"), an unaffiliated insurance company under a coinsurance agreement.

The results of operations for the life insurance segment for the periods indicated are as follows.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Revenue:				
Premiums	\$35,359	32,800	\$ 101,739	95,767
Net investment income	6,660	5,924	19,409	16,412
Realized investment gains (losses), net	(159	) 23	(271	) 104
Other income	130	261	406	675
Total revenue	41,990	39,008	121,283	112,958
Benefits and expenses:				
Insurance benefits paid or provided:				
Claims and surrenders	12,205	11,249	34,183	32,016
Increase in future policy benefit reserves	18,314	16,756	54,139	49,845
Policyholders' dividends	2,560	2,343	7,043	6,618
Total insurance benefits paid or provided	33,079	30,348	95,365	88,479
Commissions	7,351	6,282	20,073	18,558
Other general expenses	2,464	2,780	8,269	8,560
Capitalization of deferred policy acquisition costs	(6,708	) (5,685	) (18,215	) (16,941
Amortization of deferred policy acquisition costs	4,449	3,947	13,061	11,802
Amortization of cost of customer relationships acquired	163	171	454	492
Total benefits and expenses	40,798	37,843	119,007	110,950
Income before income tax expense	\$1,192	1,165	\$ 2,276	2,008

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Premiums. Premium revenues increased for the three and nine month periods ended September 30, 2014, compared to the same periods in 2013 due primarily to international new and renewal business showing positive growth and strong persistency as this block of insurance ages. First year premium revenues for the quarter ended September 30, 2014, reflected sales internationally with endowment to age sixty-five and the twenty-year endowment products continuing as the top performers in the current year.

Life insurance premium breakout is detailed below.

	Three Months Ended September 30, 2014		2013		Nine Months Ended September 30, 2014		2013	
	(In thousands)							
Premiums:								
First year	\$5,709	4,703	\$	14,984		13,736		
Renewal	29,650	28,097		86,755		82,031		
Total premiums	\$35,359	32,800	\$	101,739		95,767		

Net Investment Income. Net investment income increased as the impact of the sustained low interest rate environment has leveled and yields are beginning to rise modestly.

	Nine Months Ended September 30, 2014		Year Ended December 31, 2013		Nine Months Ended September 30, 2013	
	(In thousands, except for %)					
Net investment income, annualized	\$25,879		22,237		21,883	
Average invested assets, at amortized cost	611,257		549,578		541,937	
Annualized yield on average invested assets	4.23		% 4.05		% 4.04	%

Realized Investment Gains (Losses), Net. Losses of \$0.2 million were recorded in the current three month period ended September 30, 2014 due to other than temporary impairments that were recognized related to 2 short-term bond mutual fund issues that we anticipate disposing of in the near future if interest rates rise. Losses recorded for the nine month period ended September 30, 2014 related to sales of three bond mutual funds totaling \$12.1 million and resulting in a net loss of approximately \$25,000. The nine months ended September 30, 2014 also includes sinking par calls on bonds purchased at a premium which resulted in a loss offset by gains from issuer calls and redemptions.

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Claims and Surrenders. These amounts fluctuate from period to period but were within anticipated ranges based upon management's expectations.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
	(In thousands)			
Death claims	\$ 1,378	1,587	\$ 4,353	4,301
Surrender benefits	6,208	5,180	15,750	14,447
Endowment benefits	4,014	3,923	12,094	11,502
Accident and health benefits	81	82	200	192
Other policy benefits	524	477	1,786	1,574
Total claims and surrenders	\$ 12,205	11,249	\$ 34,183	32,016

Death claims expense was favorable for the three months and relatively flat for the nine months ended September 30, 2014 based upon reported claims. Mortality experience is closely monitored by the Company as a key performance indicator and these amounts were within expected levels.

Surrenders increased in the three and nine month periods ended in 2014 by 19.8% and 9.0%. The majority of policy surrender benefits paid is attributable to our international business and was related to policies that have been in force nearly twenty years, where surrender charges are no longer applicable.

Endowment benefit expense primarily results from the election by policyholders of a product feature providing an annual guaranteed benefit. This is a fixed benefit over the life of the contract, thus this expense will increase with new sales and improved persistency.

Other policy benefits resulted primarily from interest paid on premium deposits and policy benefit accumulations and increased as these policy liabilities also increased.

Increase in Future Policy Benefit Reserves. Policy benefit reserves increased for the three and nine months ended September 30, 2014 compared to the same periods in 2013, primarily from growth in new sales of endowment products, which require higher initial reserve levels than whole life products. Endowment sales have become more popular with our international clients in the past few years, representing approximately 83% and 77% of total new first year premium in the nine months ended September 30, 2014 and 2013, respectively.

Commissions. Commission expense increased for the three and nine months ended September 30, 2014, compared to the same periods in 2013. This expense fluctuates directly with new premium revenues and commission rates paid are higher on first year premium sales, which were up for the three and nine months ended September 30, 2014, compared to the same periods in 2013. Renewal premiums for the three and nine months, for which we pay commissions at lower rates, were also up from the prior year.

Other General Expenses. These expenses are allocated by segment, based upon an annual expense study performed by the Company, and were down slightly for the three and nine months ended September 30, 2014, compared to the same periods in 2013.

Capitalization of Deferred Policy Acquisition Costs ("DAC"). Capitalized costs fluctuate in direct relation to commissions increasing for the three and nine months ended September 30, 2014, based upon first year and renewal premiums and commissions paid compared to 2013.

Amortization of Deferred Policy Acquisition Costs. Amortization for the three and nine months ended September 30, 2014 increased and was impacted by overall lower persistency related to this segment. As previously noted,

persistence is monitored closely by the Company and was within expectations.

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Home Service Insurance

We operate in the Home Service insurance market through our subsidiaries Security Plan Life Insurance Company ("SPLIC"), Magnolia Guaranty Life Insurance Company ("MGLIC") and Security Plan Fire Insurance Company ("SPFIC"), and focus on the life insurance needs of the middle and lower income markets, primarily in Louisiana, Mississippi and Arkansas. Our policies are sold and serviced through a home service marketing distribution system of employee-agents who work full time on a route system and through funeral homes that sell policies, collect premiums and service policyholders.

In March of the current year we completed the acquisition of MGLIC which is now a wholly owned subsidiary of SPLIC. MGLIC is licensed in Mississippi and customarily sells policies through independent funeral homes. Together, we anticipate Mississippi clients will experience enhanced support from the affiliated companies.

The following table sets forth our direct premiums by state for the periods indicated.

State	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Louisiana	\$10,559	10,463	\$ 31,614	31,319
Arkansas	413	419	1,242	1,280
Mississippi	643	126	1,803	366
Other States	194	228	614	665
Total	\$11,809	11,236	\$ 35,273	33,630

We recorded approximately \$1.4 million of additional premium in Mississippi for the nine months ended September 30, 2014 due to the purchase of MGLIC.

Home Service Insurance Products

Our home service insurance products consist primarily of small face amount ordinary whole life and pre-need policies, which are designed to fund final expenses for the insured, primarily consisting of funeral and burial costs. To a much lesser extent, our home service insurance segment sells limited-liability, named-peril property policies covering dwellings and contents. We provide \$30,000 maximum coverage on any one dwelling and contents, while content only coverage and dwelling only coverage is limited to \$20,000, respectively.

We provide final expense ordinary life insurance and annuity products primarily to middle and lower income individuals in Louisiana, Mississippi and Arkansas.

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The results of operations for the home service insurance segment for the periods indicated are as follows.

	Three Months Ended September 30, 2014		2013		Nine Months Ended September 30, 2014		2013	
	(In thousands)							
Revenue:								
Premiums	\$ 11,564		10,947		\$ 34,526		32,754	
Net investment income	3,389		3,309		9,958		9,830	
Realized investment gains (losses), net	(63	)	2		(81	)	33	
Other income	3		(7	)	7		129	
Total revenue	14,893		14,251		44,410		42,746	
Benefits and expenses:								
Insurance benefits paid or provided:								
Claims and surrenders	5,121		5,514		16,268		16,213	
Increase in future policy benefit reserves	993		642		2,845		2,408	
Policyholders' dividends	13		19		44		53	
Total insurance benefits paid or provided	6,127		6,175		19,157		18,674	
Commissions	3,765		3,658		11,356		10,869	
Other general expenses	3,227		3,205		9,895		9,696	
Capitalization of deferred policy acquisition costs	(1,418	)	(1,382	)	(4,402	)	(4,160)
Amortization of deferred policy acquisition costs	827		811		2,317		1,945	
Amortization of cost of customer relationships acquired	290		510		1,144		1,327	
Total benefits and expenses	12,818		12,977		39,467		38,351	
Income before income tax expense	\$ 2,075		1,274		\$ 4,943		4,395	

Premiums. Premiums increased 5.6% and 5.4% for the three and nine month periods ended September 30, 2014, compared to 2013 primarily from \$0.6 million and \$1.4 million of premiums recorded in the current three and nine month periods related to MGLIC.

Net Investment Income. Net investment income for our home service insurance segment was as follows.

	Nine Months Ended September 30, 2014		Year Ended December 31, 2013		Nine Months Ended September 30, 2013	
	(In thousands, except for %)					
Net investment income, annualized	\$ 13,299		13,075		13,107	
Average invested assets, at amortized cost	293,887		290,340		293,071	
Annualized yield on average invested assets	4.53		% 4.50		% 4.47	%

Realized Investment Gains (Losses), Net. Losses of \$0.1 million were recorded in the current three month period ended September 30, 2014 due to other than temporary impairments that were recognized related to 2 short-term bond mutual fund issues that we anticipate disposing of in the near future if interest rates rise. In addition, net realized losses for the nine months ended September 30, 2014 resulted from the sale of two bond mutual funds totaling \$3.0 million with a net realized loss of \$26,000 to

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move into more attractive funds in the current environment. The losses are offset by gains from issuer calls of debt securities which we experienced in 2014 and 2013.

Claims and Surrenders. Claims and surrenders decreased for the three months and remained flat for the nine months ended September 30, 2014, compared to the same periods in 2013, based upon reported claims compared to the prior year, but were within expected ranges.

	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
	(In thousands)			
Death claims	\$3,661	3,907	\$ 12,228	12,117
Surrender benefits	883	848	2,391	2,078
Endowment benefits	9	4	16	13
Property claims	439	613	1,153	1,582
Accident and health benefits	30	35	186	92
Other policy benefits	99	107	294	331
Total claims and surrenders	\$5,121	5,514	\$ 16,268	16,213

Death claims expense fluctuates based upon reported claims. Mortality experience is closely monitored by the Company as a key performance indicator and amounts were within expected levels.

Surrender benefits increased 4.1% and 15.1% for the three and nine months ended in 2014 compared to the same periods in 2013 as decisions are made by policyholders electing to cash in their policy values.

Property claims decreased 28.4% and 27.1% for the three and nine months ended September 30, 2014 as we had experienced more weather related claims in 2013.

Increase in Future Policy Benefit Reserves. The Company recorded an increase in future policy benefit reserves for the three and nine months ended September 30, 2014, compared to the corresponding periods in 2013 with the addition of MGLIC policies in the current year.

Commissions. Commission expense fluctuated for the three and nine months ended September 30, 2014, compared to the same periods in 2013 as premium collections varied. Commission expense related to MGLIC totaled \$131,000 and \$326,000 for the three and nine months ended September 30, 2014.

Other General Expenses. Expenses are allocated by segment based upon an annual expense study performed by the Company and increased between 2014 and 2013.

Capitalization of Deferred Policy Acquisition Costs ("DAC"). Capitalized costs increased slightly for the three and nine months ended September 30, 2014, as commission expense also increased during the period. DAC capitalization is directly correlated to fluctuations in new business and commissions.

Amortization of Deferred Policy Acquisition Costs. Amortization for the three and nine months ended September 30, 2014 increased compared to the corresponding period in 2013 as this segment experienced lower persistency compared to the prior year, which results in higher amortization.

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Other Non-Insurance Enterprises

This segment represents the administrative support entities to the insurance operations whose revenues are primarily intercompany and have been eliminated in consolidation under GAAP. The segment loss reported for the first nine months of 2014 and 2013 is typical since the elimination of intercompany revenue is its primary source of revenue.

Investments

The administration of our investment portfolios is handled by our management, pursuant to board-approved investment guidelines, with all trading activity approved by a committee of each entity's respective boards of directors. The guidelines used require that fixed maturities, both government and corporate, are investment grade and comprise a majority of the investment portfolio. State insurance statutes prescribe the quality and percentage of the various types of investments that may be made by insurance companies and generally permit investment in qualified state, municipal, federal and foreign government obligations, high quality corporate bonds, preferred and common stock, mortgage loans and real estate within certain specified percentages. The assets are intended to mature in accordance with the average maturity of the insurance products and to provide the cash flow for our insurance company subsidiaries to meet their respective policyholder obligations.

The following table shows the carrying value of our investments by investment category and cash and cash equivalents, and the percentage of each to total invested cash, cash equivalents and investments.

	September 30, 2014		December 31, 2013	
	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value
	(In thousands)		(In thousands)	
Marketable securities:				
U.S. Treasury and U.S. Government-sponsored enterprises	\$58,865	5.4	\$75,908	7.7
States and political subdivisions	586,286	54.0	517,712	52.1
Corporate	262,750	24.2	235,134	23.7
Mortgage-backed ⁽¹⁾	3,854	0.4	4,071	0.4
Foreign governments	133	—	127	—
Total marketable securities	911,888	84.0	832,952	83.9
Cash and cash equivalents	56,986	5.2	54,593	5.5
Other investments:				
Policy loans	52,575	4.8	48,868	4.8
Equity securities	55,643	5.1	47,259	4.8
Mortgage loans	641	0.1	671	0.1
Real estate	8,174	0.8	8,440	0.9
Other long-term investments	136	—	45	—
Total cash, cash equivalents and investments	\$1,086,043	100.0	\$992,828	100.0

⁽¹⁾ Includes \$3.1 million and \$3.8 million of U.S. Government-sponsored enterprises at September 30, 2014, and December 31, 2013, respectively.

Cash and cash equivalents increased as of September 30, 2014 due to timing of cash inflows and investment into marketable securities.

The held-to-maturity portfolio as of September 30, 2014 represented 25.3% of the total fixed maturity securities owned based upon carrying values, with the remaining 74.7% classified as available-for-sale. Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

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The following table sets forth the distribution of the credit ratings of our portfolio of fixed maturity securities by carrying value as of September 30, 2014 and December 31, 2013.

	September 30, 2014		December 31, 2013	
	Carrying Value (In thousands)	% of Total Carrying Value	Carrying Value (In thousands)	% of Total Carrying Value
AAA	\$61,663	6.8	\$55,093	6.6
AA	416,971	45.7	391,054	46.9
A	251,337	27.6	231,004	27.7
BBB	145,741	16.0	125,597	15.1
BB and other	36,176	3.9	30,204	3.7
Totals	\$911,888	100.0	\$832,952	100.0

Credit ratings reported for the periods indicated are assigned by a Nationally Recognized Statistical Rating Organization (“NRSRO”) such as Moody’s Investors Service, Standard & Poor’s or Fitch Ratings. A credit rating assigned by an NRSRO is a quality based rating, with AAA representing the highest quality and D the lowest, with BBB and above being considered investment grade. In addition, the Company may use credit ratings of the National Association of Insurance Commissioners (“NAIC”) Securities Valuation Office (“SVO”) as assigned, if there is no NRSRO rating. Securities rated by the SVO are grouped in the equivalent NRSRO category as stated by the SVO and securities that are not rated by an NRSRO are included in the “other” category.

The Company has no direct sovereign European debt exposure as of September 30, 2014. We do have indirect exposure in one bond mutual fund holding, but the amount is deemed immaterial to the current investment holdings and consolidated financials.

As of September 30, 2014, the Company held municipal securities that include third party guarantees. Detailed below is a presentation by NRSRO rating of our municipal holdings by funding type.

Municipals shown including third party guarantees

	September 30, 2014						Total	% Based on Amortized Cost	
	General Obligation		Special Revenue		Other				
	Fair Value (In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	
AAA	\$43,405	41,194	16,103	15,436	—	—	59,508	56,630	9.8
AA	127,512	123,320	196,688	188,594	14,768	14,048	338,968	325,962	56.9
A	41,574	41,883	112,316	110,295	6,678	6,707	160,568	158,885	27.7
BBB	2,746	2,793	19,586	19,007	—	—	22,332	21,800	3.8
BB and other	547	495	8,801	9,012	536	580	9,884	10,087	1.8
Total	\$215,784	209,685	353,494	342,344	21,982	21,335	591,260	573,364	100.0

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Municipals shown excluding third party guarantees

September 30, 2014

	General Obligation		Special Revenue		Other	Total		% Based on	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Amortized Cost
	(In thousands)								
AAA	\$15,635	15,404	3,793	3,714	—	—	19,428	19,118	3.3
AA	109,861	106,137	140,392	134,130	11,734	11,012	261,987	251,279	43.8
A	41,307	39,818	139,307	135,560	8,306	8,361	188,920	183,739	