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

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 June 30, 2001

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission file number 0-20148

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Class A Stock - 1,733,715 as of August 6, 2001.

The date of this Report is August 8, 2001.

Part I - Financial Information; Item 1 - Financial Statements

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

Six Months Ended June 30	2001
Revenues:	
Premiums and other considerations	$ 14,499,491
Premiums ceded	(571,395)
Net premiums earned	13,928,096
Net investment income	3,341,497
Net realized investment gains (losses), net of expenses	(3,298,100)
Other income	119,270
Total Revenues	14,090,763
Policy Benefits and Expenses:	
Policyholder benefits	9,211,451
Policyholder benefits ceded	(551,088)
Net benefits	8,660,363
Increase in net benefit reserves	2,773,707
Interest credited on policyholder deposits	413,409
Commissions	3,413,978
General expenses	3,331,683
Interest expense	314,701
Policy acquisition costs deferred	(2,030,361)
Amortization of deferred policy acquisition costs, value of insurance acquired, and goodwill	914,001
Total Policy Benefits and Expenses	17,791,481
Income (Loss) before Income Tax Expense	(3,700,718)
Income Tax Expense (Benefit)	(857,000)
Income (Loss) before cumulative effect of a change in accounting principle	(2,843,718)
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	(311,211)
Net Income (Loss)	$ (3,154,929)
Per Share Amounts:	
Income (Loss) before cumulative effect of a change in accounting principle	$(1.62)
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	(0.18)
Net Income (Loss)	$(1.80)

Part I, Item 1 (continued)

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

Three Months Ended June 30	2001
Revenues:	
Premiums and other considerations	$7,469,404
Premiums ceded	(259,863)
Net premiums earned	7,209,541
Net investment income	1,656,564
Net realized investment gains (losses), net of expenses	(3,469,996)
Other income	69,325
Total Revenues	5,465,434
Policy Benefits and Expenses:	
Policyholder benefits	4,510,476
Policyholder benefits ceded	(267,248)
Net benefits	4,243,228
Increase in net benefit reserves	1,943,644
Interest credited on policyholder deposits	217,863
Commissions	1,655,635
General expenses	1,707,876
Interest expense	143,050
Policy acquisition costs deferred	(971,548)
Amortization of deferred policy acquisition costs, value of insurance acquired, and goodwill	417,849
Total Policy Benefits and Expenses	9,357,597
Income (Loss) before Income Tax Expense	(3,892,163)
Income Tax Expense (Benefit)	(945,000)
Net Income (Loss)	$(2,947,163)
Net Income (Loss) Per Common Share	$(1.68)

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries

Condensed Consolidated Statements of Financial Condition

	June 30, 2001
ASSETS	(Unaudited)
Investments:	
Securities available for sale, at fair value:	
Fixed maturities (amortized cost of $67,337,719 and $72,516,172 in 2001 and 2000 respectively)	$ 67,690,504
Equity securities (cost of $10,951,281 and $13,677,303 in 2001 and 2000, respectively)	11,830,773
Investment real estate	3,548,764
Mortgage loans on real estate	156,000
Policy loans	4,228,579
Short-term investments	610,379
Total Investments	88,064,999
Cash and cash equivalents	26,079,323
Accrued investment income	1,351,929
Reinsurance recoverable	2,511,546
Premiums receivable	287,204
Property and equipment	2,895,336
Deferred policy acquisition costs	8,068,023
Value of insurance acquired	4,525,492
Goodwill	800,788
Federal income tax receivable	740,758
Deferred federal income tax	1,142,677
Other assets	586,221
Total Assets	$137,054,296

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	June 30, 2001
LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)
Liabilities:	
Policy Liabilities:	

Future policy benefits	$ 86,547,617
Policyholder deposits	16,320,623
Policy and contract claims	1,648,164
Unearned premiums	170,334
Other	269,357
Total Policy Liabilities	104,956,095
Notes payable	7,600,000
Accrued expenses and other liabilities	2,253,628
Total Liabilities	114,809,723
Commitments and Contingencies	
Shareholders' Equity:	
Common stock, 6,000,000 shares authorized; 1,733,715 and 1,758,215 shares issued and outstanding in 2001 and 2000, respectively	1,733,715
Additional paid-in capital	7,419,263
Accumulated other comprehensive income (loss)	798,324
Retained earnings	12,293,271
Total Shareholders' Equity	22,244,573
Total Liabilities and Shareholders' Equity	$137,054,296

Part I; Item 1 (continued)

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

Six Months Ended June 30	2001
Cash Flows from Operations:	
Net income (loss)	$(3,154,929)
Adjustments to reconcile net income to cash from operations:	
Increase in benefit reserves	3,115,649
Decrease in claim liabilities	(168,783)
Decrease in reinsurance recoverable	175,201
Interest credited on policyholder deposits	413,409
Provision for amortization and depreciation, net of deferrals	(937,238)
Amortization of premium and accretion of discount on Securities purchased, net	(42,285)
Net realized investment (gains) losses	3,298,100
Increase in accrued investment income	(23,438)
Change in other assets and liabilities	(124,023)
Decrease in deferred federal income tax liability	(236,000)
Decrease in federal income taxes receivable	623,743

Cumulative effect of a change in accounting principle	311,211
Net Cash provided (used in) by Operations	3,250,617
Cash Flows from Investment Activities:	
Cost of securities acquired	(9,002,909)
Investments sold or matured	13,108,753
Investment management fees and margin interest	(170,395)
Additions to property and equipment, net	(157,092)
Other investing activities, net	76,833
Net Cash provided by Investment Activities	3,855,190
Cash Flows from Financing Activities:	
Policyholder deposits	511,638
Policyholder withdrawals	(985,671)
Payments on notes payable - bank	(400,000)
Brokerage account advances, net	---
Repurchase of common stock	(246,225)
Net Cash used in Financing Activities	(1,120,258)
Net Increase in Cash and Cash Equivalents	5,985,549
Cash and Cash Equivalents at Beginning of Period	20,093,774
Cash and Cash Equivalents at End of Period	$26,079,323

Part I; Item 1 (continued)

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

Note 1 - BASIS OF PRESENTATION

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

Note 2 - COMPREHENSIVE INCOME

The components of comprehensive income, net of related tax, for the three months and six months ended June 30, 2001 and 2000 are as follows:

	Three Months Ended June 30,	Six Months En

COMPREHENSIVE INCOME:	2001	2000	2001
Net Income (Loss)	$(2,947,163)	$ 829,192	$(3,154,929)
Net unrealized gains (losses) on securities	2,308,564	(3,111,712)	2,371,618
Comprehensive Income (Loss)	$ (638,599)	$(2,282,520)	$ (783,311)

Note 3 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

Note 4 - NET REALIZED INVESTMENT GAINS, NET OF EXPENSES

The Company recorded pretax reductions to the carrying value of available for sale securities totaling $2,715,000 and $2,762,000 for the six months ended June 30, 2001 and 2000, respectively, relating to declines in value which were considered by management to be other than temporary. These amounts are reported as reductions of net realized investment gains. Changes in the fair value of derivative instruments are also reported as realized gains (losses). The Company also nets certain direct, incremental investment management fees against net realized investment gains presented in the Condensed Consolidated Statements of Income. Such costs are based directly on or, are primarily associated with, realized capital gains. Costs netted against realized investment gains total $23,000 and $283,000 for the six months ended June 30, 2001 and 2000, respectively.

Part I; Item 1 (continued)

Note 5 - INCOME TAXES

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

Note 6 - SEGMENT INFORMATION

The Company's operations are managed along five principal insurance product lines: Home Service Life, Broker Life, Preneed Life, Dental, and Other Health. Products in all five lines are sold through independent agency operations. Home Service Life consists primarily of traditional life insurance coverage sold in amounts of $10,000 and under to middle and lower income individuals. This distribution channel is characterized by a significant amount of agent contact with customers throughout the year. Broker Life product sales consist primarily of simplified issue and graded-benefit policies in amounts of $10,000 and under. Other products in this segment which are not aggressively marketed include: group life, universal life, annuities and participating life coverages. Preneed Life products are sold to individuals in connection with prearrangement of their funeral and include single premium and multi-pay policies with coverages generally in amounts of $10,000 and less. These policies are generally sold to older individuals at increased premium rates. Dental products are term coverages generally sold to small and intermediate size employer groups. Other Health products include various accident and health coverages sold to individuals and employer groups. Segment information as of June 30, 2001 and 2000, and for the periods then ended is as follows:

	Three Months Ended June 30,		Six Months En
REVENUE:	2001	2000	2001
Home Service Life	$ 2,344,220	$ 2,178,382	$ 4,682,981
Broker Life	1,602,379	1,470,882	3,091,439
Preneed Life	2,530,092	1,228,505	4,667,413
Dental	2,073,328	1,950,207	4,172,980
Other Health	385,411	340,184	774,050
Segment Totals	8,935,430	7,168,160	17,388,863
Net realized investment gains (losses)	(3,469,996)	1,530,931	(3,298,100)
Total Revenue	$ 5,465,434	$ 8,699,091	$14,090,763

	Three Months Ended June 30,		Six Months En
NET INVESTMENT INCOME:	2001	2000	2001
Home Service Life	$ 549,316	$ 537,315	$1,112,364
Broker Life	685,730	640,963	1,398,252
Preneed Life	387,505	329,844	762,276
Dental	9,822	10,056	19,787
Other Health	24,191	22,935	48,818
Segment Totals	$1,656,564	$1,541,113	$3,341,497

Part I; Item 1 (continued)

The Company evaluates performance based on several factors, of which the primary financial measure is segment profit. Segment profit represents pretax earnings, except net realized investment gains and interest expense are excluded. The majority of the Company's realized investment gains and losses are generated from investments in equity securities. The equities portfolio averaged (on a cost basis) approximately $12,838,000 and $19,721,000 during the six months ended June 30, 2001 and 2000, respectively. If these funds had been invested in fixed-maturities yielding 7%, realized investment gains (losses) would have changed and the six month segment profit totals below would have increased by approximately $300,000 and $454,000 in 2001 and 2000, respectively.

	Three Months Ended June 30,		Six Months En
SEGMENT PROFIT (LOSS):	2001	2000	2001
Home Service Life	$ 3,820	$ 52,708	$ 173,488
Broker Life	(202,945)	61,042	11,502
Preneed Life	(75,283)	(228,571)	(387,219)
Dental	(10,800)	100,984	84,698
Other Health	6,091	(53,817)	29,614
Segment Totals	(279,117)	(67,654)	(87,917)
Net realized investment gains (losses)	(3,469,996)	1,530,931	(3,298,100)
Interest expense	143,050	194,085	314,701
Income (Loss) before Federal Income Tax	$(3,892,163)	$1,269,192	$(3,700,718)

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

	Three Months Ended June 30,		Six Months En
DEPRECIATION AND AMORTIZATION:	2001	2000	2001
Home Service Life	$115,131	$ 155,196	$ 292,766
Broker Life	171,747	113,002	330,427
Preneed Life	186,721	74,167	401,511
Dental	18,006	12,664	36,006
Other Health	15,818	9,448	32,412
Segment Totals	$507,423	$ 364,477	$1,093,122

ASSETS:	June 30, 2001	December 31, 2000
Home Service Life	$45,441,758	$ 45,577,255
Broker Life	56,253,560	57,721,008
Preneed Life	32,661,505	29,421,677
Dental	736,665	799,496
Other Health	1,960,808	2,018,570
Segment Totals	$137,054,296	$135,538,006

Part I; Item 1 (continued)

Note 7 - LITIGATION

United Liberty Life Insurance Company ("United"), which the Company acquired in 1998, is defending an action in an Ohio state court brought by two policyholders. The Complaint refers to a particular class of life insurance policies that United issued over a period of years ending around 1971. It alleges that United's dividend payments on these policies from 1993 through 1999 were less than the required amount. It does not specify the amount of the alleged underpayment but implies a maximum of about $850,000. The plaintiffs also allege that United is liable to pay punitive damages, also in an unspecified amount, for breach of an implied covenant of good faith and fair dealing to the plaintiffs in relation to the dividends. The action has been certified as a class action on behalf of all policyholders residing in Ohio whose policies were still in force in 1993. United has denied the material allegations of the Complaint and is defending the action vigorously. Pre-trial discovery is continuing and will be followed by motions to dismiss or narrow the plaintiffs' claims. At this early stage of the litigation, the Company is unable to determine whether an unfavorable outcome of the action is likely to occur or, alternatively, whether the chance of such an outcome is remote. Therefore, at this time, management has no basis for estimating potential losses, if any.

Note 8 - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

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

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

FINANCIAL POSITION. Shareholders' equity totaled approximately $22,245,000 and $30,843,000 at June 30, 2001 and 2000, respectively. These balances reflect an approximate 4% decrease and a 10% increase for the respective six month periods then ended. As described above, comprehensive income (loss) totaled approximately $(783,000) and $2,873,000 for the six months ended June 30, 2001 and 2000, respectively. A significant portion of comprehensive income (loss) is attributable to changes in the value of the Company's equity portfolios. Equity securities comprised approximately 9% and 17% of the Company's total assets as of June 30, 2001 and 2000, respectively. Accordingly, as also described below, the Company's financial position can be significantly affected by movements in the equities markets. Equity portfolio positions decreased $2,726,000 on a cost basis and $747,000 on a market value basis, during the first six months of 2001. The majority of this cost basis decline is attributable to recording second quarter impairments (realized losses) which management believes are appropriate due to the continued uncertainty in the equity markets. Fixed maturity portfolio positions decreased $5,178,000 on an amortized cost basis and decreased $3,713,000 on a market value basis during the same period. However, as described in Note 3 above, $497,000 of the change between cost and market values during 2001 is attributable to the SFAS 133 transition adjustment recorded at January 1, 2001. Cash and cash equivalent positions also increased approximately $5,986,000 during the six months ended June 30, 2001.

OPERATIONS. Net premiums and other considerations increased approximately $2,645,000, or 23% during the first six months of 2001 compared to the first six months of 2000. Preneed Life, Dental, and Home Service Life premium increases were approximately $2,259,000, $336,000, and $54,000, respectively, while Broker Life experienced a modest decrease. The Preneed Life segment growth is attributable primarily to competitive marketing agreements signed with certain independent agency groups during late 2000. Dental premium growth is also primarily attributable to a key additional independent marketing arrangement signed during 2000. The Other Health segment represents less that 6% of total premium.

Pretax earnings (loss) [before the cumulative effect of a new accounting principle] totaled approximately $(3,701,000) for the six months ended June 30, 2001, compared to $5,878,000 for the six months ended June 30, 2000. The majority of this change resulted from realized investment losses. Pretax Segment (Loss) (excluding realized investment gains and losses and interest expense) for the first six months of 2001 was approximately $(88,000), compared to $(68,000) for the first six months of 2000. This change resulted primarily from improved Preneed Life sales and mortality and improved Home Service Life sales and persistency, offset by higher Broker Life and Dental claims.

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

CASH FLOW AND LIQUIDITY. Cash flow from operations totaled $3,251,000 for the six months ended June 30, 2001 compared to $(1,807,000) for the same period in the prior year. This increase is primarily attributable to growth in the Preneed Life business. The $3,855,000 of cash provided by investing activities for the six months ended March 31, 2001 resulted primarily from retaining the net proceeds from equity investment sales as cash. The $1,120,000 of cash used in financing activities during the first six months of 2001 is primarily attributable to annuity and Universal Life account withdrawals and bank loan principal repayments.

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

FORWARD-LOOKING INFORMATION.

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

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

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

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

There have been no material changes in quantitative or qualitative market risks during the six months ended June 30, 2001.

Part II - Other Information

Item 4. Submission of Matters to a Vote of Security Holders.

The 2001 annual meeting of shareholders of the Company was held on May 24, 2001. At the meeting, eight incumbent directors were re-elected to serve until the 2002 annual meeting of shareholders. The names of the incumbent directors and shares of the Company's Class A Stock voted for each were as follows:

Candidate	Votes
John H. Harralson, Jr.	1,370,143
Lane A. Hersman	1,281,719
Frank T. Kiley	1,370,143
Charles A. Mays	1,338,068
Earle V. Powell	1,370,043
Thomas G. Ward	1,370,143
Darrell R. Wells	1,313,556
Margaret A. Wells	1,313,556

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

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

b). none

SIGNATURES

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

CITIZENS FINANCIAL CORPORATION

BY: /s/ Darrell R. Wells

Darrell R. Wells
President and Chief Executive Officer

BY: /s/ Brent L. Nemec

Brent L. Nemec
Treasurer and Principal Accounting Officer

Date: August 8, 2001

EXHIBIT INDEX

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

EXHIBIT 11

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

Six Months Ended June 30	2001
Numerator(s):	
Income (Loss) before cumulative effect of a change in accounting principle	$(2,843,718)
Cumulative effect of a change in accounting principle	(311,211)
Net Income (Loss)	$ (3,154,929)
Denominator:	
Weighted average common shares	1,753,884
Earnings Per Share:	
Income (Loss) before cumulative effect of a change in accounting principle	$ (1.62)
Cumulative effect of a change in accounting principle	(0.18)
Net Income (Loss)	$ (1.80)

Three Months Ended June 31	2001
Numerator(s):	
Net Income (Loss)	$(2,947,163)
Denominator:	
Weighted average common shares	1,749,600
Earnings Per Share:	
Net Income (Loss)	$ (1.68)