

CITIZENS INC
Form 10-Q
August 07, 2009

Table of Contents

**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, 2009

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, Texas

78752

(Address of principal executive offices)

(Zip Code)

(512) 837-7100

(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 Act). ☐ Yes ☐ No

As of August 7, 2009, the Registrant had 46,980,411 shares of Class A common stock, no par value, outstanding and 1,001,714 shares of Class B common stock outstanding.

TABLE OF CONTENTS

| | Page Number |
|---|----------------|
| <u>Part I. Financial Information</u> | |
| <u>Item 1. Financial Statements</u> | |
| <u>Consolidated Statements of Financial Position, June 30, 2009, (Unaudited) and December 31, 2008</u> | 2 |
| <u>Consolidated Statements of Operations, Three Months Ended June 30, 2009 and 2008 (Unaudited)</u> | 4 |
| <u>Consolidated Statements of Operations, Six Months Ended June 30, 2009 and 2008 (Unaudited)</u> | 5 |
| <u>Consolidated Statements of Cash Flows, Six Months Ended June 30, 2009 and 2008 (Unaudited)</u> | 6 |
| <u>Notes to Consolidated Financial Statements</u> | 8 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 24 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u> | 39 |
| <u>Item 4. Controls and Procedures</u> | 40 |
| <u>Part II. Other Information</u> | |
| <u>Item 1. Legal Proceedings</u> | 40 |
| <u>Item 1A. Risk Factors</u> | 41 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 42 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 42 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 42 |
| <u>Item 5. Other Information</u> | 42 |
| <u>Item 6. Exhibits</u> | 42 |
| <u>Exhibit 21</u> | |
| <u>Exhibit 31.1</u> | |
| <u>Exhibit 31.2</u> | |
| <u>Exhibit 32.1</u> | |
| <u>Exhibit 32.2</u> | |

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****Consolidated Statements of Financial Position****(In thousands)**

| | June 30, 2009 (Unaudited) | December 31, 2008 |
|---|--|------------------------------|
| Investments: | | |
| Fixed maturities available-for-sale, at fair value (cost: \$346,577 and \$494,034 in 2009 and 2008, respectively) | \$ 340,120 | 485,155 |
| Fixed maturities held-to-maturity, at amortized cost (fair value: \$158,871 in 2009) | 161,241 | |
| Equity securities available-for-sale, at fair value (cost: \$42,270 and \$42,908 in 2009 and 2008, respectively) | 45,880 | 43,000 |
| Mortgage loans on real estate | 704 | 339 |
| Policy loans | 31,188 | 28,955 |
| Real estate held for sale | 3,855 | 4,156 |
| Real estate held for investment (less \$329 and \$283 accumulated depreciation in 2009 and 2008, respectively) | 5,926 | 4,717 |
| Other long-term investments | 120 | 680 |
| Short-term investments | 2,583 | 2,250 |
| Total investments | 591,617 | 569,252 |
| Cash and cash equivalents | 95,090 | 63,792 |
| Accrued investment income | 6,204 | 7,423 |
| Reinsurance recoverable | 12,580 | 13,241 |
| Deferred policy acquisition costs | 112,639 | 109,114 |
| Cost of customer relationships acquired | 36,174 | 33,805 |
| Goodwill | 16,809 | 15,687 |
| Other intangible assets | 1,095 | 1,073 |
| Federal income tax receivable | 500 | 2,090 |
| Property and equipment, net | 6,191 | 6,466 |
| Due premiums, net (less \$1,554 and \$2,217 allowance for doubtful accounts in 2009 and 2008, respectively) | 8,517 | 8,958 |
| Prepaid expenses | 1,811 | 454 |
| Other assets | 1,253 | 921 |
| Total assets | \$ 890,480 | 832,276 |

(Continued)

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Financial Position, Continued
(In thousands, except share amounts)

| | June 30, 2009 (Unaudited) | December 31, 2008 |
|--|---------------------------------|----------------------|
| Liabilities and Stockholders Equity | | |
| Liabilities: | | |
| Policy liabilities: | | |
| Future policy benefit reserves: | | |
| Life insurance | \$ 570,192 | 547,621 |
| Annuities | 35,680 | 34,025 |
| Accident and health | 6,966 | 7,442 |
| Dividend accumulations | 5,492 | 4,795 |
| Premiums paid in advance | 19,686 | 18,566 |
| Policy claims payable | 9,929 | 9,318 |
| Other policyholders funds | 8,113 | 7,929 |
| Total policy liabilities | 656,058 | 629,696 |
| Commissions payable | 1,832 | 2,350 |
| Deferred Federal and state income tax | 3,452 | 3,951 |
| Payable for securities in process of settlement | 15,000 | |
| Warrants outstanding | 1,892 | 4,973 |
| Other liabilities | 12,324 | 12,052 |
| Total liabilities | 690,558 | 653,022 |
| Commitments and contingencies (Note 8) | | |
| Cumulative convertible preferred stock Series A (Series A-1 \$1,000 stated value per share, 6,250 shares authorized, issued and outstanding in 2009 and 2008; Series A-2 \$935 stated value per share, 5,000 shares authorized, 4,014 issued and outstanding in 2009 and 2008) | 9,858 | 7,713 |
| Stockholders Equity: | | |
| Common stock: | | |
| Class A, no par value, 100,000,000 shares authorized, 50,116,149 shares issued in 2009 and 48,781,753 shares issued in 2008, including shares in treasury of 3,135,738 in 2009 and 2008 | 246,845 | 240,511 |
| Class B, no par value, 2,000,000 shares authorized, 1,001,714 shares issued and outstanding in 2009 and 2008 | 3,184 | 3,184 |
| Retained deficit | (48,339) | (55,432) |
| Accumulated other comprehensive loss: | | |
| Unrealized losses on securities, net of tax | (615) | (5,711) |

| | | |
|--|---------------------|---------------------|
| Treasury stock, at cost | 201,075 (11,011) | 182,552 (11,011) |
| Total stockholders' equity | 190,064 | 171,541 |
| Total liabilities and stockholders' equity | \$ 890,480 | 832,276 |

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Operations
Three Months Ended June 30,
(In thousands, except per share amounts)
(Unaudited)

| | 2009 | 2008 |
|---|--------------|-------------|
| Revenues: | | |
| Premiums: | | |
| Life insurance | \$ 34,586 | 33,491 |
| Accident and health insurance | 368 | 410 |
| Property insurance | 1,161 | 1,303 |
| Net investment income | 6,578 | 7,480 |
| Realized gains, net | 1,520 | |
| Decrease in fair value of warrants | 976 | 312 |
| Other income | 240 | 285 |
| Total revenues | 45,429 | 43,281 |
| Benefits and expenses: | | |
| Insurance benefits paid or provided: | | |
| Claims and surrenders | 14,953 | 14,730 |
| Increase in future policy benefit reserves | 9,958 | 7,733 |
| Policyholders' dividends | 1,453 | 1,577 |
| Total insurance benefits paid or provided | 26,364 | 24,040 |
| Commissions | 8,992 | 9,376 |
| Other underwriting, acquisition and insurance expenses | 7,808 | 7,020 |
| Capitalization of deferred policy acquisition costs | (5,894) | (6,309) |
| Amortization of deferred policy acquisition costs | 3,720 | 4,106 |
| Amortization of cost of customer relationships acquired and other intangibles | 818 | 715 |
| Total benefits and expenses | 41,808 | 38,948 |
| Income before Federal income tax | 3,621 | 4,333 |
| Federal income tax expense | 905 | 1,341 |
| Net income | \$ 2,716 | 2,992 |
| Net income applicable to common stockholders | \$ 1,546 | 2,493 |

Per Share Amounts:

| | | |
|--|---------|------|
| Basic and diluted earnings per share of Class A common stock | \$ 0.03 | 0.06 |
|--|---------|------|

| | | |
|--|---------|------|
| Basic and diluted earnings per share of Class B common stock | \$ 0.02 | 0.03 |
|--|---------|------|

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Operations
Six Months Ended June 30,
(In thousands, except per share amounts)
(Unaudited)

| | 2009 | 2008 |
|---|--------------|-------------|
| Revenues: | | |
| Premiums: | | |
| Life insurance | \$ 67,269 | 64,341 |
| Accident and health insurance | 764 | 794 |
| Property insurance | 2,309 | 2,739 |
| Net investment income | 14,320 | 14,944 |
| Realized gains, net | 1,821 | 16 |
| Decrease (increase) in fair value of warrants | 3,081 | (191) |
| Other income | 523 | 564 |
| Total revenues | 90,087 | 83,207 |
| Benefits and expenses: | | |
| Insurance benefits paid or provided: | | |
| Claims and surrenders | 29,760 | 27,808 |
| Increase in future policy benefit reserves | 17,716 | 14,730 |
| Policyholders' dividends | 2,915 | 2,954 |
| Total insurance benefits paid or provided | 50,391 | 45,492 |
| Commissions | 17,027 | 17,087 |
| Other underwriting, acquisition and insurance expenses | 15,117 | 13,931 |
| Capitalization of deferred policy acquisition costs | (10,951) | (11,164) |
| Amortization of deferred policy acquisition costs | 7,412 | 7,668 |
| Amortization of cost of customer relationships acquired and other intangibles | 1,684 | 1,479 |
| Total benefits and expenses | 80,680 | 74,493 |
| Income before Federal income tax | 9,407 | 8,714 |
| Federal income tax expense | 2,314 | 2,987 |
| Net income | \$ 7,093 | 5,727 |
| Net income applicable to common stockholders | \$ 4,745 | 4,716 |

Per Share Amounts:

| | | |
|--|---------|------|
| Basic earnings per share of Class A common stock | \$ 0.10 | 0.11 |
| Basic earnings per share of Class B common stock | \$ 0.05 | 0.05 |
| Diluted earnings per share of Class A common stock | \$ 0.04 | 0.11 |
| Diluted earnings per share of Class B common stock | \$ 0.02 | 0.05 |

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Cash Flows
Six Months Ended June 30,
(In thousands)
(Unaudited)

| | 2009 | 2008 |
|---|--------------|-------------|
| Cash flows from operating activities: | | |
| Net income | \$ 7,093 | 5,727 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Realized gains on sale of investments and other assets | (1,821) | (16) |
| Net deferred policy acquisition costs | (3,539) | (3,496) |
| Amortization of cost of customer relationships acquired and other intangibles | 1,684 | 1,479 |
| Increase (decrease) in fair value of warrants | (3,081) | 191 |
| Depreciation | 622 | 534 |
| Amortization of premiums and discounts on fixed maturities and short-term investments | 1,079 | 48 |
| Deferred Federal income tax expense (benefit) | (418) | 2,047 |
| Change in: | | |
| Accrued investment income | 1,267 | 51 |
| Reinsurance recoverable | 736 | 1,131 |
| Due premiums and other receivables | 235 | 10 |
| Future policy benefit reserves | 17,123 | 13,923 |
| Other policyholders' liabilities | 1,048 | 4,558 |
| Federal income tax receivable (payable) | 1,600 | (11) |
| Commissions payable and other liabilities | (317) | (346) |
| Other, net | (1,340) | (1,419) |
| Net cash provided by operating activities | 21,971 | 24,411 |
| Cash flows from investing activities: | | |
| Purchase of fixed maturities, held-to-maturity | (161,279) | |
| Sale of fixed maturities, available-for-sale | 38,670 | |
| Maturity and calls of fixed maturities, available-for-sale | 257,872 | 108,685 |
| Purchase of fixed maturities, available-for-sale | (133,554) | (109,097) |
| Sale of equity securities, available-for-sale | 1,175 | |
| Purchase of equity securities, available-for-sale | (326) | (22,798) |
| Principal payments on mortgage loans | 14 | 18 |
| Mortgage loans funded | (379) | (115) |
| Increase in policy loans | (2,234) | (1,049) |
| Sale of other long-term investments and property and equipment | 580 | 179 |
| Purchase of other long-term investments and property and equipment | (1,725) | (418) |
| Maturity of short-term investments | 2,250 | 18,000 |
| Purchase of short-term investments | (2,605) | |
| Cash acquired in acquisition | 9,770 | |
| Net cash provided by (used in) investing activities | \$ 8,229 | (6,595) |

(Continued)

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Consolidated Statements of Cash Flows, Continued
Six Months Ended June 30,
(In thousands)
(Unaudited)

| | 2009 | 2008 |
|--|---------------|------------|
| Cash flows from financing activities: | | |
| Warrants exercised | \$ 69 | |
| Annuity deposits | 2,735 | 1,350 |
| Annuity withdrawals | (1,706) | (761) |
| Net cash provided by financing activities | 1,098 | 589 |
| Net increase in cash and cash equivalents | 31,298 | 18,405 |
| Cash and cash equivalents at beginning of period | 63,792 | 21,123 |
| Cash and cash equivalents at end of period | \$ 95,090 | 39,528 |
| Supplemental disclosures of operating activities: | | |
| Cash paid during the period for income taxes | \$ 1,125 | 951 |

Supplemental Disclosure of Non-Cash Investing Activities:

On February 27, 2009, the Company acquired Integrity Capital Corporation (ICC) for 1,294,000 shares of Class A common stock. The Class A common stock had a fair value of \$8.4 million. CICA held a 13% interest in ICC prior to the acquisition with a carrying value of \$551,000, making the total non-cash acquisition price approximately \$9.0 million.

Supplemental Disclosures of Non-Cash Financing Activities:

Dividends on the Company's Series A-1 Convertible Preferred Stock, issued in 2004, and Series A-2 Convertible Preferred Stock, issued in 2005, were paid by the Company through the issuance of Class A common stock to the preferred shareholders in the amounts of \$203,000 and \$343,000 for the first six months of 2009 and 2008, respectively. Accretion of deferred issuance costs and discounts on the Convertible Preferred Stock recorded as a deduction to Class A common stock during the first six months of 2009 and 2008 was \$2,145,000 and \$668,000, respectively.

See accompanying notes to consolidated financial statements.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements
June 30, 2009
(Unaudited)

(1) Financial Statements

The interim consolidated financial statements include the accounts and operations of Citizens, Inc. (Citizens), incorporated in the state of Colorado on November 8, 1977, and its wholly-owned subsidiaries, CICA Life Insurance Company of America (CICA), Computing Technology, Inc. (CTI), Funeral Homes of America, Inc. (FHA), Insurance Investors, Inc. (III), Citizens National Life Insurance Company (CNLIC), Integrity Capital Corporation (ICC), Integrity Capital Insurance Company (ICIC), Ozark National Life Insurance Company (ONLIC), Security Plan Life Insurance Company (SPLIC), and Security Plan Fire Insurance Company (SPFIC). Citizens and its consolidated subsidiaries are collectively referred to as the Company, we, us, or our.

The consolidated statements of financial position for June 30, 2009, the consolidated statements of operations for the three and six-month periods ended June 30, 2009 and 2008, and the consolidated statements of cash flows for the six-month periods then ended 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 June 30, 2009, and for comparative periods presented, have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States of America (U.S.) generally accepted accounting principles (U.S. GAAP) have been omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2009, are not necessarily indicative of the operating results for the full year.

The Company completed its acquisition of Integrity Capital Corporation in exchange for 1,294,000 shares of Citizens, Inc. Class A common stock in the first quarter of 2009. Integrity Capital Corporation is the parent of Integrity Capital Insurance Company, an Indiana life insurance company. The transaction was valued at \$9.0 million on the closing date of February 27, 2009.

A purchase price accounting adjustment was recorded as of June 30, 2009 to increase policy reserves by \$307,000 and increase cost of insurance acquired (COIA) by \$326,000, due to the discovery of additional policy reserve items during the conversion of ONLIC, which were missing at acquisition. The difference of \$19,000 was recorded as a reduction of goodwill. ONLIC was acquired during the fourth quarter of 2008 and is expected to be fully converted to the Company s internal system in the third quarter of 2009.

Certain amounts presented in prior years have been reclassified to conform to the current presentation.

(2) Accounting Pronouncements

On January 1, 2009, the Company adopted SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R) and SFAS 160, *Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements*, an amendment to ARB No. 51 (SFAS 160). The Company used the provisions of SFAS 141R in its acquisition of Integrity Capital Corporation in the first quarter of 2009. The impact of this acquisition and the adoption of SFAS 141R did not have a material effect on the Company s consolidated financial statements. There were no noncontrolling interests in the ICC acquisition.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

On April 9, 2009, the Financial Accounting Standards Board (FASB) finalized three FASB Staff Positions (FSPs) regarding the accounting treatment for investments including mortgage-backed securities. These FSPs changed the method for determining if an other-than-temporary impairment (OTTI) exists and the amount of OTTI to be recorded through an entity's income statement. The changes brought about by the FSPs provide greater clarity and reflect a more accurate representation of the credit and noncredit components of an OTTI event. The three FSPs are as follows:

FSP Statement of Financial Accounting Standards, (SFAS) 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides additional guidance on estimating fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. The FSP also provides additional guidance on circumstances that may indicate that a transaction is not orderly. The Company adopted this FSP as of June 30, 2009 with no significant change to the Company's financial condition or results of operations.

FSP SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, provides new guidance on the recognition and presentation of an OTTI and requires additional disclosures. The Company adopted this FSP as of June 30, 2009 with no significant change to the Company's financial condition or results of operations.

FSP SFAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, an amendment of FASB 107, extends the disclosure requirements of FASB 107, Disclosures about Fair Value of Financial Instruments, to interim financial statements of publicly traded companies. The Company adopted this FSP during the second quarter of 2009 resulting in additional financial disclosures in Note 7.

As required by FSP 157-2, the Company adopted SFAS 157, *Fair Value Measurements* (SFAS 157), for non-financial assets and liabilities on January 1, 2009. Non-financial assets include goodwill and indefinite-lived intangible assets and eligible non-financial assets and liabilities included within a business combination. The provisions of SFAS 157 will be implemented at December 31, 2009 in conjunction with the Company's annual goodwill and intangible asset impairment testing. The adoption of the provisions of SFAS 157 relating to goodwill and indefinite-lived intangible assets at December 31, 2009 is not expected to have a material effect on our consolidated financial statements.

In April 2008, FASB issued SFAS No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP SFAS 142-3). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, *Goodwill and Other Intangible Assets* (SFAS 142). This FSP is intended to improve the consistency between the useful life of an intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset. FSP SFAS 142-3 requires an entity to disclose information related to the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement. FSP SFAS 142-3 was adopted by the Company in the first quarter of 2009. The adoption of FSP SFAS 142-3 did not have a material impact on the Company's results of operation or financial position.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires entities to disclose the date through which it has evaluated subsequent events and the basis for that date. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. SFAS 165 was effective for the Company as of June 30, 2009. The adoption of SFAS 165 did not have a material impact on our financial condition, results of operations, or disclosures.

In June 2009, the FASB approved the FASB Accounting Standards Codification (Codification) as the single source of authoritative nongovernmental U.S. generally accepted accounting principles (U.S. GAAP), which was launched on July 1, 2009. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. All existing accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered nonauthoritative. The Codification is effective for interim and annual periods ending after September 15, 2009. The Codification is effective for the Company during its interim period ending September 30, 2009 and is not expected to have an impact on its financial condition or results of operations. The Company is currently evaluating the impact to its financial reporting process of providing Codification references in its public filings.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(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, and has no reportable differences between segments and consolidated operations.

Below is a summary of the segment information for the three and six month periods ended June 30, 2009 and 2008.

| | Three Months Ended June 30, 2009 | | | |
|---|---|---------------------------------------|--|---------------------|
| | Life Insurance | Home Service Insurance | Other Non-Insurance Enterprises | Consolidated |
| | (In thousands) | | | |
| Revenues: | | | | |
| Premiums | \$ 25,720 | 10,395 | | 36,115 |
| Net investment income | 3,707 | 2,868 | 3 | 6,578 |
| Realized gains, net | 358 | 1,085 | 77 | 1,520 |
| Decrease in fair value of warrants | | | 976 | 976 |
| Other income | 71 | 46 | 123 | 240 |
| Total revenue | 29,856 | 14,394 | 1,179 | 45,429 |
| Benefits and expenses: | | | | |
| Insurance benefits paid or provided: | | | | |
| Claims and surrenders | 10,514 | 4,439 | | 14,953 |
| Increase in future policy benefit reserves | 8,118 | 1,840 | | 9,958 |
| Policyholders' dividends | 1,435 | 18 | | 1,453 |
| Total insurance benefits paid or provided | 20,067 | 6,297 | | 26,364 |
| Commissions | 5,247 | 3,745 | | 8,992 |
| Other underwriting, acquisition and insurance expenses | 2,707 | 4,035 | 1,066 | 7,808 |
| Capitalization of deferred policy acquisition costs | (4,495) | (1,399) | | (5,894) |
| Amortization of deferred policy acquisition costs | 3,568 | 152 | | 3,720 |
| Amortization of cost of customer relationships acquired and other intangibles | 440 | 378 | | 818 |
| Total benefits and expenses | 27,534 | 13,208 | 1,066 | 41,808 |

| | | | | |
|----------------------------------|----------|-------|-----|-------|
| Income before Federal income tax | \$ 2,322 | 1,186 | 113 | 3,621 |
|----------------------------------|----------|-------|-----|-------|

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

| | Six Months Ended June 30, 2009 | | | |
|---|---------------------------------------|----------------|-----------------------|---------------------|
| | Life | Home | Other | |
| | Insurance | Service | Non-Insurance | Consolidated |
| | | | Enterprises | |
| | | | (In thousands) | |
| Revenues: | | | | |
| Premiums | \$ 49,775 | 20,567 | | 70,342 |
| Net investment income | 7,964 | 6,270 | 86 | 14,320 |
| Realized gains, net | 418 | 1,326 | 77 | 1,821 |
| Decrease in fair value of warrants | | | 3,081 | 3,081 |
| Other income | 159 | 64 | 300 | 523 |
| Total revenue | 58,316 | 28,227 | 3,544 | 90,087 |
| Benefits and expenses: | | | | |
| Insurance benefits paid or provided: | | | | |
| Claims and surrenders | 20,224 | 9,536 | | 29,760 |
| Increase in future policy benefit reserves | 15,408 | 2,308 | | 17,716 |
| Policyholders' dividends | 2,878 | 37 | | 2,915 |
| Total insurance benefits paid or provided | 38,510 | 11,881 | | 50,391 |
| Commissions | 9,704 | 7,323 | | 17,027 |
| Other underwriting, acquisition and insurance expenses | 5,310 | 7,989 | 1,818 | 15,117 |
| Capitalization of deferred policy acquisition costs | (8,252) | (2,699) | | (10,951) |
| Amortization of deferred policy acquisition costs | 6,920 | 492 | | 7,412 |
| Amortization of cost of customer relationships acquired and other intangibles | 708 | 976 | | 1,684 |
| Total benefits and expenses | 52,900 | 25,962 | 1,818 | 80,680 |
| Income before Federal income tax | \$ 5,416 | 2,265 | 1,726 | 9,407 |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

| | Three Months Ended June 30, 2008 | | | |
|---|---|------------------|-----------------------|---------------------|
| | Life | Home | Other | |
| | Insurance | Service | Non-Insurance | Consolidated |
| | | Insurance | Enterprises | |
| | | | (In thousands) | |
| Revenues: | | | | |
| Premiums | \$ 25,399 | 9,805 | | 35,204 |
| Net investment income | 4,148 | 3,099 | 233 | 7,480 |
| Realized gains (losses), net | 3 | (3) | | |
| Decrease in fair value of warrants | | | 312 | 312 |
| Other income | 82 | 8 | 195 | 285 |
| Total revenue | 29,632 | 12,909 | 740 | 43,281 |
| Benefits and expenses: | | | | |
| Insurance benefits paid or provided: | | | | |
| Claims and surrenders | 9,187 | 5,543 | | 14,730 |
| Increase in future policy benefit reserves | 8,615 | (882) | | 7,733 |
| Policyholders' dividends | 1,557 | 20 | | 1,577 |
| Total insurance benefits paid or provided | 19,359 | 4,681 | | 24,040 |
| Commissions | 5,679 | 3,697 | | 9,376 |
| Other underwriting, acquisition and insurance expenses | 2,731 | 3,320 | 969 | 7,020 |
| Capitalization of deferred policy acquisition costs | (4,934) | (1,375) | | (6,309) |
| Amortization of deferred policy acquisition costs | 3,134 | 972 | | 4,106 |
| Amortization of cost of customer relationships acquired and other intangibles | 239 | 476 | | 715 |
| Total benefits and expenses | 26,208 | 11,771 | 969 | 38,948 |
| Income (loss) before Federal income tax | \$ 3,424 | 1,138 | (229) | 4,333 |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

| | Six Months Ended June 30, 2008 | | | |
|---|--------------------------------|------------|----------------|--------------|
| | Life | Home | Other | |
| | Insurance | Service | Non-Insurance | Consolidated |
| | | | Enterprises | |
| | | | (In thousands) | |
| Revenues: | | | | |
| Premiums | \$ 47,950 | 19,924 | | 67,874 |
| Net investment income | 8,210 | 6,183 | 551 | 14,944 |
| Realized gains (losses), net | 3 | (5) | 18 | 16 |
| Increase in fair value of warrants | | | (191) | (191) |
| Other income | 156 | 11 | 397 | 564 |
| Total revenue | 56,319 | 26,113 | 775 | 83,207 |
| Benefits and expenses: | | | | |
| Insurance benefits paid or provided: | | | | |
| Claims and surrenders | 17,818 | 9,990 | | 27,808 |
| Increase in future policy benefit reserves | 15,095 | (365) | | 14,730 |
| Policyholders' dividends | 2,915 | 39 | | 2,954 |
| Total insurance benefits paid or provided | 35,828 | 9,664 | | 45,492 |
| Commissions | 9,930 | 7,157 | | 17,087 |
| Other underwriting, acquisition and insurance expenses | 5,207 | 6,844 | 1,880 | 13,931 |
| Capitalization of deferred policy acquisition costs | (8,491) | (2,673) | | (11,164) |
| Amortization of deferred policy acquisition costs | 6,538 | 1,130 | | 7,668 |
| Amortization of cost of customer relationships acquired and other intangibles | 521 | 958 | | 1,479 |
| Total benefits and expenses | 49,533 | 23,080 | 1,880 | 74,493 |
| Income (loss) before Federal income tax | \$ 6,786 | 3,033 | (1,105) | 8,714 |

(4) Total Comprehensive Income (Loss)

| Three Months Ended June | | Six Months Ended June | |
|-------------------------|------|-----------------------|------|
| 30, | | 30, | |
| 2009 | 2008 | 2009 | 2008 |

Edgar Filing: CITIZENS INC - Form 10-Q

| | (In thousands) | | (In thousands) | | |
|---|----------------|---------|----------------|--------|---------|
| Net income | \$ | 2,716 | 2,992 | 7,093 | 5,727 |
| Other comprehensive income (loss) net of effects of deferred acquisition costs and taxes: | | | | | |
| Unrealized gains (losses) on available-for-sale securities | | 11,410 | (6,153) | 5,651 | (9,644) |
| Tax benefit (expense) | | (1,160) | 2,154 | (555) | 3,376 |
| Other comprehensive income (loss) | | 10,250 | (3,999) | 5,096 | (6,268) |
| Total comprehensive income (loss) | \$ | 12,966 | (1,007) | 12,189 | (541) |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

(5) Earnings per Share

The following tables sets forth the computation of basic and diluted earnings per share:

| | Three Months Ended June 30, | |
|---|---|-------------|
| | 2009 | 2008 |
| | (In thousands, except per share amounts) | |
| Basic and diluted earnings per share: | | |
| Numerator: | | |
| Net income | \$ 2,716 | 2,992 |
| Less: Preferred stock dividend | (98) | (165) |
| Accretion of deferred issuance costs and discounts on preferred stock | (1,072) | (334) |
| Net income available to common stockholders | \$ 1,546 | 2,493 |
| Net income allocated to Class A common stock | \$ 1,530 | 2,465 |
| Net income allocated to Class B common stock | 16 | 28 |
| Net income available to common stockholders | \$ 1,546 | 2,493 |
| Denominator: | | |
| Weighted average shares of Class A outstanding basic and diluted | 46,964 | 43,096 |
| Weighted average shares of Class B outstanding basic and diluted | 1,002 | 1,002 |
| Total weighted average shares outstanding basic and diluted | 47,966 | 44,098 |
| Basic and diluted earnings per share of Class A common stock | \$ 0.03 | 0.06 |
| Basic and diluted earnings per share of Class B common stock | \$ 0.02 | 0.03 |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

| | Six Months Ended June 30, | |
|---|---|-------------|
| | 2009 | 2008 |
| | (In thousands, except per share amounts) | |
| Basic and diluted earnings per share: | | |
| Numerator: | | |
| Net income | \$ 7,093 | 5,727 |
| Less: Preferred stock dividend | (203) | (343) |
| Accretion of deferred issuance costs and discounts on preferred stock | (2,145) | (668) |
| Net income available to common stockholders | \$ 4,745 | 4,716 |
| Net income allocated to Class A common stock | \$ 4,694 | 4,662 |
| Net income allocated to Class B common stock | 51 | 54 |
| Net income available to common stockholders | \$ 4,745 | 4,716 |
| Denominator: | | |
| Weighted average shares of Class A outstanding basic and diluted | 46,538 | 43,083 |
| Weighted average shares of Class B outstanding basic and diluted | 1,002 | 1,002 |
| Total weighted average shares outstanding basic and diluted | 47,540 | 44,085 |
| Basic earnings per share of Class A common stock | \$ 0.10 | 0.11 |
| Basic earnings per share of Class B common stock | \$ 0.05 | 0.05 |
| Diluted earnings per share of Class A common stock | \$ 0.04 | 0.11 |
| Diluted earnings per share of Class B common stock | \$ 0.02 | 0.05 |

The effects of Series A-1 and A-2 Convertible Preferred Stock are anti-dilutive; therefore, diluted income per share is reported the same as basic income per share. The Series A-1 and A-2 Convertible Preferred Stock is anti-dilutive because the amount of the dividend and accretion of deferred issuance costs and discounts for the three and six months ended June 30, 2009 and 2008 per Class A common stock share obtainable on conversion exceeds basic income per

share available to common stockholders. For the six months ended June 30, 2009, certain warrants on the Convertible Preferred Stock became dilutive. As such, the diluted weighted average shares of Class A common stock outstanding for the period was 46,599,000. Total diluted weighted average shares was 47,601,000. The warrants were anti-dilutive for the three and six months ended June 30, 2008.

(6) Investments

Investments are an integral part of the Company's overall insurance operations. We maintain a conservative investment philosophy with investment purchases only in high quality investment grade securities that provide a secure return to meet cash flow requirements related to our insurance business. Approximately 92% of our investment holdings are in fixed maturity and equity securities as of June 30, 2009.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

The following tables represent gross unrealized gains and losses for fixed maturity securities for the periods indicated.

| | | June 30, 2009 | | |
|--|------------------|-----------------------|-------------------|--------------|
| | Amortized | Gross | Gross | Fair |
| | Cost | Unrealized | Unrealized | Value |
| | | Gains | Losses | |
| | | (In thousands) | | |
| Available-for-sale securities: | | | | |
| U.S. Treasury securities | \$ 14,158 | 1,587 | (7) | 15,738 |
| U.S. Government-sponsored | 125,671 | 298 | (1,150) | 124,819 |
| Securities issued by states | 55,860 | 91 | (4,451) | 51,500 |
| Securities issued by foreign governments | 105 | 12 | | 117 |
| Public utilities | 19,590 | 377 | (28) | 19,939 |
| Corporate | 107,394 | 1,723 | (5,460) | 103,657 |
| Securities not due at a single maturity date | 23,799 | 628 | (77) | 24,350 |
| Total available-for-sale securities | 346,577 | 4,716 | (11,173) | 340,120 |
| Held-to-maturity securities: | | | | |
| U.S. Government-sponsored | 161,241 | 72 | (2,442) | 158,871 |
| Total fixed maturities | \$ 507,818 | 4,788 | (13,615) | 498,991 |

| | | December 31, 2008 | | |
|--|------------------|--------------------------|-------------------|--------------|
| | Amortized | Gross | Gross | Fair |
| | Cost | Unrealized | Unrealized | Value |
| | | Gains | Losses | |
| | | (In thousands) | | |
| Available-for-sale securities: | | | | |
| U.S. Treasury securities | \$ 11,306 | 3,113 | | 14,419 |
| U.S. Government-sponsored | 280,434 | 1,128 | (500) | 281,062 |
| Securities issued by states | 64,152 | 156 | (6,203) | 58,105 |
| Securities issued by foreign governments | 105 | 29 | | 134 |
| Public utilities | 4,231 | 22 | (100) | 4,153 |
| Corporate | 83,089 | 1,112 | (8,826) | 75,375 |
| Securities not due at a single maturity date | 50,717 | 1,564 | (374) | 51,907 |
| Total fixed maturities | \$ 494,034 | 7,124 | (16,003) | 485,155 |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

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

| | June 30, 2009 | | | | | | | | |
|---|----------------------------|--------------------------|------------------------|-------------------------------|--------------------------|------------------------|-------------------|--------------------------|------------------------|
| | 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) | | | | | | | | | |
| Available-for-sale securities: | | | | | | | | | |
| U.S. Treasury securities | \$ 993 | (7) | 1 | | | | 993 | (7) | 1 |
| U.S. Government-sponsored Security issued by states | 77,601 | (1,095) | 121 | 4,165 | (55) | 3 | 81,766 | (1,150) | 124 |
| Public utilities | 11,178 | (128) | 14 | 32,438 | (4,323) | 37 | 43,616 | (4,451) | 51 |
| Corporate | 4,260 | (28) | 3 | | | | 4,260 | (28) | 3 |
| Securities not due at a single maturity date | 13,755 | (461) | 23 | 39,408 | (4,999) | 23 | 53,163 | (5,460) | 46 |
| | 2,457 | (6) | 3 | 2,777 | (71) | 13 | 5,234 | (77) | 16 |
| Total available-for-sale | 110,244 | (1,725) | 165 | 78,788 | (9,448) | 76 | 189,032 | (11,173) | 241 |
| Held-to-maturity securities: | | | | | | | | | |
| U.S. Government-sponsored | 142,799 | (2,442) | 54 | | | | 142,799 | (2,442) | 54 |
| Total fixed maturities | \$ 253,043 | (4,167) | 219 | 78,788 | (9,448) | 76 | 331,831 | (13,615) | 295 |

| | December 31, 2008 | | | | | | | | |
|---|----------------------------|--------------------------|------------------------|-------------------------------|--------------------------|------------------------|-------------------|--------------------------|------------------------|
| | 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) | | | | | | | | | |
| Available-for-sale securities: | | | | | | | | | |
| U.S. Government-sponsored | \$ 18,680 | (265) | 14 | 11,256 | (235) | 11 | 29,936 | (500) | 25 |
| Security issued by states | 32,389 | (2,827) | 39 | 21,492 | (3,376) | 23 | 53,881 | (6,203) | 62 |
| Public utilities | | | | 1,915 | (100) | 1 | 1,915 | (100) | 1 |
| Corporate | 20,509 | (2,170) | 51 | 32,965 | (6,656) | 19 | 53,474 | (8,826) | 70 |
| Securities not due at a single maturity date | 118 | (8) | 3 | 11,629 | (366) | 24 | 11,747 | (374) | 27 |

| | | | | | | | | | |
|------------------------|-----------|---------|-----|--------|----------|----|---------|----------|-----|
| Total fixed maturities | \$ 71,696 | (5,270) | 107 | 79,257 | (10,733) | 78 | 150,953 | (16,003) | 185 |
|------------------------|-----------|---------|-----|--------|----------|----|---------|----------|-----|

As of June 30, 2009, the Company had 76 securities in an unrealized loss position for greater than 12 months, which were primarily municipal and corporate securities. The Company has reviewed these securities and determined that no other-than-temporary impairment exists. The Company also asserts its intent and ability to hold these securities until the price recovers or they mature.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

The amortized cost and fair value of fixed maturity securities at June 30, 2009 by contractual maturity are shown 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.

| | June 30, 2009 | |
|--|---------------------------|-----------------------|
| | Amortized Cost | Fair Value |
| | (In thousands) | |
| Available-for-sale securities: | | |
| Due in one year or less | \$ 11,223 | 11,276 |
| Due after one year through five years | 63,456 | 63,137 |
| Due after five years through ten years | 23,335 | 23,037 |
| Due after ten years | 224,764 | 218,321 |
| Total available-for-sale securities | 322,778 | 315,771 |
| Held-to-maturity securities: | | |
| Due after ten years | 161,241 | 158,871 |
| Securities not due at a single maturity date | 23,799 | 24,349 |
| Total fixed maturities | \$ 507,818 | 498,991 |

The securities not due at a single maturity date are mortgage-backed obligations of U.S. Government corporations and agencies.

Proceeds and gross realized gains (losses) from sales of fixed maturities available-for-sale for the six months ended June 30, 2009 and 2008 are summarized as follows:

| | Six Months Ended June 30, | |
|---------------------------|----------------------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Proceeds | \$ 38,670 | |
| Gross realized gains | \$ 1,553 | |
| Gross realized losses | \$ | |

The Company uses the specific identification method related to security sales.

There were no securities sold from the held-to-maturity portfolio during the six months ended June 30, 2009 or 2008.

Proceeds and gross realized gains (losses) from sales of equity securities for the six months ended June 30, 2009 and 2008 are summarized as follows:

| | Six Months Ended June 30, | 2009 | 2008 |
|-----------------------|----------------------------------|-----------------------|-------------|
| | | (In thousands) | |
| Proceeds | \$ | 1,175 | |
| Gross realized gains | \$ | 219 | |
| Gross realized losses | \$ | | |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

(7) Fair Value Measurements

As defined in SFAS No. 157, 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 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. SFAS No. 157 requires all assets and liabilities carried at fair value 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 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 fixed maturity 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 where we cannot corroborate the significant valuation inputs with market observable data.

The following table sets forth the Company's assets that are measured at fair value on a recurring basis as of the date indicated:

| | | June 30, 2009 | | |
|--------------------------------------|-------------------|-----------------------|----------------|----------------|
| | Total | Level 1 | Level 2 | Level 3 |
| | | (In thousands) | | |
| Financial Assets: | | | | |
| Fixed Maturities Available-for-Sale | \$ 340,120 | 15,738 | 323,778 | 604 |
| Equity Securities Available-for-Sale | 45,880 | 45,880 | | |
| Total Financial Assets | \$ 386,000 | 61,618 | 323,778 | 604 |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

The following table presents additional information about fixed maturity securities measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value:

| | June 30, 2009 (In thousands) |
|--|---|
| Beginning balance at December 31, 2008 | \$ 654 |
| Total realized and unrealized losses: | |
| Included in net income | |
| Included in other comprehensive income | (24) |
| Principal paydowns | (26) |
| Transfer in and (out) of Level 3 | |
| Ending balance at June 30, 2009 | \$ 604 |

The Company reviews 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.

The Company has real estate held for sale in ONLIC that is valued at fair value on a non-recurring basis, using Level 2 independent appraisals, in the amount of \$3.6 million, at June 30, 2009.

Financial Instruments not Carried at Fair Value

Estimates of fair values are made at a specific point in time, based on relevant market prices and information about the financial instruments. The estimated fair values of financial instruments presented below are not necessarily indicative of the amounts the Company might realize in actual market transactions. The carrying amount and fair value for the financial assets and liabilities on the consolidated balance sheets for the periods indicated are as follows:

| | June 30, 2009 | | December 31, 2008 | |
|------------------------------------|-----------------------|--------------|--------------------------|--------------|
| | Carrying | Fair | Carrying | Fair |
| | Amount | Value | Amount | Value |
| | (In thousands) | | (In thousands) | |
| Financial assets: | | | | |
| Fixed maturities, held-to-maturity | \$ 161,241 | 158,871 | | |
| Mortgage loans | 704 | 642 | 339 | 370 |
| Policy loans | 31,188 | 31,188 | 28,955 | 28,955 |
| Cash and cash equivalents | 95,090 | 95,090 | 63,792 | 63,792 |
| Short-term investments | 2,583 | 2,583 | 2,250 | 2,250 |
| Financial liabilities: | | | | |
| Annuities | 35,680 | 30,485 | 34,025 | 29,107 |

Fair values for fixed income securities are based on quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other assumptions, including the 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 7.1% and 8.2% per year, as of June 30, 2009 and December 31, 2008, respectively, with maturities ranging from one to thirty years. Management estimated the fair value using an annual interest rate of 6.25% at June 30, 2009 and December 31, 2008.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

Policy loans have a weighted average annual interest rate of 7.6% as of June 30, 2009 and December 31, 2008, and have no specified maturity dates. The aggregate fair value of policy loans approximates the carrying value reflected on the consolidated balance sheet. 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 that we have in force and cannot be valued separately and are not marketable; therefore, a fair value is not calculated.

For cash and cash equivalents, accrued investment income, reinsurance recoverable, other assets, Federal income tax payable and receivable, dividend accumulations, commissions payable, amounts held on deposit, and other liabilities, the carrying amounts approximate fair value because of the short maturity of such financial instruments.

The fair value of the Company's liabilities under annuity contract policies were estimated at June 30, 2009 using December 31, 2008 discounted cash flows using a risk free rate plus a component for non-performance risk and interest rate risk. The fair value of liabilities under all insurance contracts are taken into consideration in the overall management of interest rate risk, which minimizes exposure to changing interest rates through the matching of investment maturities with amounts due under insurance contracts.

(8) Legal Proceedings

We are a defendant in a lawsuit originally filed on August 6, 1999 in the Texas District Court, Austin, Texas, now styled *Citizens Insurance Company of America, Citizens, Inc., Harold E. Riley and Mark A. Oliver, Petitioners v. Fernando Hakim Daccach, Respondent*, in which a class was originally certified by the trial court and affirmed by the Court of Appeals for the Third District of Texas. We appealed the grant of class status to the Texas Supreme Court, which on March 2, 2007, reversed the Court of Appeal's affirmation of the trial court's class certification order, decertified the class and remanded the case to the trial court for further proceedings consistent with the Texas Supreme Court's opinion. As a result, no class action is presently certified, and plaintiffs' counsel is seeking to recertify the class. In order to recertify the class, the lead plaintiff must establish that he is qualified to represent the purported class and that the res judicata effect of a class action will not have a deleterious effect on the putative class members. The underlying lawsuit alleges that certain life insurance policies we made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. We believe the lawsuit is without merit and intend to continue a vigorous defense in any remaining proceedings, including any class recertification. If the class is recertified, we would likely be exposed to costly and time-consuming litigation, and an adverse judgment could have a material adverse effect on our results of operations and financial condition. The case is now before the Texas District Court judge for an analysis of evidence presented to determine if it warrants recertification of a class.

Security Plan Fire Insurance Company (SPFIC) is a defendant in a suit styled *The State of Louisiana v. AAA Insurance, or Road Home Litigation*, which was filed in the Civil District Court for the Parish of Orleans on August 23, 2007 by the state of Louisiana as subrogee/assignee of the insureds of more than 200 different insurance companies. The suit was filed to recover money that the state of Louisiana paid to certain insureds under the Louisiana Road Home Program for damages resulting from Hurricanes Katrina and Rita. The suit was removed to the United States District Court for the Eastern District of Louisiana on September 11, 2007 and appeals of the removal have been denied. In March 2009, the trial court judge dismissed all bad faith claims asserted against the defendants, including SPFIC. He also dismissed all claims for flood damage and all claims asserted under Louisiana's Valued Policy Law. Despite the District Court's recent rulings, the *Road Home Litigation* is still in the early stages of litigation, and no discovery has yet occurred. Therefore, it is not possible to evaluate how many claims relate to SPFIC, or the potential exposure to SPFIC. However, in the event of an adverse outcome, the potential exposure to SPFIC could be significant.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

On November 8, 2005, SPLIC was named as a defendant in a suit styled *Lilac Todd vs. Security Plan Life Insurance Company*, on behalf of Lilac Todd, which alleges that SPLIC failed to pay Ms. Todd's claim for medical expenses arising out of the loss of one of her limbs. On December 20, 2007, a Supplemental and Amended Petition for Damages was filed pursuant to which the plaintiff has asserted class action allegations. The purported class is defined as all Louisiana insureds of SPLIC whose policies contained an incontestability provision identical or similar to Ms. Todd's policy, and whose claims were denied within 10 years of the petition filing on the basis of illnesses, injuries or diseases diagnosed or which occurred at any time preceding the incontestability. This matter is in the early stages of litigation relative to the class allegations. The Plaintiffs' counsel has not established how many, if any, individuals are within the purported class. SPLIC intends to aggressively defend this action. However, in the event of an adverse outcome, the potential exposure to SPLIC could be significant.

In addition to the legal proceedings described above, we may from time to time be subject to a variety of legal and regulatory actions relating to our future, current and past business operations, including, but not limited to:

disputes over insurance coverage or claims adjudication;

regulatory compliance with insurance and securities laws in the United States and in foreign countries;

disputes with our marketing firms, consultants and employee agents over compensation and termination of contracts and related claims;

disputes regarding our tax liabilities;

disputes relative to reinsurance and coinsurance agreements; and

disputes relating to businesses acquired and operated by us.

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including not only attorneys' fees and other direct litigation costs, but also the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition.

(9) Convertible Preferred Stock

In July 2004, the Company completed a private placement of Series A-1 Convertible Preferred Stock (Series A-1 Preferred) to four unaffiliated institutional investors. We also issued to the investors warrants to purchase shares of our Class A common stock, at an exercise price of \$6.95 per share, and unit warrants to purchase Series A-2 Convertible Preferred Stock (Series A-2 Preferred). The conversion, exercise and redemption prices, along with the number of shares and warrants, have been adjusted for the respective stock dividends paid December 31, 2004 and December 30, 2005.

The Series A-1 and A-2 Preferred stock is mandatorily redeemable in July of 2009 into 1.7 million shares of Class A common stock. Both may also become redeemable at the option of the holder if certain conditions exist. Under either scenario, the shares may be redeemed in cash or shares of Class A common stock depending on the circumstances. If redeemed in stock, the redemption price is based on a defined formula.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
Notes to Consolidated Financial Statements, Continued
June 30, 2009
(Unaudited)

At June 30, 2009 and December 31, 2008, there was \$5,000 and \$73,000 in unaccreted deferred issuance costs and \$139,000 and \$2,216,000 in unaccreted net discounts, respectively. The redemption value of the series A-1 and A-2 convertible stock was \$10.0 million at June 30, 2009.

On July 13, 2009, the Company converted all of its outstanding Series A-1 and Series A-2 Convertible Preferred Stock into Class A common shares in accordance with the mandatory redemption provision of the preferred shareholder agreement dated July 12, 2004. The total amount of Class A common shares issued as part of the conversion was 1,706,686, inclusive of pro rata dividends due through the conversion date.

(10) Income Taxes

The Company recognized an additional valuation allowance of \$1,799,000 in the first quarter of 2009 due to deferred tax assets generated by other-than-temporary impairments on investment securities recorded in the quarter and additional unrealized losses occurring on the equity portfolio. Of this amount, \$135,000 was recorded as tax expense, \$1,410,000 was recorded in other comprehensive loss, and \$254,000 was additional goodwill from the 2008 acquisition of ONLIC. During the second quarter of 2009, \$1,423,000 of the valuation allowance was released due to unrealized gains arising during the quarter in the stock portfolio. Additionally, \$585,000 of the valuation allowance, related to ONLIC stocks, was released and went to reduce goodwill. The net reduction of goodwill related to tax adjustments for the year to date was \$331,000.

(11) Subsequent Events

Management has evaluated subsequent events through August 7, 2009, which is the date that the Company's financial statements were issued. Other than as discussed in Note 8, no material subsequent events have occurred since June 30, 2009 that required recognition or disclosure in these financial statements other than as noted below.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

June 30, 2009

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, 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 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 potential customers;

Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing the Company's products;

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; and

Our success at managing risks involved in the foregoing.

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 to reflect the occurrence of unanticipated events.

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 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.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009

Overview

Citizens, Inc. is an insurance holding company serving the life insurance needs of individuals in the United States and in more than 34 countries around the world. We pursue a strategy of offering ordinary whole life insurance with a focus on cash accumulation and final expense insurance products in niche markets where we believe we are able to achieve competitive advantages. Our core operations include issuing and servicing:

U.S. Dollar-denominated ordinary whole life insurance policies predominantly to high net worth, high income foreign residents, principally in Latin America and the Pacific Rim, through independent marketing consultants;

ordinary whole life insurance policies to middle income households in the midwest and the southern United States through independent marketing consultants; and

final expense and limited liability property policies to middle to lower income households in Louisiana and Arkansas through employee and independent agents in our home service distribution channel.

Life Insurance. For more than 30 years, CICA and its predecessors have participated in the foreign marketplace through the issuance of U.S. Dollar-denominated ordinary whole life insurance to foreign nationals. Traditionally, this market has focused on the top 3-5% of the population of a country in terms of income and net worth. Over the years, however, there has been a shift to encompass a broader spectrum of the population, as upper middle classes develop in Latin America and the Pacific Rim. We make our insurance products available using third-party marketing organizations and independent marketing consultants. We received applications from 26 countries outside of the U.S. in the first six months of 2009. Historically, the majority of our international business has come from Latin America; however, the Pacific Rim now also represents a meaningful and growing source of new business.

Through the domestic market of our Life Insurance segment, we provide ordinary whole life, credit life insurance, and final expense policies to middle income families and individuals in certain markets in the midwest and southern U.S. The majority of our revenues domestically are the result of U.S. domiciled life insurance company acquisitions since 1987.

In the three and six months ended June 30, 2009, our Life Insurance segment generated income before Federal income tax of \$2.3 million and \$5.4 million, compared to \$3.4 million and \$6.8 million for the same periods in 2008. The Life Insurance segment represented 57.6% of total income before Federal income tax at June 30, 2009. The decrease in the Life Insurance segment in 2009 was due primarily to a reduction in net investment income as a result of the low interest rate environment, significant call activity in the Company's bond portfolio, as well as the reduction in international new business, which decreased 15% during the six months ending June 30, 2009 compared to the same period in 2008. The Company believes the decrease in the first year premium is related to the global recession affecting the world economy and increased foreign government restrictions upon financial transactions. Our strategy in operating the Life Insurance segment is to increase new business written through our existing marketers, as well as recruit new marketers and expand the number of countries from which we receive policy applications.

Home Service Insurance. We provide final expense ordinary life insurance to middle and lower income individuals, primarily in Louisiana and Arkansas. Policies in this segment are sold and serviced through funeral homes or the home service marketing distribution system utilizing employee-agents who work on a route system to collect premiums and service policyholders.

During the three and six months ended June 30, 2009, income before Federal income tax from this segment was \$1.2 million and \$2.3 million compared to \$1.1 million and \$3.0 million during the same periods in 2008. The decrease in income in 2009 is primarily the result of higher general expenses in the current year, in addition to a reserve increase related to ONLIC conversion adjustments. The 2008 income also reflected a reserve adjustment due to a SPLIC policy lapse issue that had the effect of decreasing reserves by \$1.8 million and increasing income for the six months ended. ONLIC was acquired in the fourth quarter of 2008. The Company has noted improved sales related to ONLIC and SPLIC in 2009, which is a reflection of increased marketing efforts. The Company also recognized

\$1.3 million of capital gains from the sales of investment securities during the first six months ended June 30, 2009. The Home Service Insurance segment represented 24.0% of total income before Federal income tax for the six months ended June 30, 2009 compared to 34.8% for the same period in 2008. Our business strategy in this segment is to continue to serve existing customers in Louisiana and Arkansas, as well as expand the business through direct sales and the acquisition of similar operations.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

June 30, 2009

Other Non-Insurance. This segment consists of non-insurance entities. Income before Federal income tax was \$0.1 million and \$1.7 million for the three and six months ended June 30, 2009 compared to losses of \$0.2 million and \$1.1 million for the same period in 2008. The increase in 2009 income for this segment was related to a decrease in the fair value of warrants totaling \$1.0 million and \$3.1 million in the three and six months ended June 30, 2009 compared to income of \$0.3 million and expense of \$0.2 million for the three and six months ended June 30, 2008.

Marketplace Conditions and Trends

Described below are some of the significant trends affecting the life insurance industry and the possible effects they may have on our future operations.

The global recession may have an adverse impact on our insurance policy sales. We anticipate new insurance policy sales will be at lower levels than we experienced during 2008 or until such time as the global economy recovers.

As an increasing percentage of the world population reaches retirement age, we believe we will benefit from increased demand for living products rather than death products, as aging baby boomers will require cash accumulation to provide expenses to meet their lifetime needs. Our ordinary life products are designed to accumulate cash values to provide for living expenses in a policy owner's later years, while continuously providing a death benefit.

We are exposed to a variety of risks, including the current market conditions as well as the credit crisis, current recession and corresponding potential changes in the fair value of our investments. In the normal course of business, we employ established policies and procedures to manage our exposure to fluctuations in the current market and changes in the fair value of our investments.

Because of the trends described above, coupled with increasing costs of regulatory compliance such as the Sarbanes-Oxley Act of 2002, we believe there is a trend toward consolidation of domestic life insurance companies. We believe these trends should be a benefit to our acquisition strategy as more complementary acquisition candidates may become available for us to consider.

Many of the events and trends affecting the life insurance industry have had an impact on the life reinsurance industry. These events led to a decline in the availability of reinsurance. While we currently cede a limited amount of our primary insurance business to reinsurers, we may find it difficult to obtain reinsurance in the future, forcing us to seek reinsurers who are more expensive to us. If we cannot obtain affordable reinsurance coverage, either our net exposures will increase or we will have to reduce our underwriting commitments. The Company is currently negotiating adding an additional reinsurer during 2009 to diversify exposure in this area.

Recent Acquisition

The Company completed its acquisition of Integrity Capital Corporation in exchange for 1,294,000 shares of Class A common stock in the first quarter of 2009. Integrity Capital Corporation is the parent of Integrity Capital Insurance Company, an Indiana life insurance company. The transaction was valued at \$9.0 million on February 27, 2009, the closing date.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009

Consolidated Results of Operations

The following table sets forth our consolidated net income for the periods indicated:

| | Net Income (in thousands) | Basic Earnings per Class A Share | Net Income Decrease from Previous Year |
|------------------------------------|--|---|---|
| Three Months Ended June 30, | | | |
| 2009 | \$ 2,716 | \$ 0.03 | (9.2)% |
| 2008 | 2,992 | 0.06 | (15.2) |

| | Net Income (in thousands) | Basic Earnings per Class A Share | Net Income Increase (Decrease) from Previous Year |
|----------------------------------|--|---|--|
| Six Months Ended June 30, | | | |
| 2009 | \$ 7,093 | \$ 0.10 | 23.9% |
| 2008 | 5,727 | 0.11 | (0.4) |

Revenues: Total revenues for the three and six months ended June 30, 2009 increased 5.0% and 8.3% over the same period in 2008 due primarily to increases in life insurance premiums, realized gains on investments and the adjustment in fair value of the Company's warrants. Total revenues excluding fair value adjustments increased 3.5% and 4.3% for the three and six months ended in 2009 compared to 2008.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|-------------|----------------------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | | |
| Revenues: | | | | |
| Premiums: | | | | |
| Life insurance | \$ 34,586 | 33,491 | 67,269 | 64,341 |
| Accident and health insurance | 368 | 410 | 764 | 794 |
| Property insurance | 1,161 | 1,303 | 2,309 | 2,739 |
| Net investment income | 6,578 | 7,480 | 14,320 | 14,944 |
| Realized gains, net | 1,520 | | 1,821 | 16 |
| Decrease (increase) in fair value of warrants | 976 | 312 | 3,081 | (191) |
| Other income | 240 | 285 | 523 | 564 |
| Total revenues | 45,429 | 43,281 | 90,087 | 83,207 |
| Exclude increase (decrease) in fair value of warrants | (976) | (312) | (3,081) | 191 |
| Total revenues excluding fair value adjustments | \$ 44,453 | 42,969 | 87,006 | 83,398 |

Premium Income. Premium income increased for the three and six months ended June 30, 2009 to \$36.1 million and \$70.3 million from \$35.2 million and \$67.9 million for the same period in 2008. The increase in 2009 was due primarily to an increase in renewal premiums totaling \$32.1 million and \$61.8 million for the three and six months

ended June 30, 2009 compared to \$29.2 million and \$56.4 million for the same periods in 2008. In addition, approximately \$1.0 million and \$1.8 million of premium income for the three and six months ended June 30, 2009 related to the acquisitions of Integrity Capital Insurance Company (ICIC) and Ozark National Life Insurance Company (ONLIC), which were not included in the first six months of 2008.

Net Investment Income. Net investment income decreased to \$6.6 million and \$14.3 million for the three and six months ended June 30, 2009 compared to \$7.5 million and \$14.9 million during the same period in 2008. The decrease in 2009 resulted from increased call activity on the fixed maturity securities portfolio due to the low interest rate environment. The time lag between the security being called and the money being reinvested, as well as the lower investment rates have depressed the net investment income in 2009 compared to 2008. Investment income from fixed maturity securities accounted for approximately 80% of total investment income for the six months ended June 30, 2009. We continue to invest primarily in bonds of U.S. Government-sponsored enterprises, such as FNMA and FHLMC.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------|--|-------------|----------------------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | | |
| Gross investment income: | | | | |
| Fixed maturity securities | \$ 5,613 | 6,522 | 12,130 | 13,027 |
| Equity securities | 280 | 210 | 549 | 299 |
| Mortgage loans | 7 | 6 | 13 | 12 |
| Policy loans | 600 | 501 | 1,185 | 994 |
| Real estate investments | 359 | 215 | 714 | 429 |
| Other investment income | 124 | 318 | 521 | 729 |
| Total investment income | 6,983 | 7,772 | 15,112 | 15,490 |
| Less investment expenses | 405 | 292 | 792 | 546 |
| Net investment income | \$ 6,578 | 7,480 | 14,320 | 14,944 |

Investment income related to equity securities increased from \$210,000 and \$299,000 for the three and six months ended June 30, 2008 to \$280,000 and \$549,000 for the same periods in 2009. This increase resulted primarily from the equity securities of ONLIC acquired in the fourth quarter of 2008, which are included in the three and six months ended June 30, 2009 and are not included in the comparable three and six months of 2008.

Realized Gains, Net. The Company realized net gains of \$1.5 million and \$1.8 million for the three and six months ended June 30, 2009 compared to minimal realized items for the same periods in 2008. The increase in realized amounts in 2009 is primarily due to gains related to sales of fixed maturity securities sold in the first three and six months of 2009 offset by realized losses of \$111,000 relating to other-than-temporary impairments recorded in the first quarter of 2009.

Change in Fair Value of Warrants. The Company recognized revenues from adjusting the fair value of our Class A common stock warrants of \$1.0 million and \$3.1 million in the three and six months ended June 30, 2009 compared to a gain of \$0.3 million and a loss of \$0.2 million for the same periods in 2008. The Company adjusts the warrant liability at each reporting date to reflect the current fair value of warrants computed based upon the stock value and current market conditions, calculated using the Black-Scholes option pricing model. As the stock value increases and decreases, the warrant liability also increases and decreases in a like manner. The adjustment to fair value is recorded as an increase or decrease in fair value of warrants on the income statement.

Benefits and Expenses: The table below summarizes the benefits and expenses for the three and six months ended June 30, 2009 and 2008.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--|-------------|----------------------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | | |
| Benefits and expenses: | | | | |
| Insurance benefits paid or provided: | | | | |
| Claims and surrenders | \$ 14,953 | 14,730 | 29,760 | 27,808 |
| Increase in future policy benefit reserves | 9,958 | 7,733 | 17,716 | 14,730 |

Edgar Filing: CITIZENS INC - Form 10-Q

| | | | | |
|---|-----------|---------|----------|----------|
| Policyholders dividends | 1,453 | 1,577 | 2,915 | 2,954 |
| Total insurance benefits paid or provided | 26,364 | 24,040 | 50,391 | 45,492 |
| Commissions | 8,992 | 9,376 | 17,027 | 17,087 |
| Other underwriting, acquisition and insurance expense | 7,808 | 7,020 | 15,117 | 13,931 |
| Capitalization of deferred policy acquisition costs | (5,894) | (6,309) | (10,951) | (11,164) |
| Amortization of deferred policy acquisition costs | 3,720 | 4,106 | 7,412 | 7,668 |
| Amortization of cost of customer relationships acquired and other intangibles | 818 | 715 | 1,684 | 1,479 |
| Total benefits and expenses | \$ 41,808 | 38,948 | 80,680 | 74,493 |

Table of Contents**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****June 30, 2009**

Claims and Surrenders. As noted in the table below, claims and surrenders increased from \$14.7 million and \$27.8 million in the three and six months ended June 30, 2008 to \$15.0 million and \$29.8 million during the same periods in 2009.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------|--|-------------|----------------------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | | |
| Death claims | \$ 5,647 | 6,118 | 11,782 | 11,902 |
| Surrender benefits | 5,155 | 3,735 | 9,628 | 7,177 |
| Endowments | 3,570 | 3,664 | 6,594 | 6,794 |
| Property claims | 253 | 677 | 750 | 1,048 |
| Accident and health benefits | 70 | 90 | 210 | 160 |
| Other policy benefits | 258 | 446 | 796 | 727 |
| Total claims and surrenders | \$ 14,953 | 14,730 | 29,760 | 27,808 |

Death Claims decreased to \$5.6 million and \$11.8 million for the three and six months ended June 30, 2009 compared to \$6.1 million and \$11.9 million for the same periods in 2008. These amounts vary from period to period and were within Company expectations.

Surrender benefits increased to \$5.2 million and \$9.6 million for the three and six months ended June 30, 2009 compared to \$3.7 million and \$7.2 million for the same period in 2008. These amounts represent payments to contract holders upon termination of a contract. The Company monitors surrenders on an ongoing basis. Surrenders as a percent of ordinary whole life insurance in force were 0.5% in the first six months of 2009 and 0.3% in the first six months of 2008. Management believes this increase in surrenders may be the result of the global recession affecting our policyholders.

Increase in Reserves. Included in the increase in 2009 reserves compared to 2008 were ONLIC reserve corrections of \$0.4 million reported as of June 30, 2009. These adjustments to increase reserves were related to data issues that were discovered in the current quarter. In addition, 2008 reserves were depressed due to a correction of \$796,000 related to a reserve factor error that was corrected in the first quarter of 2008. In addition, the three months ended June 30, 2008 reflected a manual correction that decreased reserves related to a policy lapse correction.

Policyholders Dividends. The Company sells participating ordinary whole life products. These policyholder dividends are factored into the premiums and, therefore, have no impact on profitability.

Commissions. Commissions during the three and six months ended June 30, 2009 decreased to \$9.0 million and \$17.0 million from \$9.4 million and \$17.1 million in 2008. Commission expense reported in 2008 was high due to the use of a manual calculation estimation method related to SPLIC and SPFIC. This process has been partially automated in 2009 and is resulting in a more refined estimate of the commission expense in the current year.

Other Underwriting, Acquisition and Insurance Expense. These expenses increased to \$7.8 million and \$15.1 million for the three and six months ended June 30, 2009 compared to \$7.0 million and \$13.9 million in 2008. The increase in 2009 was due primarily to increased expenses related to the acquisitions of ONLIC, ICC and ICIC.

Federal Income Tax. The effective tax rates for the three and six months ended June 30, 2009 were 25.0% and 24.6% versus 30.1% and 37.6% for the same periods in 2008. The rate variance from the statutory rate of 35% is due to the fact that the changes in fair value of our Class A common stock warrants, which resulted in a gain of \$1.0 million and \$3.1 million and a gain of \$0.3 million and a loss of \$0.2 million for the three and six months ended June 30, 2009 and 2008, respectively, are not tax effected. Additionally, the Company recorded an additional valuation allowance of

\$135,000 in the first six months of 2009 related to other-than-temporary impairments recognized in the quarter.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009

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 based on net income before Federal income taxes.

| | Life Insurance | Home Service Insurance | Other Non-Insurance Enterprises | Total |
|--|---------------------------|---------------------------------------|--|--------------|
| | (In thousands) | | | |
| Income (loss) before Federal income tax: | | | | |
| Three months ended: | | | | |
| June 30, 2009 | \$ 2,322 | 1,186 | 113 | 3,621 |
| June 30, 2008 | 3,424 | 1,138 | (229) | 4,333 |
| Six months ended: | | | | |
| June 30, 2009 | 5,416 | 2,265 | 1,726 | 9,407 |
| June 30, 2008 | 6,786 | 3,033 | (1,105) | 8,714 |

Life Insurance

Our Life Insurance segment consists of issuing primarily ordinary whole life insurance in U.S. Dollar-denominated amounts to foreign residents, and domestically through independent marketing firms and consultants.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--|-------------|--------------------------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | (In thousands) | |
| Revenue: | | | | |
| Premiums | \$ 25,720 | 25,399 | 49,775 | 47,950 |
| Net investment income | 3,707 | 4,148 | 7,964 | 8,210 |
| Realized gains, net | 358 | 3 | 418 | 3 |
| Other income | 71 | 82 | 159 | 156 |
| Total revenue | 29,856 | 29,632 | 58,316 | 56,319 |
| Benefits and expenses: | | | | |
| Insurance benefits paid or provided: | | | | |
| Claims and surrenders | 10,514 | 9,187 | 20,224 | 17,818 |
| Increase in future policy benefit reserves | 8,118 | 8,615 | 15,408 | 15,095 |
| Policyholders dividends | 1,435 | 1,557 | 2,878 | 2,915 |
| Total insurance benefits paid or provided | 20,067 | 19,359 | 38,510 | 35,828 |
| Commissions | 5,247 | 5,679 | 9,704 | 9,930 |
| Other underwriting, acquisition and insurance expenses | 2,707 | 2,731 | 5,310 | 5,207 |
| | (4,495) | (4,934) | (8,252) | (8,491) |

| | | | | |
|---|----------|--------|--------|--------|
| Capitalization of deferred policy acquisition costs | | | | |
| Amortization of deferred policy acquisition costs | 3,568 | 3,134 | 6,920 | 6,538 |
| Amortization of cost of customer relationships acquired and other intangibles | 440 | 239 | 708 | 521 |
| Total benefits and expenses | 27,534 | 26,208 | 52,900 | 49,533 |
| Income before Federal income tax | \$ 2,322 | 3,424 | 5,416 | 6,786 |

Table of Contents**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****June 30, 2009**

Premiums. Premium revenues increased 1.3% and 3.8% to \$25.7 million and \$49.8 million for the three and six months ended June 30, 2009 compared to \$25.4 million and \$48.0 million for the same three and six months in 2008. The increase was primarily due to an increase in renewal business and increased premium revenue related to the acquisition of ICIC in the first quarter of 2009.

Net Investment Income. Net investment income decreased 10.6% and 3.0% comparing the three and six months ended June 30, 2009 to the same three and six months of 2008. The decrease resulted from lower yields on the fixed maturity securities portfolio due to significant call activity in the portfolio from credit spreads tightening. The bond yield decreased due to a time lag between the security being called and when the proceeds were reinvested into lower yielding securities.

Claims and Surrenders. Claims and surrenders increased to \$10.5 million and \$20.2 million for the three and six months ended June 30, 2009 compared to \$9.2 million and \$17.8 million for the same three and six months of 2008. These amounts fluctuate from period to period but were within anticipated ranges based upon management's expectations.

Commissions. Commission expense decreased to \$5.2 million and \$9.7 million for the three and six months ended June 30, 2009 compared to \$5.7 million and \$9.9 million for the same periods in 2008, as a result of increased premium revenue related to renewal business, which pays a lower commission rate, versus the 2008 premium, which had a higher percent of first year premiums with higher commission rates, as noted above.

Home Service Insurance

We provide final expense ordinary life insurance to middle and lower income individuals in Louisiana and Arkansas. Our policies in this segment are sold and serviced through a home service marketing distribution system utilizing employee-agents.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--|---------------|----------------------------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | | |
| Revenue: | | | | |
| Premiums | \$ 10,395 | 9,805 | 20,567 | 19,924 |
| Net investment income | 2,868 | 3,099 | 6,270 | 6,183 |
| Realized gains (losses), net | 1,085 | (3) | 1,326 | (5) |
| Other income | 46 | 8 | 64 | 11 |
| Total revenue | 14,394 | 12,909 | 28,227 | 26,113 |
| Benefits and expenses: | | | | |
| Insurance benefits paid or provided: | | | | |
| Claims and surrenders | 4,439 | 5,544 | 9,536 | 9,990 |
| Increase (decrease) in future policy benefit reserves | 1,840 | (883) | 2,308 | (365) |
| Policyholders' dividends | 18 | 20 | 37 | 39 |
| Total insurance benefits paid or provided | 6,297 | 4,681 | 11,881 | 9,664 |
| Commissions | 3,745 | 3,697 | 7,323 | 7,157 |
| Other underwriting, acquisition and insurance expenses | 4,035 | 3,320 | 7,989 | 6,844 |

Edgar Filing: CITIZENS INC - Form 10-Q

| | | | | |
|--|--------------|------------|------------|------------|
| Capitalization of deferred policy acquisition costs | (1,399) | (1,375) | (2,699) | (2,673) |
| Amortization of deferred policy acquisition costs | 152 | 972 | 492 | 1,130 |
| Amortization of cost of customer relationships acquired and other intangibles | 378 | 476 | 976 | 958 |
| Total benefits and expenses | 13,208 | 11,771 | 25,962 | 23,080 |
| Income before Federal income tax | \$ 1,186 | 1,138 | 2,265 | 3,033 |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

June 30, 2009

Premiums. The ONLIC acquisition represented the majority of the increased premium revenue in 2009 compared to 2008. It is the Company's objective to continue to build this Arkansas business as part of our Home Service Insurance segment operations.

Net Investment Income. Net investment income decreased 7.5% to \$2.9 million for the three months ended June 30, 2009 compared to \$3.1 million for the same period in 2008; however, it increased 1.4% from \$6.2 million for the six months ended June 30, 2008 to \$6.3 million in 2009. The decrease in investment income for the three months of 2009 compared to the same period in 2008 was due to the decline in interest rates on new securities purchased and an increase in call activity for fixed maturity bonds. The six month increase resulted primarily from a lawsuit settlement of \$240,000 related to an Enron bond recorded to investment income and income related to the ONLIC acquired invested assets totaling \$641,000, which was included in 2009 and was not in 2008.

Realized Gains (Losses), Net. Net realized gains of \$1.1 million and \$1.3 million for the three and six months ended June 30, 2009 were recognized related to bond sales, which resulted in gross gains of \$1.4 million for the six months ended June 30, 2009. The gains were offset by realized losses of \$103,000 resulting from other-than-temporary impairments recorded on ONLIC's bond portfolio during the first quarter of 2009.

Claims and Surrenders. Claims and surrenders decreased with \$4.4 million and \$9.5 million recorded for the three and six month periods ended June 30, 2009 compared to \$5.5 million and \$10.0 million for the same periods in 2008. This decrease related to a decrease in death benefits for SPLIC and a decrease in casualty claims for SPFIC in 2009 compared to the same period in 2008.

Increase (Decrease) in Future Policy Benefit Reserves. Policy reserves increased for the three and six months ended June 30, 2009 to \$1.8 million and \$2.3 million compared to a decrease in 2008 of \$0.9 million and \$0.4 million for the same periods. The increase in 2009 included \$0.4 million resulting from a correction related to ONLIC reserves caused by data issues discovered in the current quarter. The 2008 decrease in reserves reflected a manual adjustment of \$1.8 million that corrected for a system lapse issue for the three months ended June 30, 2008, and the decrease for the six months included a reserve adjustment decrease of \$0.8 million relating to a reserve factor error.

Other Underwriting, Acquisition and Insurance Expenses. Other underwriting, acquisition and insurance expenses increased to \$4.0 million and \$8.0 million for the three and six months ended June 30, 2009 compared to \$3.3 million and \$6.8 million for the same periods in 2008. The increase was a result of a reallocation of expenses between companies that increased the allocation to the Home Service Insurance segment.

Other Non-Insurance Enterprises

Income before Federal income tax expense for other non-insurance enterprises increased from losses of \$0.2 million and \$1.1 million for the three and six months ended June 30, 2008 to income of \$0.1 million and \$1.7 million for the same periods in 2009. Overall, other non-insurance operations are relatively immaterial to the consolidated results, except for the fair value adjustment related to the Company's warrants. The fair value adjustment for the three and six months ended June 30, 2009 was \$1.0 million and \$3.1 million, which was recorded as revenue, compared to revenue of \$312,000 and a loss of \$191,000 recorded for the same periods in 2008. These amounts fluctuate due to the movement in the stock price and fair value calculation using the Black-Scholes valuation model.

Investments

The administration of our investment portfolio is handled by our management, pursuant to board-approved investment guidelines, with all trading activity approved by a committee of the respective boards of directors of our insurance company subsidiaries. The guidelines used require that bonds, both government and corporate, are of high quality and comprise a majority of the investment portfolio. The assets selected 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.

Table of Contents**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****June 30, 2009**

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

| | June 30, 2009 | | December 31, 2008 | |
|--|--|-----------------------------|--|-----------------------------|
| | Carrying Value (In thousands) | Percent of Total | Carrying Value (In thousands) | Percent of Total |
| Fixed maturity securities: | | | | |
| U.S. Government-sponsored corporations and U.S. Government agencies (1) | \$ 301,798 | 43.9% | \$ 295,481 | 46.6% |
| Corporate | 103,657 | 15.1 | 75,375 | 11.8 |
| Municipal bonds | 51,500 | 7.5 | 58,105 | 9.2 |
| Mortgage-backed (2) | 24,350 | 3.6 | 51,907 | 8.2 |
| Public utilities | 19,939 | 2.9 | 4,153 | 0.7 |
| Foreign governments | 117 | | 134 | |
| Total fixed maturity securities | 501,361 | 73.0 | 485,155 | 76.5 |
| Cash and cash equivalents | 95,090 | 13.9 | 63,792 | 10.1 |
| Short-term investments | 2,583 | 0.4 | 2,250 | 0.4 |
| Other investments: | | | | |
| Policy loans | 31,188 | 4.5 | 28,955 | 4.6 |
| Equity securities | 45,880 | 6.7 | 43,000 | 6.8 |
| Mortgage loans | 704 | 0.1 | 339 | 0.1 |
| Real estate and other long-term investments | 9,901 | 1.4 | 9,553 | 1.5 |
| Total cash, cash equivalents and investments | \$ 686,707 | 100.0% | \$ 633,044 | 100.0% |

(1) Includes U.S. Treasury securities of \$15,738,000 and \$14,419,000 and U.S. Government agencies and U.S. Government-sponsored corporations of \$286,061,000 and \$281,062,000 at June 30, 2009 and December 31, 2008, respectively.

(2) Includes \$20,351,000 and \$46,371,000 of U.S. Government

agencies and U.S.
Government-sponsored
corporations at June 30,
2009 and December 31,
2008, respectively.

The Company established a held-to-maturity portfolio during the current quarter of 2009 in accordance with the accounting guidance and management's intent at the time of purchase of the security. The held-to-maturity portfolio as of June 30, 2009 represents 32.2% of the total fixed maturity securities owned based upon carrying values, with the remaining 67.8% classified as available-for-sale. Held-to-maturity securities are reported in the financials at amortized cost and available-for-sale securities are reported at fair value.

The Company experienced significant call volume during the first and second quarters in 2009 as market interest rates declined. Approximately 60% of the fixed maturity portfolio at June 30, 2009 is exposed to call risk. The Company has reinvested a portion of the proceeds in shorter duration corporate securities in anticipation that interest rates will rise and these future funds can be reinvested in longer term bonds yielding higher rates. As of June 30, 2009, balances held in cash and cash equivalents were higher compared to December 31, 2008 due to a time lag of reinvesting the fixed maturity securities that were called. This balance is expected to decline and be more in line with the year-end 2008 balances as these funds are reinvested in longer term fixed maturities.

Table of Contents**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****June 30, 2009**

The following table shows the distribution of the credit ratings of our portfolio of fixed maturity securities by carrying value.

| | June 30, 2009 | | December 31, 2008 | |
|-------------------------|-----------------------|----------|--------------------------|----------|
| | Carrying Value | % | Carrying Value | % |
| | (In thousands) | | (In thousands) | |
| AAA and U.S. Government | \$ 351,219 | 70.1% | \$ 379,547 | 78.2% |
| AA | 24,995 | 5.0 | 37,263 | 7.7 |
| A | 76,364 | 15.2 | 56,043 | 11.6 |
| BBB | 44,051 | 8.8 | 7,217 | 1.5 |
| BB and other | 4,732 | 0.9 | 5,085 | 1.0 |
| Totals | \$ 501,361 | 100.0% | \$ 485,155 | 100.0% |

The Company's holding of BBB bonds increased during the first six months of 2009, as the Company purchased additional public utility and industrial corporate bonds in order to shorten its portfolio duration in light of the historically low interest rates.

Other-Than-Temporary Impairment (OTTI) Review

Unrealized losses for all investment securities are reviewed to determine whether the losses are other-than-temporary. Investment securities are evaluated for OTTI at least quarterly and more frequently when economic or market conditions warrant such an evaluation. In conducting this assessment, the Company evaluates a number of factors including, but not limited to:

how much fair value has declined below amortized cost;

how long the decline in fair value has existed;

the financial condition of the issuer;

contractual or estimated cash flows of the security;

underlying supporting collateral;

past events, current conditions and forecasts;

significant rating agency changes on the issuer; and

the Company's intent and ability to hold the fixed maturity security until maturity or for a period of time sufficient to allow for full recovery in fair value.

The term other-than-temporary is not intended to indicate that the decline in security value is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings or other comprehensive income is recognized. In the first quarter of 2009, the Company recorded

other-than-temporary impairment charges relating to our bond and stock portfolios totaling \$111,000 recognized in earnings. There were no OTTI charges recorded relating to the second quarter of 2009.

Table of Contents

**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009**

Liquidity and Capital Resources

Liquidity refers to a company's ability to generate sufficient cash flows to meet the needs of its operations. Liquidity is managed on insurance operations and seeks to ensure stable and reliable sources of cash flows to meet obligations provided by a variety of sources.

Liquidity requirements of Citizens are met primarily by funds provided from operations. Premium deposits and revenues, investment income and investment maturities are the primary sources of funds, while investment purchases, policy benefits, and operating expenses are the primary uses of funds. We historically have not had to liquidate investments to provide cash flow and did not do so during the first six months of 2009. For the first six months of 2009, the Company experienced high call volume related to fixed maturity securities totaling \$253.8 million compared to \$98.4 million for the first six months of 2008.

A potential liquidity concern is the risk of an extraordinary level of early policyholder withdrawals. We include provisions within our insurance policies, such as surrender charges, that help limit and discourage early withdrawals. Since these contractual withdrawals, as well as the level of surrenders experienced, were largely consistent with our assumptions in asset liability management, our associated cash outflows have, to date, not had an adverse impact on our overall liquidity. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. Cash flow projections and cash flow tests under various market interest rate scenarios are also performed annually to assist in evaluating liquidity needs and adequacy. We currently anticipate that available liquidity sources and future cash flows will be adequate to meet our needs for funds.

Cash flows from our insurance operations have been sufficient to meet current needs. Cash flows from operating activities were \$22.0 million and \$24.4 million for the six months ended June 30, 2009 and 2008, respectively. We have traditionally also had significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows, for the most part, are reinvested into fixed income securities. During the second quarter of 2009 with purchases of \$161.3 million, the Company established a held-to-maturity portfolio. Net cash inflows from investment activity totaled \$8.2 million for the six months ended June 30, 2009, and net cash outflows totaled \$6.6 million for the six months ended June 30, 2008. The inflows from investing activities for the six months ended June 30, 2009 were a result of the significant amount of call activity that was not fully reinvested and \$9.8 million in cash acquired in the Integrity Capital Corporation acquisition. The outflows from investing activities for the six months ended June 30, 2008 primarily related to the investment of excess cash and cash equivalents generated from operations.

Stockholders' equity at June 30, 2009 was \$190.1 million, compared to \$171.5 million at December 31, 2008. The increase in 2009 was largely due to the issuance of \$8.4 million of Class A common stock for the acquisition of ICC, income earned during the period, and a decrease in unrealized losses on investments offset by the accretion of deferred issuance costs and discounts on preferred stock.

Investments increased to \$591.6 million at June 30, 2009 from \$569.3 million at December 31, 2008. Fixed maturities are categorized into fixed maturities available-for-sale, which are carried in our consolidated financial statements at fair value, and fixed maturities held-to-maturity, which are carried in our consolidated financial statements at amortized cost. Fixed maturities available-for-sale were 57.5% of investments at June 30, 2009 and 85.2% at December 31, 2008. Likewise, fixed maturities held-to-maturity were 27.3% of investments at June 30, 2009. There were no securities classified as held-to-maturity at December 31, 2008.

Policy loans were \$31.2 million at June 30, 2009 and \$29.0 million at December 31, 2008. These loans, which are secured by the underlying policy values, have yields ranging from 5% to 12% and maturities that are related to the maturity or termination of the applicable policies. Management believes that we maintain adequate liquidity despite the uncertain maturities of these loans.

Our cash balances at our primary depositories were significantly in excess of Federal Deposit Insurance Corporation coverage at June 30, 2009 and December 31, 2008. Management monitors the solvency of all financial institutions in which we have funds to minimize the exposure for loss. Management does not believe we have significant risk for

such a loss.

Table of Contents**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****June 30, 2009**

The National Association of Insurance Commissioners (NAIC) has established minimum capital requirements in the form of Risk-Based Capital (RBC). Risk-based capital factors the type of business written by an insurance company, the quality of its assets, and various other aspects of an insurance company's business to develop a minimum level of capital called authorized control level risk-based capital and compares this level to adjusted statutory capital that includes capital and surplus as reported under statutory accounting principles, plus certain investment reserves. Should the ratio of adjusted statutory capital to authorized control level risk-based capital fall below 200%, a series of actions by the affected company would begin. Two of our subsidiaries fell below the minimum threshold at December 31, 2008. A capital contribution of \$1.0 million was made to SPFIC during the first quarter of 2009 due to the fact that the ratio fell below 200% at December 31, 2008. A capital contribution of \$1.0 million was also made to ONLIC during the first quarter of 2009 due to its ratio falling below 200% at December 31, 2008. The decline in SPFIC's capital balance mainly resulted from hurricane losses in 2008 and an increase in operating expenses. The reduction in ONLIC's capital balance resulted from declines in asset values of preferred and common stock holdings. The capital contributions made in the first quarter of 2009 increased the ratios and action plans have been submitted to the insurance departments. The capital balance of ONLIC was determined to be at company action level at June 30, 2009 due to continued declines relative to its investment holdings and surplus strain related to new business. The Company is in the process of submitting documents to the respective insurance departments to merge ONLIC into SPLIC. This merger is expected to resolve any capital issues.

Contractual obligations and off-balance sheet arrangements

There have been no material changes in contractual obligations from those reported at December 31, 2008 in the Company's Form 10-K for the year ended December 31, 2008. The Company does not have off-balance sheet arrangements at June 30, 2009 and does not expect any future effects on the Company's financials related to any such arrangements. We do not utilize special purpose entities as investment vehicles, nor are there any such entities in which we have an investment that engages in speculative activities of any nature, and we do not use such investments to hedge our investment positions.

Parent Company Liquidity and Capital Resources

We are a holding company and have had minimal operations of our own. Our assets consist primarily of the capital stock of our subsidiaries. Accordingly, our cash flows depend upon the availability of statutorily permissible payments, primarily payments under management agreements from our two primary life insurance subsidiaries, CICA and SPLIC. The ability to make payments is limited by applicable laws and regulations of Colorado, CICA's state of domicile, and Louisiana, SPLIC's state of domicile, which subject insurance operations to significant regulatory restrictions. These laws and regulations require, among other things, that these insurance subsidiaries maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay to the holding company. We historically have not relied upon dividends from subsidiaries for our cash flow needs.

Critical Accounting Policies

Our critical accounting policies are as follows:

Policy Liabilities

Future policy benefit reserves have been computed by the net level premium method with assumptions as to investment yields, dividends on participating business, mortality and withdrawals based upon our experience. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of policy liabilities and the increase in future policy benefit reserves. Management's judgments and estimates for future policy benefit reserves provide for possible unfavorable deviation.

We continue to use the original assumptions (including a provision for the risk of adverse deviation) in subsequent periods to determine the changes in the liability for future policy benefits (the lock-in concept) unless a premium deficiency exists. Management monitors these assumptions and has determined that a premium deficiency does not exist at June 30, 2009. Management believes that our policy liabilities and increase in future policy benefit reserves as of and for the six months ended June 30, 2009 and 2008 are based upon assumptions, including a provision for the risk of adverse deviation, that do not warrant revision. The relative stability of these assumptions and management's

analysis is discussed below.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009

Deferred Policy Acquisition Costs

Acquisition costs, consisting of commissions and policy issuance, underwriting and agency expenses that relate to and vary with the production of new business, are deferred. These deferred policy acquisition costs are amortized primarily over the estimated premium paying period of the related policies in proportion to the ratio of the annual premium recognized to the total premium revenue anticipated, using the same assumptions as were used in computing liabilities for future policy benefits.

We utilize the factor method to determine the amount of costs to be capitalized and the ending asset balance. The factor method is based on the ratio of premium revenue recognized for the policies in force at the end of each reporting period compared to the premium revenue recognized for policies in force at the beginning of the reporting period. The factor method ensures that policies that lapsed or surrendered during the reporting period are no longer included in the deferred policy acquisition costs calculation. The factor method limits the amount of deferred costs to its estimated realizable value, provided actual experience is comparable to that contemplated in the factors.

Inherent in the capitalization and amortization of deferred policy acquisition costs are certain management judgments about what acquisition costs are deferred, the ending asset balance and the annual amortization. Approximately 80% of our capitalized deferred acquisition costs are attributed to first year excess commissions. The remaining 20% are attributed to costs that vary with and are directly related to the acquisition of new insurance business. Those costs generally include costs related to the production, underwriting and issuance of new business.

A recoverability test that considers, among other things, actual experience and projected future experience is performed at least annually. These annual recoverability tests initially calculate the available premium (gross premium less benefit and expense portion of premium) for the next 30 years. The available premium per policy and the deferred policy acquisition costs per policy are then calculated. The deferred policy acquisition costs are then evaluated over two methods utilizing reasonable assumptions and two other methods using pessimistic assumptions. The two methods using reasonable assumptions illustrate an early-deferred policy acquisition recoverability period. The two methods utilizing pessimistic assumptions still support early recoverability of our aggregate deferred policy acquisition costs. Management believes that our deferred policy acquisition costs and related amortization as of and for the six months ended June 30, 2009 and 2008 limits the amount of deferred costs to its estimated realizable value. This belief is based upon the analysis performed on capitalized expenses that vary with and are primarily related to the acquisition of new and renewal insurance business, utilization of the factor method and annual recoverability testing.

Cost of Customer Relationships Acquired

Cost of Customer Relationships Acquired (CCRA) is set up when we purchase a block of insurance. CCRA is amortized primarily over the emerging profit of the related policies using the same assumptions as were used in computing liabilities for future policy benefits. We utilize various methods to determine the amount of the ending asset balance, including a static model and a dynamic model. Inherent in the amortization of CCRA are certain management judgments about the ending asset balance and the annual amortization. The assumptions used are based upon interest, mortality and lapses at the time of purchase.

A recoverability test that considers, among other things, actual experience and projected future experience is performed at least annually. These annual recoverability tests initially calculate the available premium (gross premium less benefit and expense portion of premium) for the next thirty years. The CCRA is then evaluated utilizing reasonable assumptions. Management believes that our CCRA and related amortization is recoverable as of and for the six months ended June 30, 2009 and 2008. This belief is based upon the analysis performed on estimated future results of the block and our annual recoverability testing.

Goodwill

SFAS No. 142, *Goodwill and Other Intangible Assets*, (SFAS 142) requires that goodwill balances be reviewed for impairment at least annually or more frequently if events occur or circumstances change that would indicate that a triggering event, as defined in SFAS 142, has occurred. A reporting unit is defined as an operating segment or one level below an operating segment. Most of the Company's reporting units, for which goodwill has been allocated, are equivalent to the Company's operating segments as there is no discrete financial information available for the separate

components of the segment or all of the components of the segment have similar economic characteristics. As of December 31, 2008, the Company had goodwill allocated to both the Life Insurance segment as well as the Home Service Insurance segment.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

June 30, 2009

The goodwill impairment test follows a two step process as defined in SFAS 142. In the first step, the fair value of a reporting unit is compared to its carrying value. If the carrying value of a reporting unit exceeds its fair value, the second step of the impairment test is performed for purposes of measuring the impairment. In the second step, the fair value of the reporting unit is allocated to all of the assets and liabilities of the reporting unit to determine an implied goodwill value. If the carrying amount of the reporting unit goodwill exceeds the implied goodwill value, an impairment loss is recognized in an amount equal to that excess.

Management's determination of the fair value of each reporting unit incorporates multiple inputs including discounted cash flow calculations, peer company price to earnings multiples, the level of the Company's Class A common stock price and assumptions that market participants would make in valuing the reporting unit. Other assumptions can include levels of economic capital, future business growth, and earnings projections.

The Company completed its annual goodwill assessment for the individual reporting units within the Life Insurance segment and Home Service Insurance segment as of December 31, 2008 and no impairment of goodwill was identified. Goodwill increased by \$1.5 million in the first quarter of 2009 due to the acquisition of ICC.

Additional goodwill in the amount of \$254,000 was included in the first quarter of 2009. This amount related to the acquisition of ONLIC in the fourth quarter of 2008. This arose from an additional tax valuation allowance related to impairments on investments recorded in 2009, which resulted in an assumption change from the original acquisition. During the second quarter of 2009, a tax valuation allowance in the amount of \$585,000 was released and reduced goodwill. Thus, goodwill was reduced in 2009 by \$331,000 related to tax valuation allowances. In addition, goodwill was increased by \$19,000 in the second quarter of 2009 as a result of a policy reserve omission at purchase date, which was discovered and recorded in the quarter.

Valuation of Investments in Fixed Maturity and Equity Securities

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period.

Based upon current accounting guidance, investment securities must be classified as held-to-maturity, available-for-sale or trading. Management determines the appropriate classification at the time of purchase. The classification of securities is significant since it directly impacts the accounting for unrealized gains and losses on securities. Debt securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and the Company has the ability to hold the securities to maturity. Securities not classified as held-to-maturity are classified as available-for-sale and are carried at fair value, with the unrealized holding gains and losses, net of tax, reported in other comprehensive income and do not affect earnings until realized.

The Company evaluates all securities on a quarterly basis, and more frequently when economic conditions warrant additional evaluations, for determining if an other-than-temporary impairment (OTTI) exists pursuant to the accounting guidelines. In evaluating the possible impairment of securities, consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial conditions and near-term prospects of the issuer, and the ability and intent of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the Federal government or its agencies, by government-sponsored agencies, or whether downgrades by bond rating agencies have occurred, and reviews of the issuer's financial condition.

If management determines that an investment experienced an OTTI, management must then determine the amount of OTTI to be recognized in earnings. If management does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis less any current period loss, the OTTI will be separated into the amount representing the credit loss and the amount related to all other factors. The amount of OTTI related to the credit loss is determined based on the present value of cash flows expected

to be collected and is recognized in earnings. The amount of OTTI related to other factors will be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings will become the new amortized cost basis of the investment. If management intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current period credit loss, the OTTI will be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. Any recoveries related to the value of these securities are recorded as an unrealized gain (as other comprehensive income (loss) in shareholders' equity) and not recognized in income until the security is ultimately sold.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

June 30, 2009

The Company from time to time may dispose of an impaired security in response to asset/liability management decisions, future market movements, business plan changes, or if the net proceeds can be reinvested at a rate of return that is expected to recover the loss within a reasonable period of time.

Premium Revenue and Related Expenses

Premiums on life and accident and health policies are reported as earned when due or, for short duration contracts, over the contract period on a pro rata basis. Benefits and expenses are associated with earned premiums so as to result in recognition of profits over the estimated life of the contracts. This matching is accomplished by means of provisions for future benefits and the capitalization and amortization of deferred policy acquisition costs.

Annuities are accounted for in a manner consistent with accounting for interest bearing financial instruments. Our primary annuity products do not include fees or other such charges.

Tax Accounting

A deferred tax asset or deferred tax liability should be recorded only if a determination is made that is more-likely-than-not that the tax treatment on which the deferred tax item depends will be sustained in the event of an audit. The determination inherently involves management's judgment. In addition, the Company must record a tax valuation allowance with respect to deferred tax assets if it is more-likely-than-not that the tax benefit will not be realized. This valuation allowance is in essence a contra account to the deferred tax asset. Management must determine the portion of the deferred tax asset and resulting tax benefit that may not be realized based upon judgment of expected outcomes. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record adjustments to the valuation allowance in future reporting periods. Such a charge could have a material adverse effect on our results of operations, financial condition and capital position.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

The nature of our business exposes our investments to market risk. Market risk is the risk of loss that may occur when changes in interest rates and public equity prices adversely affect the value of our invested assets. Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the fair value of our investments. The fair value of our fixed maturity portfolio generally increases when interest rates decrease and decreases when interest rates increase.

Market Risk Related to Interest Rates

Our exposure to interest rate changes results from our significant holdings of fixed maturity investments, which comprised over 84.7% of our investment portfolio as of June 30, 2009. These investments are mainly exposed to changes in U.S. Treasury rates. Our fixed maturities investments include U.S. Government-sponsored enterprises, U.S. Government bonds, securities issued by government agencies, and corporate bonds. Approximately 64.3% of the fixed maturities we owned at June 30, 2009 are instruments of U.S. Government-sponsored enterprises, or are backed by U.S. Government agencies.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

June 30, 2009

To manage interest rate risk, we perform periodic projections of asset and liability cash flows to evaluate the potential sensitivity of our investments and liabilities. We assess interest rate sensitivity with respect to our available-for-sale fixed maturities investments using hypothetical test scenarios that assume either upward or downward 100 basis point shifts in the prevailing interest rates.

We performed a sensitivity analysis, as of December 31, 2008, for our interest rate sensitive assets. The change in fair values of our debt and equity securities as of June 30, 2009 was within the expected range of this analysis.

Changes in interest rates typically have a sizable effect on the fair values of our debt and equity securities. The interest rate of the ten-year U.S. Treasury bond increased to 3.5% as of June 30, 2009 from 2.2%, at December 31, 2008. We continue to manage our investment portfolio in a conservative manner, and despite the current financial crisis, our unrealized losses, net of tax, decreased to \$8.8 million for the six months ended June 30, 2009 on a portfolio of \$501.4 million from \$8.9 million at December 31, 2008 on a portfolio of \$485.2 million. This primarily relates to our holdings of fixed maturities and equity securities.

There are no fixed maturities or other investments that we classify as trading instruments. At June 30, 2009 and December 31, 2008, we had no investments in derivative instruments, nor did we have any subprime or collateralized debt obligation risk.

Market Risk Related to Equity Prices

Changes in the level or volatility of equity prices affect the value of equity securities we hold as investments. However, our equity investments portfolio was only 7.8% of our total investments at June 30, 2009. Thus, we believe that potential significant decreases in the equity markets would not have a material adverse impact on our total investment portfolio.

Item 4. CONTROLS AND PROCEDURES

The Company has established disclosure controls and procedures to ensure, among other things, that material information relating to the Company, including its consolidated subsidiaries, is made known to the officers who certify the financial reports and to the other members of the senior management and the Board of Directors.

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are responsible for establishing and maintaining the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)). Based upon an evaluation at the end of the period, the CEO and CFO concluded that the disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

During the six months ended June 30, 2009, there have been no changes in the Company s internal controls over financial reporting that materially affect or are reasonably likely to effect, the Company s internal controls over financial reporting (as defined in rules 13a-15(f) and 15d-15(f) under the Exchange Act).

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are a defendant in a lawsuit originally filed on August 6, 1999 in the Texas District Court, Austin, Texas, now styled *Citizens Insurance Company of America, Citizens, Inc., Harold E. Riley and Mark A. Oliver, Petitioners v. Fernando Hakim Daccach, Respondent*, in which a class was originally certified by the trial court and affirmed by the Court of Appeals for the Third District of Texas. We appealed the grant of class status to the Texas Supreme Court, which on March 2, 2007, reversed the Court of Appeal s affirmation of the trial court s class certification order, decertified the class and remanded the case to the trial court for further proceedings consistent with the Texas Supreme Court s opinion. As a result, no class action is presently certified, and plaintiffs counsel is seeking to recertify the class. In order to recertify the class, the lead plaintiff must establish that he is qualified to represent the purported class and that the res judicata effect of a class action will not have a deleterious effect on the putative class members. The underlying lawsuit alleges that certain life insurance policies we made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in

violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. We believe the lawsuit is without merit and intend to continue a vigorous defense in any remaining proceedings, including any class recertification. If the class is recertified, we would likely be exposed to costly and time-consuming litigation, and an adverse judgment could have a material adverse effect on our results of operations and financial condition. The case is now before the Texas District Court judge for an analysis of evidence presented to determine if it warrants recertification of a class.

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

June 30, 2009

Security Plan Fire Insurance Company (SPFIC) is a defendant in a suit styled *The State of Louisiana v. AAA Insurance, or Road Home Litigation*, which was filed in the Civil District Court for the Parish of Orleans on August 23, 2007 by the state of Louisiana as subrogee/assignee of the insureds of more than 200 different insurance companies. The suit was filed to recover money that the state of Louisiana paid to certain insureds under the Louisiana Road Home Program for damages resulting from Hurricanes Katrina and Rita. The suit was removed to the United States District Court for the Eastern District of Louisiana on September 11, 2007 and appeals of the removal have been denied. In March 2009, the trial court judge dismissed all bad faith claims asserted against the defendants, including SPFIC. He also dismissed all claims for flood damage and all claims asserted under Louisiana's Valued Policy Law. Despite the District Court's recent rulings, the *Road Home Litigation* is still in the early stages of litigation, and no discovery has yet occurred. Therefore, it is not possible to evaluate how many claims relate to SPFIC, or the potential exposure to SPFIC. However, in the event of an adverse outcome, the potential exposure to SPFIC could be significant.

On November 8, 2005, SPLIC was named as a defendant in a suit styled *Lilac Todd vs. Security Plan Life Insurance Company*, on behalf of Lilac Todd, which alleges that SPLIC failed to pay Ms. Todd's claim for medical expenses arising out of the loss of one of her limbs. On December 20, 2007, a Supplemental and Amended Petition for Damages was filed pursuant to which the plaintiff has asserted class action allegations. The purported class is defined as all Louisiana insureds of SPLIC whose policies contained an incontestability provision identical or similar to Ms. Todd's policy, and whose claims were denied within 10 years of the petition filing on the basis of illnesses, injuries or diseases diagnosed or which occurred at any time preceding the incontestability. This matter is in the early stages of litigation relative to the class allegations. The Plaintiffs' counsel has not established how many, if any, individuals are within the purported class. SPLIC intends to aggressively defend this action. However, in the event of an adverse outcome, the potential exposure to SPLIC could be significant.

In addition to the legal proceedings described above, we may from time to time be subject to a variety of legal and regulatory actions relating to our future, current and past business operations, including, but not limited to:

disputes over insurance coverage or claims adjudication;

regulatory compliance with insurance and securities laws in the United States and in foreign countries;

disputes with our marketing firms, consultants and employee agents over compensation and termination of contracts and related claims;

disputes regarding our tax liabilities;

disputes relative to reinsurance and coinsurance agreements; and

disputes relating to businesses acquired and operated by us.

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including not only attorneys' fees and other direct litigation costs, but also the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition.

Item 1A. Risk Factors

There are no updates to our risk factors as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008, except as noted below.

Unexpected losses in future reporting periods may require us to adjust the valuation allowance against our deferred tax assets.

Due to significant unrealized losses and realized OTTI losses in our investment portfolio as of December 31, 2008, we recorded a deferred tax asset (DTA) as of December 31, 2008, as well as established a valuation allowance of \$7.7 million relative to that asset. The valuation allowance was established based on facts, circumstances and information available at the reporting date, which indicated it was more likely than not that some or all of the DTA would not be realized.

Table of Contents**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES****June 30, 2009**

Currently, we evaluate our DTA quarterly for recoverability based on available evidence. This process involves management's judgment about assumptions, which are subject to change from period to period due to tax rate changes or variances between our projected operating performance and our actual results. Ultimately, future adjustments to the DTA valuation allowance, if any, will be determined based upon changes in the expected realization of the net deferred tax assets. The realization of the deferred tax assets depends on the existence of sufficient taxable income in either the carry back or carry forward periods under applicable tax law. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record adjustments to the valuation allowance in future reporting periods. Such a charge could have a material adverse effect on our results of operation, financial condition and capital position.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

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

We held an annual meeting of shareholders on June 2, 2009. At the meeting, our shareholders elected all of our Class A and Class B director nominees, and there were no other persons nominated to serve on our Board. Our shareholders also ratified the appointment of Ernst & Young LLP as the independent registered public accounting firm for the Company for 2009.

Item 5. Other Information

None.

Item 6. Exhibits

| Exhibit Number | |
|-------------------|--|
| | The following exhibits are filed herewith: |
| 3.1 | Restated and Amended Articles of Incorporation (a) |
| 3.2 | Bylaws (b) |
| 4.1 | Amendment to State Series A-1 and A-2 Senior Convertible Preferred Stock (c) |
| 10.1 | Self-Administered Automatic Reinsurance Agreement Citizens Insurance Company of America and Riunione Adriatica di Sicurtà, S.p.A. (d) |
| 10.2 | Bulk Accidental Death Benefit Reinsurance Agreement between Connecticut General Life Insurance Company and Citizens Insurance Company of America, as amended (e) |
| 10.3 | Coinsurance Reinsurance Agreement, Assumption Reinsurance Agreement, Administrative Services Agreement dated March 9, 2004, between Citizens Insurance Company of America and Texas International Life Insurance Company, Reinsurance Trust Agreement dated March 9, 2004, by and among Citizens Insurance Company of America, Texas International Life Insurance Company and Wells Fargo Bank, N.A. (f) |
| 10.4 | Coinsurance Reinsurance Agreement, Assumption Reinsurance Agreement, Administrative Services Agreement dated March 9, 2004, between Combined Underwriters Life Insurance Company and Texas International Life Insurance Company, Reinsurance Trust Agreement dated March 9, 2004, by and among Combined Underwriters Life Insurance Company, Texas |

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009

| | |
|----------------|---|
| Exhibit Number | The following exhibits are filed herewith: |
| 10.5(a) | Securities Purchase Agreement dated July 12, 2004 among Citizens, Inc., Mainfield Enterprises, Inc., Steelhead Investments Ltd., Portside Growth and Opportunity Fund, and Smithfield Fiduciary LLC (h) |
| 10.5(b) | Registration Rights Agreement dated July 12, 2004 among Citizens, Inc., Mainfield Enterprises, Inc., Steelhead Investments Ltd., Portside Growth and Opportunity Fund, and Smithfield Fiduciary LLC (h) |
| 10.5(c) | Unit Warrant dated July 12, 2004, to Mainfield Enterprises, Inc. (h) |
| 10.5(d) | Unit Warrant dated July 12, 2004, to Steelhead Investments Ltd. (h) |
| 10.5(e) | Unit Warrant dated July 12, 2004, to Portside Growth and Opportunity Fund (h) |
| 10.5(f) | Unit Warrant dated July 12, 2004, to Smithfield Fiduciary LLC (h) |
| 10.5(g) | Warrant to Purchase Class A Common Stock to Mainfield Enterprises, Inc. (h) |
| 10.5(h) | Warrant to Purchase Class A Common Stock to Steelhead Investments Ltd. (h) |
| 10.5(i) | Warrant to Purchase Class A Common Stock to Portside Growth and Opportunity Fund (h) |
| 10.5(j) | Warrant to Purchase Class A Common Stock to Smithfield Fiduciary LLC (h) |
| 10.5(k) | Subordination Agreement among Regions Bank, the Purchasers and Citizens, Inc. dated July 12, 2004 (h) |
| 10.5(l) | Non-Exclusive Finder's Agreement dated September 29, 2003, between Citizens, Inc. and the Shemano Group, Inc. (h) |
| 10.6 | Self-Administered Automatic Reinsurance Agreement between Citizens Insurance Company of America and Converium Reinsurance (Germany) Ltd. (i) |
| 10.7 | Self-Administered Automatic Reinsurance Agreement between Citizens Insurance Company of America and Scottish Re Worldwide (England) (j) |
| 11 | Statement re: Computation of per share earnings (see financial statements) |
| 21 | Subsidiaries of the Registrant* |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act* |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act* |

- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act*
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act*

Table of Contents

CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
June 30, 2009

*** Filed herewith.**

(a) Filed on
March 15, 2004
with the
Registrant's
Annual Report on
Form 10-K for the
Year Ended
December 31,
2003 as
Exhibit 3.1, and
incorporated
herein by
reference.

(b) Filed on
March 31, 1999
with the
Registrant's
Annual Report on
Form 10-K for the
Year Ended
December 31,
1998, as
Exhibit 3.2, and
incorporated
herein by
reference.

(c) Filed on July 15,
2004, with the
Registrant's
Current Report on
Form 8-K as
Exhibit 4.1, and
incorporated
herein by
reference.

(d) Filed as
Exhibit 10.8 with
the Registration
Statement on
Form S-4, SEC

File
No. 333-16163,
on November 14,
1996 and
incorporated
herein by
reference.

(e) Filed on April 9,
1997 as
Exhibit 10.9 with
the Registrant's
Annual Report on
Form 10-K for the
Year Ended
December 31,
1996, Amendment
No. 1, and
incorporated
herein by
reference.

(f) Filed on
March 22, 2004 as
Exhibit 10.8 of
the Registrant's
Current Report on
Form 8-K, and
incorporated
herein by
reference.

(g) Filed on
March 22, 2004 as
Exhibit 10.9 of
the Registrant's
Current Report on
Form 8-K, and
incorporated
herein by
reference.

(h) Filed on July 15,
2004 as part of
Exhibit 10.12 with
the Registrant's
Current Report on
Form 8-K, and
incorporated
herein by
reference.

- (i) Filed on
March 31, 2005,
with the
Registrant's
Annual Report on
Form 10-K for the
Year Ended
December 31,
2004, as
Exhibit 10.10(m),
and incorporated
herein by
reference.

- (j) Filed on
March 31, 2005,
with the
Registrant's
Annual Report on
Form 10-K for the
Year Ended
December 31,
2004, as
Exhibit 10.10(n),
and incorporated
herein by
reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CITIZENS, INC.

By: /s/ Harold E. Riley
Harold E. Riley
Chairman and Chief Executive Officer

By: /s/ Kay E. Osbourn
Kay E. Osbourn
Vice President, Chief Financial Officer,
Principal Accounting Officer and
Treasurer

Date: August 7, 2009

Table of Contents

EXHIBIT INDEX

| Exhibit No. | Description |
|----------------|---|
| 21 | Subsidiaries of the Registrant* |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act* |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act* |
| 32.1 | Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act* |
| 32.2 | Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act* |