CITIZENS FINANCIAL CORP /KY/
Form 10-Q
May 15, 2002

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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 March 31, 2002

or

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

Commission file number 0-20148

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Class A Stock - 1,716,815 as of May 11, 2002.

The date of this Report is May 14, 2002.

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Part I - Financial Information; Item 1 - Financial Statements

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

Three Months Ended March 31	2002
Revenues:	
Premiums and other considerations	$ 8,595,976
Premiums ceded	(338,734)
Net premiums earned	8,257,242
Net investment income	1,467,823
Net realized investment gains (losses)	(328,401)
Other income	51,823
Total Revenues	9,448,487
Policy Benefits and Expenses:	
Policyholder benefits	4,776,105
Policyholder benefits ceded	(491,128)
Net benefits	4,284,977
Increase in net benefit reserves	2,286,494
Interest credited on policyholder deposits	187,322
Commissions	1,694,633
General expenses	1,500,883
Interest expense	81,228
Policy acquisition costs deferred	(570,895)
Amortization of deferred policy acquisition costs, value of insurance acquired, and goodwill	450,788
Total Policy Benefits and Expenses	9,915,430
Income (Loss) before income tax and cumulative effect of a change in accounting principle	(466,943)
Income Tax Expense (Benefit)	(70,000)
Income (Loss) before cumulative effect of a change in accounting principle	(396,943)
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	---
Net Loss	$ (396,943)
Per Share Amounts:	
Income (Loss) before cumulative effect of a change in accounting principle	$ (0.23)
Cumulative effect from prior years (since January 1, 1999) of accounting for embedded options	---
Net Loss	$ (0.23)

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	March 31, 2002
ASSETS	(Unaudited)
Investments:	
Securities available for sale, at fair value:	
Fixed maturities (amortized cost of $79,857,559 and $75,872,277 in 2002 and 2001 respectively)	$ 80,363,013
Equity securities (cost of $6,981,538 and $7,055,402 in 2002 and 2001, respectively)	8,046,594
Investment real estate	3,414,614
Mortgage loans on real estate	156,000
Policy loans	4,129,376
Short-term investments	652,192
Total Investments	96,761,789
Cash and cash equivalents	16,203,267
Accrued investment income	1,243,591
Reinsurance recoverable	2,783,352
Premiums receivable	417,248
Property and equipment	2,822,973
Deferred policy acquisition costs	8,891,436
Value of insurance acquired	4,042,191
Goodwill	755,782
Federal income tax receivable	2,851,306
Other assets	385,050
Total Assets	$ 137,157,985

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	March 31, 2002
LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)
Liabilities:	
Policy Liabilities:	
Future policy benefits	$ 91,644,028
Policyholder deposits	15,922,845
Policy and contract claims	1,504,510
Unearned premiums	255,780
Other	185,319
Total Policy Liabilities	109,512,482
Notes payable	6,766,667
Accrued expenses and other liabilities	1,921,460
Deferred federal income tax	89,321
Total Liabilities	118,289,930
Commitments and Contingencies	
Shareholders' Equity:	
Common stock, 6,000,000 shares authorized; 1,716,815 shares issued and outstanding in 2001 and 2000, respectively	1,716,815
Additional paid-in capital	7,285,938
Accumulated other comprehensive income	1,019,620
Retained earnings	8,845,682
Total Shareholders' Equity	18,868,055
Total Liabilities and Shareholders' Equity	$ 137,157,985

Part I; Item 1 (continued)

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

Three Months Ended March 31	2002
Cash Flows from Operations:	
Net loss	$ (396,943)
Adjustments to reconcile net loss to cash from operations:	
Increase in benefit reserves	2,316,777
Increase (decrease) in claim liabilities	62,154
(Increase) decrease in reinsurance recoverable	(27,672)

Interest credited on policyholder deposits	187,322
Provision for amortization and depreciation, net of deferrals	(43,198)
Amortization of premium and accretion of discount on securities purchased, net	(7,394)
Net realized investment (gains) losses	328,401
Decrease in accrued investment income	146,959
Change in other assets and liabilities	40,946
Increase (decrease) in deferred federal income tax liability	(41,000)
Decrease in federal income taxes receivable	3,627
Cumulative effect of a change in accounting principle	---
Net Cash provided by Operations	2,569,979
Cash Flows from Investment Activities:	
Cost of securities acquired	(8,961,804)
Investments sold or matured	4,720,959
Investment management fees	(41,968)
Additions to property and equipment, net	(13,423)
Other investing activities, net	7,273
Net Cash provided by (used in) Investment Activities	(4,288,963)
Cash Flows from Financing Activities:	
Policyholder deposits	169,524
Policyholder withdrawals	(351,732)
Payments on notes payable - bank	(329,167)
Net Cash used in Financing Activities	(511,375)
Net Increase (Decrease) in Cash and Cash Equivalents	(2,230,359)
Cash and Cash Equivalents at Beginning of Period	18,433,626
Cash and Cash Equivalents at End of Period	$ 16,203,267

Part I; Item 1 (continued)

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

Note 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q in conformity with accounting principles generally accepted in the United States. The accompanying unaudited condensed financial statements reflect all adjustments which are, in the opinion of management, necessary to a fair presentation of the results for the interim periods. All such adjustments are of a normal recurring nature. For further information, refer to the December 31, 2001 consolidated financial statements and footnotes included in the Company's annual report on Form 10-K.

Note 2 - COMPREHENSIVE INCOME

The components of comprehensive income, net of related tax, for the three months ended March 31, 2002 and 2001 are as follows:

COMPREHENSIVE INCOME:	Three Months Ended March 31, 2002	2001
Net Loss	$ (396,943)	$ (68,065)
Net unrealized gain (loss) on securities	(737,785)	63,054
Comprehensive Loss	$ (1,134,728)	$ (5,011)

Note 3 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

Note 4 - NET REALIZED INVESTMENT GAINS, NET OF EXPENSES

The Company recorded pretax reductions to the carrying value of available for sale securities totaling $513,007 and $7,145 for the three months ended March 31, 2002 and 2001, respectively, relating to declines in value which were considered by management to be other than temporary. These amounts are reported as reductions of net realized investment gains. The Company also nets certain direct, incremental investment management fees against net realized investment gains presented in the Condensed Consolidated Statements of Income. Such costs are based directly on or, are primarily associated with, realized capital gains. Costs netted against realized investment gains total $2,875 and $26,889 for the three months ended March 31, 2002 and 2001, respectively.

Part I; Item 1 (continued)

Note 5 - INCOME TAXES

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

Note 6 - SEGMENT INFORMATION

The Company's operations are managed along five principal insurance product lines: Home Service Life, Broker Life, Preneed Life, Dental, and Other Health. Products in all five lines are sold through independent agency operations. Home Service Life consists primarily of traditional life insurance coverage sold in amounts of $10,000 and under to middle and lower income individuals. This distribution channel is characterized by a significant amount of agent contact with customers throughout the year. Broker Life product sales consist primarily of simplified issue and graded-benefit policies in amounts of $10,000 and under. Other products in this segment which are not aggressively marketed include: group life, universal life, annuities and participating life coverages. Preneed Life products are sold to individuals in connection with prearrangement of their funeral and include single premium and multi-pay policies with coverages generally in amounts of $10,000 and less. These policies are generally sold to older individuals at increased premium rates. Dental products are term coverages generally sold to small and intermediate size employer groups. Other Health products include various accident and health coverages sold to individuals and employer groups. Segment information as of March 31, 2002 and 2001, and for the periods then ended is as follows:

	Three Months Ended March 31,	
REVENUE:	2002	2001
Home Service Life	$ 2,316,284	$ 2,338,761
Broker Life	1,553,223	1,791,298
Preneed Life	3,527,266	2,137,321
Dental	2,012,898	2,099,652
Other Health	367,217	388,639
Segment Totals	9,776,888	8,755,671
Realized investment gains (losses)	(328,401)	171,896
Total Revenue	$ 9,448,487	$ 8,927,567

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

	Three Months Ended March 31,	
INVESTMENT INCOME:	2002	2001
Home Service Life	$ 476,831	$ 563,048
Broker Life	587,537	712,522
Preneed Life	375,560	374,771
Dental	7,022	9,965
Other Health	20,873	24,627
Segment Totals	$ 1,467,823	$ 1,684,933

Part I; Item 1 (continued)

The Company evaluates performance based on several factors, of which the primary financial measure is segment profit. Segment profit represents pretax earnings, except net realized investment gains and interest expense are excluded. A significant portion of the Company's realized investment gains are generated from investments in equity securities. The equities portfolio averaged (on a cost basis) approximately $7,018,000 and $12,838,000 during the three months ended March 31, 2002 and 2001, respectively.

SEGMENT PROFIT (LOSS):	Three Months Ended March 31, 2002	2001
Home Service Life	$ (3,604)	$ 169,668
Broker Life	38,593	214,447
Preneed Life	(216,053)	(174,235)
Dental	156,757	95,498
Other Health	(33,007)	23,523
Segment Totals	(57,314)	328,901
Realized investment gains (losses)	(328,401)	171,896
Interest expense	81,228	171,651
Income (Loss) before Federal Income Tax	$ (466,943)	$ 329,146

Depreciation and amortization amounts below consist of depreciation expense along with amortization of the value of insurance acquired and deferred policy acquisition costs. The first quarter of 2001 also includes approximately $29,000 and goodwill amortization. As further described in Note 8, beginning in 2002, goodwill amortization is no longer permitted.

DEPRECIATION AND AMORTIZATION:	Three Months Ended March 31, 2002	2001
Home Service Life	$ 159,270	$ 177,635
Broker Life	160,706	158,680
Preneed Life	180,950	206,380
Dental	14,844	18,000
Other Health	11,930	16,594
Segment Totals	$ 527,700	$ 577,289

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

ASSETS:	March 31, 2002	December 31, 2001
Home Service Life	$ 44,533,792	$ 44,818,038
Broker Life	54,383,735	54,954,194
Preneed Life	35,734,312	34,138,535
Dental	581,199	726,728
Other Health	1,924,947	1,959,588
Segment Totals	$ 137,157,985	$ 136,597,083

Part I; Item 1 (continued)

Note 7 - LITIGATION

United Liberty Life Insurance Company ("United Liberty"), which the Company acquired in 1998, is defending an action in an Ohio state court brought by two policyholders. The Complaint refers to a particular class of life insurance policies that United Liberty issued over a period of years ending around 1971. It alleges that United Liberty's dividend payments on these policies from 1993 through 1999 were less than the required amount. It does not specify the amount of the alleged underpayment but implies a maximum of about $850,000. The plaintiffs also allege that United Liberty is liable to pay punitive damages, also in an unspecified amount, for breach of an implied covenant of good faith and fair dealing to the plaintiffs in relation to the dividends. The action has been certified as a class action on behalf of all policyholders whose policies were issued in Ohio and were still in force in 1993. United Liberty has denied the material allegations of the Complaint and is defending the action vigorously. Pre-trial discovery is continuing. United Liberty has filed a motion for summary judgment to which the plaintiffs have not yet responded. Although United Liberty has requested mediation of the action, the plaintiffs would not agree to the request for mediation until United Liberty made an offer to settle the case. Consequently, United Liberty has offered to settle the matter for payments over time, which would include attorneys' fees, and which would be contingent upon an exchange or reformation of the insurance policies currently owned by the members of the class for policies with an increased premium and a set dividend. At this stage of the litigation, the Company is unable to determine whether an unfavorable outcome of the action is likely to occur or, alternatively, whether the chance of such an outcome is remote. Therefore, at this time, management has no basis for estimating potential losses, if any. In addition, the Company is party to other lawsuits in the normal course of business. Management believes recorded claims liabilities are adequate to ensure these other suits will be resolved without material financial impact to the Company.

Note 8 - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations", and No. 142, "Goodwill and Other Intangible Assets", effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives. The Company adopted the new rules on accounting for goodwill and other intangible assets in the first quarter of 2002. Application of the nonamortization provisions of the Statement is expected to increase net income approximately $90,000 ($0.05 per share) per year. During 2002, the Company will perform the first of the required impairment tests of goodwill as of January 1, 2002 and has not yet determined what the effect of these tests will be on the earnings and financial position of the Company.

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

FINANCIAL POSITION. Shareholders' equity totaled approximately $18,868,000 and $20,002,000 at March 31, 2002 and December 31, 2001, respectively. These balances reflect an approximate 6% decrease for the three months ended March 31, 2002. As described above, the comprehensive loss totaled approximately $1,135,000 and $5,000 for the three months ended March 31, 2002 and 2001, respectively. A significant portion of the 2002 comprehensive loss is attributable to changes in the value of the Company's fixed maturity and equity portfolios. Equity securities comprised approximately 6% of the Company's total assets as of March 31, 2002 and December 31, 2001. Accordingly, as also described below, the Company's financial position can be significantly affected by movements in the equities markets. Equity portfolio positions decreased $74,000 on a cost basis and $70,000 on a market value basis, during the first three months of 2002. Fixed maturity portfolio positions increased $3,985,000 on an amortized cost basis and increased $2,828,000 on a market value basis during the same period. This difference resulted primarily from increasing interest rates during the quarter. Cash and cash equivalent positions also decreased approximately $2,230,000 during the quarter ended March 31, 2002.

The Company does not believe significant changes have occurred in the qualitative or quantitative market risks for its investment securities since December 31, 2001. However, an increasing interest rate environment would tend to reduce the market value of existing fixed maturity investments while also providing the opportunity for higher reinvestment yields on short term investments and new cash flow.

OPERATIONS. Net premiums and other considerations increased approximately $1,236,000, or 18% during the first quarter of 2002 compared to the first quarter of 2001. Preneed Life and Home Service Life premium increases were approximately $1,387,000 and $64,000, respectively, while Broker Life and Dental each experienced modest decreases. The Preneed Life segment growth is attributable primarily to continued expansion into independently owned funeral homes and a joint marketing agreement with a casket distributor. Preneed Life growth also accounts for more than seventy-five percent of the Increase in Net Benefit Reserves for the quarter. Broker Life and Dental premium reductions are primarily attributable to increased competition in the broker market, and the mid-2001 loss of certain dental groups which had above average claim rates. The Other Health segment represents approximately 4% of total premium.

Pretax earnings (loss) (before the cumulative effect of a new accounting principle) decreased approximately $796,000 to $(467,000) for the three months ended March 31, 2002, primarily due to an approximate $500,000 decrease in realized investment gains. Pretax Segment Profit (Loss) (excluding realized investment gains and interest expense) for the first three months of 2002 was approximately $(57,000), compared to $329,000 for the first three months of 2001. This decrease resulted primarily from a decline in investment yields and increased mortality rates, partially offset by improved Dental profitability. Below are the approximate, annualized pretax investment income and total return yields for the three months ended March 31, 2002 and 2001.

Three Months Ended March 31	2002	2001
Investment Income	$ 1,467,823	$1,684,933
Realized and Unrealized Losses	(1,481,686)	(511,128)
Total Return	$ (13,863)	$1,173,805
Average Cash and Investments	$112,716,671	$113,070,808

Investment Income Yield - Annualized	5.21%	5.96%
Total Return - Annualized	(0.05)%	4.15%

The change in the Company's effective income tax rate is due to the lack of tax loss carryback potential for a portion of the Company's operations.

CASH FLOW AND LIQUIDITY. Cash flow from operations totaled $2,570,000 for the quarter ended March 31, 2002 compared to $1,975,000 for the same period in the prior year. This increase is primarily attributable to growth in Preneed Life business. The $4,289,000 of cash used by investing activities for the quarter ended March 31, 2002 resulted primarily from investing the proceeds of Preneed Life sales in fixed maturity securities. The $511,000 of cash used in financing activities during the first quarter of 2002 is primarily attributable to bank loan principal repayments along with annuity and Universal Life account withdrawals.

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

FORWARD-LOOKING INFORMATION.

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

|X| the market value of the Company's investments, including stock market performance and prevailing interest rate levels;

|X| customer and agent response to new products, distribution channels and marketing initiatives, including exposure to unrecoverable advanced commissions;

|X| mortality, morbidity, lapse rates, and other factors which may affect the profitability of the Company's insurance products;

|X| regulatory changes or actions, including those relating to regulation of insurance products and insurance companies;

|X| ratings assigned to the Company and its subsidiaries by independent rating organizations which the Company believes are important to the sale of its products;

|X| general economic conditions and increasing competition which may affect the Company's ability to sell its products;

|X| the Company's ability to achieve anticipated levels of operating efficiencies and meet cash requirements based upon projected liquidity sources;

|X| unanticipated adverse litigation outcomes; and

|X| changes in the Federal income tax laws and regulations which may affect the relative tax advantages of some of the Company's products.

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

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

The primary changes in quantitative market risks during the three months ended March 31, 2002 are discussed in Part I, Item 2 above.

Part II - Other Information

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

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

b). none

SIGNATURES

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

CITIZENS FINANCIAL CORPORATION

BY: /s/ Darrell R. Wells

Darrell R. Wells
President and Chief Executive Officer

BY: /s/ Brent L. Nemec

Brent L. Nemec
Treasurer and Principal Accounting Officer

Date: May 14, 2002

EXHIBIT INDEX

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

EXHIBIT 11

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

Three Months Ended March 31	2002	
Numerator(s):		
Income (Loss) before cumulative effect of a change in accounting principle	$ (396,943)	
Cumulative effect of a change in accounting principle	---	
Net Loss	$ (396,943)	
Denominator:		
Weighted average common shares	1,716,815	
Earnings Per Share:		
Income (Loss) before cumulative effect of a change in accounting principle	$ (0.23)	$
Cumulative effect of a change in accounting principle	---	
Net Loss	$ (0.23)	$