CITIZENS FINANCIAL CORP /KY/
Form 10-Q
November 09, 2004

==

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

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2004

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 ~~~~~

Indicate by check mark whether the registrant is an accelerated filer (as determined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ~~~~~ No ~~X~~

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 - 1,671,628 as of November 5, 2004.

The date of this Report is November 9, 2004.

Part I - Financial Information; Item 1 - Financial Statements

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

Nine Months Ended September 30	2004
Revenues:	
Premiums and other considerations	$ 22,262,399
Premiums ceded	(934,239)
Net premiums earned	21,328,160
Net investment income	5,091,174
Net realized investment gains	1,203,866
Other income	123,548
Total Revenues	27,746,748
Policy Benefits and Expenses:	
Policyholder benefits	17,440,821
Policyholder benefits ceded	(810,063)
Net benefits	16,630,758
Increase in net benefit reserves	1,232,877
Interest credited on policyholder deposits	485,207
Commissions	3,677,250
General expenses	5,863,013
Interest expense	265,768
Policy acquisition costs deferred	(936,598)
Amortization of deferred policy acquisition costs and value of insurance acquired	1,364,772
Total Policy Benefits and Expenses	28,583,047
Loss before income tax	(836,299)
Income tax (benefit)	--
Net Loss	$ (836,299)
Net Loss per Common Share, basic and diluted	$ (0.50)

Part I - Financial Information; Item 1 - Financial Statements

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

Three Months Ended September 30	2004
Revenues:	
Premiums and other considerations	$ 7,361,683
Premiums ceded	(301,367)
Net premiums earned	7,060,316
Net investment income	1,751,197
Net realized investment gains	914,109
Other income	28,197
Total Revenues	9,753,819
Policy Benefits and Expenses:	
Policyholder benefits	6,142,749
Policyholder benefits ceded	(269,057)
Net benefits	5,873,692
Increase (decrease) in net benefit reserves	(4,561)
Interest credited on policyholder deposits	146,775
Commissions	1,136,614
General expenses	2,098,273
Interest expense	87,942
Policy acquisition costs deferred	(302,143)
Amortization of deferred policy acquisition costs and value of insurance acquired	558,640
Total Policy Benefits and Expenses	9,595,232
Income before income tax	158,587
Income tax (benefit)	12,604

Net Income	$ 145,983
Net Income per Common Share, basic and diluted	$ 0.09

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	September 30, 2004
ASSETS	(Unaudited)
Investments:	
Securities available for sale, at fair value:	
Fixed maturities (amortized cost of $100,629,443 and $104,768,393 in 2004 and 2003, respectively)	$ 103,668,849
Equity securities (cost of $10,550,565 and $8,061,783 in 2004 and 2003, respectively)	12,326,634
Investment real estate	3,091,654
Policy loans	4,520,744
Short-term investments	642,747
Total Investments	124,250,628
Cash and cash equivalents	11,182,790
Accrued investment income	1,619,315
Reinsurance recoverable	2,562,003
Premiums receivable	445,172
Property and equipment	1,585,747
Deferred policy acquisition costs	10,241,786
Value of insurance acquired	2,805,013
Goodwill	755,782
Federal income tax receivable	-

Other assets	361,118
Total Assets	$ 155,809,354

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	September 30, 2004
LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)
Liabilities:	
Policy Liabilities:	
Future policy benefits	$ 110,578,081
Policyholder deposits	15,346,345
Policy and contract claims	1,645,649
Unearned premiums	240,584
Other	226,942
Total Policy Liabilities	128,037,601
Note payable - bank	3,145,835
Note payable - related party	3,000,000
Accrued expenses and other liabilities	2,444,868
Deferred federal income tax	746,991
Total Liabilities	137,375,295
Commitments and Contingencies	
Shareholders' Equity:	
Common stock, 6,000,000 shares authorized; 1,677,628 and 1,685,228 shares issued and outstanding in 2004 and 2003, respectively	1,677,628

Additional paid-in capital	7,120,921
Accumulated other comprehensive income	3,089,428
Retained earnings	6,546,082
Total Shareholders' Equity	18,434,059
Total Liabilities and Shareholders' Equity	$ 155,809,354

Part I; Item 1 (continued)

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

Nine Months Ended September 30	2004
Cash Flows from Operations:	
Net loss	$ (836,299)
Adjustments to reconcile net loss to cash from operations:	
Increase in benefit reserves	1,185,398
Decrease in claim liabilities	(17,600)
Decrease in reinsurance recoverable	272,219
Interest credited on policyholder deposits	415,676
Provision for amortization and depreciation, net of deferrals	608,594
Amortization of premium and accretion of discount on securities purchased, net	(22,802)
Net realized investment gains	(1,203,866)
(Increase) decrease in accrued investment income	66,461
Change in other assets and liabilities	290,939
Decrease (increase) in deferred federal income tax liability	1,541
Increase in federal income taxes receivable	(154,749)
Net Cash provided by Operations	605,512
Cash Flows from Investment Activities:	

Cost of securities acquired	(35,273,943)
Investments sold or matured	38,351,808
Investment management fees	(355,241)
Additions to real estate	(74,522)
(Additions) reductions to property and equipment, net	975,063
Other investing activities, net	9,872
Net Cash provided by (used in) Investment Activities	3,633,037
Cash Flows from Financing Activities:	
Policyholder deposits	464,466
Policyholder withdrawals	(1,064,621)
Payments on notes payable - bank	(987,500)
Repurchase of common stock	(57,000)
Net Cash used in Financing Activities	(1,644,655)
Net Increase (Decrease) in Cash and Cash Equivalents	2,593,894
Cash and Cash Equivalents at Beginning of Period	8,588,896
Cash and Cash Equivalents at End of Period	$11,182,790

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 that 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, 2003 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 (loss), net of related tax, for the three and nine month periods ended September 30, 2004 and 2003 are as follows:

COMPREHENSIVE INCOME:	Three Months Ended September 30, 2004	2003	Nine Months Ended 2004
Net Income (Loss)	$ 145,983	$ 252,875	$ (836,299)
Net unrealized gains (losses) on securities	1,313,490	(526,373)	(1,506,044)
Comprehensive Income (Loss)	$ 1,459,473	$ (273,498)	$(2,342,343)

Note 3 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company's derivatives outstanding at September 30, 2004 include approximately $237,000 of embedded options on convertible bonds and $43,000 of other open option positions. Hedge accounting is not used for these securities and changes in market value are reported currently as realized gains or losses.

Note 4 - NET REALIZED INVESTMENT GAINS, NET OF EXPENSES

The Company recorded pretax reductions to the carrying value of available for sale securities totaling $754,000 and $135,000 for the nine months ended September 30, 2004 and 2003, respectively, relating to declines in value which were considered by management to be other than temporary. These amounts are included along with other net realized gains. Until the Company terminated its investment management agreements on January 31, 2004, the Company also netted certain direct, incremental investment management fees against net realized investment gains presented in the Condensed Consolidated Statements of Operations. Such costs are based directly on or, are primarily associated with capital gains. Costs netted against realized investment gains total $46,000 and $236,000 for the nine months ended September 30, 2004 and 2003, respectively.

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. The effective tax rate differs from the statutory tax rate of 34% primarily due to the small life insurance company tax deduction and dividends-received tax deductions.

Part I; Item 1 (continued)

The Company has recorded no tax benefit for the nine months ended September 30, 2004 due to the inability to carry back any additional net operating losses for tax purposes and management's judgment that it is not likely the full tax benefit will be realized in the foreseeable future.

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 policies. Preneed Life products are sold to individuals in connection with prearrangement of their funeral and include single premium and multi-pay policies with face values generally in amounts of $10,000 and less. These policies are generally sold to older individuals at increased premium rates. Dental products are term policies generally sold to small and intermediate size employer groups. Other Health products include various accident and health policies sold to individuals and employer groups. Segment information as of September 30, 2004 and 2003, and for the periods then ended is as follows:

	Three Months Ended September 30,		Nine Months Ended
REVENUE:	2004	2003	2004
Home Service Life	$ 2,258,087	$ 2,267,969	$ 6,843,235
Broker Life	1,438,001	1,485,946	4,432,764
Preneed Life	2,425,517	3,953,455	7,442,557
Dental	2,460,382	2,052,254	6,967,390
Other Health	257,723	339,705	856,937
Segment Totals	8,839,710	10,099,329	26,542,882
Net realized investment gains (losses)	914,109	925,557	1,203,866
Total Revenue	$9,753,819	$ 11,024,886	$ 27,746,748

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

	Three Months Ended September 30,		Nine Months Ended
NET INVESTMENT INCOME:	2004	2003	2004
Home Service Life	$ 482,579	$ 434,121	$ 1,376,742
Broker Life	606,476	580,429	1,813,459
Preneed Life	630,611	537,241	1,811,312
Dental	10,347	7,047	28,045
Other Health	21,184	22,003	61,616
Segment Totals	$ 1,751,197	$1,580,841	$ 5,091,174

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 $12,011,000 and $9,941,000 during the nine months ended September 30, 2004 and 2003, respectively.

	Three Months Ended September 30,		Nine Months Ended
SEGMENT PROFIT (LOSS):	2004	2003	2004
Home Service Life	$ 69,150	$ (122,951)	$ 7,653
Broker Life	(40,954)	(312,089)	(507,584)
Preneed Life	(442,352)	(59,469)	(732,577)
Dental	(103,444)	(10,726)	(275,837)
Other Health	(149,980)	(57,379)	(266,052)
Segment Totals	(667,580)	(562,614)	(1,774,397)
Net realized investment gains	914,109	925,557	1,203,866
Interest expense	87,942	90,068	265,768
Profit (Loss) before Federal Income Tax	$ 158,587	$ 272,875	$ (836,299)

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

	Three Months Ended September 30,		Nine Mont Septemb
DEPRECIATION AND AMORTIZATION:	2004	2003	2004
Home Service Life	$ 262,179	$ 196,679	$ 496,256
Broker Life	105,418	182,691	303,600
Preneed Life	226,266	147,511	652,624
Dental	9,723	15,759	37,694
Other Health	11,152	7,918	58,259
Segment Totals	$ 614,738	$ 550,558	$1,548,433

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

ASSETS:	September 30, 2004	December 31, 2003
Home Service Life	$ 41,088,897	$41,312,914
Broker Life	53,477,111	54,585,019
Preneed Life	58,553,630	60,100,723
Dental	906,899	930,279
Other Health	1,782,817	1,951,397
Segment Totals	$155,809,354	$158,880,332

Part I; Item 1 (continued)

Note 7 - LITIGATION

United Liberty Life Insurance Company, which the Company acquired in 1998, is defending an action in an Ohio state court brought by two policyholders in 2000. The Complaint referred to a class of life insurance policies, including related certificates of participation, that United Liberty issued over a period of years ending around 1971 (known as "Five Star Policies"). It alleged that United Liberty's dividend payments on these policies from 1993 through 1999 were less than the amounts required by the certificates of participation. It did not specify the amount of the alleged underpayment but implied a maximum of about $850,000. The plaintiffs also alleged 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 who were Ohio residents and whose policies were still in force in 1993. United Liberty denied the material allegations of the Complaint and has defended the action vigorously.

As a result of a provisional settlement agreement dated October 8, 2004 that would apply to all holders of the Five Star policies wherever they reside, the Company has recognized as of September 30, 2004 an obligation for future payments to the policyholders and their attorneys totaling $825,000. The terms of the settlement agreement are subject to the approval of the court in which the action is pending. The court has scheduled a hearing on the issue of approval for January 24, 2005, following notice to members of the class, who will be afforded the opportunity to argue in support of or opposition to the settlement agreement. Accordingly, this description is subject to change depending upon the outcome of the January hearing.

The $825,000 obligation for future payments consist of [i] up to $500,000 payable to all persons who owned Five Star Policies that were still in force in 1993, [ii] $315,000 in attorneys' fees payable to counsel for the class and [iii] a $10,000 incentive award payable to the lead plaintiffs for the class.

The $500,000 portion is payable in respect of dividend obligations on the Five Star Policies from 1993 through 2000 and is to be paid in three annual installments beginning within 60 days after the time within which any appeal may be taken from the trial court's approval of the settlement agreement has expired. The Company currently projects the first payment date to be around April 30, 2005 (the "Initial Payment Date"). The attorneys' fees and incentive award are also payable by the Initial Payment Date.

The Company has reflected in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2004 the $500,000 portion of the amount payable for dividends in "Policy Benefits and Expenses", and the $325,000 for attorneys' fees and incentive award in "General expenses". The total amount payable of $825,000 is reflected in the Condensed Consolidated Statement of Financial Position as of September 30, 2004 in "Accrued expenses and other liabilities". The Settlement Agreement also provides that the Company will have no further obligation to pay dividends on the Five Star Policies of the kind that gave rise to the litigation. This change permitted the Company to reduce the reserves it will be required to maintain for the Five Star Policies to the extent they remain in force by the $500,000 settlement amount for dividends. This reduction in reserves is reflected in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2004 in "Policyholder benefits", and in the Condensed Consolidated Statement of Financial Position as of September 30, 2004 in "Future policy benefits".

In 2001, Citizens Security was named a co-defendant in an action in an Alabama state court brought by an alleged policyholder in which a former independent agent was also named a defendant. The action was described in or referred to in Part I, Item 1, of the Company's Form 10-Qs for the quarterly periods ended March 31 and June 30, 2004. This action was dismissed by agreement of the parties on August 12, 2004 and the Company paid an amount in complete settlement of all claims. This amount is included in "Policyholder benefits" in the Condensed Consolidated Statements of Operations for the nine months ended September 30, 2004.

In addition, the Company is party to other lawsuits in the normal course of business. Management believes that recorded claims liabilities are adequate to ensure that these other suits will be resolved without material financial impact to the Company.

Part I; Item 1 (continued)

Note 8 - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2004, the Company adopted Statement of Position 03-1, "Accounting and Reporting by Insurance Enterprises for certain Nontraditional Long-Duration Contracts and for Separate Accounts (SOP 03-1)." The provisions of SOP 03-1 did not have a material impact on the Company's financial statements.

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

EXECUTIVE SUMMARY

The Company's management continuously monitors the performance and outlook of the Company by analyzing several indicators that they judge to be critical. Some, but not necessarily all, of the indicators of particular interest to management are:

- The general economic environment
- Trend of premium volume
- Lapse rates
- Mortality and morbidity rates
- Trend of general expense levels
- Asset and Shareholders' Equity growth
- General interest rate movements
- Investment yields
- Diversity (e.g. by industry) and mix (e.g. between fixed income securities and equity securities) of our portfolios
- Segment performance and trends

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its financial condition and results of operations are based on its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. Preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to investments, agent receivables, intangible assets, policy liabilities, income taxes, regulatory requirements, contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company believes the following accounting policies, judgments and estimates, which have been discussed with the Audit Committee of the Board of Directors, critically impact preparation of its consolidated financial statements.

Investment in Debt and Equity Securities. The Company holds debt and equity interests in a variety of companies, many of which are seeking to exploit recent technology advancements. The majority of these are publicly traded and many have experienced volatile market prices. We periodically evaluate whether the declines in fair value of our investments are other-than-temporary. These evaluations involve significant judgment. Our evaluation consists of a review of qualitative and quantitative factors, including analysis of the Company's competitive position in its markets, deterioration in the financial condition of the issuer, downgrades of the security by a rating agency, and other publicly available issuer-specific news or general market conditions. Declines in fair values of securities deemed to be temporary and which the Company has the ability and intent to hold until recovery are included as an unrealized loss in shareholders' equity. Declines in fair values of securities deemed to be other-than-temporary are included in net income as realized investment losses. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the current carrying value of the investments, thereby possibly requiring an impairment charge in the future.

Deferred Acquisition Costs ("DAC"). The Company is required to defer certain policy acquisition costs and amortize them over future periods. These costs include commissions and certain other expenses that vary with and are primarily associated with acquiring new business. The deferred costs are recorded as an asset commonly referred to as deferred policy acquisition costs. The DAC asset balance is subsequently charged to income over the lives of the underlying contracts in relation to the anticipated emergence of revenue or profits. Actual revenue or profits can vary from Company estimates resulting in increases or decreases in the rate of amortization. The Company regularly evaluates its DAC balances to determine if actual experience or other evidence suggests that earlier estimates should be revised. Assumptions considered significant include surrender and lapse rates, mortality, expense levels, investment performance, and estimated interest spread. Should actual experience dictate that the Company change its assumptions regarding the emergence of future revenues or profits (commonly referred to as "unlocking"), the Company would record a charge or credit to bring its DAC balance to the level it would have been if using the new assumptions from the inception date of each policy.

DAC is also subject to periodic recoverability and loss recognition testing. These tests ensure that the present value of future contract-related cash flows will support the capitalized DAC balance to be amortized in the future. The present value of these cash flows, less the benefit reserve, is compared with the unamortized DAC balance and if the DAC balance is greater, the deficiency is charged to expense as a component of amortization and the asset balance is reduced to the recoverable amount. For more information about accounting for DAC see Note 1, Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements included in the Company's Form 10-Q/A for December 31, 2003.

Goodwill and Intangible Impairment. The balance of our goodwill and value of insurance acquired (VIF) was $3.6 million at September 30, 2004. The recovery of these assets is dependent on the fair value of the business to which they relate. Effective in 2002, pursuant to SFAS No. 142, "Goodwill and Other Intangible Assets", ("SFAS No. 142"), goodwill is no longer amortized but is subject to annual impairment tests based on the estimated fair value of the respective assets. There are numerous assumptions and estimates underlying the determination of the estimated fair value of these assets. Different valuation methods and assumptions can produce significantly different results that could affect the amount of any potential impairment charge that might be required to be recognized. During both 2004 and 2003, the Company concluded that no impairment adjustment was necessary for its goodwill or VIF.

Policy Liabilities and Policy Intangible Assets. Establishing policy liabilities for the Company's long-duration insurance contracts requires making many assumptions, including policyholder persistency, mortality rates, investment yields, discretionary benefit increases, new business pricing, and operating expense levels. The Company evaluates historical experience for these factors when assessing the need for changing current assumptions. However, since many of these factors are interdependent and subject to short-term volatility during the long-duration contract period, substantial estimates and judgment are required. Accordingly, if actual experience emerges differently from that assumed, any such difference would be recognized in the current year's Consolidated Statement of Operations.

Deferred Taxes. The Company records a valuation allowance to reduce its deferred tax assets to the amount that it believes is more likely than not to be realized. In assessing the need for the valuation allowance, the Company has not assumed future taxable income. In the event the Company were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to deferred tax assets would increase income in the period such determination was made. Likewise, should the Company determine that it would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to deferred tax assets would be charged to income in the period such determination was made.

Litigation. As further described in Note 7 of the Notes to Consolidated Financial Statements, United Liberty has been a party to an outstanding lawsuit concerning payment of policyholder dividends. The parties have reached a provisional settlement agreement dated October 8, 2004. As described in Note 7, the Company has recorded the financial impact of the agreement as of September 30, 2004.

OPERATIONS. Net premiums and other considerations decreased approximately $1,411,000, or 16.7% during the three months ended September 30, 2004 compared to the three months ended September 30, 2003 and decreased approximately $4,934,000 for the first nine months of 2004 compared to the first nine months of 2003. Below is a summary of net premiums earned by segment, for the three and nine month periods ended September 30, 2004, along with the change from the same periods of 2003.

	Three Months Ended September 30,		Nine Months Ended September 30,	
NET PREMIUMS EARNED	Total	Change	Total	Change
Home Service Life	$ 1,765,959	$ (55,121)	$ 5,433,083	$ (130,1
Broker Life	798,906	(89,616)	2,577,497	(47,1
Preneed Life	1,809,504	(1,590,581)	5,585,090	(5,238,0
Dental	2,449,825	404,828	6,938,664	667,6
Other Health	236,122	(80,926)	793,826	(186,4
Segment Totals	$ 7,060,316	$ (1,411,416)	$21,328,160	$(4,934,0

Preneed Life premiums declined during the three quarters of 2004 compared to the same period in 2003 as the result of the Company lowering crediting rates related to face amount growth, lowering commission rates and changing the focus of our marketing efforts in the second half of 2003 and further reducing crediting rates as of September 1, 2004. The Company is in the process of redirecting the focus of our marketing efforts to the Home Service, Broker and Dental segments in an effort to improve profitability in those segments. During 2004, Dental premiums were favorably impacted by additional broker relationships, increasing participation of certain groups and normal inflationary premium increases. The Other Health segment products are not being actively marketed. All other segments experienced only modest changes in premium from the first three quarters of 2003.

The increase in net benefit reserves decreased $4,700,000 or 79% during the first three quarters of 2004 compared to the same period in 2003 primarily due to the decrease in Preneed policies issued and in force during the period. The decrease in net benefit reserves in the third quarter was $2,027,000 or 100% compared to the third quarter of 2003.

Pretax loss increased approximately $315,000 to $836,000 for the nine months ended September 30, 2004, primarily due to unfavorable mortality and Dental morbidity rates, settlement of two separate lawsuits and increased general expenses, partially offset by an increase in realized investment gains of $443,000 and an increase in net investment income of $758,000. Net investment income increased 17.5% for the first three quarters of 2004 compared to the same period of 2003, in spite of a decline in invested assets, due to an increased yield on the Company's fixed maturities portfolio resulting from investing in longer term fixed maturity securities. Net realized investment gains increased to $1,204,000 for the first nine months of 2004 from net investment gains of $761,000 for the same period in 2003. Net benefits increased $1,432,000 or 9% during the first nine months of 2004 from the same period in 2003 due primarily to adverse mortality rates in the Broker and the Preneed segments along with adverse morbidity in the Dental and Other Health segments, partially offset by an increase in Net realized investment gains of $443,000. Commissions decreased $1,323,000 or 26% for the nine months ended September 30, 2004 compared to the same period in 2003 due to a lowering in commission rates in the second half of 2003 on the Preneed premium and the decrease in that premium. General expenses increased $645,000, or 12.4% for the first nine months of 2004 due to the Company continuing to incur costs associated with outside consultants who were employed to review profitability of the Company's life products and perform other actuarial calculations and analysis, the cost of a severance agreement settlement, legal costs associated with two separate litigation cases, and the costs of a market conduct examination conducted by the Office of Insurance of the Company's domiciliary state. Policy acquisition costs deferred decreased $687,000 or 42% for the nine months ended September 30, 2004 compared to the same period in 2003 principally due to the substantial decline in first year Preneed premiums during the same period. Pretax Segment loss (excluding realized investment gains (losses) and interest expense) for the first nine months of 2004 was approximately $1,774,000 compared to $1,002,000 for the first nine months of 2003. This is primarily attributable to the factors described above relative to revenue changes, mortality and morbidity rates, increased general expenses and the settlement of two separate lawsuits discussed in Note 7 to the Condensed Consolidated Financial Statements. Below are the approximate, annualized pretax investment income and total return yields for the nine months ended September 30, 2004 and 2003.

Nine Months Ended September 30	2004	2003
Investment Income	$ 5,091,174	$ 4,332,680
Realized and Unrealized Gains (Losses)	(1,127,711)	4,357,479
Total Return	$ 3,963,463	$ 8,690,159
Average Cash and Investments	$135,697,066	$130,248,047
Investment Income Yield - Annualized	4.99%	4.44%
Total Return - Annualized	3.88%	8.90%

The Company has recorded no income tax benefit due to not having any ability to carry back any additional net operating losses for tax purposes and management's judgment that it is not likely the full tax benefit will be realized in the foreseeable future.

FINANCIAL POSITION. Shareholders' equity totaled approximately $18,434,000 and

$20,833,000 at September 30, 2004 and December 31, 2003, respectively. These balances reflect an approximate 11.5% decrease for the nine months ended September 30, 2004. As described above, the comprehensive income (loss) totaled approximately $(2,472,000) and $1,913,000 for the nine months ended September 30, 2004 and 2003, respectively. A significant portion of the comprehensive income (loss) is attributable to changes in the value of the Company's fixed maturity and equity portfolios. Equity securities comprised approximately 7.9% and 7.1% of the Company's total assets as of September 30, 2004 and December 31, 2003, respectively. Accordingly, as also described below, the Company's financial position can be significantly affected by movements in the equities markets. Equity portfolio positions increased $2,489,000 on a cost basis and $990,000 on a market value basis, during the first nine months of 2004. Fixed maturity portfolio positions decreased $4,139,000 on an amortized cost basis and $4,971,000 on a market value basis during the same period. This difference resulted primarily from disposals and maturities during the period. Cash and cash equivalent positions increased approximately $7,441,000 during the quarter ended September 30, 2004 primarily due to recent reductions in the Company's fixed income and equities portfolios to take advantage of favorable market conditions.

Equity markets continue to be highly volatile and were slightly unfavorable in the third quarter of 2004. Interest yields on fixed maturity investments held in our portfolio are continuing to slowly increase. Low short-term rates continue to adversely impact the Company's investment portfolio yield and operating earnings. The 2004 environment described continues to generate a relatively high level of qualitative investment risk. However, measures of quantitative risk per unit of investment are not believed to have changed significantly from those previously disclosed in the Company's 2003 Form 10-K/A.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not participate in any off-balance sheet arrangements.

CASH FLOW AND LIQUIDITY. Cash flow from operations totaled $606,000 for the nine months ended September 30, 2004 compared to $5,158,000 for the same period in the prior year. The decrease in the positive cash flow is primarily attributable to the decline in Preneed Life business which was growing during the second quarter of 2003 and adverse mortality and morbidity rates. The $3,633,000 of cash provided from investing activities for the nine months ended September 30, 2004 resulted primarily from sales and maturities of investments late in the third quarter and by proceeds from the sale of the Company's interest in an aircraft. The $1,645,000 of cash used in financing activities during the first nine months of 2004 is primarily attributable to bank loan principal repayments along with annuity and Universal Life account withdrawals. The Company also purchased 7,600 shares of its common stock at a price of $7.50 per share as part of a buy back plan. Due to continued earnings pressure from low yields on investments and cash equivalents and the declining Preneed premiums, the Company is completing a strategic review of its products and operations. A key element of this initiative is improving profitability of the Preneed, Home Service, and Broker Life segments by increasing premiums in the Home Service and Broker segments, strengthening underwriting practices, modifying commissions, and where possible, lowering interest crediting or policy growth rates. Regarding the currently scheduled debt repayments, the Company believes its available funds will be adequate to service 2004 debt obligations and, with other available assets, management believes it will be adequate to service debt obligations through 2005. The Company sold its interest in an aircraft to SMC Advisors Inc., an entity owned by the Company's Chairman, in April 2004, generating $971,000 in additional cash. In addition, the Company's Chairman has expressed potential willingness to loan the Company an additional $2,000,000 if necessary, which could service debt obligations through the majority of 2007. For the quarter ended September 30, 2004, the Company did not meet one of its bank debt covenants (debt to earnings ratio), however the lender has waived this violation for the quarter and for several previous quarters. In return for the waiver the Company's Chairman has personally guaranteed the outstanding bank debt.

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's insurance 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 that 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

Quantitative and Qualitative Risk. The primary changes in quantitative market risks during the nine months ended September 30, 2004 are discussed in Part I, Item 2 above.

Part I; Item 4 - Controls and Procedures

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. Within the past 90 days, the Company conducted an evaluation of its disclosure controls and procedures, with the supervision and participation of its Chief Executive Officer and Principal Financial Officer. The Company does not expect that its disclosure controls and procedures will prevent all error and fraud. Such a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must balance the constraint of prudent resource expenditure with a judgmental evaluation of risks and benefits. Based on this evaluation of disclosure controls and procedures, the Company's Chief Executive Officer and Principal Financial Officer have concluded that such controls and procedures provide reasonable assurance that material information required to be included in the Company's periodic SEC reports is made known on a timely basis to the Company's principal executive and financial officers.

CHANGES IN INTERNAL CONTROLS. There have been no significant changes in the Company's internal controls or changes in other factors that could significantly affect these controls subsequent to their evaluation, nor has the Company implemented any corrective actions regarding significant deficiencies or material weaknesses in internal controls.

Part II - Other Information

Item 1. Legal Proceedings.

In 2001, Citizens Security Life Insurance Company was named a co-defendant in an action in an Alabama state court brought by an alleged policyholder in which a former independent agent was also named a defendant. The action was described in Part II, Item 1, of the Company's Form 10-Q for the quarterly period ended March 31, 2004 and described or referred to in Part I, Item 1, of the Company's Form 10-Qs for the periods ended March 31 and June 30, 2004 and herein. This action was dismissed by agreement of the parties on August 12, 2004 and the Company paid an amount in complete settlement of all claims. This amount is included in "Polcyholder benefits" in the Condensed Consolidated Statement of Operations for the nine months ended September 30, 2004.

Item 6. Exhibits.

Exhibit 11	Statement re: computation of per share earnings
Exhibit 31.1	Rule 13a-14(a)/15d-14(a) Certification --Principal Executive Officer
Exhibit 31.2	Rule 13a-14(a)/15d-14(a) Certification --Principal Financial Officer
Exhibit 32.1	Section 1350 Certification --Principal Executive Officer
Exhibit 32.2	Section 1350 Certification --Principal Financial Officer

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/ Len E. Schweitzer

Len E. Schweitzer
Treasurer and Principal Financial Officer

Date: November 9, 2004