

CITIZENS INC
Form 10-Q
August 11, 2008

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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 June 30, 2008**

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 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 8, 2008 the Registrant had 43,123,558 Class A common stock outstanding and 1,001,714 shares of Class B common stock outstanding.

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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, 2008 (Unaudited)	December 31, 2007
Assets		
Investments:		
Fixed maturities available-for-sale, at fair value (cost: \$498,651 and \$502,635 in 2008 and 2007, respectively)	\$ 491,278	500,426
Equity securities available-for-sale, at fair value (cost: \$59,494 and \$36,696 in 2008 and 2007, respectively)	53,988	35,669
Mortgage loans on real estate	388	291
Policy loans	26,539	25,490
Real estate held for investment (less \$258 and \$249 accumulated depreciation in 2008 and 2007, respectively)	5,123	5,152
Other long-term investments	681	618
Short-term investments		17,650
Total investments	577,997	585,296
Cash and cash equivalents	39,528	21,123
Accrued investment income	7,064	7,115
Reinsurance recoverable	12,361	13,492
Deferred policy acquisition costs	104,151	100,655
Cost of customer relationships acquired	30,171	31,636
Goodwill	11,386	11,386
Other intangible assets	1,052	1,066
Federal income tax receivable	726	715
Property and equipment, net	6,479	6,795
Due premiums, net (less \$1,910 and \$1,780 allowance for doubtful accounts in 2008 and 2007, respectively)	7,771	7,656
Prepaid expenses	1,427	
Other assets	842	974
Total assets	\$ 800,955	787,909

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

	June 30, 2008 (Unaudited)	December 31, 2007
Liabilities and Stockholders Equity		
Liabilities:		
Future policy benefit reserves:		
Life insurance	\$ 522,282	508,209
Annuities	23,912	22,792
Accident and health	7,612	8,293
Premiums paid in advance	18,808	16,140
Policy claims payable	8,842	6,908
Dividend accumulations	4,783	4,825
Other policyholders funds	4,355	4,357
Total policy liabilities	590,594	571,524
Commissions payable	2,127	2,385
Deferred Federal income tax	3,482	4,810
Payable for securities in process of settlement	3,000	7,000
Warrants outstanding	1,194	1,003
Other liabilities	10,722	10,810
Total liabilities	611,119	597,532
Commitments and contingencies (Note 7)		
Cumulative convertible preferred stock Series A		
(Series A-1 - \$500 stated value per share, 25,000 shares authorized, issued and outstanding in 2008 and 2007; Series A-2 - \$935 stated value per share, 5,000 shares authorized, 4,014 issued and outstanding in 2008 and 2007)		
	14,888	14,220
Stockholders Equity:		
Common stock:		
Class A, no par value, 100,000,000 shares authorized, 46,259,296 shares issued in 2008 and 46,205,830 shares issued in 2007, including shares in treasury of 3,135,738 in 2008 and 2007		
	225,144	225,812
Class B, no par value, 2,000,000 shares authorized, 1,001,714 shares issued and outstanding in 2008 and 2007		
	3,184	3,184
Retained deficit	(33,998)	(39,725)
Accumulated other comprehensive loss:		
Unrealized losses on securities, net of tax	(8,371)	(2,103)
	185,959	187,168
Treasury stock, at cost	(11,011)	(11,011)

Total stockholders' equity	174,948	176,157
Total liabilities and stockholders' equity	\$ 800,955	787,909

See accompanying notes to consolidated financial statements.

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

	2008	2007
Revenues:		
Premiums:		
Life insurance	\$ 33,491	31,538
Accident and health insurance	410	381
Property insurance	1,303	1,183
Net investment income	7,480	7,064
Realized losses, net		(119)
Decrease in fair value of warrants	312	231
Other income	285	433
Total revenues	43,281	40,711
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	14,730	12,024
Increase in future policy benefit reserves	7,733	8,389
Policyholders' dividends	1,577	1,422
Total insurance benefits paid or provided	24,040	21,835
Commissions	9,376	8,997
Other underwriting, acquisition and insurance expenses	7,020	7,324
Capitalization of deferred policy acquisition costs	(6,309)	(6,782)
Amortization of deferred policy acquisition costs	4,106	3,329
Amortization of cost of customer relationships acquired and other intangibles	715	826
Total benefits and expenses	38,948	35,529
Income before Federal income tax	4,333	5,182
Federal income tax expense	1,341	1,655
Net income	\$ 2,992	3,527
Net income available to common stockholders	\$ 2,493	3,016
Per Share Amounts:		
Basic and diluted earnings per share of Class A common stock	\$ 0.06	0.07
Basic and diluted earnings per share of Class B common stock	\$ 0.03	0.04

See accompanying notes to consolidated financial statements.

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

	2008	2007
Revenues:		
Premiums:		
Life insurance	\$ 64,341	61,378
Accident and health insurance	794	803
Property insurance	2,739	2,362
Net investment income	14,944	14,131
Realized gains (losses), net	16	(132)
Increase in fair value of warrants	(191)	(196)
Other income	564	785
Total revenues	83,207	79,131
Benefits and expenses:		
Insurance benefits paid or provided:		
Claims and surrenders	27,808	25,204
Increase in future policy benefit reserves	14,730	15,324
Policyholders' dividends	2,954	2,652
Total insurance benefits paid or provided	45,492	43,180
Commissions	17,087	17,386
Other underwriting, acquisition and insurance expenses	13,931	14,224
Capitalization of deferred policy acquisition costs	(11,164)	(12,906)
Amortization of deferred policy acquisition costs	7,668	6,480
Amortization of cost of customer relationships acquired and other intangibles	1,479	1,667
Total benefits and expenses	74,493	70,031
Income before Federal income tax	8,714	9,100
Federal income tax expense	2,987	3,134
Net income	\$ 5,727	5,966
Net income available to common stockholders	\$ 4,716	4,952
Per Share Amounts:		
Basic and diluted earnings per share of Class A common stock	\$ 0.11	0.12
Basic and diluted earnings per share of Class B common stock	\$ 0.05	0.06

See accompanying notes to consolidated financial statements.

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

	2008	2007
Cash flows from operating activities:		
Net income	\$ 5,727	5,966
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized losses (gains) on sale of investments and other assets	(16)	132
Net deferred policy acquisition costs	(3,496)	(6,426)
Amortization of cost of customer relationships acquired and other intangibles	1,479	1,667
Increase in fair value of warrants	191	196
Depreciation	534	455
Amortization of premiums and discounts on fixed maturities and short-term investments	48	737
Deferred Federal income tax expense (benefit)	2,047	(531)
Change in:		
Accrued investment income	51	(158)
Reinsurance recoverable	1,131	1,861
Due premiums and other receivables	10	473
Future policy benefit reserves	13,923	13,705
Other policy liabilities	4,558	73
Federal income tax receivable	(11)	(2,089)
Commissions payable and other liabilities	(346)	42
Other, net	(1,419)	(1,217)
Net cash provided by operating activities	24,411	14,886
Cash flows from investing activities:		
Sale of fixed maturities, available-for-sale		3,344
Maturity and calls of fixed maturities, available-for-sale	108,685	42,265
Purchase of fixed maturities, available-for-sale	(109,097)	(60,600)
Sale of equity securities, available-for-sale		74
Purchase of equity securities, available-for-sale	(22,798)	(10,111)
Principal payments on mortgage loans	18	94
Mortgage loans funded	(115)	
Sale of other long-term investments and property and equipment	179	340
Increase in policy loans	(1,049)	(1,479)
Purchase of other long-term investments and property and equipment	(418)	(3,445)
Maturity of short-term investments	18,000	
Net cash used in investing activities	\$ (6,595)	(29,518)

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

	2008	2007
Cash flows from financing activities:		
Annuity deposits	\$ 1,350	1,114
Annuity withdrawals	(761)	(971)
Net cash provided by financing activities	589	143
Net increase (decrease) in cash and cash equivalents	18,405	(14,489)
Cash and cash equivalents at beginning of period	21,123	24,521
Cash and cash equivalents at end of period	\$ 39,528	10,032
Supplemental disclosures of operating activities:		
Cash paid during the period for income taxes	\$ 951	5,754

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 \$343,000 and \$345,000 for the first six months of 2008 and 2007, 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 2008 and 2007 was \$668,000 and \$669,000, respectively.

See accompanying notes to consolidated financial statements.

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**CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(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), 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, or our.

The consolidated statement of financial position as of June 30, 2008, the consolidated statements of operations for the three and six-month periods ended June 30, 2008 and 2007, 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, 2008, 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, 2007 filed with the Securities and Exchange Commission. The results of operations for the six months ended June 30, 2008, are not necessarily indicative of the operating results for the full year.

At December 31, 2007, the Security Plan in force policies were converted to the Company's mainframe policy administration system and Security Plan's original computer system was discontinued except for historical information. The initial conversion was successful and all in force amounts were reconciled between systems. The Company recognized, due to the uniqueness of the home service business, that some actuarial estimates will be necessary until ongoing system modifications and enhancements are completed some time in 2008. These actuarial adjustments were not in 2007.

During the first quarter of 2008, the Company discovered an overstatement of life reserves, due to the use of an incorrect reserve factor going back several years, in the amount of \$796,000. The error was corrected during the quarter, resulting in an increase to net income of \$517,000 during the quarter.

The Company allowed its policy administration system to maintain Security Plan's Home Service policies on its policy master file beyond the normal sixty days past due standard to protect customer relationships and assist the Home Service field force as Security Plan's business was integrated into its primary computer system. This accommodation resulted in overstatement of deferred acquisition costs (DAC) asset and reserve balances on these policies and understatement of DAC amortization expense and due premium. To compensate for the discrepancy caused by this temporary accommodation, the Company analyzed all policies with a paid to date older than ninety days and manually adjusted policy reserves during the second quarter to reflect the lapsed policies. The amounts related to the first quarter were immaterial. The Company expects to eliminate this temporary accommodation in its policy administration system before September 30, 2008.

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The Company has previously accounted for the conversion of a policy from premium paying to extended term insurance (ETI) as the surrender of the premium paying policy for its cash value, with the cash value being applied as a single premium to purchase the ETI policy. Thus, premiums and surrenders were overstated by the amount of this single premium. Beginning in the first quarter of 2008, the Company no longer accounts for the conversion of a premium paying policy to ETI as a surrender of one policy and simultaneous purchase of a single premium policy. To effect this change, prior year life premiums have been reduced by \$922,000 and \$1,898,000 for the three months and six months ended June 30, 2007, respectively, with a corresponding reduction in claims and surrenders. For the full year 2007, the amount was \$4,157,000.

(2) Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 141 (Revised 2007), *Business Combinations* (FAS 141R). FAS 141R will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, research and development assets and restructuring costs. In addition, under FAS 141R, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income taxes. FAS 141R is effective for fiscal years beginning after December 15, 2008. The Company will determine the impact of adopting FAS 141R on its consolidated financial statements, should applicable transactions occur in the future.

In April 2008, the FASB issued Staff Position (FSP) No. 142-3, *Determining the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 amends the factors to be considered in determining the useful life of intangible assets. Its intent is to improve the consistency between the useful life of an intangible asset and the period of expected cash flows used to measure such asset's fair value. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently assessing the potential impact, if any, of FSP 142-3 on its financial statements.

As of January 1, 2008, the Company adopted SFAS No. 157 (FAS 157), *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The adoption of FAS 157 did not have a material impact on our consolidated financial statements. Additionally, on January 1, 2008, the Company elected the partial adoption of FAS 157 under the provisions of FASB Staff Position (FSP) FAS 157-2, which amends FAS 157 to allow an entity to delay the application of this statement until January 1, 2009 for certain non-financial assets and liabilities. Under the provisions of the FSP, we will delay the application of FAS 157 for fair value measurements used in the impairment testing of goodwill and indefinite-lived intangible assets and eligible non-financial assets and liabilities included within a business combination. In January, 2008, FASB also issued proposed FSP FAS 157-c that would amend FAS 157 to clarify the principles on fair value measurement of liabilities. Management is monitoring the status of this proposed FSP for any impact on our consolidated financial statements. See Note 6 for additional disclosures about fair value measurement.

As of January 1, 2008, the Company adopted SFAS No. 159 (FAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities*. This Statement provides an option, on specified election dates, to report selected financial assets and liabilities, including insurance contracts, at fair value. Subsequent changes in fair value for designated items are reported in income in the current period. The adoption of FAS 159 did not impact our consolidated financial statements, as no items were elected for measurement at fair value upon initial adoption. We will continue to evaluate eligible financial assets and liabilities on their election dates. Any future elections will be disclosed in accordance with the provisions outlined in the Statement.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (FAS 162). FAS 162 identifies the sources of generally accepted accounting principles and provides a framework, or hierarchy, for selecting the principles to be used in preparing financial statements for non-governmental entities in conformity with GAAP. This statement will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly In Conformity with Generally Accepted Accounting Principles*. The adoption of FAS 162 is not expected to have an impact on our results of operations or financial condition.

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In May 2008, the FASB issued SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts* an interpretation of FASB Statement No. 60 (FAS 163). FAS 163 applies to financial guarantee insurance and reinsurance contracts that are: (i) issued by enterprises that are included within the scope of SFAS No. 60, *Accounting and Reporting by Insurance Enterprises* (FAS 60); and (ii) not accounted for as derivative instruments. FAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The adoption of FAS 163 will not have an impact on our results of operations or financial condition, as the Company does not issue financial guarantee insurance contracts.

(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 net income before federal income taxes for its three reportable segments.

The allocation of expenses within the Citizens, Inc. management services agreement was changed in the first quarter of 2008 to reflect the conversion of Security Plan s policies to our policy administration system at year end 2007. Approximately \$1.0 million in expenses per quarter were reallocated from the Life Insurance segment to the Home Service segment, which is reflected in the lower profits for the Home Service segment.

The measurement of segment profit and loss and segment assets do not include material transactions between segments. The Company has no reportable differences between segments and consolidated operations.

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The following summary presents the Company's profit (loss) measurement from continuing operations for each reportable segment, along with certain components of that profit (loss) measurement, for the periods indicated.

	Three Months Ended June 30,	
	2008	2007
	(In thousands)	
Profit (Loss) Measurement		
Income (loss) before federal income tax:		
Life Insurance	\$ 3,140	2,698
Home Service Insurance	734	2,865
Other Non-Insurance Enterprises	459	(381)
Total consolidated pretax income	\$ 4,333	5,182
Selected Components of Profit (Loss) Measurement		
Revenue:		
Life Insurance	\$ 29,632	27,226
Home Service Insurance	12,909	12,966
Other Non-Insurance Enterprises	740	519
Total consolidated revenue	\$ 43,281	40,711
Premiums:		
Life Insurance	\$ 25,399	23,239
Home Service Insurance	9,805	9,863
Other Non-Insurance Enterprises		