

CITIZENS INC  
Form 10-Q  
November 03, 2011

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

FORM 10-Q

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- Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2011

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  
(State of other jurisdiction of  
incorporation or organization)

84-0755371  
I.R.S. Employer Identification No.)

400 East Anderson Lane, Austin, TX  
(Address of principal executive  
offices)

78752  
(Zip Code)

(512) 837-7100

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small 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 Exchange Act).   
Yes  No

As of November 1, 2011, the Registrant had 48,946,546 shares of Class A common stock, no par value, outstanding and 1,001,714 shares of Class B common stock outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Financial Position  
(In thousands)

| Assets   | September<br>30,<br>2011<br>(Unaudited) | December<br>31,<br>2010 |
|--|---|-------------------------|
| Investments:   |   |                         |
| Fixed maturities available-for-sale, at fair value (cost: \$536,537 and \$578,412 in 2011 and 2010, respectively)        | \$564,269                               | 575,737                 |
| Fixed maturities held-to-maturity, at amortized cost (fair value: \$133,951 and \$79,103 in 2011 and 2010, respectively) | 131,820                                 | 80,232                  |
| Equity securities available-for-sale, at fair value (cost: \$44,340 and \$19,844 in 2011 and 2010, respectively)         | 45,366                                  | 23,304                  |
| Mortgage loans on real estate  | 1,453                                   | 1,489                   |
| Policy loans   | 38,075                                  | 35,585                  |
| Real estate held for investment (less \$1,115 and \$1,017 accumulated depreciation in 2011 and 2010, respectively)       | 9,126                                   | 9,200                   |
| Other long-term investments  | 141                                     | 148                     |
| Short-term investments   | 2,066                                   | -                       |
| Total investments  | 792,316                                 | 725,695                 |
| Cash and cash equivalents  | 64,425                                  | 49,723                  |
| Accrued investment income  | 8,465                                   | 7,433                   |
| Reinsurance recoverable  | 9,890                                   | 9,729                   |
| Deferred policy acquisition costs  | 134,587                                 | 125,684                 |
| Cost of customer relationships acquired  | 29,108                                  | 31,631                  |
| Goodwill   | 17,160                                  | 17,160                  |
| Other intangible assets  | 913                                     | 1,019                   |
| Federal income tax receivable  | 344                                     | 1,914                   |
| Property and equipment, net  | 7,992                                   | 7,101                   |
| Due premiums, net (less \$1,466 and \$1,568 allowance for doubtful accounts in 2011 and 2010, respectively)              | 7,807                                   | 8,537                   |
| Prepaid expenses   | 1,027                                   | 474                     |
| Other assets   | 727                                     | 406                     |
| Total assets   | \$1,074,761                             | 986,506                 |

See accompanying notes to consolidated financial statements

(Continued)



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Financial Position  
(In thousands, except share amounts)

| Liabilities and Stockholders' Equity  | September<br>30,<br>2011<br>(Unaudited) | December<br>31,<br>2010 |
|---|---|-------------------------|
| Liabilities:  |   |                         |
| Policy liabilities:   |   |                         |
| Future policy benefit reserves:   |   |                         |
| Life insurance  | \$679,257                               | 637,140                 |
| Annuities   | 45,891                                  | 42,096                  |
| Accident and health   | 5,553                                   | 5,910                   |
| Dividend accumulations  | 10,291                                  | 9,498                   |
| Premiums paid in advance  | 25,360                                  | 23,675                  |
| Policy claims payable   | 9,517                                   | 10,540                  |
| Other policyholders' funds  | 8,489                                   | 8,191                   |
| Total policy liabilities  | 784,358                                 | 737,050                 |
| Commissions payable   | 2,368                                   | 2,538                   |
| Deferred federal income tax   | 18,543                                  | 9,410                   |
| Payable for securities in process of settlement   | 6,654                                   | -                       |
| Warrants outstanding  | 133                                     | 1,587                   |
| Other Liabilities   | 8,188                                   | 8,287                   |
| Total liabilities   | 820,244                                 | 758,872                 |
| Commitments and contingencies (Note 8)  |   |                         |
| Stockholders' equity:   |   |                         |
| Common stock:   |   |                         |
| Class A, no par value, 100,000,000 shares authorized, 52,082,284 shares issued in 2011 and 51,822,497 shares issued in 2010, including shares in treasury of 3,135,738 in 2011 and 2010 | 258,496                                 | 256,703                 |
| Class B, no par value, 2,000,000 shares authorized, 1,001,714 shares issued and outstanding in 2011 and 2010  | 3,184                                   | 3,184                   |
| Accumulated deficit   | (15,337 )                               | (22,581 )               |
| Accumulated other comprehensive income:   |   |                         |
| Unrealized gains on securities, net of tax  | 19,185                                  | 1,339                   |
| Treasury stock, at cost   | (11,011 )                               | (11,011 )               |
| Total stockholders' equity  | 254,517                                 | 227,634                 |
| Total liabilities and stockholders' equity  | \$1,074,761                             | 986,506                 |

See accompanying notes to consolidated financial statements.





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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Operations  
 Three Months Ended September 30,  
 (In thousands, except share amounts)  
 (Unaudited)

|   | 2011     | 2010     |
|---|----------|----------|
| Revenues:   |          |          |
| Premiums:   |          |          |
| Life insurance  | \$38,639 | 36,433   |
| Accident and health insurance                           | 383      | 392      |
| Property insurance                                      | 1,277    | 1,230    |
| Net investment income                                   | 7,693    | 7,272    |
| Realized investment gains (losses), net                 | 35       | (103 )   |
| Decrease in fair value of warrants                      | 239      | 128      |
| Other income  | 282      | 103      |
| Total revenues  | 48,548   | 45,455   |
| Benefits and expenses:                                  |          |          |
| Insurance benefits paid or provided:                    |          |          |
| Claims and surrenders                                   | 14,803   | 15,739   |
| Increase in future policy benefit reserves              | 14,365   | 11,398   |
| Policyholders' dividends                                | 2,169    | 1,977    |
| Total insurance benefits paid or provided               | 31,337   | 29,114   |
| Commissions   | 9,224    | 9,229    |
| Other general expenses                                  | 6,857    | 6,587    |
| Capitalization of deferred policy acquisition costs     | (7,121 ) | (6,973 ) |
| Amortization of deferred policy acquisition costs       | 4,500    | 3,800    |
| Amortization of cost of customer relationships acquired | 708      | 719      |
| Total benefits and expenses                             | 45,505   | 42,476   |
| Income before federal income tax                        | 3,043    | 2,979    |
| Federal income tax expense                              | 820      | 1,313    |
| Net income  | \$2,223  | 1,666    |
| Per Share Amounts:                                      |          |          |
| Basic earnings per share of Class A common stock        | \$0.05   | 0.03     |
| Basic earnings per share of Class B common stock        | 0.02     | 0.02     |
| Diluted earnings per share of Class A common stock      | 0.05     | 0.03     |
| Diluted earnings per share of Class B common stock      | 0.02     | 0.02     |

See accompanying notes to consolidated financial statements.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Operations  
 Nine Months Ended September 30,  
 (In thousands, except per share amounts)  
 (Unaudited)

|   | 2011       | 2010      |
|---|------------|-----------|
| Revenues:   |            |           |
| Premiums:   |            |           |
| Life insurance  | \$ 112,481 | 105,114   |
| Accident and health insurance                           | 1,151      | 1,215     |
| Property insurance                                      | 3,781      | 3,592     |
| Net investment income                                   | 22,924     | 23,896    |
| Realized investment gains, net                          | 41         | 648       |
| Decrease in fair value of warrants                      | 1,454      | 380       |
| Other income  | 509        | 602       |
| Total revenues  | 142,341    | 135,447   |
| Benefits and expenses:                                  |            |           |
| Insurance benefits paid or provided:                    |            |           |
| Claims and surrenders                                   | 44,587     | 46,410    |
| Increase in future policy benefit reserves              | 39,683     | 30,726    |
| Policyholders' dividends                                | 5,751      | 5,324     |
| Total insurance benefits paid or provided               | 90,021     | 82,460    |
| Commissions   | 28,226     | 26,385    |
| Other general expenses                                  | 20,386     | 20,562    |
| Capitalization of deferred policy acquisition costs     | (22,170 )  | (19,946 ) |
| Amortization of deferred policy acquisition costs       | 13,249     | 13,962    |
| Amortization of cost of customer relationships acquired | 2,113      | 2,311     |
| Total benefits and expenses                             | 131,825    | 125,734   |
| Income before federal income tax                        | 10,516     | 9,713     |
| Federal income tax expense                              | 3,270      | 3,257     |
| Net income  | \$7,246    | 6,456     |
| Per Share Amounts:                                      |            |           |
| Basic earnings per share of Class A common stock        | \$0.15     | 0.13      |
| Basic earnings per share of Class B common stock        | 0.07       | 0.07      |
| Diluted earnings per share of Class A common stock      | 0.15       | 0.13      |
| Diluted earnings per share of Class B common stock      | 0.07       | 0.07      |

See accompanying notes to consolidated financial statements.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Cash Flows  
 Nine Months Ended September 30,  
 (In thousands)  
 (Unaudited)

|   | 2011       | 2010       |
|---|------------|------------|
| Cash flows from operating activities:   |            |            |
| Net income  | \$7,246    | 6,456      |
| Adjustments to reconcile net income to net cash provided by operating activities:     |            |            |
| Realized gains on sale of investments and other assets                                | (41 )      | (648 )     |
| Net deferred policy acquisition costs   | (8,921 )   | (5,984 )   |
| Amortization of cost of customer relationships acquired                               | 2,113      | 2,332      |
| Decrease in fair value of warrants  | (1,454 )   | (380 )     |
| Depreciation  | 753        | 787        |
| Amortization of premiums and discounts on fixed maturities and short-term investments | 3,208      | 2,548      |
| Deferred federal income tax benefit   | (567 )     | (61 )      |
| Change in:  |            |            |
| Accrued investment income   | (1,032 )   | (951 )     |
| Reinsurance recoverable   | (161 )     | 1,176      |
| Due premiums and other receivables  | 730        | 1,736      |
| Future policy benefit reserves  | 39,308     | 30,223     |
| Other policyholders' liabilities  | 1,747      | 5,897      |
| Federal income tax receivable   | 1,570      | 2,120      |
| Commissions payable and other liabilities   | (269 )     | (4,754 )   |
| Other, net  | (668 )     | (1,021 )   |
| Net cash provided by operating activities   | 43,562     | 39,476     |
| Cash flows from investing activities:   |            |            |
| Sale of fixed maturities, available-for-sale  | -          | 7,074      |
| Maturity and calls of fixed maturities, available-for-sale                            | 127,342    | 137,506    |
| Maturity and calls of fixed maturities, held-to-maturity                              | 52,900     | 150,350    |
| Purchase of fixed maturities, available-for-sale                                      | (82,184 )  | (246,238 ) |
| Purchase of fixed maturities, held-to-maturity  | (104,466 ) | (71,452 )  |
| Sale of equity securities, available-for-sale   | -          | 591        |
| Calls of equity securities, available-for-sale  | 682        | 100        |
| Purchase of equity securities, available-for-sale                                     | (25,000 )  | (205 )     |
| Principal payments on mortgage loans  | 36         | 33         |
| Increase in policy loans  | (2,464 )   | (2,874 )   |
| Sale of other long-term investments   | 5          | 42         |
| Purchase of other long-term investments   | (25 )      | (1,799 )   |
| Sale of property and equipment  | 2          | -          |
| Purchase of property and equipment  | (1,662 )   | -          |
| Maturity of short-term investments  | -          | 2,500      |
| Purchase of short-term investments  | (2,066 )   | -          |
| Proceeds from assumption reinsurance agreement  | 4,550      | -          |
| Net cash used in investing activities   | (32,350 )  | (24,372 )  |

See accompanying notes to consolidated financial statements.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

Consolidated Statements of Cash Flows, Continued  
 Nine Months Ended September 30,  
 (In thousands)  
 (Unaudited)

|   | 2011     | 2010     |
|---|----------|----------|
| Cash flows from financing activities:             |          |          |
| Warrants exercised                                | \$1,791  | -        |
| Annuity deposits                                  | 4,818    | 4,041    |
| Annuity withdrawals                               | (3,119 ) | (2,404 ) |
| Net cash provided by financing activities         | 3,490    | 1,637    |
| Net increase in cash and cash equivalents         | 14,702   | 16,741   |
| Cash and cash equivalents at beginning of year    | 49,723   | 48,625   |
| Cash and cash equivalents at end of period        | \$64,425 | 65,366   |
| Supplemental disclosures of operating activities: |          |          |
| Cash paid during the period for income taxes      | \$2,267  | 1,200    |

## Supplemental Disclosures of Non-Cash Investing Activities:

In 2010, the Company sold a parcel of real estate and issued a mortgage loan for \$102,000.

See accompanying notes to consolidated financial statements.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
Notes to Consolidated Financial Statements  
September 30, 2011  
(Unaudited)

(1) Financial Statements

Basis of Presentation and Consolidation

The accompanying consolidated financial statements of Citizens, Inc. and its wholly-owned subsidiaries have been prepared in conformity with U.S. generally accepted accounting principles ("U.S. GAAP").

The consolidated financial statements include the accounts and operations of Citizens, Inc. ("Citizens"), a Colorado corporation, and its wholly-owned subsidiaries, CICA Life Insurance Company of America ("CICA"), Computing Technology, Inc. ("CTI"), Insurance Investors, Inc. ("III"), Citizens National Life Insurance Company ("CNLIC"), Security Plan Life Insurance Company ("SPLIC"), and Security Plan Fire Insurance Company ("SPFIC"). Integrity Capital Corporation and Integrity Capital Life Insurance Company were merged into CICA effective April 1, 2011. All significant inter-company accounts and transactions have been eliminated. Citizens and its wholly-owned subsidiaries are collectively referred to as "the Company," "we," "us" or "our."

The consolidated statements of financial position for September 30, 2011, the consolidated statements of operations for the three and nine-month periods ended September 30, 2011 and 2010, and the consolidated statements of cash flows for the nine-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 September 30, 2011, and for comparative periods have been made.

We provide primarily life insurance and a small amount of health insurance policies through our insurance subsidiaries: CICA, SPLIC, and CNLIC. CICA and CNLIC issue ordinary whole-life policies, burial insurance, pre-need policies, and accident and health related policies, throughout the Midwest and southern United States. CICA also issues ordinary whole-life policies to non-U.S. residents. SPLIC offers final expense and home service life insurance in Louisiana, Arkansas and Mississippi and SPFIC, a wholly-owned subsidiary of SPLIC, writes a limited amount of property insurance in Louisiana.

CTI provides data processing systems and services, as well as furniture and equipment, to the Company. III provides aviation transportation to the Company.

Use of Estimates

The preparation of financial statements, in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The most significant estimates include those used in the evaluation of other-than-temporary impairments on debt and equity securities and valuation allowances on investments, actuarially determined liabilities and assumptions, goodwill impairment, valuation allowance on deferred tax assets, and contingencies relating to litigation and regulatory matters. Certain of these estimates are particularly sensitive to market conditions, and deterioration and/or volatility in the worldwide debt or equity markets could have a material impact on the Consolidated Financial Statements.

#### Acquisitions

On August 1, 2011, SPLIC entered into assumption reinsurance agreements with Escude Life Insurance Company in Rehabilitation, and Benton Life Insurance Company in Rehabilitation. At the time the agreements were executed, both companies were under receivership with the Louisiana Department of Insurance. In total, SPLIC assumed approximately \$4.5 million in reserve liabilities and received approximately \$4.6 million in cash, with a minimal reinsurance ceding commission being paid. These transactions are not deemed material.



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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued  
September 30, 2011  
(Unaudited)

Reclassification

Reclassifications have been made in the current year related to certain prior year reported amounts to provide consistent presentation. The Company recorded reclassifications related to DAC amounts capitalized and amortized to properly reflect the amount used to develop the DAC asset balance and to provide consistent presentation with the current year. We recorded increases to DAC capitalized of \$0.8 million and \$2.5 million and an increase in amortization for the same amounts for the three and nine months ended September 30, 2010, respectively.

Significant Accounting Policies

For a description of significant accounting policies, see Note 1 of the Notes to Consolidated Financial Statements included in our 2010 Form 10-K Annual Report, which should be read in conjunction with these accompanying Consolidated Financial Statements.

(2) Accounting Pronouncements

Accounting Standards Not Yet Adopted

In October 2010, the Financial Accounting Standards Board ("FASB") issued guidance modifying the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal contracts. The guidance specifies that the costs must be based on successful efforts. The guidance also specifies that advertising costs should be included as deferred acquisition costs only when the direct-response advertising accounting criteria are met. If application of the guidance would result in the capitalization of acquisition costs that had not been capitalized prior to adoption, the entity may elect not to capitalize those additional costs. The new guidance is effective for reporting periods beginning after December 15, 2011, and should be applied prospectively, with retrospective application permitted. The Company is in the process of evaluating the impact of adoption of the guidance on the results of operations and financial position. Based upon its initial review of this guidance, the Company will adopt this standard on January 1, 2012, with a retrospective application. The financial impact is currently estimated to result in a reduction in the DAC asset upon implementation between \$10.0 million and \$13.0 million as a retrospective adjustment to beginning of year retained earnings at the date of adoption, and an estimated increase in pre-tax earnings of \$0.5 million to \$1.0 million.

In June 2011, the FASB amended its guidance on the presentation of comprehensive income in financial statements to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items that are recorded in other comprehensive income. The new accounting guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The provisions of this new guidance are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will have no impact on our financial statements.

Accounting Standards Update ("ASU") 2011-04, "Fair Value Measurement ("Topic 820") – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs." ASU 2011-04 amends Topic 820, "Fair Value Measurements and Disclosures," to converge the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value

measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on the Company's financial statements.

#### Accounting Standards Recently Adopted

In December 2010, the FASB issued disclosure guidance for entities that enter into business combinations that are material. The guidance specifies that if an entity presents comparative financial statements, the entity should disclose pro forma revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. The guidance expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination. The Company will apply the guidance to any business combinations entered into on or after January 1, 2011.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued  
September 30, 2011  
(Unaudited)

## (3) Segment Information

The Company has three reportable segments: Life Insurance, Home Service Insurance, and Other Non-Insurance Enterprises. The accounting policies of the segments are in accordance with U.S. GAAP and are the same as those used in the preparation of the consolidated financial statements. The Company evaluates profit and loss performance based on U.S. GAAP income before federal income taxes for its three reportable segments.

The Company has no reportable differences between segments and consolidated operations.

|   | Three Months Ended September 30, 2011 |                              |                                       | Consolidated |
|---|---------------------------------------|------------------------------|---------------------------------------|--------------|
|   | Life<br>Insurance                     | Home<br>Service<br>Insurance | Other<br>Non-Insurance<br>Enterprises |              |
|   | (In thousands)                        |                              |                                       |              |
| Revenues:   |                                       |                              |                                       |              |
| Premiums  | \$29,491                              | 10,808                       | -                                     | 40,299       |
| Net investment income                                   | 4,309                                 | 3,178                        | 206                                   | 7,693        |
| Realized investment gains, net                          | 25                                    | 4                            | 6                                     | 35           |
| Decrease in fair value of warrants                      | -                                     | -                            | 239                                   | 239          |
| Other income  | 240                                   | 6                            | 36                                    | 282          |
| Total revenue   | 34,065                                | 13,996                       | 487                                   | 48,548       |
| Benefits and expenses:                                  |                                       |                              |                                       |              |
| Insurance benefits paid or provided:                    |                                       |                              |                                       |              |
| Claims and surrenders                                   | 9,834                                 | 4,969                        | -                                     | 14,803       |
| Increase in future policy benefit reserves              | 13,133                                | 1,232                        | -                                     | 14,365       |
| Policyholders' dividends                                | 2,152                                 | 17                           | -                                     | 2,169        |
| Total insurance benefits paid or provided               | 25,119                                | 6,218                        | -                                     | 31,337       |
| Commissions   | 5,516                                 | 3,708                        | -                                     | 9,224        |
| Other general expenses                                  | 2,983                                 | 3,233                        | 641                                   | 6,857        |
| Capitalization of deferred policy acquisition costs     | (5,484 )                              | (1,637 )                     | -                                     | (7,121 )     |
| Amortization of deferred policy acquisition costs       | 3,680                                 | 820                          | -                                     | 4,500        |
| Amortization of cost of customer relationships acquired | 206                                   | 502                          | -                                     | 708          |
| Total benefits and expenses                             | 32,020                                | 12,844                       | 641                                   | 45,505       |
| Income (loss) before income tax expense                 | \$2,045                               | 1,152                        | (154 )                                | 3,043        |

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
Notes to Consolidated Financial Statements, Continued  
September 30, 2011  
(Unaudited)

|   | Nine Months Ended September 30, 2011 |                              |                                       | Consolidated   |
|---|--------------------------------------|------------------------------|---------------------------------------|----------------|
|   | Life<br>Insurance                    | Home<br>Service<br>Insurance | Other<br>Non-Insurance<br>Enterprises |                |
|   | (In thousands)                       |                              |                                       |                |
| <b>Revenues:</b>  |                                      |                              |                                       |                |
| Premiums  | \$85,027                             | 32,386                       | -                                     | 117,413        |
| Net investment income                                   | 12,662                               | 9,690                        | 572                                   | 22,924         |
| Realized investment gains, net                          | 29                                   | 6                            | 6                                     | 41             |
| Decrease in fair value of warrants                      | -                                    | -                            | 1,454                                 | 1,454          |
| Other income  | 404                                  | 20                           | 85                                    | 509            |
| <b>Total revenue</b>                                    | <b>98,122</b>                        | <b>42,102</b>                | <b>2,117</b>                          | <b>142,341</b> |
| <b>Benefits and expenses:</b>                           |                                      |                              |                                       |                |
| <b>Insurance benefits paid or provided:</b>             |                                      |                              |                                       |                |
| Claims and surrenders                                   | 29,691                               | 14,896                       | -                                     | 44,587         |
| Increase in future policy benefit reserves              | 36,957                               | 2,726                        | -                                     | 39,683         |
| Policyholders' dividends                                | 5,696                                | 55                           | -                                     | 5,751          |
| <b>Total insurance benefits paid or provided</b>        | <b>72,344</b>                        | <b>17,677</b>                | <b>-</b>                              | <b>90,021</b>  |
| Commissions   | 16,916                               | 11,310                       | -                                     | 28,226         |
| Other general expenses                                  | 8,936                                | 9,488                        | 1,962                                 | 20,386         |
| Capitalization of deferred policy acquisition costs     | (16,971 )                            | (5,199 )                     | -                                     | (22,170 )      |
| Amortization of deferred policy acquisition costs       | 11,290                               | 1,959                        | -                                     | 13,249         |
| Amortization of cost of customer relationships acquired | 705                                  | 1,408                        | -                                     | 2,113          |
| <b>Total benefits and expenses</b>                      | <b>93,220</b>                        | <b>36,643</b>                | <b>1,962</b>                          | <b>131,825</b> |
| <b>Income before income tax expense</b>                 | <b>\$4,902</b>                       | <b>5,459</b>                 | <b>155</b>                            | <b>10,516</b>  |

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|   | Three Months Ended September 30, 2010 |                              |                                       | Consolidated  |
|---|---------------------------------------|------------------------------|---------------------------------------|---------------|
|   | Life<br>Insurance                     | Home<br>Service<br>Insurance | Other<br>Non-Insurance<br>Enterprises |               |
|   | (In thousands)                        |                              |                                       |               |
| <b>Revenues:</b>  |                                       |                              |                                       |               |
| Premiums  | \$27,514                              | 10,541                       | -                                     | 38,055        |
| Net investment income                                   | 3,893                                 | 3,244                        | 135                                   | 7,272         |
| Realized investment gains (losses), net                 | 1                                     | (96 )                        | (8 )                                  | (103 )        |
| Decrease in fair value of warrants                      | -                                     | -                            | 128                                   | 128           |
| Other income  | 78                                    | 10                           | 15                                    | 103           |
| <b>Total revenue</b>                                    | <b>31,486</b>                         | <b>13,699</b>                | <b>270</b>                            | <b>45,455</b> |
| <b>Benefits and expenses:</b>                           |                                       |                              |                                       |               |
| <b>Insurance benefits paid or provided:</b>             |                                       |                              |                                       |               |
| Claims and surrenders                                   | 10,498                                | 5,241                        | -                                     | 15,739        |
| Increase in future policy benefit reserves              | 10,688                                | 710                          | -                                     | 11,398        |
| Policyholders' dividends                                | 1,965                                 | 12                           | -                                     | 1,977         |
| <b>Total insurance benefits paid or provided</b>        | <b>23,151</b>                         | <b>5,963</b>                 | <b>-</b>                              | <b>29,114</b> |
| Commissions   | 5,572                                 | 3,657                        | -                                     | 9,229         |
| Other general expenses                                  | 2,603                                 | 3,529                        | 455                                   | 6,587         |
| Capitalization of deferred policy acquisition costs     | (5,414 )                              | (1,559 )                     | -                                     | (6,973 )      |
| Amortization of deferred policy acquisition costs       | 3,448                                 | 352                          | -                                     | 3,800         |
| Amortization of cost of customer relationships acquired | 232                                   | 487                          | -                                     | 719           |
| <b>Total benefits and expenses</b>                      | <b>29,592</b>                         | <b>12,429</b>                | <b>455</b>                            | <b>42,476</b> |
| <b>Income (loss) before income tax expense</b>          | <b>\$1,894</b>                        | <b>1,270</b>                 | <b>(185 )</b>                         | <b>2,979</b>  |

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|   | Nine Months Ended September 30, 2010 |                      |                              |                |
|---|--------------------------------------|----------------------|------------------------------|----------------|
|   | Life                                 | Home                 | Other                        | Consolidated   |
|   | Insurance                            | Service<br>Insurance | Non-Insurance<br>Enterprises |                |
|   | (In thousands)                       |                      |                              |                |
| <b>Revenues:</b>  |                                      |                      |                              |                |
| Premiums  | \$78,364                             | 31,557               | -                            | 109,921        |
| Net investment income                                   | 13,239                               | 10,251               | 406                          | 23,896         |
| Realized investment gains (losses), net                 | 116                                  | 585                  | (53 )                        | 648            |
| Decrease in fair value of warrants                      | -                                    | -                    | 380                          | 380            |
| Other income  | 487                                  | 63                   | 52                           | 602            |
| <b>Total revenue</b>                                    | <b>92,206</b>                        | <b>42,456</b>        | <b>785</b>                   | <b>135,447</b> |
| <b>Benefits and expenses:</b>                           |                                      |                      |                              |                |
| <b>Insurance benefits paid or provided:</b>             |                                      |                      |                              |                |
| Claims and surrenders                                   | 30,644                               | 15,766               | -                            | 46,410         |
| Increase in future policy benefit reserves              | 28,123                               | 2,603                | -                            | 30,726         |
| Policyholders' dividends                                | 5,267                                | 57                   | -                            | 5,324          |
| <b>Total insurance benefits paid or provided</b>        | <b>64,034</b>                        | <b>18,426</b>        | <b>-</b>                     | <b>82,460</b>  |
| Commissions   | 15,316                               | 11,069               | -                            | 26,385         |
| Other general expenses                                  | 8,234                                | 10,964               | 1,364                        | 20,562         |
| Capitalization of deferred policy acquisition costs     | (15,097 )                            | (4,849 )             | -                            | (19,946 )      |
| Amortization of deferred policy acquisition costs       | 13,108                               | 854                  | -                            | 13,962         |
| Amortization of cost of customer relationships acquired | 837                                  | 1,474                | -                            | 2,311          |
| <b>Total benefits and expenses</b>                      | <b>86,432</b>                        | <b>37,938</b>        | <b>1,364</b>                 | <b>125,734</b> |
| <b>Income (loss) before income tax expense</b>          | <b>\$5,774</b>                       | <b>4,518</b>         | <b>(579 )</b>                | <b>9,713</b>   |

## (4)Total Comprehensive Income

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2011 | September 30,<br>2010 | September 30,<br>2011 | September 30,<br>2010 |
|   | (In thousands)        |                       |                       |                       |
| Net income  | \$2,223               | 1,666                 | 7,246                 | 6,456                 |
| <b>Other comprehensive income net of effects of deferred acquisition costs and taxes:</b> |                       |                       |                       |                       |
| Unrealized gains on available-for-sale securities   | 15,431                | 11,288                | 27,546                | 21,554                |
| Tax expense   | (5,460 )              | (2,700 )              | (9,700 )              | (7,135 )              |
| Other comprehensive income  | 9,971                 | 8,588                 | 17,846                | 14,419                |
| <b>Total comprehensive income</b>   | <b>\$12,194</b>       | <b>10,254</b>         | <b>25,092</b>         | <b>20,875</b>         |



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## (5) Earnings Per Share

The following tables set forth the computation of basic and diluted earnings per share.

|  | Three Months Ended<br>September 30,<br>2011          2010<br>(In thousands,<br>except per share amounts) |        |
|--|--|--------|
| Basic and diluted earnings per share:                              |  |        |
| Numerator:   |  |        |
| Net income   | \$2,223  | 1,666  |
| Net income allocated to Class A common stock                       | \$2,200  | 1,649  |
| Net income allocated to Class B common stock                       | 23   | 17     |
| Net income available to common stockholders                        | \$2,223  | 1,666  |
| Denominator:   |  |        |
| Weighted average shares of Class A outstanding - basic and diluted | 48,912   | 48,687 |
| Weighted average shares of Class B outstanding - basic and diluted | 1,002  | 1,002  |
| Basic and diluted earnings per share of Class A common stock       | \$0.05   | 0.03   |
| Basic and diluted earnings per share of Class B common stock       | 0.02   | 0.02   |

|  | Nine Months Ended<br>September 30,<br>2011          2010<br>(In thousands,<br>except per share amounts) |        |
|--|---|--------|
| Basic and diluted earnings per share:                              |   |        |
| Numerator:   |   |        |
| Net income   | \$7,246   | 6,456  |
| Net income allocated to Class A common stock                       | \$7,172   | 6,390  |
| Net income allocated to Class B common stock                       | 74  | 66     |
| Net income available to common stockholders                        | \$7,246   | 6,456  |
| Denominator:   |   |        |
| Weighted average shares of Class A outstanding - basic             | 48,762  | 48,687 |
| Weighted average shares of Class A outstanding - diluted           | 48,764  | 48,687 |
| Weighted average shares of Class B outstanding - basic and diluted | 1,002   | 1,002  |
| Basic earnings per share of Class A common stock                   | \$0.15  | 0.13   |
| Basic earnings per share of Class B common stock                   | 0.07  | 0.07   |
| Diluted earnings per share of Class A common stock                 | 0.15  | 0.13   |
| Diluted earnings per share of Class B common stock                 | 0.07  | 0.07   |



The diluted earnings per share calculation has assumptions regarding the exercise of warrants issued to certain investors as discussed below in Note 9 - Convertible Preferred Stock: Warrants. For the three months ended September 30, 2011, no dilution occurred. The calculation for the nine months ended September 30, 2011 assumes the issue of 1,851 additional shares with a reduction in net income of \$0.1 million.

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## (6) Investments

The Company invests primarily in fixed maturity securities, which totaled 81.2% of total investments and cash and cash equivalents at September 30, 2011.

|  | September 30, 2011                     |                                 | December 31, 2010                      |                                 |
|--|--|---------------------------------|--|---------------------------------|
|  | Carrying<br>Value<br>(In<br>thousands) | % of Total<br>Carrying<br>Value | Carrying<br>Value<br>(In<br>thousands) | % of Total<br>Carrying<br>Value |
| Fixed maturity securities                    | \$696,089                              | 81.2                            | \$655,969                              | 84.6                            |
| Equity securities                            | 45,366                                 | 5.3                             | 23,304                                 | 3.0                             |
| Mortgage loans                               | 1,453                                  | 0.2                             | 1,489                                  | 0.2                             |
| Policy loans                                 | 38,075                                 | 4.4                             | 35,585                                 | 4.6                             |
| Real estate                                  | 9,126                                  | 1.1                             | 9,200                                  | 1.2                             |
| Other long-term investments                  | 141                                    | -                               | 148                                    | -                               |
| Short-term investments                       | 2,066                                  | 0.3                             | -                                      | -                               |
| Cash and cash equivalents                    | 64,425                                 | 7.5                             | 49,723                                 | 6.4                             |
| Total cash, cash equivalents and investments | \$856,741                              | 100.0                           | \$775,418                              | 100.0                           |

During the nine months ended September 30, 2011, we reinvested \$24.0 million of proceeds received from calls and prepayments of bonds in bond mutual funds. This resulted in a decrease of our fixed maturity holdings and an increase of our equity securities holdings as a percentage of total investments. Our cash balances fluctuate until excess available funds are invested.

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The following tables represent gross unrealized gains and losses for fixed maturities and equity securities as of the periods indicated.

|  | Cost or<br>Amortized<br>Cost | September 30, 2011           |                               | Fair<br>Value |
|--|------------------------------|------------------------------|-------------------------------|---------------|
|  |                              | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |               |
| (In thousands)   |                              |                              |                               |               |
| Fixed maturities:  |                              |                              |                               |               |
| Fixed maturities available-for-sale:                                 |                              |                              |                               |               |
| U.S. Treasury securities   | \$10,241                     | 3,654                        | -                             | 13,895        |
| U.S. Government-sponsored enterprises                                | 206,139                      | 3,256                        | 61                            | 209,334       |
| States of the United States and political subdivisions of the states | 139,253                      | 9,424                        | 1,660                         | 147,017       |
| Foreign governments  | 105                          | 39                           | -                             | 144           |
| Corporate  | 171,472                      | 14,221                       | 1,732                         | 183,961       |
| Securities not due at a single maturity date                         | 9,327                        | 598                          | 7                             | 9,918         |
| Total available-for-sale securities                                  | 536,537                      | 31,192                       | 3,460                         | 564,269       |
| Held-to-maturity securities:   |                              |                              |                               |               |
| U.S. Government-sponsored enterprises                                | 84,588                       | 426                          | 43                            | 84,971        |
| States of the United States and political subdivisions of the states | 47,232                       | 1,862                        | 114                           | 48,980        |
| Total held-to-maturity securities                                    | 131,820                      | 2,288                        | 157                           | 133,951       |
| Total fixed maturities   | \$668,357                    | 33,480                       | 3,617                         | 698,220       |
| Equity securities:   |                              |                              |                               |               |
| Stock mutual funds   | \$18,931                     | 1,295                        | 815                           | 19,411        |
| Bond mutual funds  | 24,000                       | -                            | 68                            | 23,932        |
| Common stock   | 17                           | 10                           | -                             | 27            |
| Preferred stock  | 1,392                        | 604                          | -                             | 1,996         |
| Total equity securities  | \$44,340                     | 1,909                        | 883                           | 45,366        |

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|  | Cost or<br>Amortized<br>Cost | December 31, 2010<br>Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|------------------------------|---|-------------------------------|---------------|
|  | (In thousands)               |   |                               |               |
| Fixed maturities:  |                              |   |                               |               |
| Available-for-sale securities:                                       |                              |   |                               |               |
| U.S. Treasury securities   | \$ 10,908                    | 1,917   | -                             | 12,825        |
| U.S. Government-sponsored enterprises                                | 290,904                      | 441   | 6,390                         | 284,955       |
| States of the United States and political subdivisions of the states | 107,214                      | 539   | 6,034                         | 101,719       |
| Foreign governments  | 106                          | 26  | -                             | 132           |
| Corporate  | 155,277                      | 7,237   | 1,216                         | 161,298       |
| Securities not due at a single maturity dates                        | 14,003                       | 833   | 28                            | 14,808        |
| Total available-for-sale securities                                  | 578,412                      | 10,993  | 13,668                        | 575,737       |
| Held-to-maturity securities:   |                              |   |                               |               |
| U.S. Government-sponsored enterprises                                | 80,232                       | 272   | 1,401                         | 79,103        |
| Total fixed maturities   | \$658,644                    | 11,265  | 15,069                        | 654,840       |
| Equity securities:   |                              |   |                               |               |
| Stock mutual funds   | \$ 17,931                    | 2,566   | 19                            | 20,478        |
| Common stock   | 17                           | 29  | -                             | 46            |
| Preferred stock  | 1,896                        | 884   | -                             | 2,780         |
| Total equity securities  | \$ 19,844                    | 3,479   | 19                            | 23,304        |

At September 30, 2011, the Company had \$9.3 million of mortgage-backed security holdings based on amortized cost, of which \$8.5 million, or 91.4%, were residential U.S. Government-sponsored issues. Mortgage-backed securities are also referred to as securities not due at a single maturity date throughout this report. The majority of the Company's equity securities are diversified stock and bond mutual funds.

#### Valuation of Investments in Fixed Maturity and Equity Securities

Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

The Company monitors all debt and equity securities on an on-going basis relative to changes in credit ratings, market prices, earnings trends and financial performance, in addition to specific region or industry reviews. The assessment of whether impairments have occurred is based on a case-by-case evaluation of underlying reasons for the decline in fair value. The Company determines other-than-temporary impairment by reviewing relevant evidence related to the specific security issuer as well as the Company's intent to sell the security, or if it is more likely than not that the Company would be required to sell a security before recovery of its amortized cost.

When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the following: (a) the amount representing the credit loss; and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value.

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The Company evaluates whether a credit impairment exists for debt securities by considering primarily the following factors: (a) changes in the financial condition of the security's underlying collateral; (b) whether the issuer is current on contractually obligated interest and principal payments; (c) changes in the financial condition, credit rating and near-term prospects of the issuer; (d) the extent to which the fair value has been less than the amortized cost of the security; and (e) the payment structure of the security. The Company's best estimate of expected future cash flows used to determine the credit loss amount is a quantitative and qualitative process. Quantitative review includes information received from third party sources such as financial statements, pricing and rating changes, liquidity and other statistical information. Qualitative factors include judgments related to business strategies, economic impacts on the issuer and overall judgment related to estimates and industry factors. The Company's best estimate of future cash flows involves assumptions including, but not limited to, various performance indicators, such as historical and projected default and recovery rates, credit ratings, and current delinquency rates. These assumptions require the use of significant management judgment and include the probability of issuer default and estimates regarding timing and amount of expected recoveries, which may include estimating the underlying collateral value. In addition, projections of expected future debt security cash flows may change based upon new information regarding the performance of the issuer.

The primary factors considered in evaluating whether an impairment exists for an equity security include, but are not limited to: (a) the length of time and the extent to which the fair value has been less than the cost of the security; (b) changes in the financial condition, credit rating and near-term prospects of the issuer; (c) whether the issuer is current on contractually obligated payments; and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery.

The Company did not recognize any other-than-temporary impairments ("OTTI") during the nine months ended September 30, 2011 and September 30, 2010.

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

|  | September 30, 2011  |                   |                 |                        |                   |                 |            |                   |                 |
|--|---------------------|-------------------|-----------------|------------------------|-------------------|-----------------|------------|-------------------|-----------------|
|  | Less than 12 months |                   |                 | Greater than 12 months |                   |                 | Total      |                   |                 |
|  | Fair Value          | Unrealized Losses | # of Securities | Fair Value             | Unrealized Losses | # of Securities | Fair Value | Unrealized Losses | # of Securities |
| (In thousands, except for # of securities)             |                     |                   |                 |                        |                   |                 |            |                   |                 |
| Fixed maturities:                                      |                     |                   |                 |                        |                   |                 |            |                   |                 |
| Available-for-sale securities:                         |                     |                   |                 |                        |                   |                 |            |                   |                 |
| U.S.   |                     |                   |                 |                        |                   |                 |            |                   |                 |
| Government-sponsored enterprises                       | \$ 15,955           | 46                | 15              | 1,005                  | 15                | 1               | 16,960     | 61                | 16              |
| Securities issued by states and political subdivisions | 4,653               | 54                | 7               | 10,778                 | 1,606             | 8               | 15,431     | 1,660             | 15              |
| Corporate  | 30,327              | 1,235             | 31              | 5,998                  | 497               | 6               | 36,325     | 1,732             | 37              |
| Securities not due at a single maturity date           | 563                 | 2                 | 1               | 70                     | 5                 | 2               | 633        | 7                 | 3               |
| Total available-for-sale securities                    | 51,498              | 1,337             | 54              | 17,851                 | 2,123             | 17              | 69,349     | 3,460             | 71              |
| Held-to-maturity securities:                           |                     |                   |                 |                        |                   |                 |            |                   |                 |
| U.S.   |                     |                   |                 |                        |                   |                 |            |                   |                 |
| Government-sponsored enterprises                       | 21,164              | 28                | 10              | 1,124                  | 15                | 1               | 22,288     | 43                | 11              |
| Securities issued by states and political subdivisions | 5,783               | 114               | 6               | -                      | -                 | -               | 5,783      | 114               | 6               |
| Total held-to-maturity securities                      | 26,947              | 142               | 16              | 1,124                  | 15                | 1               | 28,071     | 157               | 17              |
| Total fixed maturities                                 | \$ 78,445           | 1,479             | 70              | 18,975                 | 2,138             | 18              | 97,420     | 3,617             | 88              |
| Equity securities:                                     |                     |                   |                 |                        |                   |                 |            |                   |                 |
| Stock mutual funds                                     | \$ 9,649            | 815               | 3               | -                      | -                 | -               | 9,649      | 815               | 3               |
| Bond mutual funds                                      | 23,932              | 68                | 10              | -                      | -                 | -               | 23,932     | 68                | 10              |
| Total equity securities                                | \$ 33,581           | 883               | 13              | -                      | -                 | -               | 33,581     | 883               | 13              |

|  | December 31, 2010   |                   |                 |                        |                   |                 |            |                   |                 |
|--|---------------------|-------------------|-----------------|------------------------|-------------------|-----------------|------------|-------------------|-----------------|
|  | Less than 12 months |                   |                 | Greater than 12 months |                   |                 | Total      |                   |                 |
|  | Fair Value          | Unrealized Losses | # of Securities | Fair Value             | Unrealized Losses | # of Securities | Fair Value | Unrealized Losses | # of Securities |

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Value      Losses   Securities   Value      Losses   Securities   Value      Losses   Securities  
(In thousands, except for # of securities)

Fixed maturities:

Available-for-sale securities:

|                                       |            |       |     |   |   |   |         |       |     |
|---------------------------------------|------------|-------|-----|---|---|---|---------|-------|-----|
| U.S. Government-sponsored enterprises | \$ 234,994 | 6,390 | 170 | - | - | - | 234,994 | 6,390 | 170 |
|---------------------------------------|------------|-------|-----|---|---|---|---------|-------|-----|

|  |        |       |    |       |       |   |        |       |    |
|--|--------|-------|----|-------|-------|---|--------|-------|----|
| Securities issued by states and political subdivisions | 66,836 | 3,270 | 60 | 9,626 | 2,764 | 8 | 76,462 | 6,034 | 68 |
|--|--------|-------|----|-------|-------|---|--------|-------|----|

|           |        |       |    |       |     |   |        |       |    |
|-----------|--------|-------|----|-------|-----|---|--------|-------|----|
| Corporate | 28,072 | 1,040 | 21 | 2,443 | 176 | 7 | 30,515 | 1,216 | 28 |
|-----------|--------|-------|----|-------|-----|---|--------|-------|----|

|  |     |   |   |     |    |   |     |    |   |
|--|-----|---|---|-----|----|---|-----|----|---|
| Securities not due at a single maturity date | 569 | 8 | 2 | 201 | 20 | 5 | 770 | 28 | 7 |
|--|-----|---|---|-----|----|---|-----|----|---|

|                                     |         |        |     |        |       |    |         |        |     |
|-------------------------------------|---------|--------|-----|--------|-------|----|---------|--------|-----|
| Total available-for-sale securities | 330,471 | 10,708 | 253 | 12,270 | 2,960 | 20 | 342,741 | 13,668 | 273 |
|-------------------------------------|---------|--------|-----|--------|-------|----|---------|--------|-----|

Held-to-maturity securities:

|                                       |        |       |    |   |   |   |        |       |    |
|---------------------------------------|--------|-------|----|---|---|---|--------|-------|----|
| U.S. Government-sponsored enterprises | 45,699 | 1,401 | 18 | - | - | - | 45,699 | 1,401 | 18 |
|---------------------------------------|--------|-------|----|---|---|---|--------|-------|----|

|                        |            |        |     |        |       |    |         |        |     |
|------------------------|------------|--------|-----|--------|-------|----|---------|--------|-----|
| Total fixed maturities | \$ 376,170 | 12,109 | 271 | 12,270 | 2,960 | 20 | 388,440 | 15,069 | 291 |
|------------------------|------------|--------|-----|--------|-------|----|---------|--------|-----|

Equity securities:

|                    |          |    |   |   |   |   |       |    |   |
|--------------------|----------|----|---|---|---|---|-------|----|---|
| Stock mutual funds | \$ 2,910 | 19 | 1 | - | - | - | 2,910 | 19 | 1 |
|--------------------|----------|----|---|---|---|---|-------|----|---|



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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
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(Unaudited)

As of September 30, 2011, the Company had 17 available-for-sale securities and 1 held-to-maturity security that were in an unrealized loss position for greater than 12 months. These securities consisted of U.S. Government, municipals, corporate and mortgage-backed securities. We have reviewed these securities and determined that no other-than-temporary impairment exists based on our evaluation of the credit worthiness of the issuers and the fact that we do not intend to sell the investments nor is it likely that we will be required to sell the securities before recovery of their amortized cost bases which may be maturity. We continue to monitor all securities on an on-going basis, and future information may become available which could result in impairments being recorded.

The amortized cost and fair value of fixed maturity securities at September 30, 2011 by contractual maturity are shown in the table below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The Company has experienced significant issuer calls over the past two years as a result of the declining interest rate environment.

|  | September 30, 2011 |               |
|--|--------------------|---------------|
|  | Amortized<br>Cost  | Fair<br>Value |
|  | (In thousands)     |               |
| Available-for-sale securities:               |                    |               |
| Due in one year or less                      | \$ 5,658           | 5,782         |
| Due after one year through five years        | 33,114             | 34,587        |
| Due after five years through ten years       | 102,451            | 107,403       |
| Due after ten years                          | 385,987            | 406,579       |
| Total available-for-sale securities          | 527,210            | 554,351       |
| Held-to-maturity securities:                 |                    |               |
| Due after five years through ten years       | 18,381             | 19,065        |
| Due after ten years                          | 113,439            | 114,886       |
| Total held-to-maturity securities            | 131,820            | 133,951       |
| Securities not due at a single maturity date | 9,327              | 9,918         |
| Total fixed maturities                       | \$ 668,357         | 698,220       |

The securities not due at a single maturity date are primarily mortgage-backed obligations of U.S. Government-sponsored enterprises and corporate securities.

The Company uses the specific identification method of the individual security to determine the cost basis used in the calculation of realized gains and losses related to security sales. Proceeds and gross realized gains from sales of securities for the three and nine months ended September 30, 2011 and 2010 are summarized as follows.

|          | Fixed Maturities Available-for-Sale         |     |  |       | Equity Securities                           |   |  |     |
|----------|---|-----|--|-------|---|---|--|-----|
|          | Three Months Ended<br>September 30,<br>2011 |     | Nine Months Ended<br>September 30,<br>2011 |       | Three Months Ended<br>September 30,<br>2010 |   | Nine Months Ended<br>September 30,<br>2010 |     |
| Proceeds | \$-   | 208 | -  | 7,074 | -   | - | -  | 591 |

(In thousands)

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|                      |     |    |   |     |   |   |   |     |
|----------------------|-----|----|---|-----|---|---|---|-----|
| Gross realized gains | \$- | 69 | - | 811 | - | - | - | 166 |
|----------------------|-----|----|---|-----|---|---|---|-----|

During the three and nine months ended September 30, 2011 and 2010, no securities were sold for realized losses nor were there any securities sold from the held-to-maturity portfolio.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
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(7) Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We hold available-for-sale fixed maturity securities and equity securities, which are carried at fair value.

Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our view of market assumptions in the absence of observable market information. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. All assets and liabilities carried at fair value are required to be classified and disclosed in one of the following three categories:

- Level 1 - Quoted prices for identical instruments in active markets.
- Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs or whose significant value drivers are observable.
- Level 3 - Instruments whose significant value drivers are unobservable.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as U.S. Treasury securities and actively traded mutual fund investments.

Level 2 includes those financial instruments that are valued by independent pricing services or broker quotes. These models are primarily industry-standard models that consider various inputs, such as interest rates, credit spreads and foreign exchange rates for the underlying financial instruments. All significant inputs are observable, or derived from observable information in the marketplace or are supported by observable levels at which transactions are executed in the marketplace. Financial instruments in this category primarily include corporate fixed maturity securities, U.S. Government-sponsored enterprise securities, municipal securities and certain mortgage and asset-backed securities.

Level 3 is comprised of financial instruments whose fair value is estimated based on non-binding broker prices utilizing significant inputs not based on or corroborated by readily available market information. This category consists of two private placement mortgage-backed securities where we cannot corroborate the significant valuation inputs with market observable data.

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The following tables set forth our assets and liabilities that are measured at fair value on a recurring basis as of the dates indicated.

| Available-for-sale investments                          | September 30, 2011 |         |         | Total<br>Fair Value |
|---|--------------------|---------|---------|---------------------|
|   | Level 1            | Level 2 | Level 3 |                     |
|   | (In thousands)     |         |         |                     |
| Financial assets:                                       |                    |         |         |                     |
| Fixed maturities:                                       |                    |         |         |                     |
| U.S. Treasury and U.S. Government-sponsored enterprises | \$ 13,895          | 209,334 | -       | 223,229             |
| Corporate   | -                  | 183,961 | -       | 183,961             |
| Municipal bonds   | -                  | 147,017 | -       | 147,017             |
| Mortgage-backed   | -                  | 9,442   | 476     | 9,918               |
| Foreign governments                                     | -                  | 144     | -       | 144                 |
| Total fixed maturities                                  | 13,895             | 549,898 | 476     | 564,269             |
| Equity securities:                                      |                    |         |         |                     |
| Stock mutual funds                                      | 19,411             | -       | -       | 19,411              |
| Bond mutual funds                                       | 23,932             | -       | -       | 23,932              |
| Common stock  | 27                 | -       | -       | 27                  |
| Preferred stock   | 1,996              | -       | -       | 1,996               |
| Total equity securities                                 | 45,366             | -       | -       | 45,366              |
| Total financial assets                                  | \$59,261           | 549,898 | 476     | 609,635             |
| Financial liabilities:                                  |                    |         |         |                     |
| Warrants outstanding                                    | \$-                | 133     | -       | 133                 |

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| Available-for-sale investments                          | Level 1  | December 31, 2010 |         | Total<br>Fair Value |
|---|----------|-------------------|---------|---------------------|
|   |          | Level 2           | Level 3 |                     |
|   |          | (In thousands)    |         |                     |
| Financial assets:                                       |          |                   |         |                     |
| Fixed maturities:                                       |          |                   |         |                     |
| U.S. Treasury and U.S. Government-sponsored enterprises | \$12,825 | 284,955           | -       | 297,780             |
| Corporate   | -        | 161,298           | -       | 161,298             |
| Municipal bonds   | -        | 101,719           | -       | 101,719             |
| Mortgage-backed   | -        | 14,289            | 519     | 14,808              |
| Foreign governments                                     | -        | 132               | -       | 132                 |
| Total fixed maturities                                  | 12,825   | 562,393           | 519     | 575,737             |
| Equity securities:                                      |          |                   |         |                     |
| Stock mutual funds                                      | 20,478   | -                 | -       | 20,478              |
| Common stock  | 46       | -                 | -       | 46                  |
| Preferred stock   | 2,780    | -                 | -       | 2,780               |
| Total equity securities                                 | 23,304   | -                 | -       | 23,304              |
| Total financial assets                                  | \$36,129 | 562,393           | 519     | 599,041             |
| Financial liabilities:                                  |          |                   |         |                     |
| Warrants outstanding                                    | \$-      | 1,587             | -       | 1,587               |

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
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## Financial Instruments Valuation

Fixed maturity securities, available-for-sale. At September 30, 2011, our fixed maturity securities, valued using a third-party pricing source, totaled \$549.9 million for Level 2 assets and comprised 90.2% of total reported fair value of our financial assets. Fair values for Level 3 assets are based upon unadjusted broker quotes that are non-binding. The Level 1 and Level 2 valuations are reviewed and updated quarterly through random testing by comparisons to separate pricing models, other third party pricing services, and back tested to recent trades. For the nine months ended September 30, 2011, there were no material changes to the valuation methods or assumptions used to determine fair values, and no broker or third party prices were changed from the values received.

Equity securities, available-for-sale. Our available-for-sale equity securities are classified as Level 1 assets as their fair values are based upon quoted market prices.

Warrants outstanding. Our outstanding warrants are classified as Level 2 liabilities as their fair values are based upon industry standard models that consider various observable inputs.

The following table presents additional information about fixed maturity securities measured at fair value on a recurring basis that are classified as Level 3 assets and for which we have utilized significant unobservable inputs to determine fair value.

|  | September<br>30,<br>2011<br>(In<br>thousands) |
|--|---|
| Balance at beginning of period         | \$ 519  |
| Total realized and unrealized losses:  |   |
| Included in net income                 | -   |
| Included in other comprehensive income | 7   |
| Principal paydowns                     | (50 )   |
| Transfer in and (out) of Level 3       | -   |
| Balance at end of period               | \$ 476  |

We review the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets. Such reclassifications are reported as transfers in and out of Level 3 at the beginning fair value for the reporting period in which the changes occur.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES  
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Financial Instruments not Carried at Fair Value

Estimates of fair values are made at a specific point in time, based on relevant market prices and information about the financial instruments. The estimated fair values of financial instruments presented below are not necessarily indicative of the amounts the Company might realize in actual market transactions.

The carrying amount and fair value for the financial assets and liabilities on the consolidated balance sheets not otherwise disclosed for the periods indicated are as follows:

|                                    | September 30, 2011 |            | December 31, 2010 |            |
|------------------------------------|--------------------|------------|-------------------|------------|
|                                    | Carrying Value     | Fair Value | Carrying Value    | Fair Value |
|                                    | (In thousands)     |            |                   |            |
| <b>Financial assets:</b>           |                    |            |                   |            |
| Fixed maturities, held-to-maturity | \$ 131,820         | 133,951    | 80,232            | 79,103     |
| Mortgage loans                     | 1,453              | 1,392      | 1,489             | 1,433      |
| Policy loans                       | 38,075             | 38,075     | 35,585            | 35,585     |
| Cash and cash equivalents          | 64,425             | 64,425     | 49,723            | 49,723     |
| <b>Financial liabilities:</b>      |                    |            |                   |            |
| Annuities                          | 45,891             | 46,024     | 42,096            | 38,619     |

Fair values for fixed income securities are based on quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other assumptions, including a discount rate and estimates of future cash flows.

Mortgage loans are secured principally by residential and commercial properties. Weighted average interest rates for these loans were approximately 6.7% per year as of September 30, 2011 and December 31, 2010, with maturities ranging from one to thirty years. Fair value was estimated using a discount rate of 6.25% applied to current cash flows projected.

Policy loans had a weighted average annual interest rate of 7.7% as of both September 30, 2011 and December 31, 2010, and no specified maturity dates. The aggregate fair value of policy loans approximates the carrying value reflected on the consolidated balance sheets. These loans typically carry an interest rate that is at or above the crediting rate applied to the related policy and contract reserves. Policy loans are an integral part of the life insurance policies we have in force, cannot be valued separately and are not marketable. Therefore, the fair value of policy loans approximates the carrying value.

The fair value of the Company's liabilities under annuity contract policies was estimated at September 30, 2011, using discounted cash flows with an interest rate of 3.2%, which is based upon the 10-year treasury rate reduced for a non-performance risk adjustment. The fair value of liabilities under all insurance contracts are taken into consideration in the overall management of interest rate risk, which seeks to minimize exposure to changing interest rates through the matching of investment maturities with amounts due under insurance contracts.

(8)

Legal Proceedings

We are a defendant in a lawsuit filed on August 6, 1999, in the Texas District Court, Austin, Texas, now styled Delia Bolanos Andrade, et al., Plaintiffs, v. Citizens Insurance Company of America, et al., Defendants in which a class was originally certified by the trial court and reversed by the Texas Supreme Court in 2007 with an order to the trial court to conduct further proceedings consistent with its ruling. The underlying lawsuit alleged that certain life insurance policies CICA made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. On December 9, 2009, the trial court denied the recertification of the class after conducting additional proceedings in accordance with the Texas Supreme Court's ruling. The remaining plaintiffs must now proceed individually, and not as a class, if they intend to pursue their claims against us. No individual cases have been pursued by the plaintiffs. The probability of the plaintiffs pursuing their cases individually is unknown. Further, an estimate of any possible loss or range of losses cannot be made at this time in regard to individuals pursuing claims. However, should the plaintiffs pursue their claims individually, we intend to vigorously defend any proceedings.

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SPFIC is a defendant in a statewide putative class action lawsuit in Louisiana styled *The State of Louisiana v. AAA Insurance (the "Road Home Litigation")*, which was filed in the Civil District Court for the Parish of Orleans on August 23, 2007. The Louisiana Attorney General filed the Road Home Litigation as a putative class action lawsuit in state court against SPFIC and approximately 200 other insurers on behalf of the State of Louisiana, as assignee, and on behalf of a class of Road Home fund recipients alleging that SPFIC and the other insurers have failed to pay all damages owed under their policies. The insurers removed the matter to federal court. The defendants filed a motion to dismiss, and in March 2009, the district court granted part of the defendants' motion, dismissing all of the extra-contractual claims, including the bad faith and breach of fiduciary duty claims. As a result, the remaining claims are for breach of contract and declaratory relief on the alleged underpayment of claims by the insurers. The court did not dismiss the class action allegations. The defendants also had moved to dismiss the complaint on grounds that the State had no standing to bring the lawsuit as an assignee of insureds because of anti-assignment language in the insurers' policies. The court denied the defendants' motion for reconsideration on the assignment issue but found the matter was ripe for consideration by the federal appellate court. The defendants filed a petition for permission to appeal to the Fifth Circuit. The Fifth Circuit accepted review. On July 20, 2011, the Fifth Circuit ruled, based on a ruling from the Louisiana Supreme Court, that there was no public policy which precludes an anti-assignment clause from applying to post loss assignments, but the language of the anti-assignment language must be evaluated on a policy by policy basis and clearly and unambiguously express that the non-assignment clause applies to post-loss assignments. We anticipate the State will vigorously pursue the matter in the district court and are uncertain as to the impact a case by case analysis of claims will have on SPFIC. An estimate of possible loss or range of loss cannot be made at this time as a result of the July 20, 2011 Fifth Circuit ruling. SPFIC intends to vigorously defend any remaining proceedings.

SPFIC is vigorously defending a number of matters in various stages of development filed in the aftermath of Hurricane Katrina in addition to the Road Home Litigation, including a number of individual lawsuits, which are immaterial to the Company's financial statements.

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

- disputes over insurance coverage or claims adjudication;
- regulatory compliance with insurance and securities laws;
- disputes with our marketing firms, consultants and agents over compensation and termination of contracts and related claims;
- disputes regarding our tax liabilities;
- disputes relating to reinsurance and coinsurance agreements; and
- disputes relating to businesses acquired and operated by us.

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including attorneys' fees, other direct litigation costs and the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition.

In July 2004, the Company completed a private placement of Series A-1 Convertible Preferred Stock ("Series A-1 Preferred") to four unaffiliated institutional investors. The investors were also issued unit warrants to purchase Series A-2 Convertible Preferred Stock ("Series A-2 Preferred"). In 2005, three of the four investors exercised their right to purchase the Series A-2 Preferred. We also issued to the investors warrants to purchase shares of our Class A common stock at various exercise prices that range from \$6.72 to \$7.93, with most of them striking at \$6.95. The conversion, exercise and redemption prices, along with the number of shares and warrants, were adjusted for stock dividends paid on December 31, 2004 and 2005.

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On July 13, 2009, the Company converted all of its outstanding Series A-1 Preferred and Series A-2 Preferred into Class A common shares in accordance with the mandatory redemption provision of the preferred shareholder agreement dated July 12, 2004. The total amount of Class A common shares issued as part of the conversion was 1,706,682, inclusive of pro rata dividends due through the conversion date.

On July 12, 2011, 255,216 warrant shares were exercised for cash totaling \$1.8 million. The remaining shares were exercised by a cashless provision that resulted in the issuance of 1,989 Class A shares by the Company to the warrant holders.

There are outstanding warrants to purchase the Company's stock at prices ranging from \$6.72 to \$7.93, which were issued to investors of the Series A-2 Preferred. These warrants are outstanding until 2012.

| Warrants<br>Outstanding | As of September 30, 2011 |                 | Fair<br>Value<br>(In thousands) |
|-------------------------|--------------------------|-----------------|---------------------------------|
|                         | Expiration Date          | Strike<br>Price |                                 |
| 63,961                  | 7/12/12                  | \$ 6.72         | \$ 57                           |
| 55,963                  | 9/30/12                  | 7.93            | 37                              |
| 56,463                  | 10/06/12                 | 7.86            | 39                              |
| 176,387                 |                          |                 | \$ 133                          |

The fair value of the warrants is calculated using the Black-Scholes option pricing model and is classified as a liability on the balance sheet in the amount of \$0.1 million and \$1.6 million at September 30, 2011, and December 31, 2010, respectively. The change in fair value of warrants is reported as a component of revenue in the income statement. The change in fair value of warrants for the nine months ended September 30, 2011 and 2010 caused an increase in revenues of \$1.5 million and \$0.4 million, respectively.

(10) Income Taxes

The effective tax rate was 26.9% and 44.1% for the third quarter of 2011 and 2010, respectively, and 31.1% and 33.5% for the nine months ended September 30, 2011 and 2010, respectively. In periods where our effective tax rate is lower than the statutory tax rate of 35%, the difference is primarily due to gains and losses from the change in fair value of outstanding warrants to purchase Class A common stock. The change in fair value of outstanding warrants, which is not taxable, resulted in an increase in income, as previously noted, of \$1.5 million and \$0.4 million for the nine months ended September 30, 2011 and 2010, respectively. In 2010, the tax rate was higher than the statutory rate due primarily to tax expense on Citizens' redemption of its stock that was held by its subsidiaries, generating taxable transactions resulting in \$0.9 million and \$1.4 million of tax expense during the three and nine months ended September 30, 2010, respectively. The effects of this tax expense were offset by releases of tax valuation allowances in the three and nine month periods ended September 30, 2010, respectively.

(11) Related Party Transactions

The Company previously filed a plan of merger with the Departments of Insurance of Colorado and Indiana related to the planned merger of Integrity Capital Corporation and the merger of the down-line subsidiary Integrity Capital

Insurance Company into CICA. The Company received approval from the respective state insurance departments to merge Integrity Capital Insurance Company into CICA as of April 1, 2011. The capital contribution did not impact the overall consolidated financial position or results of operations of the Company. However, the Company does anticipate the elimination of duplicative overhead and annual regulatory reporting expenses. Integrity Capital Corporation and Integrity Capital Insurance Company were merged into CICA as of April 1, 2011.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q are not statements of historical fact and constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act (the "Act"), including, without limitation, statements specifically identified as forward-looking statements within this document. Many of these statements contain risk factors as well. In addition, certain statements in future filings by the Company with the Securities and Exchange Commission, in press releases, and in oral and written statements made by us or with the approval of the Company, which are not statements of historical fact, constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or non-payment of dividends, capital structure, and other financial items, (ii) statements of our plans and objectives by our management or Board of Directors, including those relating to products or services, (iii) statements of future economic performance and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "assumes," "estimates," "plans," "projects," "could," "expects," "intends," "targeted," "may," "will" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that could cause the Company's future results to differ materially from expected results include, but are not limited to:

- Changes in foreign and U.S. general economic, market, and political conditions, including the performance of financial markets and interest rates;
- Changes in consumer behavior, which may affect the Company's ability to sell its products and retain business;
- The timely development of and acceptance of new products of the Company and perceived overall value of these products and services by existing and potential customers;
- Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing the Company's products;
- The performance of our investment portfolio, which may be adversely affected by changes in interest rates, adverse developments and ratings of issuers whose debt securities we may hold, and other adverse macroeconomic events;
  - Results of litigation we may be involved in;
- Changes in assumptions related to deferred acquisition costs and the value of any businesses we may acquire;
- Regulatory, accounting or tax changes that may affect the cost of, or the demand for, the Company's products or services;
  - Our concentration of business from persons residing in Latin America and the Pacific Rim;
    - Our success at managing risks involved in the foregoing;
    - Changes in tax laws;
- Effects of acquisitions and restructuring, including possible difficulties in integrating and realizing the projected results of acquisitions;
  - Changes in statutory or U.S. GAAP accounting principles, policies or practices; and
- The risk factors discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 under the heading "Part II. - Item 1A - Risk Factors."

Such forward-looking statements speak only as of the date on which such statements are made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

We make available, free of charge, through our Internet website (<http://www.citizensinc.com>), our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Section 16 Reports filed by officers and directors, news releases, and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such reports with, or furnish such reports to, the Securities and Exchange Commission. We are not including any of the information contained on our website as part of, or incorporating it by reference into, this Quarterly Report on Form 10-Q.

Overview

Citizens is an insurance holding company serving the life insurance needs of individuals in the United States since 1969 and internationally since 1975. Through our insurance subsidiaries, we pursue a strategy of offering traditional insurance products in niche markets where we believe we are able to achieve competitive advantages. As of September 30, 2011, we had approximately \$1.1 billion of total assets and approximately \$5.2 billion of insurance in force. Our core insurance operations include issuing and servicing:

- U.S. Dollar-denominated ordinary whole life insurance and endowment policies predominantly to high net worth, high income foreign residents, principally in Latin America and the Pacific Rim through independent marketing consultants;
- ordinary whole life insurance policies to middle income households concentrated in the Midwest and southern United States through independent marketing consultants; and
- final expense and limited liability property policies to middle and lower income households in Louisiana, Arkansas and Mississippi through employee and independent agents in our home service distribution channel.

We were formed in 1969 by our Chairman, Harold E. Riley. Prior to our formation, Mr. Riley had many years of experience in the international and domestic life insurance business. Our Company has experienced significant growth through acquisitions in the domestic market and through market expansion in the international market. We seek to capitalize on the experience of our management team in marketing and operations as we strive to generate bottom line return using knowledge of our niche markets and our well-established distribution channels. We believe our underwriting processes, policy terms, pricing practices and proprietary administrative systems enable us to be competitive in our current markets, while protecting our shareholders and servicing our policyholders.

Current Financial Highlights

Our assets grew from \$986.5 million as of December 31, 2010, to \$1.1 billion as of September 30, 2011. Total stockholders' equity increased from \$227.6 million at December 31, 2010, to \$254.5 million at September 30, 2011.

Financial highlights for the three and nine month periods ended September 30, 2011 compared to the same periods in 2010 were:

- Insurance revenues rose 5.9% and 6.8% for the three and nine month periods from \$38.1 million and \$109.9 million to \$40.3 million and \$117.4 million, respectively, primarily from sales in our life insurance segment, which increased \$2.0 million and \$6.7 million, respectively, from amounts reported in the same periods of 2010.

-

Net investment income increased 5.8% to \$7.7 million for the three month period and decreased 4.1% to \$22.9 million for the nine month period. For both the three and nine month periods, the average yield on the portfolio was lower than the comparable periods in 2010. For the three month period, the increase in the investment assets due to premium revenue was sufficient to offset the lower yield and resulted in an increase in net investment income.

- Claims and surrenders expense decreased 5.9% and 3.9% for the comparable three and nine month periods, respectively, as a result of favorable development.



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

## Our Operating Segments

Our business is comprised of three operating business segments, as detailed below.

- Life Insurance
- Home Service Insurance
- Other Non-Insurance Enterprises

Our insurance operations are the primary focus of the Company, as those segments generate the majority of our income. See the discussion under Segment Operations for detailed analysis. The amount of insurance, number of policies, and average face amounts of policies issued during the periods indicated are shown below.

|              | Nine Months Ended September 30,  |                                 |   |                                  |                                 |   |
|--------------|----------------------------------|---------------------------------|---|----------------------------------|---------------------------------|---|
|              | 2011                             |                                 |   | 2010                             |                                 |   |
|              | Amount of<br>Insurance<br>Issued | Number of<br>Policies<br>Issued | Average<br>Policy<br>Face<br>Amount<br>Issued | Amount of<br>Insurance<br>Issued | Number of<br>Policies<br>Issued | Average<br>Policy<br>Face<br>Amount<br>Issued |
| Life         | \$ 265,605,986                   | 4,181                           | \$ 63,527                                     | \$ 244,734,829                   | 3,802                           | \$ 64,370                                     |
| Home Service | 152,408,350                      | 21,285                          | 7,160   | 149,400,287                      | 20,040                          | 7,455   |

Note: All discussions below compare or state results for the three and nine months ended September 30, 2011, compared to the three and nine months ended September 30, 2010.

## Consolidated Results of Operations

## Revenues

Revenues are generated primarily by insurance premiums and investment income on invested asset.

|   | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |         |
|---|-------------------------------------|--------|------------------------------------|---------|
|   | 2011                                | 2010   | 2011                               | 2010    |
|   | (In thousands)                      |        |                                    |         |
| Revenues:                               |                                     |        |                                    |         |
| Premiums:                               |                                     |        |                                    |         |
| Life insurance                          | \$38,639                            | 36,433 | 112,481                            | 105,114 |
| Accident and health insurance           | 383                                 | 392    | 1,151                              | 1,215   |
| Property insurance                      | 1,277                               | 1,230  | 3,781                              | 3,592   |
| Net investment income                   | 7,693                               | 7,272  | 22,924                             | 23,896  |
| Realized investment gains (losses), net | 35                                  | (103)  | 41                                 | 648     |
| Decrease in fair value of warrants      | 239                                 | 128    | 1,454                              | 380     |

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|   |          |        |          |         |
|---|----------|--------|----------|---------|
| Other income                                    | 282      | 103    | 509      | 602     |
| Total revenues                                  | 48,548   | 45,455 | 142,341  | 135,447 |
| Exclude fair value adjustments                  | (239 )   | (128 ) | (1,454 ) | (380 )  |
| Total revenues excluding fair value adjustments | \$48,309 | 45,327 | 140,887  | 135,067 |

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

Net investment income performance is summarized as follows.

|   | Nine Months<br>Ended<br>September 30,<br>2011 |         | Year Ended<br>December 31,<br>2010 |         | Nine Months<br>Ended<br>September 30,<br>2010 |         |   |
|---|---|---------|------------------------------------|---------|---|---------|---|
|   | (In thousands, except for %)                  |         |                                    |         |   |         |   |
| Net investment income, annualized           | \$  | 30,565  |                                    | 30,077  |   | 31,861  |   |
| Average invested assets, at amortized cost  |   | 744,234 |                                    | 696,134 |   | 684,074 |   |
| Annualized yield on average invested assets |   | 4.11    | %                                  | 4.32    | %   | 4.66    | % |

Yields on invested assets vary between segment operations due to different portfolio mixes in the segments. The life segment invests more in U.S. government securities while the home service segment has a larger investment in the corporate and municipal sectors.

We have traditionally invested in fixed maturity securities with a large percent held in callable issues. Over the past few years, we have experienced significant call activity related to fixed maturity security holdings due to the historically low interest rate environment over the past few years. As these call proceeds were invested into lower yielding securities, the yield on the portfolio has declined. The recent declines in yield rates by quarter appear to be leveling off as the reinvestment of calls is resulting in a lesser impact relative to yield changes. If market interest rates begin to rise, our portfolio yield will rise, as new money investments would be invested at higher rates.

Investment income from debt securities accounted for approximately 85.4% of total investment income for the nine months ended September 30, 2011. We continue to hold investments in bonds of U.S. Government-sponsored enterprises, such as FNMA and FHLMC, which comprised 43.5% of the total fixed maturity portfolio based on amortized cost at September 30, 2011. We have increased our investment purchases of corporate and municipal securities over the past several quarters, focusing on utility service sectors in these corporate securities. In addition, we have reinvested proceeds from bond calls totaling \$24.0 million into equity securities related to bond mutual funds during the current quarter. These securities offer a competitive yield with a shorter duration.

|                           | Three Months Ended<br>September 30,<br>2011 |        | Nine Months Ended<br>September 30,<br>2011 |        |
|---------------------------|---|--------|--|--------|
|                           | (In thousands)                              |        |  |        |
| Gross investment income:  |   |        |  |        |
| Fixed maturity securities | \$6,740                                     | 6,478  | 19,990                                     | 21,425 |
| Equity securities         | 311   | 162    | 886  | 494    |
| Mortgage loans            | 22  | 25     | 73   | 78     |
| Policy loans              | 756   | 683    | 2,175                                      | 1,996  |
| Long-term investments     | 61  | 36     | 168  | 186    |
| Other investment income   | 23  | 39     | 106  | 146    |
| Total investment income   | 7,913                                       | 7,423  | 23,398                                     | 24,325 |
| Investment expenses       | (220 )                                      | (151 ) | (474 )                                     | (429 ) |
| Net investment income     | \$7,693                                     | 7,272  | 22,924                                     | 23,896 |

Lower investment income from fixed maturity investments for the nine months resulted from declining yields, as previously noted. The increase in the asset balances of fixed maturity and equity securities from new money investments is offsetting the yield decline for the three month period. In addition, the increase in the asset balance of policy loans, which represents policyholders utilizing their accumulated policy cash value, contributed to the increase to investment income.

Realized Gains (Losses), Net. Net realized gains in the portfolio during the three and nine months of 2011 resulted primarily from issuer calls. The Company recorded net realized losses of \$0.1 million, related to bond holdings, in the third quarter of 2010. The net realized gains during the nine months of 2010 were primarily the result of sales of several available-for-sale debt and equity securities, including some securities that had previously been impaired. The Company recorded a valuation allowance of \$0.1 million during the first quarter of 2010 on a non-performing mortgage loan.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

Change in Fair Value of Warrants. The Company adjusts the liability related to its outstanding warrants to purchase shares of Class A common stock at each reporting date to reflect the current fair value of the warrants computed based on the Class A common stock value calculated using the Black-Scholes option pricing model. As the Class A common stock value increases and decreases, the change in the warrant liability also increases and decreases in inverse order. The adjustment to fair value is recorded as an increase or decrease in the fair value of the warrants in the consolidated statement of operations. The remaining warrants expire in 2012.

See Note 9 - Convertible Preferred Stock: Warrants of the accompanying financial statements for further discussion.

## Benefits and Expenses

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2011                                | 2010     | 2011                               | 2010      |
|   | (In thousands)                      |          |                                    |           |
| Benefits and expenses:                                  |                                     |          |                                    |           |
| Insurance benefits paid or provided:                    |                                     |          |                                    |           |
| Claims and surrenders                                   | \$14,803                            | 15,739   | 44,587                             | 46,410    |
| Increase in future policy benefit reserves              | 14,365                              | 11,398   | 39,683                             | 30,726    |
| Policyholders' dividends                                | 2,169                               | 1,977    | 5,751                              | 5,324     |
| Total insurance benefits paid or provided               | 31,337                              | 29,114   | 90,021                             | 82,460    |
| Commissions   | 9,224                               | 9,229    | 28,226                             | 26,385    |
| Other general expenses                                  | 6,857                               | 6,587    | 20,386                             | 20,562    |
| Capitalization of deferred policy acquisition costs     | (7,121 )                            | (6,973 ) | (22,170 )                          | (19,946 ) |
| Amortization of deferred policy acquisition costs       | 4,500                               | 3,800    | 13,249                             | 13,962    |
| Amortization of cost of customer relationships acquired | 708                                 | 719      | 2,113                              | 2,311     |
| Total benefits and expenses                             | \$45,505                            | 42,476   | 131,825                            | 125,734   |

Claims and Surrenders. A detail of claims and surrender benefits is provided below.

|                              | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                              | 2011                                | 2010   | 2011                               | 2010   |
|                              | (In thousands)                      |        |                                    |        |
| Death claims                 | \$4,917                             | 5,977  | 15,531                             | 17,912 |
| Surrender benefits           | 5,166                               | 5,126  | 14,915                             | 14,863 |
| Endowments                   | 3,576                               | 3,616  | 10,595                             | 10,446 |
| Property claims              | 586                                 | 469    | 1,601                              | 1,340  |
| Accident and health benefits | 79                                  | 98     | 334                                | 485    |
| Other policy benefits        | 479                                 | 453    | 1,611                              | 1,364  |
| Total claims and surrenders  | \$14,803                            | 15,739 | 44,587                             | 46,410 |

The Company reported fewer claims and recorded a \$0.5 million decrease in death claims during the current year due to a decrease related to incurred but not yet reported claims accrual which resulted in a reduction in claims

expense. This liability is estimated using historical claims experience and is reviewed at each reporting period. Property claims increased in the current quarter and nine months of 2011 compared to the same periods in 2010, as 2010 claims reported were lower than historical experience.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

**Increase in Future Policy Benefit Reserves.** Reserves as of September 30, 2011, were impacted by international sales of endowment policies that produce a faster reserve build-up than whole life products.

**Policyholder Dividends.** All of our international policies are participating, and the dividends are factored into the premium rates charged. As policy provisioned dividend rates increase each year that a policy is in force, dividend expense is expected to increase as this block of insurance becomes more seasoned.

**Commissions.** Commission expense is directly related to new and renewal insurance premium fluctuations and production levels by agents and associates. Commission expense increased from the prior year amounts as premium revenues increased. Also, first year premium volume was up for the nine months ended September 30, 2011, which resulted in higher commissions as first year premiums have higher commission rates than renewal business.

**Capitalized and Amortized Deferred Policy Acquisition Costs.** Costs capitalized under current accounting guidance include certain commissions, policy issuance costs, and underwriting and agency expenses that relate to and vary with the production of new business. The increases for the three and nine month periods of 2011 compared to the same periods in 2010 are the result of increased premium production in the current year. Amortization for the three months ended September 30, 2010 included an adjustment that decreased amortization by \$0.5 million which affects current year comparability. Amortization of deferred policy acquisition costs is impacted by persistency and may fluctuate from year to year.

**Federal Income Tax.** The effective rates for the three and nine months ended September 30, 2011, were 26.9% and 31.1%, respectively, versus 44.1% and 33.5% for the same periods in 2010. Differences between our effective tax rate and the statutory tax rate result from income and expense items that are treated differently for financial reporting and tax purposes. See Note 10 - Income Taxes in the consolidated financial statements for further discussion.

## Segment Operations

The Company has three reportable segments: Life Insurance, Home Service Insurance and Other Non-Insurance Enterprises. These segments are reported in accordance with U.S. GAAP. The Company evaluates profit and loss performance of its segments based on net income before income taxes.

|                                 | Income (Loss) Before Income Taxes   |        |                                    |        |
|---------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                                 | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|                                 | 2011                                | 2010   | 2011                               | 2010   |
|                                 | (In thousands)                      |        |                                    |        |
| Life Insurance                  | \$2,045                             | 1,894  | 4,902                              | 5,774  |
| Home Service Insurance          | 1,152                               | 1,270  | 5,459                              | 4,518  |
| Other Non-Insurance Enterprises | (154 )                              | (185 ) | 155                                | (579 ) |
| Total                           | \$3,043                             | 2,979  | 10,516                             | 9,713  |

## Life Insurance

Our Life Insurance segment issues ordinary whole life insurance domestically and U.S. Dollar-denominated ordinary whole-life policies to foreign residents. These contracts are designed to provide a fixed amount of insurance coverage

over the life of the insured. Additionally, the Company issues endowment contracts, which are principally accumulation contracts that incorporate an element of life insurance protection. For the majority of our business, we retain only the first \$100,000 of risk on any one life. We operate this segment through CICA and CNLIC insurance subsidiaries.



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

## International Sales

We focus our sales of U.S. Dollar-denominated ordinary whole life insurance and endowment policies to high net worth, high income residents in Latin America and the Pacific Rim. We have successfully participated in the foreign marketplace since 1975, and we continue to seek opportunities for expansion of our foreign operations. We believe positive attributes of our international insurance business include:

- larger face amount policies typically issued when compared to our U.S. operations, which results in lower underwriting and administrative costs per unit of coverage;
- premiums typically paid annually rather than monthly or quarterly, which saves us administrative expenses, accelerates cash flow and results in lower policy lapse rates than premiums with more frequently scheduled payments; and
  - favorable persistency levels and mortality rates that are comparable to U.S. policies.

## International Products

We offer several ordinary whole life insurance and endowment products designed to meet the needs of our non-U.S. policyowners. These policies have been structured to provide:

- U.S. Dollar-denominated cash values that accumulate, beginning in the first policy year, to a policyholder during his or her lifetime;
  - premium rates that are competitive with or better than most foreign local companies;
    - a hedge against local currency inflation;
    - protection against devaluation of foreign currency;
  - capital investment in a more secure economic environment (i.e., the United States); and
    - lifetime income guarantees for an insured or for surviving beneficiaries.

Our international products have living benefit features. Every policy contains guaranteed cash values and is participating (i.e., provides for cash dividends as apportioned by the board of directors). Once a policyowner pays the annual premium and the policy is issued, we immediately pay a cash dividend as well as an annual guaranteed endowment, if elected, to the owner. The policyowner has several options with regard to the dividend, including the right to assign dividends to our stock investment plan, registered under the Securities Act of 1933 (the "Securities Act") and administered in the United States by our unaffiliated transfer agent.

The following table sets forth, by territory, our direct collected premiums from our international life insurance business for the periods indicated. The information is presented in accordance with statutory accounting practices prescribed by the state of Colorado, the state of domicile of CICA, our subsidiary that writes all of our international business.

| Country   | Three Months Ended |       | Nine Months Ended |        |
|-----------|--------------------|-------|-------------------|--------|
|           | September 30,      |       | September 30,     |        |
|           | 2011               | 2010  | 2011              | 2010   |
|           | (In thousands)     |       |                   |        |
| Colombia  | \$5,665            | 5,304 | 16,254            | 15,673 |
| Venezuela | 4,838              | 4,140 | 14,758            | 11,575 |

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|                |          |        |        |        |
|----------------|----------|--------|--------|--------|
| Taiwan         | 3,291    | 3,586  | 11,459 | 11,067 |
| Ecuador        | 3,392    | 3,248  | 9,908  | 9,130  |
| Argentina      | 2,643    | 2,578  | 6,915  | 6,799  |
| Other Non-U.S. | 8,117    | 7,649  | 22,010 | 20,238 |
| Total          | \$27,946 | 26,505 | 81,304 | 74,482 |

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

## Domestic Sales

In the Midwest and the southern United States, we seek to serve middle income households through the sale of cash accumulation ordinary whole life insurance products. The majority of our inforce business results from blocks of business of insurance companies we have acquired over the past 15 years.

## Domestic Products

Our domestic life insurance products focus primarily on living needs and provide benefits focused toward accumulating money for living benefits while providing a modest death benefit for the policyowner. The features of our domestic life insurance products include:

- cash accumulation/living benefits;
- tax-deferred interest earnings;
- guaranteed lifetime income or monthly income options for the policyowner or surviving family members;
- accidental death benefit coverage options; and
- an option to waive premium payments in the event of disability.

Our life insurance products are principally designed to address the insured's concern about outliving his or her monthly income, while at the same time providing death benefits. The primary purpose of our product portfolio is to help the insured create capital for needs such as retirement income, children's higher education funds, business opportunities, emergencies and health care needs.

The following table sets forth our direct collected life insurance premiums by state for the periods indicated, in accordance with statutory accounting practices prescribed by the states of domicile of our insurance company subsidiaries.

| State        | Three Months Ended    |                       | Nine Months Ended     |                       |
|--------------|-----------------------|-----------------------|-----------------------|-----------------------|
|              | September 30,<br>2011 | September 30,<br>2010 | September 30,<br>2011 | September 30,<br>2010 |
|              | (In thousands)        |                       |                       |                       |
| Texas        | \$1,336               | 1,526                 | 4,213                 | 4,605                 |
| Indiana      | 375                   | 491                   | 1,334                 | 1,470                 |
| Missouri     | 295                   | 338                   | 1,089                 | 1,220                 |
| Kentucky     | 241                   | 337                   | 784                   | 1,006                 |
| Mississippi  | 265                   | 274                   | 818                   | 909                   |
| Other States | 875                   | 892                   | 2,524                 | 2,716                 |
| Total        | \$3,387               | 3,858                 | 10,762                | 11,926                |

A number of domestic life insurance companies we acquired had blocks of accident and health insurance policies, which we did not consider to be a core part of our business. We have ceded this business to an unaffiliated insurance company under a coinsurance agreement, under which it assumes substantially all of our accident and health policies. The premium amounts ceded under the coinsurance agreement for the nine months ended September 30, 2011 and 2010, were \$3.5 million and \$4.0 million, respectively.



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

The results of operations for the life insurance segment for the periods indicated are as follows.

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2011                                | 2010     | 2011                               | 2010      |
|   | (In thousands)                      |          |                                    |           |
| Revenue:  |                                     |          |                                    |           |
| Premiums  | \$29,491                            | 27,514   | 85,027                             | 78,364    |
| Net investment income                                   | 4,309                               | 3,893    | 12,662                             | 13,239    |
| Realized investment gains, net                          | 25                                  | 1        | 29                                 | 116       |
| Other income  | 240                                 | 78       | 404                                | 487       |
| Total revenue   | 34,065                              | 31,486   | 98,122                             | 92,206    |
| Benefits and expenses:                                  |                                     |          |                                    |           |
| Insurance benefits paid or provided:                    |                                     |          |                                    |           |
| Claims and surrenders                                   | 9,834                               | 10,498   | 29,691                             | 30,644    |
| Increase in future policy benefit reserves              | 13,133                              | 10,688   | 36,957                             | 28,123    |
| Policyholders' dividends                                | 2,152                               | 1,965    | 5,696                              | 5,267     |
| Total insurance benefits paid or provided               | 25,119                              | 23,151   | 72,344                             | 64,034    |
| Commissions   | 5,516                               | 5,572    | 16,916                             | 15,316    |
| Other general expenses                                  | 2,983                               | 2,603    | 8,936                              | 8,234     |
| Capitalization of deferred policy acquisition costs     | (5,484 )                            | (5,414 ) | (16,971 )                          | (15,097 ) |
| Amortization of deferred policy acquisition costs       | 3,680                               | 3,448    | 11,290                             | 13,108    |
| Amortization of cost of customer relationships acquired | 206                                 | 232      | 705                                | 837       |
| Total benefits and expenses                             | 32,020                              | 29,592   | 93,220                             | 86,432    |
| Income before income tax expense                        | \$2,045                             | 1,894    | 4,902                              | 5,774     |

Premiums. Premium revenues increased for the three and nine month periods ended September 30, 2011, compared to the same three and nine month periods in 2010 due to international renewal business, which experienced strong persistency as this block of insurance ages. In addition, first year premiums increased as a percentage of total premiums in the current year compared to 2010, reflecting improved new business performance which has shown improved sales in our endowment and whole life policies.

Life insurance premium breakout is detailed below.

|                | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|----------------|-------------------------------------|--------|------------------------------------|--------|
|                | 2011                                | 2010   | 2011                               | 2010   |
|                | (In thousands)                      |        |                                    |        |
| Premiums:      |                                     |        |                                    |        |
| First year     | \$3,957                             | 4,172  | 12,678                             | 11,396 |
| Renewal        | 25,534                              | 23,342 | 72,349                             | 66,968 |
| Total premiums | \$29,491                            | 27,514 | 85,027                             | 78,364 |

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

Net Investment Income. Net investment income has been negatively impacted by the low interest rate environment, which has resulted in declining portfolio yields.

|   | Nine Months Ended<br>September 30,<br>2011 |         | Year Ended<br>December 31,<br>2010 |         | Nine Months<br>Ended<br>September 30,<br>2010 |         |
|---|--|---------|------------------------------------|---------|---|---------|
|   | (In thousands, except for %)               |         |                                    |         |   |         |
| Net investment income, annualized           | \$   | 16,883  |                                    | 16,523  |   | 17,652  |
| Average invested assets, at amortized cost  | \$   | 426,027 |                                    | 396,360 |   | 387,955 |
| Annualized yield on average invested assets |  | 3.96    | %                                  | 4.17    | %   | 4.55    |
|   |  |         |                                    |         |   | %       |

Claims and Surrenders. These amounts fluctuate from period to period but were within anticipated ranges based upon management's expectations.

|                              | Three Months Ended<br>September 30,<br>2011 |       | Nine Months Ended<br>September 30,<br>2011 |        | September 30,<br>2010 |        |
|------------------------------|---|-------|--|--------|-----------------------|--------|
|                              | (In thousands)                              |       |  |        |                       |        |
| Death claims                 | \$  | 1,447 |  | 1,987  |                       | 4,793  |
| Surrender benefits           |   | 4,372 |  | 4,477  |                       | 12,808 |
| Endowment benefits           |   | 3,573 |  | 3,611  |                       | 10,587 |
| Accident and health benefits |   | 64    |  | 65     |                       | 221    |
| Other policy benefits        |   | 378   |  | 358    |                       | 1,282  |
| Total claims and surrenders  | \$  | 9,834 |  | 10,498 |                       | 29,691 |
|                              |   |       |  |        |                       | 30,644 |

- Death claims expense was lower for the three and nine months in 2011 due to fewer reported claims. In addition, the nine months ended in 2011 includes a \$0.2 million release of incurred but not reported liability related to our claim experience calculation. Mortality experience is closely monitored by the Company as a key performance indicator and these amounts were within expected levels.
- Surrenders as a percent of ordinary whole life insurance in force decreased from 0.6% in the nine months of 2010 to 0.5% in the nine months of 2011. The majority of policy surrender benefits paid is attributable to our international business and was related to policies that have been in force over fifteen years, where surrender charges are no longer applicable.
- Endowment benefit expense results from the election by policyholders of a product feature that provides an annual benefit. This is a fixed benefit over the life of the contract, and this expense will increase with new sales and improved persistency.
- Other policy benefits increased in the current year due primarily to interest paid on premium deposits and dividend accumulations, as these policyholder liability accounts have increased.

Increase in Future Policy Benefit Reserves. Policy benefit reserves increased for the three and nine months ended September 30, 2011, compared to the same periods in 2010, primarily due to increased sales of endowment products, which build up reserve balances more quickly compared to other life product sales. Endowment sales have become more popular relative to our international sales in the past few years, representing approximately 75% and 57% of total new first year premium through the nine months in 2011 and 2010, respectively.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

**Commissions.** Commission expense increased for the nine months ended September 30, 2011, compared to the same periods in 2010, as premium revenues increased. This expense fluctuates directly with premium revenues and were lower in the three months ended 2011 compared to 2010, despite the rise in premiums for the current year. Commission rates paid to agents are higher on first year premium sales, which were up for the three months ended 2011 and 2010. Renewal premiums for the three months ended, which pay commissions at lower rates, are up \$1.4 million in 2011 over 2010 causing commission expense to be flat period to period.

**Other General Expenses.** Current year amounts reflect an increase in expenses based upon an annual expense study by segment that resulted in a cost increase in the life segment compared to the prior year allocations. The effect of the allocation change is muted because total consolidated expenses were slightly lower in the current year than in 2010.

**Capitalization of Deferred Policy Acquisition Costs ("DAC").** Capitalized costs increased for the three and nine months ended September 30, 2011, mainly due to an increase in first year commissions paid during the period. DAC capitalization is directly correlated to fluctuations in first year commissions.

**Amortization of Deferred Policy Acquisition Costs.** Amortization costs decreased for the nine months ended September 30, 2011, compared to 2010, primarily because of improved persistency. The Company canceled its contract with a high volume producer in the second quarter of 2009 due to poor experience. Policies sold by this organization lapsed at high rates during the first and second quarter of 2010, which resulted in higher DAC amortization in those periods. Amortization for the three months ended in 2011 was up compared to 2010, as DAC asset balances are higher causing amortization to trend upward.

**Home Service Insurance**

We operate in the Home Service market through our subsidiaries Security Plan Life Insurance Company ("SPLIC") and Security Plan Fire Insurance Company ("SPFIC"), and focus on the life insurance needs of the middle and lower income markets, primarily in Louisiana, Mississippi and Arkansas. Our policies are sold and serviced through a home service marketing distribution system of employee-agents who work full time on a route system and through funeral homes that sell policies, collect premiums and service policyholders.

On August 1, 2011, SPLIC entered into assumption reinsurance agreements with Escude Life Insurance Company in Rehabilitation, and Benton Life Insurance Company in Rehabilitation. At the time the agreements were executed, both companies were under receivership with the Louisiana Department of Insurance. In total, SPLIC assumed approximately \$4.5 million in reserve liabilities and received approximately \$4.6 million in cash, with a minimal reinsurance ceding commission being paid. These transactions are not deemed material.



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

The following table sets forth our direct collected life insurance premiums by state for the periods indicated, in accordance with statutory accounting practices prescribed by the states of domicile of our insurance company subsidiaries.

| State        | Three Months Ended |        | Nine Months Ended |        |
|--------------|--------------------|--------|-------------------|--------|
|              | September 30,      |        | September 30,     |        |
|              | 2011               | 2010   | 2011              | 2010   |
|              | (In thousands)     |        |                   |        |
| Louisiana    | \$10,186           | 10,006 | 30,633            | 29,973 |
| Arkansas     | 1,119              | 1,136  | 3,156             | 3,423  |
| Mississippi  | 91                 | 83     | 269               | 248    |
| Other states | 278                | 263    | 798               | 812    |
| Total        | \$11,674           | 11,488 | 34,856            | 34,456 |

## Home Service Insurance Products

Our home service insurance products consist primarily of small face amount ordinary whole life and pre-need policies, which are designed to fund final expenses for the insured, primarily consisting of funeral and burial costs. To a much lesser extent, our home service insurance segment sells limited-liability, named-peril property policies covering dwellings and contents. We provide \$30,000 maximum coverage on any one dwelling and contents, while content only coverage and dwelling only coverage is limited to \$20,000, respectively.

We provide final expense ordinary life insurance and annuity products primarily to middle and lower income individuals primarily in Louisiana, Mississippi and Arkansas. New products were approved for sale in Mississippi during the current year and we expect to increase sales as we expand our marketing force in this state.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

The results of operations for the home service insurance segment for the periods indicated are as follows.

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2011 | September 30,<br>2010 | September 30,<br>2011 | September 30,<br>2010 |
|   | (In thousands)        |                       |                       |                       |
| Revenue:  |                       |                       |                       |                       |
| Premiums  | \$10,808              | 10,541                | 32,386                | 31,557                |
| Net investment income                                   | 3,178                 | 3,244                 | 9,690                 | 10,251                |
| Realized investment gains (losses), net                 | 4                     | (96 )                 | 6                     | 585                   |
| Other income  | 6                     | 10                    | 20                    | 63                    |
| Total revenue   | 13,996                | 13,699                | 42,102                | 42,456                |
| Benefits and expenses:                                  |                       |                       |                       |                       |
| Insurance benefits paid or provided:                    |                       |                       |                       |                       |
| Claims and surrenders                                   | 4,969                 | 5,241                 | 14,896                | 15,766                |
| Increase in future policy benefit reserves              | 1,232                 | 710                   | 2,726                 | 2,603                 |
| Policyholders' dividends                                | 17                    | 12                    | 55                    | 57                    |
| Total insurance benefits paid or provided               | 6,218                 | 5,963                 | 17,677                | 18,426                |
| Commissions   | 3,708                 | 3,657                 | 11,310                | 11,069                |
| Other general expenses                                  | 3,233                 | 3,529                 | 9,488                 | 10,964                |
| Capitalization of deferred policy acquisition costs     | (1,637 )              | (1,559 )              | (5,199 )              | (4,849 )              |
| Amortization of deferred policy acquisition costs       | 820                   | 352                   | 1,959                 | 854                   |
| Amortization of cost of customer relationships acquired | 502                   | 487                   | 1,408                 | 1,474                 |
| Total benefits and expenses                             | 12,844                | 12,429                | 36,643                | 37,938                |
| Income before income tax expense                        | \$1,152               | 1,270                 | 5,459                 | 4,518                 |

**Premiums.** The premium increases were due to ongoing home service marketing efforts, as well as a SPFIC rate increase of 5.7% for named peril policies that became effective January 1, 2011.

**Net Investment Income.** Net investment income decreased for the three and nine months ended September 30, 2011, compared to the same periods in 2010, as the Company experienced significant call activity over the past two years and reinvested proceeds during a declining interest rate environment, which has depressed our investment income and lowered portfolio yields. The recent declines in yield rates by quarter appear to be leveling off as the reinvestment of calls is resulting in a lesser impact relative to yield changes.

Net investment income for our home service insurance segment is summarized as follows:

|  | Nine Months<br>Ended<br>September 30,<br>2011 | Year Ended<br>December 31,<br>2010 | Nine Months<br>Ended<br>September 30,<br>2010 |
|--|---|------------------------------------|---|
|  | (In thousands, except for %)                  |                                    |   |
| Net investment income, annualized          | \$ 12,920                                     | 13,008                             | 13,668  |
| Average invested assets, at amortized cost | 284,886                                       | 279,682                            | 279,199                                       |

|   |      |   |      |   |      |   |
|---|------|---|------|---|------|---|
| Annualized yield on average invested assets | 4.54 | % | 4.65 | % | 4.90 | % |
|---|------|---|------|---|------|---|

Realized Gains, Net. Net realized gains of \$0.6 million for the nine months ended September 30, 2010 were mostly due to sales of several available-for-sale debt and equity securities, some of which were previously impaired.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

Claims and Surrenders. Claims and surrenders decreased for the three and nine months ended September 30, 2011, compared to the same periods in 2010, and were within expected ranges.

|                              | Three Months Ended    |                       | Nine Months Ended     |                       |
|------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                              | September 30,<br>2011 | September 30,<br>2010 | September 30,<br>2011 | September 30,<br>2010 |
|                              | (In thousands)        |                       |                       |                       |
| Death claims                 | \$3,470               | 3,990                 | 10,738                | 12,141                |
| Surrender benefits           | 794                   | 649                   | 2,107                 | 1,780                 |
| Endowment benefits           | 3                     | 5                     | 8                     | 19                    |
| Property claims              | 586                   | 469                   | 1,601                 | 1,340                 |
| Accident and health benefits | 15                    | 33                    | 113                   | 137                   |
| Other policy benefits        | 101                   | 95                    | 329                   | 349                   |
| Total claims and surrenders  | \$4,969               | 5,241                 | 14,896                | 15,766                |

- Death claims expense was lower for the three and nine months in 2011 due to fewer reported claims. In addition, the nine months includes a \$0.3 million incurred but not reported release of liability related to our claim experience calculation. Mortality experience is closely monitored by the Company as a key performance indicator and these amounts were within expected levels.
- Surrender benefits have increased in the three and nine months ended September 30, 2011, compared to the same periods in 2010, which may be attributable to the current economic conditions.
- Property claims increased for the three and nine months of 2011 compared to the same periods in 2010, as 2010 claims reported were lower than historical experience.

Other General Expenses. Other general expenses decreased for the nine months ended September 30, 2011, compared to the same period in 2010, due to an overall decrease in expenses and a reallocation of expenses that became effective January 1, 2011, which reduced the home service segment allocation and increased the life segment allocation in the current year.

Capitalization of Deferred Policy Acquisition Costs ("DAC"). Capitalized costs increased for the nine months ended September 30, 2011, mainly due to an increase in first year commissions paid during the period. DAC capitalization is directly correlated to fluctuations in first year commissions.

Amortization of Deferred Policy Acquisition Costs. Amortization for the nine month period of 2011 includes an adjustment that resulted in an increase of \$0.3 million due to a refinement in an estimate using system generated information related to SPLIC assumptions. Amortization has also increased in the three and nine months ended September 30, 2011 due to the increase in the DAC as a result of new business. Amortization reported for the three months ended September 30, 2010, is impacted by an adjustment that decreased amortization by \$0.3 million in that reporting period.

Other Non-Insurance Enterprises

Overall, other non-insurance operations are immaterial to the consolidated results, except for the fair value adjustment related to the Company's warrants to purchase Class A common stock. These amounts fluctuate due to the movement in the stock price and fair value calculation using the Black-Scholes valuation model.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

## Investments

The administration of our investment portfolios is handled by our management, pursuant to board-approved investment guidelines, with all trading activity approved by a committee of the respective boards of directors of our insurance company subsidiaries. The guidelines used require that fixed maturities, both government and corporate, are of high quality and comprise a majority of the investment portfolio. State insurance statutes prescribe the quality and percentage of the various types of investments that may be made by insurance companies and generally permit investment in qualified state, municipal, federal and foreign government obligations, high quality corporate bonds, preferred and common stock, mortgage loans and real estate within certain specified percentages. The assets are intended to mature in accordance with the average maturity of the insurance products and to provide the cash flow for our insurance company subsidiaries to meet their respective policyholder obligations.

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

|   | September 30, 2011               |                           | December 31, 2010                |                           |
|---|----------------------------------|---------------------------|----------------------------------|---------------------------|
|   | Carrying Value<br>(In thousands) | % of Total Carrying Value | Carrying Value<br>(In thousands) | % of Total Carrying Value |
| Marketable securities:                                  |                                  |                           |                                  |                           |
| U.S. Treasury and U.S. Government-sponsored enterprises |                                  |                           |                                  |                           |
| Government-sponsored enterprises                        | \$ 307,817                       | 35.9                      | \$ 378,012                       | 48.8                      |
| Corporate   | 183,961                          | 21.5                      | 161,298                          | 20.8                      |
| Municipal bonds   | 194,249                          | 22.7                      | 101,719                          | 13.1                      |
| Mortgage-backed (1)                                     | 9,918                            | 1.2                       | 14,808                           | 1.9                       |
| Foreign governments                                     | 144                              | -                         | 132                              | -                         |
| Short-term investments                                  | 2,066                            | 0.2                       | -                                | -                         |
| Total marketable securities                             | 698,155                          | 81.5                      | 655,969                          | 84.6                      |
| Cash and cash equivalents                               | 64,425                           | 7.5                       | 49,723                           | 6.4                       |
| Other investments:                                      |                                  |                           |                                  |                           |
| Policy loans  | 38,075                           | 4.4                       | 35,585                           | 4.6                       |
| Equity securities                                       | 45,366                           | 5.3                       | 23,304                           | 3.0                       |
| Mortgage loans  | 1,453                            | 0.2                       | 1,489                            | 0.2                       |
| Real estate   | 9,126                            | 1.1                       | 9,200                            | 1.2                       |
| Other long-term investments                             | 141                              | -                         | 148                              | -                         |
| Total cash, cash equivalents and investments            | \$ 856,741                       | 100.0                     | \$ 775,418                       | 100.0                     |

(1) Includes \$8.5 million and \$13.2 million of U.S. Government-sponsored enterprises at September 30, 2011 and December 31, 2010, respectively.



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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

The Company increased holdings in investment grade municipal securities with higher yields during the first nine months of 2011. Cash and cash equivalents increased as of September 30, 2011, based upon timing of cash inflows and investment into marketable securities. Investments in equity securities increased in the current year as the Company invested proceeds from fixed maturity bond holdings into bond mutual funds in the current period totaling \$24.0 million.

The held-to-maturity portfolio as of September 30, 2011, represented 18.9% of the total fixed maturity securities owned based upon carrying values, with the remaining 81.1% classified as available-for-sale. Held-to-maturity securities are reported in the financial statements at amortized cost and available-for-sale securities are reported at fair value.

The following table sets forth the distribution of the credit ratings of our portfolio of fixed maturity securities by carrying value as of September 30, 2011 and December 31, 2010.

|              | September 30, 2011               |                           | December 31, 2010                |                           |
|--------------|----------------------------------|---------------------------|----------------------------------|---------------------------|
|              | Carrying Value<br>(In thousands) | % of Total Carrying Value | Carrying Value<br>(In thousands) | % of Total Carrying Value |
| AAA          | \$42,649                         | 6.1                       | \$428,194                        | 65.3                      |
| AA           | 462,033                          | 66.4                      | 59,454                           | 9.1                       |
| A            | 93,279                           | 13.4                      | 73,341                           | 11.2                      |
| BBB          | 80,483                           | 11.6                      | 84,489                           | 12.9                      |
| BB and other | 17,645                           | 2.5                       | 10,491                           | 1.5                       |
| Totals       | \$696,089                        | 100.0                     | \$655,969                        | 100.0                     |

The significant change from fixed maturity securities held in AAA and AA ratings is due to the credit quality downgrade of the U.S. Government by Standard & Poor's during the third quarter of 2011. This resulted in 253 securities with a carrying value totaling approximately \$301.9 million as of September 30, 2011, moving from the AAA rating category into the AA category for the current reporting period. This significantly reduced our holdings in AAA investments compared to prior reporting periods.

In addition, the Company made new investments in the AA credit category of taxable municipals and corporate bonds, primarily public utility issuers with an average maturity of seven years. The increase in non-investment grade securities was due to downgrades of issuers in the current period, as the Company does not purchase below investment grade securities.

Credit ratings reported for the periods indicated are assigned by a Nationally Recognized Statistical Rating Organization ("NRSRO") such as Moody's Investors Service, Standard & Poor's and Fitch Ratings. A credit rating assigned by a NRSRO is a quality based rating, with AAA representing the highest quality and D the lowest, with BBB and above being considered investment grade. In addition, the Company may use credit ratings of the National Association of Insurance Commissioners ("NAIC") Securities Valuation Office ("SVO") as assigned, if there is no NRSRO rating. Securities rated by the SVO are grouped in the equivalent NRSRO category as stated by the SVO and securities that are not rated by a NRSRO are included in the "other" category.





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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

As of September 30, 2011, the Company held municipal securities that include third party guarantees. Detailed below is a presentation by NRSRO rating of our municipal holdings by funding type.

Municipals shown including third party guarantees

|              | September 30, 2011 |                |                 |                |            |                |            |                |
|--------------|--------------------|----------------|-----------------|----------------|------------|----------------|------------|----------------|
|              | General Obligation |                | Special Revenue |                | Other      |                | Total      |                |
|              | Fair Value         | Amortized Cost | Fair Value      | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost |
|              | (In thousands)     |                |                 |                |            |                |            |                |
| AAA          | \$ 16,246          | 14,664         | 8,713           | 8,294          | -          | -              | 24,959     | 22,958         |
| AA           | 48,667             | 45,615         | 80,928          | 75,834         | 5,912      | 5,581          | 135,507    | 127,030        |
| A            | 2,365              | 2,454          | 23,098          | 22,534         | -          | -              | 25,463     | 24,988         |
| BBB          | 513                | 517            | 4,365           | 4,755          | 921        | 1,046          | 5,799      | 6,318          |
| BB and other | -                  | -              | 4,269           | 5,191          | -          | -              | 4,269      | 5,191          |
| Total        | \$ 67,791          | 63,250         | 121,373         | 116,608        | 6,833      | 6,627          | 195,997    | 186,485        |

Municipals shown excluding third party guarantees

|              | September 30, 2011 |                |                 |                |            |                |            |                |
|--------------|--------------------|----------------|-----------------|----------------|------------|----------------|------------|----------------|
|              | General Obligation |                | Special Revenue |                | Other      |                | Total      |                |
|              | Fair Value         | Amortized Cost | Fair Value      | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost |
|              | (In thousands)     |                |                 |                |            |                |            |                |
| AAA          | \$ -               | -              | 8,713           | 8,294          | -          | -              | 8,713      | 8,294          |
| AA           | 45,958             | 42,621         | 64,796          | 60,708         | 5,912      | 5,581          | 116,666    | 108,910        |
| A            | 9,289              | 9,013          | 37,487          | 35,887         | -          | -              | 46,776     | 44,900         |
| BBB          | 513                | 517            | 5,607           | 6,028          | 921        | 1,046          | 7,041      | 7,591          |
| BB and other | 12,031             | 11,099         | 4,770           | 5,691          | -          | -              | 16,801     | 16,790         |
| Total        | \$ 67,791          | 63,250         | 121,373         | 116,608        | 6,833      | 6,627          | 195,997    | 186,485        |

The Company held investments in special revenue bonds that had a greater than 10% exposure based upon activity as noted in the table below.

| Fair Value | September 30, 2011 |                | % of Total Fair Value |
|------------|--------------------|----------------|-----------------------|
|            | Amortized Cost     | (In thousands) |                       |

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|                           |           |        |      |   |
|---------------------------|-----------|--------|------|---|
| Public improvements       | \$ 24,137 | 23,352 | 12.3 | % |
| Refunding bonds and notes | 24,681    | 23,887 | 12.6 | % |

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

The tables below represent the Company's exposure of municipal holdings in states that exceed 10% of the total municipal portfolio as of September 30, 2011.

## Municipal Exposure by State

|   | September 30, 2011 |                |                 |                |            |                |            |                |        |
|---|--------------------|----------------|-----------------|----------------|------------|----------------|------------|----------------|--------|
|   | General Obligation |                | Special Revenue |                | Other      |                | Total      |                |        |
|   | Fair Value         | Amortized Cost | Fair Value      | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost |        |
|   | (In thousands)     |                |                 |                |            |                |            |                |        |
| Louisiana securities including third party guarantees |                    |                |                 |                |            |                |            |                |        |
| AA  | \$ 11,828          | 11,228         | 18,675          | 18,001         | -          | -              | 30,503     | 29,229         |        |
| A   | 783                | 773            | 13,538          | 13,234         | -          | -              | 14,321     | 14,007         |        |
| BBB   | 513                | 517            | 4,365           | 4,755          | 921        | 1,046          | 5,799      | 6,318          |        |
| BB and other  | -                  | -              | 4,269           | 5,191          | -          | -              | 4,269      | 5,191          |        |
| Total   | \$ 13,124          | 12,518         | 40,847          | 41,181         | 921        | 1,046          | 54,892     | 54,745         |        |
| Louisiana securities excluding third party guarantees |                    |                |                 |                |            |                |            |                |        |
| AA  |                    | \$9,507        | 8,984           | 13,015         | 12,583     | -              | -          | 22,522         | 21,567 |
| A   |                    | 3,104          | 3,017           | 17,455         | 16,879     | -              | -          | 20,559         | 19,896 |
| BBB   |                    | 513            | 517             | 5,607          | 6,028      | 921            | 1,046      | 7,041          | 7,591  |
| BB and other  |                    | -              | -               | 4,770          | 5,691      | -              | -          | 4,770          | 5,691  |
| Total   |                    | \$13,124       | 12,518          | 40,847         | 41,181     | 921            | 1,046      | 54,892         | 54,745 |
| Texas securities including third party guarantees     |                    |                |                 |                |            |                |            |                |        |
| AAA   | \$ 16,246          | 14,664         | 4,354           | 4,043          | -          | -              | 20,600     | 18,707         |        |
| AA  | 6,655              | 6,232          | 5,664           | 5,496          | -          | -              | 12,319     | 11,728         |        |
| A   | -                  | -              | 3,241           | 3,301          | -          | -              | 3,241      | 3,301          |        |
| Total   | \$ 22,901          | 20,896         | 13,259          | 12,840         | -          | -              | 36,160     | 33,736         |        |

Texas securities  
excluding third  
party guarantees

|       |           |        |        |        |   |   |        |        |
|-------|-----------|--------|--------|--------|---|---|--------|--------|
| AAA   | \$ -      | -      | 4,354  | 4,043  | - | - | 4,354  | 4,043  |
| AA    | 21,807    | 19,884 | 5,664  | 5,496  | - | - | 27,471 | 25,380 |
| A     | -         | -      | 3,241  | 3,301  | - | - | 3,241  | 3,301  |
| BBB   | 1,094     | 1,012  | -      | -      | - | - | 1,094  | 1,012  |
| Total | \$ 22,901 | 20,896 | 13,259 | 12,840 | - | - | 36,160 | 33,736 |

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

The Company invests in municipal securities of issuers in the state of Louisiana and receives a credit that reduces its premium tax liability in that state. At September 30, 2011, total holdings of municipal securities in Louisiana represented 28.0% of all municipal holdings based upon fair value. The Company also holds 18.4% of its municipal holdings in Texas issuers. There were no other states or individual issuer holdings that represented or exceeded 10% of the total municipal portfolio as of September 30, 2011.

Valuation of Investments

We evaluate the carrying value of our fixed maturity and equity securities at least quarterly. The Company monitors all debt and equity securities on an on-going basis relative to changes in credit ratings, market prices, earnings trends and financial performance, in addition to specific region or industry reviews. The assessment of whether impairments have occurred is based on a case-by-case evaluation of underlying reasons for the decline in fair value. The Company determines other-than-temporary impairment by reviewing all relevant evidence related to the specific security issuer as well as the Company's intent to sell the security, or if it is more likely than not that the Company would be required to sell a security before recovery of its amortized cost.

When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the following: a) the amount representing the credit loss; and b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings becomes the new amortized cost basis of the investment. The new amortized cost basis is not adjusted for subsequent recoveries in fair value.

The Company did not recognize any other-than-temporary impairments for the nine months ended 2011 or 2010. The Company recognized a valuation allowance on one mortgage loan totaling \$45,000 during the first quarter of 2010.

Liquidity and Capital Resources

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

Liquidity requirements of the Company are met primarily by funds provided from operations. Premium deposits and revenues, investment income and investment maturities are the primary sources of funds, while investment purchases, policy benefits, and operating expenses are the primary uses of funds. We historically have not had to liquidate investments to provide cash flow and did not do so during the first nine months of 2011. Our investments as of September 30, 2011, consist of 71.2% of marketable debt securities classified as available-for-sale that could be readily converted to cash for liquidity needs.

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

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

Cash flows from our insurance operations have been sufficient to meet current needs. Cash flows from operating activities were \$43.6 million and \$39.5 million for the nine months ended September 30, 2011 and 2010, respectively. We have traditionally also had significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows, for the most part, are reinvested in fixed income securities. Net cash outflows from investing activities totaled \$32.4 million and \$24.4 million for the nine months ended September 30, 2011 and 2010, respectively.

The NAIC has established minimum capital requirements in the form of Risk-Based Capital ("RBC"). RBC factors the type of business written by an insurance company, the quality of its assets, and various other aspects of an insurance company's business to develop a minimum level of capital called "authorized control level risk-based capital" and compares this level to adjusted statutory capital that includes capital and surplus as reported under statutory accounting principles, plus certain investment reserves. Should the ratio of adjusted statutory capital to control level RBC fall below 200%, a series of remedial actions by the affected company would be required.

All insurance subsidiaries were above the RBC minimums at September 30, 2011. The ratios of adjusted statutory capital to control level RBC are shown below.

|       | September 30,<br>2011 |   | December 31,<br>2010 |   |
|-------|-----------------------|---|----------------------|---|
| CICA  | 973                   | % | 858                  | % |
| CNLIC | 2,665                 | % | 2,804                | % |
| SPFIC | 318                   | % | 311                  | % |
| SPLIC | 1,300                 | % | 1,238                | % |

## Contractual Obligations and Off-balance Sheet Arrangements

There have been no material changes in contractual obligations from those reported in the Company's Form 10-K for the year ended December 31, 2010. The Company does not have off-balance sheet arrangements at September 30, 2011, and does not expect any future effects on the Company's financial condition related to any such arrangements. We do not utilize special purpose entities as investment vehicles, nor are there any such entities in which we have an investment that engage in speculative activities of any nature, and we do not use such investments to hedge our investment positions.

## Parent Company Liquidity and Capital Resources

Citizens is a holding company and has had minimal operations of its own. Its assets consist primarily of the capital stock of its subsidiaries, cash, fixed income securities, mutual funds and investment real estate. Accordingly, Citizens' cash flows depend upon the availability of statutorily permissible payments, primarily payments under management agreements from its two primary life insurance subsidiaries, CICA and SPLIC. The ability to make payments is limited by applicable laws and regulations of Colorado, CICA's state of domicile, and Louisiana, SPLIC's state of domicile, which subject insurance operations to significant regulatory restriction. These laws and regulations require, among other things, that these insurance subsidiaries maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay to the holding company. Citizens historically has not relied upon dividends from subsidiaries for its cash flow needs. However, CICA and SPLIC do dividend available funds from time to time in relation to new acquisition target strategies. CICA has contributed amounts in the form of dividends to Citizens



totaling \$10.5 million, \$9.3 million and \$6.8 million in 2009, 2010 and 2011, respectively.

#### Critical Accounting Policies

We have prepared a current assessment of our critical accounting policies and estimates in connection with preparing our interim unaudited consolidated financial statements as of and for the three and nine months ended September 30, 2011 and 2010. We believe that the accounting policies set forth in the Notes to our Consolidated Financial Statements and “Critical Accounting Policies and Estimates” in the Management’s Discussion and Analysis of Consolidated Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2010 continue to describe the significant judgments and estimates used in the preparation of our consolidated financial statements.

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## CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

## General

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

The following table summarizes net unrealized gains and losses for the periods indicated.

|   | September 30, 2011 |               |  | December 31, 2010 |               |  |
|---|--------------------|---------------|--|-------------------|---------------|--|
|   | Amortized<br>Cost  | Fair<br>Value | Net<br>Unrealized<br>Gains<br>(Losses)<br>(In thousands) | Amortized<br>Cost | Fair<br>Value | Net<br>Unrealized<br>Gains<br>(Losses) |
| Fixed maturities,<br>available-for-sale | \$536,537          | 564,269       | 27,732   | 578,412           | 575,737       | (2,675 )                               |
| Fixed maturities,<br>held-to-maturity   | 131,820            | 133,951       | 2,131  | 80,232            | 79,103        | (1,129 )                               |
| Total fixed maturities                  | \$668,357          | 698,220       | 29,863   | 658,644           | 654,840       | (3,804 )                               |
| Total equity securities                 | \$44,340           | 45,366        | 1,026  | 19,844            | 23,304        | 3,460                                  |

## Market Risk Related to Interest Rates

Our exposure to interest rate changes results from our significant holdings of fixed maturity investments, which comprised 87.9% of our investment portfolio based on the carrying value as of September 30, 2011. These investments are mainly exposed to changes in U.S. Treasury rates. Our fixed maturities investments include U.S. Government-sponsored enterprises, U.S. Government bonds, securities issued by government agencies, municipal bonds and corporate bonds. Approximately 44.1% of the fixed maturities at fair value on September 30, 2011, were invested in U.S. Treasury and U.S. Government-sponsored enterprises.

To manage interest rate risk, we perform periodic projections of asset and liability cash flows to evaluate the potential sensitivity of our investments and liabilities. We assess annually interest rate sensitivity with respect to our available-for-sale fixed maturities investments using hypothetical test scenarios that assume either upward or downward shifts in the prevailing interest rates. The changes in fair values of our debt and equity securities as of September 30, 2011, were within the expected range of this analysis.

Changes in interest rates typically have a sizable effect on the fair values of our debt and equity securities. The interest rate of the ten-year U.S. Treasury bond decreased to 1.9% during the quarter ended September 30, 2011, from 3.3% at December 31, 2010. Net unrealized gains on fixed maturity securities totaled \$29.9 million at September 30, 2011, compared to losses of \$3.8 million at December 31, 2010.

The fixed maturity portfolio is exposed to call risk, as a significant portion of the current bond holdings are callable. A decreasing interest rate environment can result in increased call activity as experienced over the past several years, and an increasing rate environment will likely result in securities being paid at their stated maturity.

There are no fixed maturities or other investments classified as trading instruments. Approximately 80.8% of fixed maturities were held in available-for-sale and 19.2% in held-to-maturity based upon fair value at September 30, 2011. At September 30, 2011, and December 31, 2010, we had no investments in derivative instruments, nor did we have any subprime or collateralized debt obligation risk.

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CITIZENS, INC. AND CONSOLIDATED SUBSIDIARIES

September 30, 2011

Market Risk Related to Equity Prices

Changes in the level or volatility of equity prices affect the value of equity securities we hold as investments. Our equity investments portfolio represented 5.7% of our total investments at September 30, 2011, with 95.5% invested in diversified equity and bond mutual funds. We believe that significant decreases in the equity markets would not have a material adverse impact on our total investment portfolio.

Item 4. CONTROLS AND PROCEDURES

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

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

During the quarter ended September 30, 2011, there were no changes in the Company's internal controls over financial reporting that materially affect or are reasonably likely to affect the Company's internal controls over financial reporting (as defined in rules 13a-15(f) and 15d-15(f) under the Exchange Act).

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are a defendant in a lawsuit filed on August 6, 1999, in the Texas District Court, Austin, Texas, now styled Delia Bolanos Andrade, et al., Plaintiffs, v. Citizens Insurance Company of America, et al., Defendants in which a class was originally certified by the trial court and reversed by the Texas Supreme Court in 2007 with an order to the trial court to conduct further proceedings consistent with its ruling. The underlying lawsuit alleged that certain life insurance policies CICA made available to non-U.S. residents, when combined with a policy feature that allowed certain cash benefits to be assigned to two non-U.S. trusts for the purpose of accumulating ownership of our Class A common stock, along with allowing the policyholders to make additional contributions to the trusts, were actually offers and sales of securities that occurred in Texas by unregistered dealers in violation of the Texas securities laws. The remedy sought was rescission and return of the insurance premium payments. On December 9, 2009, the trial court denied the recertification of the class after conducting additional proceedings in accordance with the Texas Supreme Court's ruling. The remaining plaintiffs must now proceed individually, and not as a class, if they intend to pursue their claims against us. No individual cases have been pursued by the plaintiffs. The probability of the plaintiffs pursuing their cases individually is unknown. Further, an estimate of any possible loss or range of losses cannot be made at this time in regard to individuals pursuing claims. However, should the plaintiffs pursue their claims individually, we intend to vigorously defend any proceedings.

SPFIC is a defendant in a statewide putative class action lawsuit in Louisiana styled The State of Louisiana v. AAA Insurance (the "Road Home Litigation"), which was filed in the Civil District Court for the Parish of Orleans on August 23, 2007. The Louisiana Attorney General filed the Road Home Litigation as a putative class action lawsuit in

state court against SPFIC and approximately 200 other insurers on behalf of the State of Louisiana, as assignee, and on behalf of a class of Road Home fund recipients alleging that SPFIC and the other insurers have failed to pay all damages owed under their policies. The insurers removed the matter to federal court. The defendants filed a motion to dismiss, and in March 2009, the district court granted part of the defendants' motion, dismissing all of the extra-contractual claims, including the bad faith and breach of fiduciary duty claims. As a result, the remaining claims are for breach of contract and declaratory relief on the alleged underpayment of claims by the insurers. The court did not dismiss the class action allegations. The defendants also had moved to dismiss the complaint on grounds that the State had no standing to bring the lawsuit as an assignee of insureds because of anti-assignment language in the insurers' policies. The court denied the defendants' motion for reconsideration on the assignment issue but found the matter was ripe for consideration by the federal appellate court. The defendants filed a petition for permission to appeal to the Fifth Circuit. The Fifth Circuit accepted review. On July 20, 2011, the Fifth Circuit ruled, based on a ruling from the Louisiana Supreme Court, that there was no public policy which precludes an anti-assignment clause from applying to post loss assignments, but the language of the anti-assignment language must be evaluated on a policy by policy basis and clearly and unambiguously express that the non-assignment clause applies to post-loss assignments. We anticipate the State will vigorously pursue the matter in the district court and are uncertain as to the impact a case by case analysis of claims will have on SPFIC. An estimate of possible loss or range of loss cannot be made at this time as a result of the July 20, 2011 Fifth Circuit ruling. SPFIC intends to vigorously defend any remaining proceedings.

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SPFIC is vigorously defending a number of matters in various stages of development filed in the aftermath of Hurricane Katrina in addition to the Road Home Litigation, including a number of individual lawsuits, which are immaterial to the Company's financial statements.

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

- disputes over insurance coverage or claims adjudication;
- regulatory compliance with insurance and securities laws;
- disputes with our marketing firms, consultants and agents over compensation and termination of contracts and related claims;
- disputes regarding our tax liabilities;
- disputes relating to reinsurance and coinsurance agreements; and
- disputes relating to businesses acquired and operated by us.

In the absence of countervailing considerations, we would expect to defend any such claims vigorously. However, in doing so, we could incur significant defense costs, including attorneys' fees, other direct litigation costs and the expenditure of substantial amounts of management time that otherwise would be devoted to our business. If we suffer an adverse judgment as a result of any claim, it could have a material adverse effect on our business, results of operations and financial condition.

Item 1A. RISK FACTORS

There are no updates to our risk factors as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. (RESERVED)

Item 5. OTHER INFORMATION

On November 3, 2011, the Company issued a news release (the "Release") reporting, among things, results of operations for its third quarter of 2011. A copy of the Release is furnished as Exhibit 99.1 to this Quarterly Report on Form 10-Q. Citizens also announced that it would hold a conference call to discuss its financial results at 10:00 a.m. Central Daylight Time on Friday, November 4, 2011.

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## Item 6. EXHIBITS

| Exhibit Number | The following exhibits are filed herewith:  |
|----------------|---|
| 3.1            | Restated and Amended Articles of Incorporation (a)  |
| 3.2            | Bylaws (b)  |
| 4.1            | Amendment to State Series A-1 and A-2 Senior Convertible Preferred Stock (c)                  |
| 11             | Statement re: Computation of per share earnings (see financial statements)                    |
| <u>31.1</u>    | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act*   |
| <u>31.2</u>    | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act*   |
| <u>32.1</u>    | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act*   |
| <u>32.2</u>    | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act*   |
| <u>99.1</u>    | News Release reporting third quarter results issued on November 3, 2011 (furnished herewith). |
| 101.INS        | XBRL Instance Document (furnished herewith)   |
| 101.SCH        | XBRL Taxonomy Extension Schema (furnished herewith)   |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase (furnished herewith)                             |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase (furnished herewith)                              |
| 101.LAB        | XBRL Taxonomy Extension Label Linkbase (furnished herewith)                                   |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase (furnished herewith)                            |

\* Filed herewith.

- (a) Filed on March 15, 2004 with the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 2003 as Exhibit 3.1 and incorporated herein by reference.
- (b) Filed on March 31, 1999 with the Registrant's Annual Report on Form 10-K for the Year Ended December 31, 1998, as Exhibit 3.2, and incorporated herein by reference.
- (c) Filed on July 15, 2004, with the Registrant's Current Report on Form 8-K as Exhibit 4.1, and incorporated herein by reference.

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SIGNATURES

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

CITIZENS, INC.

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

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

Date: November 3, 2011