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CITIZENS FINANCIAL CORP /KY/

Form 10-Q

August 11, 2004

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

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-20148

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

Kentucky
(State of Incorporation)

61-1187135
(I.R.S. Employer Identification No.)

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Class A Stock - 1,677,628 as of August 10, 2004.

The date of this Report is August 11, 2004.

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Part I - Financial Information; Item 1 - Financial Statements

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

Six Months Ended June 30	2004
Revenues:	
Premiums and other considerations	\$ 14,900,716
Premiums ceded	(632,872)
Net premiums earned	14,267,844
Net investment income	3,339,977
Net realized investment gains (losses)	289,757
Other income	95,351
Total Revenues	17,992,929
Policy Benefits and Expenses:	
Policyholder benefits	11,298,072
Policyholder benefits ceded	(541,006)
Net benefits	10,757,066
Increase in net benefit reserves	1,237,438
Interest credited on policyholder deposits	338,432
Commissions	2,540,636
General expenses	3,764,740
Interest expense	177,826
Policy acquisition costs deferred	(634,455)
Amortization of deferred policy acquisition costs and value of insurance acquired	806,132
Total Policy Benefits and Expenses	18,987,815
Loss before income tax	(994,886)
Income tax benefit	(12,604)
Net Loss	\$ (982,282)

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Net Loss per Common Share, basic and diluted \$ (0.58)

Part I - Financial Information; Item 1 - Financial Statements

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

Three Months Ended June 30	2004
<hr/>	
Revenues:	
Premiums and other considerations	\$ 7,506,098
Premiums ceded	(310,822)
<hr/>	
Net premiums earned	7,195,276
Net investment income	1,716,296
Net realized investment gains	61,571
Other income	48,762
<hr/>	
Total Revenues	9,021,905
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Policy Benefits and Expenses:	
Policyholder benefits	5,746,093
Policyholder benefits ceded	(273,574)
<hr/>	
Net benefits	5,472,519
Increase in net benefit reserves	788,757
Interest credited on policyholder deposits	183,404
Commissions	1,217,065
General expenses	2,014,904
Interest expense	87,238
Policy acquisition costs deferred	(285,687)
Amortization of deferred policy acquisition costs and value of insurance acquired	392,736
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Total Policy Benefits and Expenses	9,870,936
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Loss before income tax	(849,031)
Income tax (benefit)	23,644

Net Loss	\$ (872,675)

Net Loss per Common Share, basic and diluted	\$ (0.52)

Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	June 30, 2004

ASSETS	(Unaudited)
Investments:	
Securities available for sale, at fair value:	
Fixed maturities (amortized cost of \$104,345,690 and \$104,768,393 in 2004 and 2003, respectively)	\$ 104,147,222
Equity securities (cost of \$13,481,909 and \$8,061,783 in 2004 and 2003, respectively)	16,372,069
Investment real estate	3,067,389
Policy loans	4,454,320
Short-term investments	642,748

Total Investments	128,683,748
Cash and cash equivalents	3,741,831
Accrued investment income	1,752,425
Reinsurance recoverable	2,696,948
Premiums receivable	241,885
Property and equipment	1,538,537
Deferred policy acquisition costs	10,471,919
Value of insurance acquired	2,910,684
Goodwill	755,782

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Federal income tax receivable	---
Other assets	232,118
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Total Assets	\$ 153,025,877
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Part I; Item 1 (continued)

Citizens Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Financial Condition

	June 30, 2004
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LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)
Liabilities:	
Policy Liabilities:	
Future policy benefits	\$ 110,507,549
Policyholder deposits	15,338,670
Policy and contract claims	1,781,614
Unearned premiums	258,153
Other	228,149
<hr/>	
Total Policy Liabilities	128,114,135
Note payable - bank	3,475,002
Note payable - related party	3,000,000
Accrued expenses and other liabilities	1,356,512
Deferred federal income tax	48,651
<hr/>	
Total Liabilities	135,994,300
Commitments and Contingencies	
Shareholders' Equity:	
Common stock, 6,000,000 shares authorized; 1,685,228 and 1,685,228 shares issued and outstanding in 2004 and 2003, respectively	1,685,228

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Additional paid-in capital	7,170,321
Accumulated other comprehensive income	1,775,939
Retained earnings	6,400,089

Total Shareholders' Equity	17,031,577

Total Liabilities and Shareholders' Equity	\$ 153,025,877

Part I; Item 1 (continued)

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

Six Months Ended June 30	2004

Cash Flows from Operations:	
Net loss	\$ (982,282)
Adjustments to reconcile net loss to cash from operations:	
Increase in benefit reserves	1,132,435
Increase (decrease) in claim liabilities	118,365
Decrease (increase) in reinsurance recoverable	137,274
Interest credited on policyholder deposits	315,996
Provision for amortization and depreciation, net of deferrals	297,977
Amortization of premium and accretion of discount on securities purchased, net	14,044
Net realized investment (gains) losses	(289,757)
Increase in accrued investment income	(66,649)
Change in other assets and liabilities	(644,459)
Decrease (increase) in deferred federal income tax liability	1,541
Increase in federal income taxes receivable	(48,582)

Net Cash provided by (used in) Operations	(14,097)
Cash Flows from Investment Activities:	
Cost of securities acquired	(23,427,698)
Investments sold or matured	19,016,146

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Investment management fees	(355,241)
Additions to real estate	--
(Additions) reductions to property and equipment, net	1,012,810
Other investing activities, net	87,497

Net Cash used in Investment Activities	(3,666,486)
Cash Flows from Financing Activities:	
Policyholder deposits	276,968
Policyholder withdrawals	(785,117)
Payments on notes payable - bank	(658,333)
Repurchase of common stock	--

Net Cash used in Financing Activities	(1,166,482)
Net Decrease in Cash and Cash Equivalents	(4,847,065)
Cash and Cash Equivalents at Beginning of Period	8,588,896

Cash and Cash Equivalents at End of Period	\$3,741,831

Part I; Item 1 (continued)

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

Note 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q in conformity with accounting principles generally accepted in the United States. The accompanying unaudited condensed financial statements reflect all adjustments that are, in the opinion of management, necessary to a fair presentation of the results for the interim periods. All such adjustments are of a normal recurring nature. For further information, refer to the December 31, 2003 consolidated financial statements and footnotes included in the Company's annual report on Form 10-K.

Note 2 - COMPREHENSIVE INCOME

The components of comprehensive income (loss), net of related tax, for the three and six month periods ended June 30, 2004 and 2003 are as follows:

	-----		-----
	Three Months Ended June 30,		Six Months En
	-----		-----
COMPREHENSIVE INCOME:	2004	2003	2004

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Net Loss	\$ (872,675)	\$ (319,740)	\$ (982,282)
Net unrealized gains (losses) on securities	(4,191,038)	2,420,849	(2,819,534)
Comprehensive Income (Loss)	\$ (5,063,713)	\$ 2,101,109	\$ (3,801,816)

Note 3 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company's derivatives outstanding at June 30, 2004 include approximately \$227,000 of embedded options on convertible bonds and \$(90,000) of other open option positions. Hedge accounting is not used for these securities and changes in market value are reported currently as realized gains or losses.

Note 4 - NET REALIZED INVESTMENT GAINS (LOSSES), NET OF EXPENSES

The Company recorded pretax reductions to the carrying value of available for sale securities totaling \$101,000 and \$135,000 for the six months ended June 30, 2004 and 2003, respectively, relating to declines in value which were considered by management to be other than temporary. These amounts are included along with other net realized gains (losses). Until the Company terminated its investment management agreements on January 31, 2004, the Company also netted certain direct, incremental investment management fees against net realized investment gains and losses presented in the Condensed Consolidated Statements of Operations. Such costs are based directly on or, are primarily associated with capital gains. Costs netted against realized investment gains and losses total \$46,000 and \$225,000 for the six months ended June 30, 2004 and 2003, respectively.

Note 5 - INCOME TAXES

Current taxes are provided based on estimates of the projected effective annual tax rate. Deferred taxes reflect the net effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Income before federal income taxes differs from taxable income principally due to the small life insurance company tax deduction and dividends-received tax deductions.

Part I; Item 1 (continued)

Note 6 - SEGMENT INFORMATION

The Company's operations are managed along five principal insurance product lines: Home Service Life, Broker Life, Preneed Life, Dental, and Other Health. Products in all five lines are sold through independent agency operations. Home Service Life consists primarily of traditional life insurance coverage sold in amounts of \$10,000 and under to middle and lower income individuals. This distribution channel is characterized by a significant amount of agent contact with customers throughout the year. Broker Life product sales consist primarily of simplified issue and graded-benefit policies in amounts of \$10,000 and under.

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Other products in this segment, which are not aggressively marketed, include: group life, universal life, annuities and participating life coverages. Preneed Life products are sold to individuals in connection with prearrangement of their funeral and include single premium and multi-pay policies with coverages generally in amounts of \$10,000 and less. These policies are generally sold to older individuals at increased premium rates. Dental products are term coverages generally sold to small and intermediate size employer groups. Other Health products include various accident and health coverages sold to individuals and employer groups. Segment information as of June 30, 2004 and 2003, and for the periods then ended is as follows:

REVENUE:	Three Months Ended June 30,		Six Months En
	2004	2003	2004
Home Service Life	\$ 2,345,217	\$ 2,259,771	\$ 4,586,813
Broker Life	3,388,451	1,367,436	2,992,999
Preneed Life	635,017	4,193,478	5,017,029
Dental	2,318,403	2,090,956	4,507,041
Other Health	273,246	334,803	599,290
Segment Totals	8,960,334	10,246,444	17,703,172
Net realized investment gains (losses)	61,571	111,435	289,757
Total Revenue	\$9,021,905	\$ 10,357,879	\$ 17,992,929

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

NET INVESTMENT INCOME:	Three Months Ended June 30,		Six Months En
	2004	2003	2004
Home Service Life	\$ 466,654	\$ 377,689	\$ 894,163
Broker Life	643,110	511,544	1,206,983
Preneed Life	576,522	466,522	1,180,701
Dental	9,354	5,096	17,698
Other Health	20,656	16,999	40,432
Segment Totals	\$ 1,716,296	\$1,377,850	\$ 3,339,977

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The Company evaluates performance based on several factors, of which the primary financial measure is segment profit. Segment profit represents pretax earnings, except net realized investment gains (losses) and interest expense are excluded. A significant portion of the Company's realized investment gains (losses) are generated from investments in equity securities. The equities portfolio averaged (on a cost basis) approximately \$11,964,000 and \$9,066,000 during the six months ended June 30, 2004 and 2003, respectively.

	Three Months Ended June 30,		Six Months En
SEGMENT PROFIT (LOSS):	2004	2003	2004
Home Service Life	\$ 55,612	\$ (35,157)	\$ (61,497)
Broker Life	(321,048)	(240,873)	(466,630)
Preneed Life	(213,085)	(257,999)	(290,225)
Dental	(246,349)	63,984	(172,393)
Other Health	(98,494)	68,271	(116,072)
Segment Totals	(823,364)	(401,774)	(1,106,817)
Net realized investment gains (losses)	61,571	111,435	289,757
Interest expense	87,238	97,401	177,826
Loss before Federal Income Tax	\$ (849,031)	\$ (387,740)	\$ (994,886)

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

	Three Months Ended June 30,		Six Months En
DEPRECIATION AND AMORTIZATION:	2004	2003	2004
Home Service Life	\$ 100,117	\$ 175,994	\$ 234,077
Broker Life	114,977	86,170	198,182
Preneed Life	196,953	131,698	426,358
Dental	11,817	14,231	27,970
Other Health	24,147	3,506	47,107
Segment Totals	\$ 448,011	\$ 411,599	\$ 933,694

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

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ASSETS:	June 30, 2004	December 31, 2003
Home Service Life	\$ 40,146,974	\$41,312,914
Broker Life	53,129,025	54,585,019
Preneed Life	57,200,594	60,100,723
Dental	816,325	930,279
Other Health	1,732,959	1,951,397
Segment Totals	\$153,025,877	\$158,880,332

Part I; Item 1 (continued)

Note 7 - LITIGATION

United Liberty, which the Company acquired in 1998, is defending an action in an Ohio state court brought by two policyholders in 2000. The Complaint refers to a particular class of life insurance policies that United Liberty issued over a period of years ending around 1971. It alleges that United Liberty's dividend payments on these policies from 1993 through 1999 were less than the required amount. It does not specify the amount of the alleged underpayment but implies a maximum of about \$850,000. The plaintiffs also allege that United Liberty is liable to pay punitive damages, also in an unspecified amount, for breach of an implied covenant of good faith and fair dealing to the plaintiffs in relation to the dividends. The action has been certified as a class action on behalf of all policyholders who were Ohio residents and whose policies were still in force in 1993. United Liberty has denied the material allegations of the Complaint and is defending the action vigorously. United Liberty has filed a motion for summary judgment, which has been fully briefed and argued and awaits decision by the Court. Efforts to settle the action, including mediation, have not been successful. The Company expects that the Court will decide pending motions in the third quarter, which may dispose of all issues in the case or set the stage for trial. At this stage, the Company remains unable to determine whether an unfavorable outcome of this action is likely to occur or whether the chance of such an outcome is remote and therefore does not have a basis for estimating the potential loss, if any, that may ultimately result.

Since 2001, Citizens Security has been defending an action in an Alabama state court brought by an alleged policyholder in which a former independent agent is also a defendant. The action was described in Note 7 to Part I, Item 1, of the Company's Form 10-Q for the quarterly period ended March 31, 2004. The parties settled this action in early August 2004. For strategic reasons related to other potential claims, the Company has not disclosed the specific amount paid in settlement. It is included under "Policyholder benefits" in the Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2004 in "Policy and contract claims" in the Condensed Consolidated Statement of Financial Condition.

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

Note 8 - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

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

EXECUTIVE SUMMARY

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

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

OPERATIONS. Net premiums and other considerations decreased approximately \$1,618,000, or 18.4% during the three months ended June 30, 2004 compared to the three months ended June 30, 2003 and decreased approximately \$3,523,000 for the first six months of 2004 compared to the first six months of 2003. Below is a summary of net premiums earned by segment, for the three and six month periods ended June 30, 2004, along with the change from the same periods of 2003.

NET PREMIUMS EARNED	Three Months Ended June 30,		Six Months Ended June 30,	
	Total	Change	Total	Change
Home Service Life	\$ 1,865,307	\$ (1,507)	\$ 3,667,124	\$ (75,000)
Broker Life	730,065	(105,148)	1,778,591	42,400
Preneed Life	2,039,119	(1,668,954)	3,775,586	(3,647,400)
Dental	2,308,784	223,130	4,488,839	262,800
Other Health	252,001	(65,116)	557,704	(105,400)
Segment Totals	\$ 7,195,276	\$ (1,617,595)	\$14,267,844	\$ (3,522,600)

Preneed Life premiums declined \$3,647,000 or 49% during the first half of 2004

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

The increase in net benefit reserves decreased \$2,700,000 or 69% during the first half of 2004 compared to the same period in 2003 primarily due to the decrease in Preneed policies issued and in force during the period. The decrease in net benefit reserves in the second quarter was \$1,486,000 or 65% compared to the second quarter of 2003.

Pretax loss increased approximately \$201,000 to \$995,000 for the six months ended June 30, 2004, primarily due to unfavorable mortality and Dental morbidity rates, settlement of a lawsuit and increased general expenses, partially offset by an increase in realized investment gains of \$454,000 and an increase in net investment income of \$588,000. Net investment income increased 21% for the first half of 2004 compared to the same period of 2003, in spite of a decline in invested assets, due to a decrease in cash and cash equivalents and an increased

yield on the Company's fixed maturities portfolio resulting from investing in longer term fixed maturity securities. Net realized investment gains increased to \$290,000 for the first six months of 2004 from net investment losses of \$165,000 for the same period in 2003, as the Company took advantage of the stronger equities markets of the past twelve months. Net benefits increased \$631,000 or 6% during the first six months of 2004 from the same period in 2003 due primarily to adverse mortality rates in Broker and the Preneed segments along with adverse morbidity in the Dental segment. Commissions decreased \$848,000 or 25% for the six months ended June 30, 2004 compared to the same period in 2003 due to a lowering in commission rates in the second half of 2003 on the Preneed premium and the decrease in that premium. General expenses increased \$340,000, or 9.9% for the first half of 2004 due to the Company continuing to incur costs associated with outside consultants who were employed to review profitability of the Company's life products in the current interest rate environment and perform other actuarial calculations and analysis, the cost of a severance agreement settlement and the costs of a market conduct examination conducted by the Office of Insurance of the Company's domiciliary state. Policy acquisition costs deferred decreased \$503,000 or 44% for the six months ended June 30, 2004 compared to the same period in 2003 principally due to the substantial decline in first year Preneed premiums during the same period. Pretax Segment loss (excluding realized investment gains (losses) and interest expense) for the first six months of 2004 was approximately \$1,107,000 compared to \$440,000 for the first six months of 2003. This is primarily attributable to the factors described above relative to revenue changes, mortality and morbidity rates, increased general expenses and the settlement of one of the lawsuits discussed in Note 7 to the Condensed Consolidated Financial Statements. Below are the approximate, annualized pretax investment income and total return yields for the six months ended June 30, 2004 and 2003.

Six Months Ended June 30	2004	2003
Investment Income	\$ 3,339,977	\$ 2,751,831
Realized and Unrealized Gains (Losses)	(4,165,601)	4,276,072

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Total Return	\$(825,624)	\$ 7,027,911
Average Cash and Investments	\$136,572,241	\$128,685,929
Investment Income Yield - Annualized	4.89%	4.28%
Total Return - Annualized	(1.21)%	10.92%

The income tax benefit of \$13,000 is at a lower effective rate on the pretax operating loss, excluding net realized investment gains, (1.0%) than the full year rate for 2003 of 5.2% due to the Company not having any ability to carry back any additional net operating losses for tax purposes and management's judgment that it is not likely the full tax benefit will be realized in the foreseeable future.

FINANCIAL POSITION. Shareholders' equity totaled approximately \$17,032,000 and \$20,833,000 at June 30, 2004 and December 31, 2003, respectively. These balances reflect an approximate 18.2% decrease for the six months ended June 30, 2004. As described above, the comprehensive income (loss) totaled approximately \$(3,802,000) and \$2,186,000 for the six months ended June 30, 2004 and 2003, respectively. A significant portion of the comprehensive income (loss) is attributable to changes in the value of the Company's fixed maturity and equity portfolios. Equity securities comprised approximately 10.7% and 7.1% of the Company's total assets as of June 30, 2004 and December 31, 2003, respectively. Accordingly, as also described below, the Company's financial position can be significantly affected by movements in the equities markets. Equity portfolio positions increased \$5,420,000 on a cost basis and \$5,035,000 on a market value basis, during the first six months of 2004. Fixed maturity portfolio positions decreased \$423,000 on an amortized cost basis and \$4,493,000 on a market value basis during the same period. This difference resulted primarily from a significant decrease in bond prices during the period. Cash and cash equivalent positions decreased approximately \$1,559,000 during the quarter ended June 30, 2004.

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

OFF-BALANCE SHEET ARRANGEMENTS

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

CASH FLOW AND LIQUIDITY. Cash flow from operations totaled \$(14,000) for the six months ended June 30, 2004 compared to \$3,489,000 for the same period in the prior year. The decrease in the positive cash flow is primarily attributable to the decline in Preneed Life business which was growing during the second quarter of 2003 and adverse mortality and morbidity rates. The \$3,666,000 of cash used in investing activities for the six months ended June 30, 2004 resulted primarily from investing a large portion of cash held at the beginning of the year, partially offset by proceeds from the sale of the Company's interest in an aircraft. The \$1,166,000 of cash used in financing activities during the first six months of 2004 is primarily attributable to bank loan principal repayments along with annuity and Universal Life account withdrawals. Due to continued

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earnings pressure from low yields on investments and cash equivalents and the declining Preneed premiums, the Company is completing a strategic review of its products and operations. A key element of this initiative is improving profitability of the Preneed, Home Service, and Broker Life segments by increasing premiums in the Home Service and Broker segments, strengthening underwriting practices, modifying growth commissions, and where possible, lowering interest crediting or policy growth rates. Regarding the currently scheduled debt repayments, the Company believes its available funds will be adequate to service 2004 debt obligations and, with other available assets, management believes it will be adequate to service debt obligations through 2005. The Company sold its interest in an aircraft to SMC Advisors Inc., a related entity, in April 2004, generating \$971,000 in additional cash. In addition, the Company's Chairman has expressed potential willingness to loan the Company an additional \$2,000,000 if necessary, which could service debt obligations through the majority of 2007. For the quarter ended June 30, 2004, the Company did not meet one of its bank debt covenants (debt to earnings ratio), however the lender has waived this violation for the quarter and for several previous quarters. In return for the waiver the Company's Chairman has personally guaranteed the outstanding bank debt.

FORWARD-LOOKING INFORMATION.

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

- |X| the market value of the Company's investments, including stock market performance and prevailing interest rate levels;
- |X| customer and agent response to new products, distribution channels and marketing initiatives, including exposure to unrecoverable advanced commissions;
- |X| mortality, morbidity, lapse rates, and other factors which may affect the profitability of the Company's insurance products;
- |X| regulatory changes or actions, including those relating to regulation of insurance products and insurance companies;
- |X| ratings assigned to the Company and its subsidiaries by independent rating organizations which the Company believes are important to the sale of its products;
- |X| general economic conditions and increasing competition which may affect the Company's ability to sell its products;
- |X| the Company's ability to achieve anticipated levels of operating efficiencies and meet cash requirements based upon projected liquidity sources;
- |X| unanticipated adverse litigation outcomes; and
- |X| changes in the Federal income tax laws and regulations that may affect the relative tax advantages of some of the Company's products.

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

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

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

Part I; Item 4 - Controls and Procedures

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

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

Part II - Other Information

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

The 2004 annual meeting of shareholders of the Company was held on June 30, 2004. At the meeting, five incumbent directors were re-elected and one new director was elected to serve until the 2005 annual meeting of shareholders. The names of the directors and shares of the Company's Class A Stock voted for each were as follows:

Candidate	Votes
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John H. Harralson, Jr.	1,365,211
Frank T. Kiley	1,358,826
George A. Turk *	1,354,973
Thomas G. Ward	1,368,211
Darrell R. Wells	1,365,711
Margaret A. Wells	1,365,511
* new director	

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

- a). Exhibit 10.16 Form of Indemnification Agreement between the Company and its Directors, Executive Officers and Certain Other Officers
- Exhibit 10.17 Aircraft Interest Purchase Agreement
- Exhibit 11 Statement re: computation of per share earnings.
- Exhibit 31.1 Rule 13a-14(a)/15d-14(a) Certification --Principal Executive Officer
- Exhibit 31.2 Rule 13a-14(a)/15d-14(a) Certification --Principal Financial Officer
- Exhibit 32.1 Section 1350 Certification --Principal Executive Officer
- Exhibit 32.2 Section 1350 Certification --Principal Financial Officer
- b). Reports on Form 8-K: On May 17, 2004 the Company filed a Form 8-K to furnish, pursuant to Item 12, a press release disclosing the Company's earnings for the first quarter of 2004.
- On July 1, 2004 the Company filed a Form 8-K to furnish, pursuant to Item 12, remarks by the Company's Chief Executive Officer at the Company's 2004 Annual Meeting.

SIGNATURES

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

CITIZENS FINANCIAL CORPORATION

BY: /s/ Darrell R. Wells

Darrell R. Wells
President and Chief Executive Officer

BY: /s/ Len E. Schweitzer

Len E. Schweitzer
Treasurer and Principal Financial Officer

Date: August 11, 2004