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Citizens Financial Services, Inc. (CZFS – OTC Pink)

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John A. Howard, CFA
May 3, 2019

Price:	\$61.50	Diluted EPS	2017A: *	\$ 4.18	P/E	2017A:	14.7x
52 Wk. Range:	\$55.51 - \$66.50	(FY: DEC)	2018A:	\$5.14		2018A:	12.0x
Div/Div Yld: *	\$1.78/2.9%		2019E:	\$5.25		2019E:	11.7x
Shrs/Mkt Cap:	3.5 mm / \$215 mm	Book Value: **		\$40.83	Price/Book Value: **		1.51x

* Cash dividend is most recent regular quarterly dividend (annualized). 2017 EPS excludes \$0.44 per share deferred tax asset charge.

** Tangible book value is \$33.73.

Background

Citizens Financial Services, Inc. (“the Company”) of Mansfield, Pennsylvania, is a financial holding company for First Citizens Community Bank, a full service community bank. First Citizens Community Bank (the “Bank”) has been operating since 1932, and as of March 31, 2019, the Company had total assets of approximately \$1.4 billion. The Company has completed various acquisitions, such as the acquisition of The First National Bank of Fredericksburg (“FNB”), a bank with roughly \$230 million in assets, in 2015, and more recently, the S&T Bank branch located in State College, PA in December of 2018. The Company currently has offices in Tioga, Bradford, Potter, Clinton, Union, Lebanon, Berks, Schuylkill, Lancaster and Centre counties in Pennsylvania and one location in Wellsville (Allegany County), New York. A new full-service office was also recently opened in Fivepointville (Lancaster County), PA. The region has a fairly diverse economic base, and has benefited from the Marcellus Shale, an area throughout much of Appalachia that contains significant untapped natural gas reserves. Citizens Financial Services, through its subsidiaries, focuses on highly personalized service and offers a variety of products and services to individuals and small- to medium-sized businesses. Personal banking products and services include deposit accounts, personal loans, retirement services, CDs and IRAs, while examples of business products include business and agricultural loans (according to the American Bankers Association, it is the number two agricultural lender in Pennsylvania) and commercial services. Electronic services offered include mobile banking, ATMs, direct deposit, internet banking, OverDraft Protection, remote deposit, lockbox, on-line mortgage application, cash management and merchant card services. Through the Investment and Trust Services division, a variety of brokerage services are offered, such as professional asset management, estate planning, mutual funds and annuities, as well as life insurance, mineral management services, financial planning and trust administration. The Company’s stock is traded on the OTC Pink market under the symbol “CZFS.”

First Quarter Reflected Higher Earnings and an Increased Dividend

Citizens Financial Services reported another good quarter in the period ended March 31, 2019. Although earnings were a touch short of our projections, they still reflected a respectable increase from the year-ago level, particularly given the rise in interest costs over the past year. Balance sheet growth was generally in the mid-single digits, and asset quality, while slipping a bit from year-end 2018, was still commendable. We would also note that the Board boosted the Company’s cash dividend again in the quarter, as it typically does at least once a year. Finally, we would note that the stock price has been performing well and is up from our last report, which we did not find surprising given its earlier valuation.

Net income in the first quarter of 2019 was \$4,405,000, or \$1.26 per diluted share, versus \$4,247,000, or \$1.21 per diluted share, in the year-ago quarter. Contributing to the higher earnings was net interest income, which increased 4% to \$11,915,000 in 2019’s first quarter, versus \$11,420,000 in the year-ago quarter. One thing that has been a bit of an earnings headwind has been the increase in funding costs.

SYMBOL: CZFS

TOTAL ASSETS: \$1.4 BB

HQ: MANSFIELD, PA

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1ST QUARTER HIGHLIGHTS:

EARNINGS WERE UP ABOUT 4%

EPS: \$1.26 VS. \$1.21

CASH DIVIDEND WAS ALSO INCREASED AND THE STOCK PRICE HAS BEEN MOVING UP

INTEREST COSTS HAVE BEEN INCREASING MORE RAPIDLY

NET INTEREST INCOME WAS UP 4%

THE PROVISION DECLINED AS WELL, REFLECTING GOOD ASSET QUALITY AND A STRONG RESERVE POSITION

NONINTEREST INCOME WAS UP 7%, WHILE NONINTEREST EXPENSE INCREASED 6%

PROFITABILITY METRICS WERE IMPRESSIVE

CASH DIVIDEND WAS INCREASED

OVER THE PAST TEN YEARS, THE TOTAL RETURN TO SHAREHOLDERS HAS BEEN NEARLY 400%

ROUGHLY ONE THIRD OF THAT RETURN CAME FROM DIVIDENDS

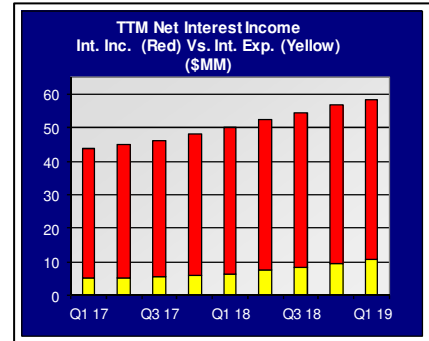
ALTHOUGH NPAS PICKED UP IN THE QUARTER, THE RATIO OF NPAS TO ASSETS HAS BEEN FAIRLY STABLE OVER THE PAST FEW YEARS

NPAS/ASSETS: 1.11%

RESERVES/LOANS: 1.20%

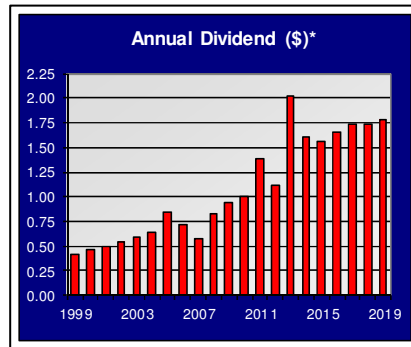
**EPS:
2017A: \$4.18 (EXCLUDING DEFERRED TAX ASSET CHARGE)
2018A: \$5.14
2019E: \$5.25**

Specifically, interest expense (seen in yellow in the chart below) has more than doubled in the past couple of years. While this increase has been more than offset by the strength in interest income, it has nevertheless had a dampening effect on the growth rate in net interest income. Adding to the benefit of the higher net interest income was a drop in the provision for loan losses to \$400,000 in the first quarter of 2019 from \$500,000 in the year-ago quarter. Noninterest income was up 7% to \$2,033,000 in 2019's first quarter, versus \$1,906,000 in the year-ago quarter, with notable improvement in fees from the Bank's brokerage and insurance business. Finally, noninterest expense increased 6% to \$8,322,000, versus \$7,832,000 in 2018's first quarter. Annualized ROAE was 12.12%, while the return on average tangible common equity was 14.63% and the annualized ROAA was 1.22%. Balance sheet growth was generally in the mid-single digits, with gross loans and deposits increasing 6% over the past year, while assets were up 5%. Stockholders' equity at March 31, 2019 was \$143 million, or 9.9% of assets.



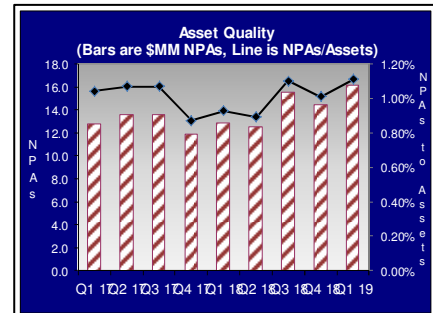
Cash Dividend Increased

As was stated at the beginning of this report, the Board of Directors increased the quarterly cash dividend to \$0.445 per share, payable March 29, 2019 to shareholders of record on March 15, 2019. Citizens Financial has had a long history of increasing cash dividends, as can be seen in the adjacent chart. And while the chart makes it appear that dividends decreased in certain years, we would note that there have been some periods where the dividend was shifted to a different year (for tax reasons, for example), and in some cases, a *special* dividend was not paid. In terms of the regular quarterly dividend, though, the Company has consistently increased it each year. Dividends have accounted for much of the total return to shareholders. Over the past ten years, for example, the total return to shareholders has been 394%, of which roughly a third came from dividends.



NPAs Have Been Trending Up But Have Been Stable as a Percentage of Assets

Nonperforming assets were \$16.1 million, or 1.11% of assets, at March 31, 2019, versus \$14.4 million, or 1.01% of assets, as of December 31, 2018, and \$12.8 million, or 0.93% of assets, at March 31, 2018. Although NPAs have modestly increased, they have been fairly stable as a percentage of assets over the past couple of years. Meanwhile the Bank has continued to move problem credits toward resolution (for example, by getting them into OREO to be sold) and has been building reserves, as the allowance for loan losses grew to \$13.1 million, or 1.20% of loans, at March 31, 2019, as compared to \$11.6 million, or 1.12% of loans, at March 31, 2018.



Projections

Based on the first quarter results and the ongoing pressure on funding costs, we are slightly lowering our 2019 earnings projections to \$18.4 million, or \$5.25 per diluted share, versus \$18.8 million, or \$5.38 per share previously. These projections could change significantly based on changing economic conditions.

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