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

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Price:	\$62.00	Diluted EPS 2018A:	\$ 5.09	P/E 2018A:	12.2x
52 Wk. Range:	\$56.00 - \$64.00	(FY: DEC) 2019A:	\$5.53	2019A:	11.2x
Div/Div Yld: *	\$1.80/2.9%	2020E:	\$5.70	2020E:	10.9x
Shrs/Mkt Cap:	3.5 mm / \$219 mm	Book Value: **	\$44.08	Price/Book Value: **	1.41x

* Cash dividend is most recent regular quarterly dividend (annualized).

** Tangible book value is \$37.09.

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 December 31, 2019, the Company had total assets of approximately \$1.47 billion. The Company has completed various acquisitions, such as the acquisition of The First National Bank of Fredericksburg (“FNB”) in 2015, the S&T Bank branch located in State College, PA in December of 2017 and it recently announced its intention to acquire MidCoast Community Bancorp, Inc. (“MidCoast”), which is based in Wilmington, DE. 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 (Allegheny County), New York. 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. According to the American Bankers Association, it is the number two agricultural lender in Pennsylvania, and it is a key element of serving the ag-rich regions of Lebanon and Lancaster. Through its 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.”

Fourth Quarter Earnings Increased 12% and Exceeded Projections

Citizens Financial Services reported excellent results for the fourth quarter of 2019, with double digit earnings growth and EPS that were \$0.05 ahead of projections. Profitability measures reflected the solid earnings growth, with ROAA and ROAE both increasing. The margin and efficiency ratio also improved, albeit slightly in the case of margins. Balance sheet growth was in the lower single-digits as anticipated though still commendable, and asset quality held up well, with nonperforming assets up from the year-ago level but down from the level at September 30, 2019.

PROFITABILITY AND EFFICIENCY RATIOS (%)

	Q4 18	Q4 19
ROAA	1.27	1.37
ROAE	12.65	13.05
Net Int. Mrgn.	3.73	3.74
Efficiency	55.7	55.0

In terms of specifics, net income was \$5,043,000, or \$1.43 per diluted share, in 2019’s fourth quarter, which was up 12% from \$4,515,000, or \$1.28 per diluted share, in the year-ago quarter. Net interest income increased 4% to \$12,790,000 from \$12,243,000, primarily due to growth in average earning assets. Noninterest income (excluding gains and losses on equity and available for sale securities) also was up 4% to \$2,083,000 in the fourth quarter of 2019 from \$1,997,000 in the year-ago quarter, with revenue growth in the wealth management division, which includes trust fees and brokerage and insurance commissions, offsetting a decrease in service charges. Noninterest expense (excluding

SYMBOL: CZFS

TOTAL ASSETS: \$1.47 BB

HQ: MANSFIELD, PA

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4TH QUARTER HIGHLIGHTS:

EPS WERE \$0.05 AHEAD OF ESTIMATES

EPS: \$1.43 VS. \$1.28

NET INTEREST INCOME GREW 4% DUE MAINLY TO HIGHER AVERAGE EARNING ASSETS

NONINTEREST INCOME WAS UP 4% (EXCLUDING SECURITY GAINS/LOSSES)

**NONINTEREST EXPENSE WAS
DOWN ON A LINKED QUARTER
BASIS**

TWELVE MONTHS HIGHLIGHTS:

EPS: \$5.53 vs. \$5.09

EARNINGS GREW 8%

FROM 12/31/18 TO 12/31/19:

ASSETS AND DEPOSITS GREW 2%

NET LOANS WERE UP 3%

EQUITY/ASSETS: 10.6%

**CITIZENS' ROAA AND
ROATCE WERE SUPERIOR TO
THE PEER GROUP MEDIAN...**

**...BUT CZFS SHARES TRADE AT
A LOWER PRICE TO TTM EPS
MULTIPLE THAN THE PEER
MEDIAN**

**THE SHARES HAVE A HIGHER
ONE-YEAR AND THREE-YEAR
TOTAL RETURN COMPARED TO
THE PEER MEDIAN AS WELL**

**ASSET QUALITY HAS BEEN
STABLE**

NPAS/ASSETS: 1.05%

RESERVES/LOANS: 1.24%

**EPS:
2018A: \$5.09
2019A: \$5.53
2020E: \$5.70**

merger-related expenses) declined about 1% to \$8,177,000 in 2019's fourth quarter versus \$8,235,000 in the year-ago quarter, and it was down about 1% on a linked quarter basis. Finally, the provision for loan losses totaled \$525,000 in 2019's fourth quarter, versus \$625,000 in the year-ago quarter.

For the twelve months ended December 31, 2019, Citizens reported net income of \$19,490,000, or \$5.53 per diluted share, which was up 8% from \$18,034,000, or \$5.09 per diluted share, in 2018. Net interest income grew 6%, while noninterest income, excluding gains/losses on equity and available for sale securities, also was up 6%. Noninterest expense, excluding merger-related costs, increased a modest 4% from 2018 to 2019. The provision for loan losses totaled \$1,675,000 for the year 2019, versus \$1,925,000 in 2018.

As was stated earlier, balance sheet growth was in the low single-digits from December 31, 2018 to December 31, 2019, with total assets and deposits up 2% and net loans increasing 3% over this period. Looking ahead, though, the balance sheet will benefit from the addition of MidCoast Community Bancorp, Inc., the acquisition of which is expected to close in 2019's second quarter. MidCoast, which has approximately \$266 million in assets, \$214 million in deposits and \$229 million in gross loans, is in an attractive market, and has grown its deposits and market share over the past several years. Citizens remains well capitalized, with shareholders' equity of \$155 million, or 10.6% of assets, at December 31, 2019.

CZFS Shares Are a Better Value Than Implied by its Higher Price to Tangible Book Value Ratio

Some investors may look at the multiple of tangible book value that CZFS shares trade at and conclude that the shares are too "expensive." One point we would make, however, is that from a valuation standpoint, comparisons are most relevant in the context of operating performance. Everything else the same, a better performing bank should trade at a premium to one that is less high performing. Looking at Citizens Financial, we see that the Company exceeds the performance of its peers in most categories. Its profitability metrics are significantly better, as measured by ROAA, ROATCE (return on average tangible common equity) and the efficiency ratio. And while its nonperforming asset ratio is higher than its peers, it is not so high that it is of any real concern. Despite the favorable profitability metrics, CZFS shares trade below the peer group on a multiple of earnings basis. And while the shares trade at a premium to the market based on the multiple of tangible book value, that premium seems quite reasonable given the much higher ROATCE. We would also note that CZFS shares have had a strong performance on a short and long-term basis, with a one-year total return of 16% versus 9% for the peer group median, and a three-year total return of 43% compared to 26% for the peer median.

	ROAA MRQ	ROATCE MRQ	Eff. Ratio MRQ	NPAs/ Assets	Price/ TTM EPS	Price/Tang. Book Value	Total Return One-Year	Total Return Three-Year
<i>CZFS</i>	1.37%	16.51%	55.0%	1.05%	11.2x	1.67x	16.1%	42.9%
<i>Peer Median</i>	1.06%	10.73%	66.2%	0.44%	13.5x	1.26x	9.4%	26.0%

NPAs Declined 8% from September 30, 2019

Nonperforming assets totaled \$15.4 million, or 1.05% of total assets, at December 31, 2019, down 8% from \$16.8 million, or 1.13% of assets, at September 30, 2019, and compared to \$14.4 million, or 1.01% of total assets, at the year-ago date. The allowance for loan losses was \$13,845,000, or 1.24% of total assets, at the end of 2019, versus \$12,884,000, or 1.19% of loans, at December 31, 2018.

Projections Maintained

Although earnings were better than expected, we are retaining our 2020 earnings projections at \$20.0 million, or \$5.70 per share. These projections exclude any impact from the addition of MidCoast's operation but they do include an assumption that there will be some additional merger-related charges.

ADDITIONAL INFORMATION UPON REQUEST

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