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

John A. Howard, CFA
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107 Windel Dr., Suite 211
Raleigh
North Carolina
27609

919-876-8868 ph

www.equityresearch.com

Price:	$54.00	**Diluted EPS**	**2018A:**	$ 5.09	**P/E**	**2018A:**	10.6x
52 Wk. Range:	$36.00 - $69.99	(FY: DEC)	**2019A:**	$5.53		**2019A:**	9.8x
Div/Div Yld: *	$1.80/3.3%		**2020E:**	$5.07		**2020E:**	10.7x
Shrs/Mkt Cap:	3.9 mm / $210 mm	**Book Value: ****		$44.78	**Price/Book Value: ****		1.21x

* Cash dividend is most recent regular quarterly dividend (annualized), does not include special dividends.
** Tangible book value is $37.77.

SYMBOL: CZFS

TOTAL ASSETS: $1.46 BB

HQ: MANSFIELD, PA

CONTACT:
GINA BOOR
(570) 662-2121

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") was founded in 1872, and as of March 31, 2020, the Company had total assets of approximately $1.46 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 MidCoast Community Bancorp, Inc. ("MidCoast") in April 2020. 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. It also has offices in Wilmington and Dover, DE. 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."

1ST QUARTER HIGHLIGHTS:

FIRST QUARTER RESULTS WERE GOOD DESPITE THE COVID-19 EPIDEMIC

WHILE COVID-19 POSES RISKS TO THE COMPANY, IT ENTERED THE CRISIS IN STRONG FINANCIAL CONDITION

THE COMPANY IS AGGRESSIVELY SERVING ITS CUSTOMER BASE AND IS ACTIVELY PROCESSING PPP APPLICATIONS

Pretax Earnings Excluding the Provision and Nonrecurring Items Increased 15%

Citizens Financial Services reported solid first quarter results, despite ongoing pressures from COVID-19. Earnings were up, notwithstanding an increase in security related losses and nonrecurring merger expenses associated with the acquisition of MidCoast Community Bancorp ("MidCoast"), which closed on April 17, 2020. Balance sheet growth was modest, as we had expected, but asset quality held up quite well. While the most tangible impact of COVID-19 can currently be seen in operations, the financial impact will increasingly be apparent as we progress through the year, similar to virtually all banks. The most important things to keep in mind, though, as we think about the COVID-19 impact, are that Citizens Financial entered the crisis with excellent earnings momentum, excellent asset quality and a strong capital position. Moreover, the Company has been highly proactive in supporting its customers through payment relief programs, the processing of Paycheck Protection Program ("PPP") applications (which it has strictly underwritten) and has also engaged in industry analysis to better manage its loan concentrations in certain high risk sectors. Bottom line, the Company is using this crisis to differentiate itself as a "partner" with its customers, which we believe will pay long-term benefits and which is in contrast to many of the megabanks (based on anecdotal evidence). While CZFS shares have contracted a good deal since the crisis, the Board is still optimistic longer term, and recently (wisely in our view) authorized the repurchase of up to $12 million of its common stock. The Board also increased its quarterly cash dividend and declared a $0.10 per share special dividend.

REPORTED EARNINGS GREW 3%, WHILE PRETAX INCOME BEFORE THE PROVISION AND NONRECURRING ITEMS WAS UP 15%

EPS: $1.29 VS. $1.25

NET INTEREST INCOME INCREASED 8%, REFLECTING A 22 BASIS POINT INCREASE IN THE NET INTEREST MARGIN

NONINTEREST INCOME EXCLUDING SECURITY GAINS/LOSSES GREW 4%

BALANCE SHEET GROWTH WAS MODEST BUT WILL BENEFIT FROM MIDCOAST ACQUISITION

EQUITY/ASSETS: 10.9%

In terms of actual results, net income was $4,531,000, or $1.29 per diluted share, in the first quarter of 2020, up 3% from $4,405,000, or $1.25 per diluted share, in the year-ago quarter. The earnings comparisons would have been stronger without: 1) equity losses of $254,000 in 2020's first quarter, versus gains of $11,000 in the first quarter of 2019, and 2) merger expenses of $376,000 in 2020's first quarter versus none in the year-ago quarter. (Pretax income before the provision for loan losses, security gains and losses and merger expenses totaled $6,450,000, up 15% from $5,615,000 in 2019's first quarter.) Earnings growth was led by net interest income, which grew 8% to $12,890,000 in 2020's first quarter from $11,915,000 in the year-ago quarter, due mainly to increased margins, which were up 22 basis points to 3.84% from 3.62% over this period. Noninterest income, excluding security gains and losses, totaled $2,105,000 in the first quarter of 2020, up 4% from $2,022,000 in the year-ago quarter. Excluding merger expenses, noninterest expense increased 3% to $8,545,000 in 2020's first quarter from $8,322,000 in the year-ago quarter. Finally, the provision for loan losses was unchanged at $400,000 in both periods. As can be seen from the adjacent table, Citizens' key performance measures were all better than its peer group medians. Balance sheet growth was modest, with loans essentially flat at $1.09 billion, assets up 1% to $1.46 billion and deposits increasing 2% to $1.21 billion. Balance sheet growth figures will obviously get a boost from the inclusion of MidCoast, the acquisition of which occurred just after quarter end. (MidCoast had assets of $266 million, deposits of $215 million and loans of $230 million at year-end 2019.) Citizens Financial's shareholders' equity was $160 million, or 10.9% of assets, at March 31, 2020.

PERFORMANCE VS. PA PEERS (%)

	CZFS	PA Peer Group Median
ROAA	1.24	0.99
ROATCE	13.65	9.57
Net Int. Mrgn.	3.84	3.47
Efficiency Ratio	55.4	68.4
Overhead Ratio	48.3	58.5
Total Return 3-YR	12.9	-12.2
Total Return 5-YR	31.3	13.5

THE COMPANY IS PARTICIPATING IN THE PPP, AND HAS APPROVED 555 LOANS TOTALING $53 MILLION

FEE INCOME OF APPROXIMATELY $2.2 MILLION SHOULD BE EARNED FROM THESE LOANS

COVID-19 and Citizens Financial's Responsiveness

As mentioned earlier, it is difficult to determine what the full impact of COVID-19 will be on Citizens Financial Services' results. However, as with the vast majority of banks, there will likely be pressure on earnings, higher delinquencies and an increase in charge-offs. Fortunately, Citizens was in good shape before the crisis began, and the Company is actively supporting its customers through this challenging time. To date, the Company has received approval from the SBA for 555 loans totaling $52.6 million under the Paycheck Protection Program ("PPP"), which is expected to generate fee income of approximately $2.2 million. It also created a payment relief program, which includes waivers of late fees for March and April, interest only payment options, deferral of principal payments for customers in certain industries and waiver of CD early withdrawal penalties through June 1, as well as other fee waivers.

NPAS WERE DOWN 6% FROM 12/31/19 AND 10% FROM 3/31/19

NPAS/ASSETS: 0.99%, DOWN FROM 1.11% AT 3/31/19

RESERVES/LOANS: 1.30%

NPAs Continue to Sequentially Decrease

Nonperforming assets continued to decline at March 31, 2020. NPAs were $14.5 million, or 0.99% of total assets, at March 31, 2020, down 6% from $15.4 million, or 1.05% of total assets, at December 31, 2019, and down 10% from $16.1 million, or 1.11% of assets, at the year-ago date. The majority of NPAs were nonaccrual loans ($11.3 million) followed by OREO ($3.1 million). The allowance for loan losses totaled $14.2 million, or 1.30% of total assets, at March 31, 2020, which was up 9% from $13.1 million, or 1.20% of loans, at the year-ago date.

EPS:
2018A: $5.09
2019A: $5.53
2020E: $5.07

Projections

Projections remain challenging to estimate accurately. However, we are tentatively projecting earnings in 2020 or of $19.2 million, or $5.07 per diluted share. As stated previously, actual earnings could vary substantially from these projections given the uncertainties of the COVID-19 crisis.

ADDITIONAL INFORMATION UPON REQUEST