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

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John A. Howard, CFA
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Price:	\$44.00	Diluted EPS 2019A:	\$ 5.53	P/E 2019A:	8.0x
52 Wk. Range:	\$36.00 - \$69.99	(FY: DEC) 2020E:	\$6.36	2020E:	6.9x
Div/Div Yld: *	\$1.84/4.2%	2021E:	\$6.80	2021E:	6.5x
Shrs/Mkt Cap:	3.9 mm / \$172 mm	Book Value: **	\$48.21	Price/Book Value: **	0.91x

* Cash dividend is most recent regular quarterly dividend (annualized), does not include special dividends.

** Tangible book value is \$39.82.

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 September 30, 2020, the Company had total assets of approximately \$1.9 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 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 three 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.”

EPS Surpassed Projections by \$0.63, Pretax “Normalized” Earnings Increased 44%

Third quarter of 2020 results were excellent, and were boosted by the inclusion of a full quarter of recently acquired MidCoast’s operations. Reflecting the acquisition, balance sheet growth was strong, and asset quality remained sound, with nonperforming assets decreasing from the year-ago level. Profitability ratios were also particularly impressive. Consistent with the strong results, the Board increased the Company’s cash dividend during the quarter. As discussed on the opposite page, Citizens Financial has more than tripled its dividend over the past 20 years, and the record of increases has been quite consistent. Finally, we would note that the Company continues to expand organically as well. The Company recently received regulatory approval to open a full service branch in Kennett Square, PA in 2020’s fourth quarter, which will further serve customers acquired from the MidCoast acquisition.

In terms of specific results, net income was \$8,007,000, or \$2.04 per diluted share, for the third quarter of 2020, up 54% from \$5,196,000, or \$1.46 per diluted share, in the year-ago quarter. There was a bit of “noise” in both the year-ago and current quarter, in that there were merger expenses of \$275,000 and security losses of \$37,000 in 2019’s third quarter, and there was a payoff of a purchase impaired loan of \$220,000, security gains of \$152,000, derivative-related income of \$531,000 in 2020’s third quarter. Excluding these nonrecurring items, pretax income before the provision increased 36% from

SYMBOL: CZFS

TOTAL ASSETS: \$1.9 BB

HQ: MANSFIELD, PA

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3RD QUARTER HIGHLIGHTS:

**EARNINGS BENEFITED FROM
THE ACQUISITION OF
MIDCOAST**

EPS: \$2.04 VS. \$1.46

**NET INCOME WAS UP 54%,
WHILE PRETAX INCOME
BEFORE THE PROVISION AND
NONRECURRING ITEMS GREW
36%**

**THE DIVIDEND WAS INCREASED
AND A NEW BRANCH OFFICE
WILL OPEN IN 2020’S FOURTH
QUARTER**

NET INTEREST INCOME WAS UP 28% DUE TO IMPROVED MARGINS AND 25% GROWTH IN AVERAGE EARNING ASSETS

NONINTEREST INCOME, EXCLUDING SECURITY GAINS AND DERIVATIVE INCOME GREW 33%

the year-ago quarter. Net interest income grew 28% to \$16,470,000 in the third quarter of 2020 from \$12,899,000 in the year-ago quarter, due to margin improvement (to 3.88% from 3.82%) and 25% growth in average earning assets (mainly acquisition based). Noninterest income (excluding security gains and losses and derivative income) was up 33% to \$2,855,000 in 2020's third quarter from \$2,140,000 in the year-ago quarter, though we would note that most of that strength came from gains on the sale of loan (\$855,000 versus \$176,000), which we expect to moderate going forward. Noninterest expense (excluding merger expenses) increased 19%, reflecting the additional costs of salaries and benefits and occupancy expenses related to the acquisition. Finally, the provision for loan losses was \$550,000 in 2020's third quarter, as compared to \$400,000 in the year-ago quarter.

Quarterly Results (\$000s)	2019		2020		
	Q3	Q4	Q1	Q2	Q3
Net Income	5,196	5,043	4,531	5,338	8,007
Pretax Income	6,262	6,046	5,420	6,392	9,766
Eliminate:					
Provision	400	525	400	550	550
Payoff - Purch. Credit Imp. Loan	-	-	-	(600)	(220)
Merger/Nonrecurring expenses	275	191	376	1,803	-
Derivative Income	-	-	-	(79)	(531)
Security Gains/Losses	(37)	(66)	254	(128)	(152)
Adjusted Pretax Earnings	6,900	6,696	6,450	7,938	9,414

YTD 2020 HIGHLIGHTS:

NET INCOME WAS UP 24%

EPS: \$4.74 VS. \$4.05

EQUITY/ASSETS: 10.2%

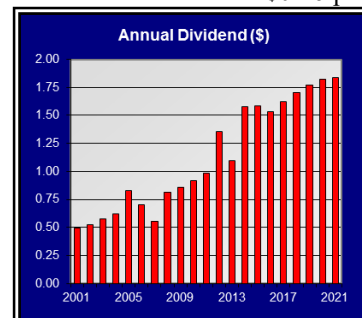
Year-to-date results likewise benefited from the MidCoast acquisition. Net income totaled \$17,876,000, or \$4.74 per diluted share, for the first nine months of 2020, up 24% from \$14,447,000, or \$4.05 per diluted share, in the year-ago period. Net interest income increased 23%, noninterest income (excluding security gains/losses and derivative income) grew 11% and noninterest expense (excluding merger expenses) was up 13% from the first nine months of 2019. Balance sheet growth benefitted from the addition of PPP loans as well as the acquisition. From September 30, 2019 to September 30, 2020, net loans grew 23%, deposits were up 29% and total assets grew 26%. Shareholders' equity was \$189 million, or 10.2% of total assets, at September 30, 2020.

QUARTERLY DIVIDEND WAS INCREASED TO \$0.46, UP 3% FROM A YEAR AGO

THE DIVIDEND HAS INCREASED 7% ON AN ANNUALIZED BASIS OVER THE PAST 20 YEARS

Dividend Increased, and it Has Grown at an Annualized Rate of 7% Over Past 20 Years

On September 1, 2020, Citizen's Financial's Board of Directors declared a cash dividend of \$0.46 per share, paid on September 25, 2020 to shareholders of record as of September 11, 2020. The quarterly dividend is 3% higher than the dividend of \$0.445 a year ago and is adjusted for the 1% stock dividend declared in June 2020. On an annualized basis, the dividend is \$1.82 per share for 2020 and (if it remains at \$0.46) \$1.84 per share for 2021. The Company has increased its dividend at an annualized rate of 7% over the past 20 years. The Company also had a higher dividend yield of 4.2% versus 3.5% for the peer group median. Citizen Financial also has an excellent ROAA and ROAE. Its quarterly ROAE, at 17.4%, was the highest of its peers.



CITIZENS' ROAA AND ROAE WERE BETTER THAN THE MAJORITY OF PA PEERS, AND CZFS SHARES TRADE AT A DISCOUNT TO PEERS ON A P/E LTM BASIS

NPAs Decreased 7% from the Year-Ago Date

At September 30, 2020, nonperforming assets totaled \$15.6 million, or 0.84% of total assets, compared to \$14.2 million, or 0.79% of total assets, at June 30, 2020, and down 7% from \$16.8 million, or 1.14% of total assets, at the year-ago date. The allowance for loan losses was \$15.2 million, or 1.11% of total assets, at September 30, 2020, versus \$13.7 million, or 1.23% of loans, at the year-ago date. The Bank currently has 12 loans (\$20 million) with COVID-related loan modifications, down from the total of 509 loans totaling \$196 million.

NPAS/ASSETS: 0.84%

RESERVES/LOANS: 1.11%

2021 Projections Announced

Projections remain challenging to estimate accurately. We are tentatively projecting 2020 earnings of \$24.3 million, or \$6.36 per diluted share, and estimating earnings of \$26.7 million, or \$6.80 per diluted share, for 2021. Fee income from PPP loans should begin in the fourth quarter and could lead to wide swings in income. Earnings could also vary substantially from these projections given the uncertainties of the COVID-19 crisis.

EPS:
2019A: \$5.53
2020E: \$6.36
2021E: \$6.80

ADDITIONAL INFORMATION UPON REQUEST

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