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

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John A. Howard, CFA
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Price:	\$69.00	Diluted EPS 2020A:	\$ 6.59	P/E 2020A:	10.5x
52 Wk. Range:	\$59.00 - \$70.00	(FY: DEC) 2021A:	\$7.38	2021A:	9.3x
Div/Div Yld: *	\$1.90 / 2.8%	2022E:	\$6.80	2022E:	10.1x
Shrs/Mkt Cap:	4.4 mm / \$303 mm	Book Value: **	\$51.40	Price/Book Value: **	1.34x

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

** Tangible book value is \$43.05.

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, 2022, the Company had total assets of approximately \$2.2 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, Chester 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.

First Quarter Results Impacted by Nonrecurring Factors

Relative to the year-ago quarter, Citizens Financial reported first quarter results that were actually a bit better than implied by the bottom-line comparisons. Reported net income was \$6.7 million, or \$1.71 per diluted share, for the first quarter of 2022, compared to \$8.5 million, or \$2.14 per diluted share, in the first quarter of 2021. However, there was a good deal of “noise” in the figures that tended to distort recurring earnings comparisons, such as: 1) widely varying loan loss provisions; 2) life insurance proceeds of roughly \$1.2 million in the year-ago quarter; 3) derivative income and net security gains of \$226,000 and \$237,000, respectively, in the year-ago quarter, versus security losses of \$45,000 in 2022’s first quarter; 4) widely varying ORE expenses and 5) a large drop in 2022’s first quarter PPP fee recognition. If we exclude all of these volatile items, we see that the adjusted pretax earnings were only down about 4%, which we considered fairly good given the slowdown (experienced nationally) in the mortgage area. Moreover, there were a number of positives in the quarter, such as solid balance sheet growth, good asset quality, an announcement that the Company was applying to join the Nasdaq Capital Market and finally, a boost in the dividend. All in all, it was a good quarter.

SYMBOL: CZFS

TOTAL ASSETS: \$2.2 BB

HQ: MANSFIELD, PA

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1ST QUARTER HIGHLIGHTS:

THERE WERE LIFE INSURANCE PROCEEDS OF \$1.2 MILLION IN THE YEAR-AGO QUARTER

THERE WERE ALSO SUBSTANTIAL GAINS ON SECURITIES AND DERIVATIVE INCOME IN THE YEAR-AGO QUARTER

EPS: \$1.71 VS. \$2.14

AVERAGE EARNING ASSET GROWTH OF 13% PARTLY OFFSET A 46 BASIS POINT DECREASE IN MARGINS

Quarterly Results (\$000s)	2021	2022
	Q1	Q2
Net Income	8,463	6,740
Pretax Income	10,079	8,212
Eliminate:		
Provision	650	250
Life Insurance Proceeds	(1,155)	-
Derivative Income	(226)	-
ORE Expenses	86	(367)
Security Gains/Losses (Net)	(237)	45
Accretion of PPP Fees	(896)	(162)
Adjusted Pretax Earnings	8,301	7,978

NET INTEREST INCOME WAS DOWN 1% BUT IT WOULD HAVE INCREASED EXCLUDING PPP FEE RECOGNITION

NONINTEREST INCOME DECLINED DUE TO LIFE INSURANCE PROCEEDS IN THE YEAR-AGO QUARTER, LOWER DERIVATIVE INCOME AND A DROP IN MORTGAGE INCOME

NONINTEREST EXPENSE INCREASED A MODEST 3%

FROM MARCH 31, 2021 TO MARCH 31, 2022: NET LOANS INCREASED 5%, DEPOSITS GREW 11% AND TOTAL ASSETS WERE UP 9%

UPON JOINING THE NASDAQ CAPITAL MARKET, CZFS WILL BENEFIT FROM BETTER ACCESS TO CAPITAL AND TRADING VOLUME SHOULD INCREASE

CASH DIVIDEND INCREASED 3% TO \$0.475 PER SHARE, OR \$1.90 ANNUALIZED

CZFS SHARES HAVE EXCELLENT TOTAL RETURNS THAT ARE BETTER THAN THE MAJORITY OF ITS PA PEERS

NPAs/ASSETS: 0.41% vs. 0.62% AT THE YEAR-AGO DATE

RESERVES/LOANS: 1.19%

**EPS:
2020A: \$6.59
2021A: \$7.38
2022E: \$6.80**

Net interest income remained flat (down 1%) compared to the year-ago quarter, with 13% growth in average earning assets partially offsetting a 46-basis point contraction in margins, although if we exclude PPP fee recognition, net interest income would have increased about 4%. Core noninterest income (excluding the life insurance proceeds, derivative income and security gains) was down about 5% to \$2.5 million in 2022's first quarter, versus \$2.6 million in the year-ago quarter. That decline was solely due to the aforementioned slowdown in the mortgage area, where gains on the sale of loans dropped roughly \$400,000. We expect comparisons in the mortgage area to remain soft for at least the next quarter or two. A couple of noninterest income components did have solid growth from the year-ago quarter, however, such as deposit service charges (+13%) and brokerage and insurance income (+28%). Cost containment was also evident in the quarter, with noninterest expense up a modest 3% to \$10.2 million in 2022's first quarter, versus \$9.9 million in the year-ago quarter. Profitability ratios in 2022's first quarter remained quite impressive: ROAA was 1.26%, while ROAE was 12.46% and ROATE (return on tangible equity) was 14.70%.

Deposits led balance sheet growth over the past year, up 11% from March 31, 2021 to March 31, 2022, while net loans were up 5% and total assets grew 9%. We would note that if PPP loans are excluded, loans increased 7% over this period. We were also pleased to see ongoing strength in commercial real estate loans, which accounted for 49% of total loans and grew 20% over the past year. Finally, we would note that Citizens Financial remained well capitalized, with shareholders' equity of \$203 million, or 9.31% of assets, at March 31, 2022.

Citizens Financial Services, Inc. Submits Application for Inclusion on Nasdaq Capital Market

During the first quarter of 2022, Citizens announced it had applied to join the Nasdaq Capital Market. The stock, which already has strong performance, should benefit from its inclusion on this market as it should improve liquidity, provide better access to capital and ultimately boost visibility. In terms of stock performance, CZFS shares are up 13% since our 2021 fourth quarter report and they have outperformed the majority of its PA peers on a short and long-term basis (as can be seen from the table to the right). Citizen's shareholders also were rewarded with an increase in the cash dividend during 2022's first quarter. On March 1, 2022, the Board of Directors declared a cash dividend of \$0.475 per share, which was paid on March 25, 2022 to shareholders of record at the close of business on March 11, 2022. This quarterly cash dividend is an increase of 3.3% over the regular cash dividend of \$0.460 per share declared one year ago, as adjusted for the 1% stock dividend declared in June 2021 and represents an annual dividend of \$1.90.

	TOTAL RETURN VS. PA PEER GROUP (%)	
	CZFS	PA Peer Group Median
YTD	14.6	0.1
One-Year	17.8	7.3
Three-Year	28.6	14.9

Nonperforming Assets Decreased 30%, While Reserves Grew 6%

Asset quality improved significantly from the year-ago date and was comparable to the end of 2021. Specifically, NPAs totaled \$9.0 million, or 0.41% of total assets, at March 31, 2022, versus \$8.8 million, or 0.41% of total assets, at December 31, 2021, and \$12.9 million, or 0.62% of total assets, at the year-ago date. Reserve coverage improved, with the allowance for loan losses increasing 6% to \$17.6 million, or 1.19% of total loans, as of March 31, 2022, from \$16.7 million, or 1.18% of total loans, at the year-ago date.

Projections

For the year 2022, we are projecting Citizens Financial will earn \$26.8 million, or \$6.80 per diluted share. The drop in earnings compared to 2021 is expected due to the absence of fee accretion on PPP-related loans and the presence of \$1.2 million in life insurance proceeds paid in the first quarter of 2021.

ADDITIONAL INFORMATION UPON REQUEST

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