EQUITY
RESEARCH
SERVICES

5003 Falls of Neuse Road

Raleigh
North Carolina
27609

919-876-8868 ph

www.equityresearch.com

AVAILABLE ON THE WEB AT www.equityresearch.com

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

John A. Howard, CFA
October 25, 2017

Price:	$61.00	**Diluted EPS**	**2016A:**	$ 3.60	**P/E**	**2016A:**	16.9x
52 Wk. Range:	$47.00 - $65.00	(FY: DEC)	**2017E:**	$4.00		**2017E:**	15.3x
Div/Div Yld: *	$1.72/2.8%		**2018E:**	$4.20		**2018E:**	14.5x
Shrs/Mkt Cap:	3.5 mm / $213 mm	**Book Value: ****		$37.20	**Price/Book Value: ****		1.64x

* Cash dividend is most recent regular quarterly dividend (annualized).
** Tangible book value is $30.62; price to tangible book value is 1.99x.

SYMBOL: CZFS

TOTAL ASSETS: $1.3 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") has been operating since 1932, and as of September 30, 2017, the Company had total assets of approximately $1.3 billion. In December 2015, the Company completed the acquisition and conversion of The First National Bank of Fredericksburg ("FNB"), a bank with roughly $230 million in assets that is based in the attractive and growing Lebanon Valley region of Pennsylvania. Including the locations of FNB, the Company has offices in Tioga, Bradford, Potter, Clinton, Union, Lebanon, Berks, Schuylkill and Lancaster counties in Pennsylvania and one location in New York State with an office in Wellsville (Allegany County). The region has a fairly diverse economic base, and has benefited from the Marcellus Shale, a section of sedimentary rock that extends 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 and commercial services. Electronic services offered include mobile banking, ATMs, direct deposit, internet banking, OverDraft Protection, remote deposit, lockbox, on-line mortgage application 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."

3RD QUARTER HIGHLIGHTS:

EARNINGS INCREASED 16%

EPS: $1.05 VS. $0.90

THE COMPANY ANNOUNCED PLANS TO ACQUIRE A BRANCH IN A NEW MARKET AND THE BOARD INCREASED THE CASH DIVIDEND

NET INTEREST INCOME WAS UP 9%

Third Quarter Results Were Excellent

Citizens Financial Services reported another outstanding quarter in the period ended September 30, 2017. Earnings were strong and exceeded our estimates. Balance sheet and loan growth were quite commendable as well, the latter benefitting from the ongoing initiatives in agricultural lending. On the asset quality side, nonperforming assets were up from the year-ago level but were essentially unchanged from June 30, 2017. Other notable events in the quarter included the Company's announcement that it was purchasing the S&T Bank branch in State College, PA, as well as the Board's decision to boost the quarterly cash dividend. Finally, we would note that the stock has continued to advance, and is up 16% since our last report dated July 25, 2017.

Net income in the third quarter of 2017 was $3,650,000, or $1.05 per diluted share, versus $3,153,000, or $0.90 per diluted share, in the year-ago quarter. As has been the case in the past several quarters, the primary earnings driver was the strong increase in net interest income, which grew 9% to $10,117,000 in 2017's third quarter, up from $9,712,000 in the year-ago quarter, with that improvement mainly coming from higher average earning assets growth. As we have discussed in previous reports, Citizens Financial's commitment to agricultural lending has led to a surge in loans,

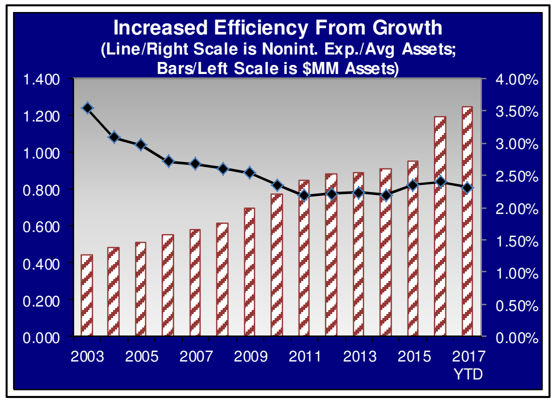
NONINTEREST INCOME AND NONINTEREST EXPENSE WERE ESSENTIALLY UNCHANGED FROM THE YEAR-AGO LEVELS

contributing to both an increase in total average earning assets but also a higher percentage of loans *within* its earning assets mix, which has benefitted margins. (For example, loans represented 60% of average earning assets at the end of 2012, with investments accounting for 39%. By the third quarter of 2017, the percentage of loans had increased to 76% and investments had dropped to 22%, reflecting a much more profitable mix.) But getting back to the quarterly results, noninterest income was essentially unchanged, as was noninterest expense, which brings us to an interesting point. Citizens Financial has a long history of improving its efficiency. One of the ways it has done that is by keeping expense growth below its rate of asset growth. Visually, its progress can be seen in a declining ratio of noninterest expense to average assets ("NIE/AA") over time, as reflected in the line in the adjacent chart. This improvement in NIE/AA has been most apparent in periods of rapid asset growth, such as the years from 2003 to 2011. The trend in NIE/AA flattened out after 2011, partly reflecting the moderation in asset growth, and the NIE/AA ratio actually increased slightly in 2015/2016 from the addition FNB in late 2015. Importantly, though, we expect there to be further improvement in NIE/AA given the Company's recent surge in loan and asset growth and the ongoing cost control efforts. In fact, this has already been occurring: In the third quarter of 2017, annualized NIE/AA was 2.29%, versus 2.42% in the year-ago quarter. Both figures compare quite favorably to comparable Pennsylvania banks.

CITIZENS FINANCIAL'S ABILITY TO GROW ASSETS FASTER THAN EXPENSES HAS BEEN A LARGE PART OF ITS IMPROVEMENT IN EFFICIENCY

WE BELIEVE FURTHER STRIDES IN EFFICIENCY WILL COME AS ASSET GROWTH CONTINUES TO BENEFIT FROM ACQUISITIONS AND FROM NEW AREAS OF LENDING

ANNUALIZED NONINTEREST EXPENSE/ASSETS WAS ONLY 2.29% IN THE THIRD QUARTER OF 2017



FIRST NINE MONTH HIGHLIGHTS:

EPS: $2.99 VS. $2.69

EARNINGS INCREASED DESPITE A LARGE INCREASE IN THE PROVISION

For the first nine months of 2017, earnings were $10,421,000, or $2.99 per diluted share, versus $9,467,000, or $2.69 per diluted share, in the year-ago period. Net interest income was up 10%, while noninterest income and noninterest expense were essentially unchanged, as they were in the quarter. The higher earnings occurred despite an increase in the provision for loan losses to $1,740,000 in 2017's first nine months, versus $770,000 in the year-ago period.

Other Notable Aspects of the Quarter Included a Branch Purchase and a Dividend Increase

LOAN GROWTH WAS 21% OVER THE PAST YEAR

STATE COLLEGE BRANCH IS BEING ACQUIRED

CASH DIVIDEND WAS INCREASED

Balance sheet growth has remained solid at Citizens Financial, particularly in terms of loans. Over the past year, assets grew 6%, while deposits were up 4% and gross loans increased 21%. Future balance sheet growth will be augmented by the addition of the S&T Bank branch located in State College, PA, which Citizens Financial recently announced it is acquiring. The branch had $38 million in deposits at June 30, 2017, and the selling bank is exiting the market. The transaction is expected to close in 2017's fourth quarter. Also noteworthy was a recent increase in the quarterly cash dividend to $0.43 per share from $0.40 per share. We will elaborate on Citizens Financial's record of dividend increases in one of our next reports.

Asset Quality Was Essentially Unchanged From the Linked Quarter

NPAS/ASSETS: 1.07%

RESERVES/LOANS: 1.15%

Nonperforming assets were $13.6 million, or 1.07% of assets, at September 30, 2017, versus $13.5 million, or 1.07% of assets, at June 30, 2017, and $11.8 million, or 0.98% of assets, at September 30, 2016. The allowance for loan losses grew to $10.4 million, or 1.15% of loans, at September 30, 2017, as compared to $8.2 million, or 1.09% of loans, at September 30, 2016.

Projections Increased

EPS:
2016A: $3.60
2017E $4.00
2018E: $4.20

We are increasing our 2017 earnings estimate to $13.9 million, or $4.00 per diluted share, and are projecting 2018 earnings at $14.6 million, or $4.20 per diluted share. These projections could change significantly based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST