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

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<b>Price:</b>	\$62.25	<b>Diluted EPS</b>	<b>2016A:</b>	\$ 3.60	<b>P/E</b>	<b>2016A:</b>	17.3x
<b>52 Wk. Range:</b>	\$58.91 - \$66.50	(FY: DEC)	<b>2017A: *</b>	\$4.18		<b>2017A:</b>	14.9x
<b>Div/Div Yld: *</b>	\$1.76/2.8%		<b>2018E:</b>	\$5.15		<b>2018E:</b>	12.1x
<b>Shrs/Mkt Cap:</b>	3.5 mm / \$218 mm	<b>Book Value: **</b>		\$38.30	<b>Price/Book Value: **</b>		1.63x

\* Cash dividend is most recent regular quarterly dividend (annualized). 2017 EPS excludes \$0.44 per share deferred tax asset charge.

\*\* Tangible book value is \$31.18.

### 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, 2018, the Company had total assets of approximately \$1.4 billion. The Company has completed various acquisitions, such as the acquisition of The First National Bank of Fredericksburg (“FNB”), a bank with roughly \$230 million in assets, in 2015, and more recently, the S&T Bank branch located in State College, PA in December of 2018. The Company currently has offices in Tioga, Bradford, Potter, Clinton, Union, Lebanon, Berks, Schuylkill, Lancaster and Centre 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, 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. 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, cash management 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.”

### Third Quarter Earnings Were Up 26%; ROAE Exceeded 13%

Citizens Financial Services reported another excellent quarter in the three months ended September 30, 2018. Earnings were up 26% and were above our expectations. The earnings strength was led by notable growth in net interest income, although noninterest income was up as well. Moreover, profitability levels, such as ROAE, were much higher than in the year-ago quarter, not only due to lower tax rates but also due to improving non-tax fundamentals. Balance sheet growth was excellent as well, with solid increases in deposits, loans and equity. And finally, asset quality remained sound. While the level of nonperforming assets rose in the quarter, much of that increase was due to a couple of isolated credits.

In terms of specific results, net income in the third quarter of 2018 was \$4,581,000, or \$1.31 per diluted share, versus \$3,650,000, or \$1.04 per diluted share, in the year-ago quarter. Fueling the earnings growth was strong net interest income, which increased 11% to \$11,770,000 in 2018’s third quarter from \$10,617,000 in the year-ago quarter. The net interest margin shrank modestly, and was 3.64% in 2018’s third quarter, versus 3.70% in the linked second quarter of 2018 and 3.79% in 2017’s third quarter, although strong average earning assets growth more than offset this moderation. Also

**SYMBOL: CZFS**

**TOTAL ASSETS: \$1.4 BB**

**HQ: MANSFIELD, PA**

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**3<sup>RD</sup> QUARTER HIGHLIGHTS:**

**EARNINGS GREW 26% AND  
WERE ABOVE OUR PROJECTION**

**EPS: \$1.31 VS. \$1.04**

**MARGINS WERE SLIGHTLY  
LOWER, THOUGH AVERAGE  
EARNINGS ASSET GROWTH WAS  
STRONG AND OFFSET THIS  
MODERATION**

**ROAE EXCEEDED 13% IN THE QUARTER**

benefitting earnings was a modest decline in the provision for loan losses to \$475,000 in the third quarter of 2018 from \$500,000 in the year-ago period. Core noninterest income was up 6%, while noninterest expense was up 7% in 2018's third quarter relative to the year-ago quarter. Key profitability metrics were also excellent, with ROAE reaching more than 13% and the efficiency ratio at around 53%, both of which are among the best ratios for the Bank's peers.

**NINE MONTHS HIGHLIGHTS:**

**EPS: \$3.85 vs. \$2.96**

**BALANCE SHEET GROWTH WAS STRONG AS WELL**

For the first nine months of 2018, earnings increased to \$13,519,000, or \$3.85 per diluted share, versus \$10,421,000, or \$2.96 per diluted share, in the year-ago period. Net interest income was up 13%, while core noninterest income was up 2%. Noninterest expense increased 8%. The provision for loan losses declined to \$1,300,000 in the first nine months of 2018, versus \$1,740,000 in the year-ago period. While we expect balance sheet growth to moderate a bit going forward, recent trends remained strong. From September 30, 2017 to September 30, 2018, gross loans increased 17%, while assets were up 11% and deposits grew 12%. Stockholders' equity at September 30, 2018 was \$134 million, or 9.5% of assets.

### **First Citizens Community Bank Was Picked as One of the Best Banks in Pennsylvania**

As we alluded to briefly in our last report (dated July 27, 2018), First Citizens Community Bank was recently selected as one of the best banks in Pennsylvania by *Forbes* magazine. That distinction was based on an extensive study that Forbes developed with market research firm Statistica, whereby they surveyed 25,000 customers about their overall satisfaction levels, with particular emphasis on issues such as: trust; terms and conditions; branch services; digital services, and financial advice. Only 124 banks in the Nation were singled out, which represents less than 2% of all banks.

**FIRST CITIZENS WAS SELECTED AS ONE OF THE BEST BANKS IN PENNSYLVANIA BASED ON AN EXTENSIVE INDEPENDENT SURVEY**

### **Long-Term Trends in Deposit Market Share Remain Impressive**

Citizens Financial has had a consistent record of building deposits in each of its top markets. The long-term market share trends have also been positive. For example, in Bradford County, PA, deposits increased from \$338 million in 2014 to \$355 million in 2018, while in Tioga County, they grew from \$316 million to \$341 million over the same period. In Lebanon County, which the Company entered in 2016 through the acquisition of FNB, deposits grew from \$137 million in 2016 to \$163 million in 2018. Market shares for the respective start dates through 2018 increased (albeit modestly in Tioga's case) in each of these markets as well. A growing market share is often a measure of a bank's franchise value in a particular market, and higher deposits clearly have positive implications for fee income and the ability to affordably fund loans.

**LONG-TERM TRENDS IN DEPOSIT GROWTH ARE POSITIVE IN THE BANK'S TOP MARKETS**

**THE TRENDS IN DEPOSIT MARKET SHARE ARE LIKEWISE FAVORABLE**

**AN INCREASING DEPOSIT MARKET SHARE OFTEN REFLECTS A GROWING FRANCHISE VALUE IN THAT MARKET**

#### **DEPOSIT/DEPOSIT MARKET SHARE, BY TOP THREE COUNTIES \***

Deposits (\$MM)	6/30/14	6/30/15	6/30/16	6/30/17	6/30/18
Bradford	338	342	342	343	355
Tioga	316	327	329	343	341
Lebanon	-	-	137	155	163
Deposit Share (%)	6/30/14	6/30/15	6/30/16	6/30/17	6/30/18
Bradford	29.75	30.57	30.97	31.05	31.07
Tioga	44.50	44.08	44.83	45.14	44.86
Lebanon	-	-	6.43	7.05	7.27

### **Asset Quality Remains Good**

Nonperforming assets were \$15.5 million, or 1.10% of assets, at September 30, 2018, versus \$12.4 million, or 0.89% of assets, as of June 30, 2018 and \$13.6 million, or 1.07% of assets, at September 30, 2017. The recent increase in NPAs is largely the result of a couple of loans that moved to nonaccrual status. The allowance for loan losses grew to \$12.4 million, or 1.17% of loans, at September 30, 2018, as compared to \$10.4 million, or 1.15% of loans, at September 30, 2017.

**NPAs/ASSETS: 1.10%**

**RESERVES/LOANS: 1.17%**

### **Projections Maintained**

Although earnings were above our expectations, we are holding constant our earnings projection at \$17.9 million, or \$5.15 per diluted share. We will introduce our 2019 estimate in our next report. These projections could change significantly based on changing economic conditions.

**EPS:  
2016A: \$3.60  
2017A \$4.18 (EXCLUDING DEFERRED TAX ASSET CHARGE)  
2018E: \$5.15**

#### **ADDITIONAL INFORMATION UPON REQUEST**

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