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

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Price:	$63.00	**Diluted EPS**	**2016A:**	$ 3.60	**P/E**	**2016A:**	17.5x
52 Wk. Range:	$48.57 - $65.00	(FY: DEC)	**2017A:** *	$4.18		**2017A:**	15.1x
Div/Div Yld: *	$1.72/2.7%		**2018E:**	$4.45		**2018E:**	14.2x
Shrs/Mkt Cap:	3.5 mm / $220 mm	**Book Value: ****		$37.00	**Price/Book Value: ****		1.70x

* Cash dividend is most recent regular quarterly dividend (annualized). 2017 EPS excludes $0.44 per share deferred tax asset charge.
** Tangible book value is $29.76; price to tangible book value is 2.12x.

SYMBOL: CZFS

TOTAL ASSETS: $1.4 BB

HQ: MANSFIELD, PA

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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 December 31, 2017, 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 2017. 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."

4TH QUARTER HIGHLIGHTS:

EARNINGS WERE AFFECTED BY A DEFERRED TAX ASSET CHARGE OF $0.44 PER SHARE

EPS: $1.19 (EXCLUDING THE DEFERRED TAX ASSET CHARGE) VS. $0.90

NET INTEREST INCOME WAS UP 14%

Fourth Quarter Results Were Strong; Earnings Affected by Deferred Tax Asset Charge

Citizens Financial Services maintained its strong momentum as it completed 2017, finishing the year with solid core earnings, improved asset quality and impressive balance sheet growth. We would note that there was a nonrecurring deferred tax asset charge in the fourth quarter – something most of the banks we follow are similarly recording in the fourth quarter – that relates to the new tax law's reduction in corporate tax rates to 21% from 34%. This charge led to reported quarterly earnings actually dropping from the year-ago level, even though operating earnings (i.e., excluding the charge) were up strongly. Based on the strength of the results, we are increasing our earnings estimate for 2018, as is discussed later in this report.

Reported net income in the fourth quarter of 2017 was $2,604,000, or $0.75 per diluted share, versus $3,171,000, or $0.91 per diluted share, in the year-ago quarter. The deferred tax asset charge resulted in a one-time increase in income tax expense of $1,531,000, or $0.44 per share, meaning that the normalized earnings in 2017's fourth quarter was actually $4,135,000, or $1.19 per diluted share, well above the year-ago figure and our projections. The majority of the strength in earnings came from net interest income, which surged 14% to $11,236,000 in 2017's fourth quarter from $9,876,000 in the year-ago quarter. Accelerating loan production, most of which has been in the previously discussed agricultural lending area, has boosted both margins and earning assets. Partly as a result, margins grew to 3.88% in 2017's fourth quarter, versus 3.75% in the year-ago quarter, while average earning assets increased 8%. Core noninterest income (excluding security gains in both quarters) was essentially unchanged at $2.0 million, while noninterest expense increased 6%. Finally, the provision for loan losses grew to $800,000 in 2017's fourth quarter from $750,000 in the year-ago quarter.

STRONG LOAN GROWTH HAS BEEN BENEFITTING MARGINS AND AVERAGE EARNING ASSETS GROWTH

FULL YEAR HIGHLIGHTS:

EPS: $4.18 (EXCLUDING DEFERRED TAX ASSET CHARGE) VS. $3.60

BALANCE SHEET GROWTH WAS IMPRESSIVE

For the full year, reported earnings were $13,025,000, or $3.74 per diluted share, versus $12,638,000, or $3.60 per diluted share, in 2016. (Earnings in 2017 before the deferred tax asset charge were $14,556,000, or $4.18 per diluted share.) Net interest income was up 11%, while core noninterest income was essentially unchanged, much as it was in the quarter. Noninterest expense was up a modest 2%. From a balance sheet standpoint, loans continued to benefit from the agricultural lending program, leading to impressive overall loan growth of 25% over the past year. In addition to the agricultural loan strength, commercial loan growth was also quite robust at 22%. Deposits were strong as well, growing 10%, while assets were up 11%. The capital position remains strong as well, with the Company's year-end tangible equity to tangible assets ratio at 7.8%, versus 8.3% at the year-ago date.

Citizens Financial Outperforms Most Pennsylvania Banks

CITIZENS FINANCIAL HAS HIGHER RETURNS THAN ITS PEER GROUP

IT ALSO HAS A MUCH BETTER EFFICIENCY RATIO

ALTHOUGH ITS MULTIPLE OF EARNINGS IS COMPARABLE, THE MULTIPLE OF TANGIBLE BOOK VALUE IS HIGHER

THE COMPANY'S RETURN ON THE MARKET VALUE OF EQUITY IS ACTUALLY SLIGHTLY BETTER THAN THE PEERS

Citizens Financial compares quite favorably to its peers, which includes Pennsylvania banks with $500 million to $5 billion in assets. The Company has much higher than typical profitability ratios. Much of this performance is due to high margins (not shown) and a low cost structure, as evidenced by the superior (lower) efficiency ratio. The one area of the table that shows Citizens Financial lagging the group is in asset quality, although with an NPA-to-assets ratio of only 1.02%, Citizens Financial's asset quality remains quite respectable. The stock trades in line with the group in terms of earnings multiples, but is higher based on the multiple of tangible book value. However, when comparing price to tangible book value ratios among various banks, it is often instructive to make the comparisons in the context of the *returns* on that equity. Simply put, a bank that earns a higher return on equity should typically trade at a higher multiple of that equity. One way to normalize for these differences is to divide the ROAE (however equity is defined) by the price multiple of that same equity. That effectively produces a return on the market value of equity, which can be a better barometer for relative value than looking at the multiple of book value in isolation. In this case, Citizens Financial actually has a higher return on the market value of equity (essentially an earnings yield) than its peers.

	ROAA * TTM	ROATCE * TTM	Eff. Ratio TTM	NPAs/ Assets	Price/ TTM EPS *	Price/Tang. Book Value	Return on Market Val. Of Comm. Equity
Citizens Finl	1.15%	13.8%	54.1%	1.02%	15.1x	2.12x	6.49%
Peer Median	0.90%	10.3%	64.7%	0.52%	16.8x	1.55x	6.11%

* *Exclude deferred tax asset charges*

Asset Quality Continues to Improve

NPAS/ASSETS: 0.87%

RESERVES/LOANS: 1.12%

Nonperforming assets were $11.8 million, or 0.87% of assets, at December 31, 2017, down from $13.6 million, or 1.07% of assets, at September 30, 2017 and $12.9 million, or 1.05% of assets, at December 31, 2016. The allowance for loan losses grew to $11.2 million, or 1.12% of loans, at December 31, 2017, as compared to $8.9 million, or 1.11% of loans, at December 31, 2016.

Projections Increased

EPS:
2016A: $3.60
2017A $4.18 (EXCLUDING DEFERRED TAX ASSET CHARGE)
2018E: $4.45

We are increasing our 2018 earnings estimate to $15.5 million, or $4.45 per diluted share. Earnings in 2017 included about $0.20 per share in security gains that are not projected in 2018. These projections could change significantly based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST