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

John A. Howard, CFA
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Price:	$56.00	**Diluted EPS**	**2017A: ***	$ 4.18	**P/E**	**2017A:**	13.4x
52 Wk. Range:	$56.00 - $66.50	(FY: DEC)	**2018A:**	$5.14		**2018A:**	10.9
Div/Div Yld: *	$1.76/3.1%		**2019E:**	$5.38		**2019E:**	10.4x
Shrs/Mkt Cap:	3.5 mm / $196 mm	**Book Value: ****		$39.73	**Price/Book Value: ****		1.41x

* Cash dividend is most recent regular quarterly dividend (annualized). 2017 EPS excludes $0.44 per share deferred tax asset charge.
** Tangible book value is $32.62.

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, 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 Wellsville (Allegany County), New York. A new full-service office is also opening in Fivepointsville (Lancaster County), PA in the first quarter. 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."

4RD QUARTER HIGHLIGHTS:

EARNINGS WERE UP SHARPLY, PARTLY DUE TO TAX LAW CHANGES

BUT EVEN EXCLUDING THESE, CORE ESRNINGS WERE UP

EPS: $1.29 VS. $0.74

Fourth Quarter Core Earnings Reflected Solid Improvement

Citizens Financial Services reported unusually strong earnings growth in the fourth quarter of 2018. While a good bit of that strength was due to the change in tax law, we would note that core earnings, excluding those changes from tax rates, were still quite commendable and reflected several favorable underlying trends. The quarter was also gratifying from a balance sheet standpoint, as loan growth was solid on both a linked quarter basis, as well as relative to the year-ago level. Finally, asset quality held up reasonably well, with nonperforming assets up from the year-ago level but down from the level at the end of 2018's third quarter.

Net income in the fourth quarter of 2018 was $4,515,000, or $1.29 per diluted share, versus $2,604,000, or $0.74 per diluted share, in the year-ago quarter. As was stated above, much of the increase related to the new tax law. As a result of the Tax Cuts and Jobs Act of 2017, which reduced corporate income tax rates from 34% to 21%, the year-ago results reflected a deferred tax asset charge of $1,531,000, or $0.44 per share, meaning that the year-ago pre-adjustment quarterly earnings were closer to $4,135,000, or $1.19 per diluted share. The year-ago quarterly earnings were also affected by

NET INTEREST INCOME WAS THE SOURCE OF MOST OF THE CORE EARNINGS GROWTH, ALTHOUGH A LOWER PROVISION HELPED AS WELL

PROFITABILITY RATIOS WERE QUITE GOOD AS WELL

ROATCE WAS MORE THAN 15% IN THE QUARTER

significant security gains, which totaled $800,000. If we focus on pretax operating results, we see that pretax income before nonrecurring and credit related charges were up about 6% to $6,071,000 in 2018's fourth quarter, versus $5,712,000 in the year-ago quarter. That improvement was largely driven by higher net interest income, which grew 9% to $12,243,000 in 2018's fourth quarter from a year-ago level of $11,236,000, as well as a drop in the provision for loan losses to $625,000 in 2018's fourth quarter from a year-ago level of $800,000. Partly offsetting the strong net interest income growth was higher noninterest expense, which was up 7% to $8,235,000 in 2018's fourth quarter, versus $7,710,000 in the year-ago quarter. Core noninterest income was essentially flat in both quarters at roughly $2.0 million. Finally, profitability metrics were excellent, as annualized ROAE was 12.65%, while annualized ROAA was 1.27%. Annualized return on average tangible common equity was 15.33%.

Quarterly Results ($000s)	2017 Q4	2018 Q4
Net Income	2,604	4,515
Pretax Income	5,538	5,360
Adjustments:		
Provision (Add)	800	625
Security Gains/Losses (Deduct/Add)	(831)	20
ORE Expense (Add)	140	66
One-Time Merger Expenses (Add)	65	-
Pretax Inc. Bef. Nonrec. Charges & Prov.	5,712	6,071

FULL YEAR HIGHLIGHTS:

EPS: $5.14 VS. $3.70

BALANCE SHEET GROWTH WAS COMMENDABLE ALSO

For the full year of 2018, earnings increased to $18,034,000, or $5.14 per diluted share, versus $13,025,000, or $3.70 per diluted share, in 2017. Net interest income was up 12%, while core noninterest income was up 2% and noninterest expense increased 8%. The provision for loan losses declined to $1,925,000 in 2018, versus $2,540,000 in 2017. Balance sheet growth was also commendable, with gross loans increasing 8% over the past year, while assets were up 5% and deposits grew 7%. Stockholders' equity at December 31, 2018 was $139 million, or 9.7% of assets.

Recent Pullback in the Stock Reflects More Compelling Valuation

CITIZENS FINANCIAL HAS QUITE IMPRESSIVE PROFITABLITY METRICS

IT ALSO HAS A MUCH BETTER EFFICIENCY RATIO

THE STOCK'S MULTIPLE OF EARNINGS IS LOWER AND, WHILE THE MULTIPLE OF TANGIBLE BOOK VALUE IS HIGHER, THAT IS CONSISTENT WITH A HIGHER ROATCE

From a valuation standpoint, comparisons are most relevant in the context of operating performance. Obviously, no two banks are identical, and a better performing one, all else being equal, should trade at a premium to one that is less high performing. When we look at Citizens Financial, we see that the Company exceeds the performance of its peers in most categories. Its profitability metrics are notably better, as measured by ROAA, ROATCE (return on average tangible common equity) and the efficiency ratio. And while its nonperforming asset ratio is higher than its peers, it is not so high that it is of great concern. Despite the favorable profitability metrics, CZFS shares appear quite reasonably valued, as they trade well below the peer group on a multiple of earnings basis. And while the shares trade at a premium to the market based on the multiple of tangible book value, that premium seems quite reasonable given the much higher ROATCE. For example, the return on the *market value* of tangible common equity (which divides ROATCE by the stock's multiple of tangible book value), was 8.9%, which is a higher level/better value than the comparable figure of 8.6% for the peer median.

	ROAA MRQ	ROATCE MRQ	Eff. Ratio MRQ	NPAs/ Assets	Price/ TTM EPS *	Price/Tang. Book Value	Return on Market Val. Of Tang. Common
Citizens Finl	1.27%	15.33%	55.7%	1.01%	10.8x	1.72x	8.9%
Peer Median	1.05%	11.74%	62.9%	0.52%	14.2x	1.46x	8.6%

NPAs Were Up From Year-Ago Level But Dropped from September 30, 2018

NPAS/ASSETS: 1.01%

RESERVES/LOANS: 1.19%

Nonperforming assets were $14.4 million, or 1.01% of assets, as of December 31, 2018, versus $15.5 million, or 1.10% of assets, at September 30, 2018 and $11.8 million, or 0.87% of assets, at December 31, 2017. The allowance for loan losses grew to $12.9 million, or 1.19% of loans, at December 31, 2018, as compared to $11.2 million, or 1.12% of loans, at December 31, 2017.

Projections

EPS:
2017A: $4.18 (EXCLUDING DEFERRED TAX ASSET CHARGE)
2018A: $5.14
2019E: $5.38

For 2019, we are projecting earnings of $18.8 million, or $5.38 per diluted share. These projections could change significantly based on changing economic conditions.

ADDITIONAL INFORMATION UPON REQUEST