

CITIZENS FINANCIAL SERVICES INC

Form 10-Q

May 10, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2018

Or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0 13222

CITIZENS FINANCIAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA

23 2265045

(State or other jurisdiction of incorporation or
organization)

(I.R.S. Employer Identification No.)

15 South Main Street

Mansfield, Pennsylvania 16933

(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code: (570) 662 2121

N/A

(Former Name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated
filer _____
filer ☒ _____

Accelerated

Non-accelerated filer
reporting company _____
(Do not check if a smaller reporting
company) _____
growth company _____

Smaller

Emerging

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes___ No __X__

The number of outstanding shares of the Registrant's Common Stock, as of May 2, 2018, was 3,481,687.

Citizens Financial Services, Inc.
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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	March 31, 2018	December 31, 2017
(in thousands except share data)		
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	\$ 10,141	\$ 16,347
Interest-bearing	2,334	2,170
Total cash and cash equivalents	12,475	18,517
Interest bearing time deposits with other banks	10,532	10,283
Equity securities	188	-
Available-for-sale debt securities	251,340	254,782
Loans held for sale	233	1,439
Loans (net of allowance for loan losses: 2018, \$11,587 and 2017, \$11,190)	1,020,151	989,335
Premises and equipment	16,378	16,523
Accrued interest receivable	4,283	4,196
Goodwill	23,296	23,296
Bank owned life insurance	27,035	26,883
Other intangibles	1,856	1,953
Other assets	14,716	14,679
TOTAL ASSETS	\$ 1,382,483	\$ 1,361,886
LIABILITIES:		
Deposits:		
Noninterest-bearing	\$ 173,124	\$ 171,840
Interest-bearing	942,029	933,103
Total deposits	1,115,153	1,104,943
Borrowed funds	124,121	114,664
Accrued interest payable	867	897
Other liabilities	12,492	12,371
TOTAL LIABILITIES	1,252,633	1,232,875
STOCKHOLDERS' EQUITY:		
Preferred Stock		
\$1.00 par value; authorized 3,000,000: none issued in 2018 or 2017	-	-
Common stock		
\$1.00 par value; authorized 15,000,000 shares; issued 3,869,939 at March 31, 2018 and December 31, 2017	3,870	3,870
Additional paid-in capital	51,113	51,108
Retained earnings	92,713	89,982
Accumulated other comprehensive income	(4,977)	(3,398)
Treasury stock, at cost: 388,177 shares at March 31, 2018 and 383,065 shares at December 31, 2017	(12,869)	(12,551)
TOTAL STOCKHOLDERS' EQUITY	129,850	129,011

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,382,483	\$1,361,886
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The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

	Three Months Ended March 31,	
(in thousands, except share and per share data)	2018	2017
INTEREST INCOME:		
Interest and fees on loans	\$ 11,861	\$ 9,717
Interest-bearing deposits with banks	58	35
Investment securities:		
Taxable	800	804
Nontaxable	527	668
Dividends	137	76
TOTAL INTEREST INCOME	13,383	11,300
INTEREST EXPENSE:		
Deposits	1,316	1,045
Borrowed funds	647	258
TOTAL INTEREST EXPENSE	1,963	1,303
NET INTEREST INCOME	11,420	9,997
Provision for loan losses	500	615
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,920	9,382
NON-INTEREST INCOME:		
Service charges	1,104	1,058
Trust	251	221
Brokerage and insurance	181	191
Gains on loans sold	72	101
Equity security gains, net	6	-
Available for sale security gains, net	-	172
Earnings on bank owned life insurance	152	166
Other	140	126
TOTAL NON-INTEREST INCOME	1,906	2,035
NON-INTEREST EXPENSES:		
Salaries and employee benefits	4,835	4,366
Occupancy	592	527
Furniture and equipment	142	139
Professional fees	295	310
FDIC insurance	100	105
Pennsylvania shares tax	300	281
Amortization of intangibles	76	76
ORE expenses	138	90
Other	1,354	1,297
TOTAL NON-INTEREST EXPENSES	7,832	7,191
Income before provision for income taxes	4,994	4,226
Provision for income taxes	747	923
NET INCOME	\$ 4,247	\$ 3,303
PER COMMON SHARE DATA:		
Net Income - Basic	\$ 1.22	\$ 0.94
Net Income - Diluted	\$ 1.22	\$ 0.94

Cash Dividends Paid	\$0.435	\$0.405
Number of shares used in computation - basic	3,478,280	3,479,180
Number of shares used in computation - diluted	3,478,643	3,479,200

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended March 31,	
(in thousands)	2018	2017
Net income	\$4,247	\$3,303
Other comprehensive loss:		
Change in unrealized gains on available for sale securities	(2,045)	70
Income tax effect	428	(24)
Change in unrecognized pension cost	46	60
Income tax effect	(9)	(21)
Less: Reclassification adjustment for investment security gains included in net income	-	(172)
Income tax effect	-	58
Other comprehensive loss, net of tax	(1,580)	(29)
Comprehensive income	\$2,667	\$3,274

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

(in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:

	Three Months Ended March 31,	
	2018	2017
Net income	\$4,247	\$3,303
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	500	615
Depreciation and amortization	69	108
Amortization and accretion of investment securities	306	382
Deferred income taxes	(181)	(174)
Equity security gains, net	(6)	-
Available for sale security gains, net	-	(172)
Earnings on bank owned life insurance	(152)	(166)
Originations of loans held for sale	(2,523)	(4,727)
Proceeds from sales of loans held for sale	3,772	5,075
Realized gains on loans sold	(72)	(101)
(Increase) decrease in accrued interest receivable	(87)	471
Decrease in accrued interest payable	(30)	(108)
Other, net	482	1,801
Net cash provided by operating activities	6,325	6,307

CASH FLOWS FROM INVESTING ACTIVITIES:

Available-for-sale securities:		
Proceeds from sales	-	18,766
Proceeds from maturity and principal repayments	22,872	29,858
Purchase of securities	(21,963)	(11,039)
Purchase of interest bearing time deposits with other banks	(249)	(746)
Proceeds from redemption of regulatory stock	2,709	2,617
Purchase of regulatory stock	(2,630)	(1,288)
Net increase in loans	(31,081)	(45,880)
Purchase of premises and equipment	(41)	(113)
Proceeds from sale of interest bearing time deposits with other banks	-	750
Proceeds from sale of foreclosed assets held for sale	195	125
Net cash used in investing activities	(30,188)	(6,950)

CASH FLOWS FROM FINANCING ACTIVITIES:

Net increase in deposits	10,210	32,106
Proceeds from long-term borrowings	2	2
Net (decrease) increase in short-term borrowed funds	9,455	(32,828)
Purchase of treasury and restricted stock	(331)	(396)
Dividends paid	(1,515)	(1,198)
Net cash (used) provided by financing activities	17,821	(2,314)
Net decrease in cash and cash equivalents	(6,042)	(2,957)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	18,517	17,754
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$12,475	\$14,797

Supplemental Disclosures of Cash Flow Information:

Interest paid	\$1,993	\$1,411
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Income taxes paid	\$-	\$-
Loans transferred to foreclosed property	\$13	\$307
Investments and time deposits sold and not settled	\$-	\$1,297

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CITIZENS FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

Citizens Financial Services, Inc. (individually and collectively with its direct and indirect subsidiaries, the "Company") is a Pennsylvania corporation and the holding company of its wholly owned subsidiary, First Citizens Community Bank (the "Bank"), and of the Bank's wholly owned subsidiary, First Citizens Insurance Agency, Inc. ("First Citizens Insurance").

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission ("SEC") and in conformity with U.S. generally accepted accounting principles. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. Certain of the prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no effect on net income or stockholders' equity. All material inter company balances and transactions have been eliminated in consolidation.

In the opinion of management of the Company, the accompanying interim financial statements at March 31, 2018 and for the periods ended March 31, 2018 and 2017 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. The financial performance reported for the Company for the three month period ended March 31, 2018 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Company on January 1, 2018. Adoption of ASU 2014-09 did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. See Note 2 for additional information related to the adoption of this standard.

In January 2016, the FASB finalized ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This accounting standard (a) requires separate presentation of equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) on the balance sheet and measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in

combination with the entity's other deferred tax assets.

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The adoption resulted in the Company recognizing a one-time cumulative effect adjustment of \$1,000 between accumulated other comprehensive income and retained earnings on the consolidated balance sheet for the fair value of equity securities included in accumulated other comprehensive income as of the beginning of the period. The adjustment had no impact on net income on any prior periods presented.

The Company has adopted this standard during the reporting period. On a prospective basis, the Company implemented changes to the measurement of the fair value of financial instruments using an exit price notion for disclosure purposes included in Note 12 to the financial statements. The March 31, 2018, fair value of each class of financial instruments disclosure did utilize the exit price notion when measuring fair value and, therefore, may not be comparable to the December 31, 2017 disclosure.

In March 2017, the FASB issued ASU 2017-07, Compensation-Retirement Benefits (Topic 71S). The amendments in this Update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component. The Company adopted the standard on January 1, 2018, which resulted in a reclassification of \$(47) from Salaries and employee benefits into Other noninterest expenses on the Consolidated Statement of Income for the period ended March 31, 2017. See note 10 for additional information on the presentation of these pension cost components.

Note 2 – Revenue recognition

Effective January 1, 2017, the Company adopted Accounting Standards Update ASU 2014-09 Revenue from Contracts with Customers – Topic 606 and all subsequent ASUs that modified ASC 606. The Company has elected to apply the standard to all prior periods presented utilizing the full retrospective approach. The implementation of the new standard had no material impact to the measurement or recognition of revenue of prior periods. Management determined that the primary sources of revenue emanating from interest and dividend income on loans and investments along with noninterest revenue resulting from investment security gains, loan servicing, gains on loans sold and earnings on bank owned life insurances are not within the scope of ASC 606. As a result, no changes were made during the period related to these sources of revenue, which cumulatively comprise 89.4 percent of the total revenue of the Company. The main types of noninterest income within the scope of the standard are as follows:

Service charges on deposit accounts – The Company has contracts with its deposit customers where fees are charged if certain parameters are not met. These agreements can be cancelled at any time by either the Company or the deposit customer. Revenue from these transactions is recognized on a monthly basis as the Company has an unconditional right to the fee consideration. The Company also has transaction fees related to specific transactions or activities resulting from a customer request or activity that include overdraft fees, online banking fees, interchange fees, ATM fees and other transaction fees. All of these fees are attributable to specific performance obligations of the Company where the revenue is recognized at a defined point in time upon the completion of the requested service/transaction.

Trust fees – Typical contracts for trust services are based on a fixed percentage of the assets earned ratably over a defined period and billed on a monthly basis. Fees charged to customers' accounts are recognized as revenue over the period during which the Company fulfills its performance obligation under the contract (i.e., holding client asset in a managed fiduciary trust account). For these accounts, the performance obligation of the Company is typically satisfied by holding and managing the customer's assets over time. Other fees related to specific customer requests are attributable to specific performance obligations of the Company where the revenue is recognized at a defined point in time, upon completion of the requested service/transaction.

Gains (losses) on sale of other real estate owned – Gains and losses are recognized at the completion of the property sale when the buyer obtains control of the real estate and all of the performance obligations of the Company have

been satisfied. Evidence of the buyer obtaining control of the asset include transfer of the property title, physical possession of the asset, and the buyer obtaining control of the risks and rewards related to the asset. In situations where the Company agrees to provide financing to facilitate the sale, additional analysis is performed to ensure that the contract for sale identifies the buyer and seller, the asset to be transferred, payment terms, and that the contract has a true commercial substance and that collection of amounts due from the buyer are reasonable. In situations where financing terms are not reflective of current market terms, the transaction price is discounted impacting the gain/loss and the carrying value of the asset.

Brokerage and insurance – Fees includes commissions from the sales of investments and insurance products recognized on a trade date basis as the performance obligation is satisfied at the point in time in which the trade is processed. Additional fees are based on a percentage of the market value of customer accounts and billed on a monthly/quarterly basis. The Company's performance obligation under the contracts with certain customers is generally satisfied through the passage of time as the Company monitors and manages the assets in the customer's portfolio and is not dependent on certain return or performance level of the customer's portfolio. Fees for these services are billed monthly and are recorded as revenue at the end of the month for which the wealth management service has been performed. Other performance obligations (such as the delivery of account statements to customers) are generally considered immaterial to the overall transaction price.

The following table depicts the disaggregation of revenue derived from contracts with customers to depict the nature, amount, timing, and uncertainty of revenue and cash flows for the three months ended March 31, 2018. All revenue in the table below relates to goods and services transferred at a point in time.

Revenue stream:

Service charges on deposit accounts	
Overdraft fees	\$367
Statement fees	54
Interchange revenue	531
ATM income	96
Other service charges	56
Total Service Charges	1,104
Trust	251
Brokerage and insurance	181
Other	85
Total	\$1,621

Note 3 - Earnings per Share

The following table sets forth the computation of earnings per share. Earnings per share calculations give retroactive effect to stock dividends declared by the Company.

	Three months ended March 31,	
	2018	2017
Net income applicable to common stock	\$4,247,000	\$3,303,000
Basic earnings per share computation		
Weighted average common shares outstanding	3,478,280	3,479,180
Earnings per share - basic	\$1.22	\$0.94
Diluted earnings per share computation		
Weighted average common shares outstanding for basic earnings per share	3,478,280	3,479,180
Add: Dilutive effects of restricted stock	363	20
Weighted average common shares outstanding for dilutive earnings per share	3,478,643	3,479,200
Earnings per share - diluted	\$1.22	\$0.94

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For the three months ended March 31, 2018 and 2017, there were 426 and 2,087 shares, respectively, related to the restricted stock plan that were excluded from the diluted earnings per share calculations since they were anti-dilutive. These anti-dilutive shares had per share prices ranging from \$49.87-\$61.04 for the three month period ended March 31, 2018 and per share prices ranging from \$49.87-\$53.15 for the three month period ended March 31, 2017.

Note 4 - Income Tax Expense

Income tax expense is less than the amount calculated using the statutory tax rate, primarily as a result of tax-exempt income earned from state and municipal securities and loans and the recognition of qualified affordable housing tax credits.

Investments in Qualified Affordable Housing Projects

As of March 31, 2018 and December 31, 2017, the Company was invested in four partnerships that provide affordable housing. The balance of the investments, which is included within other assets in the Consolidated Balance Sheet, was \$514,000 and \$541,000 as of March 31, 2018 and December 31, 2017, respectively. Investments purchased prior to January 1, 2015, are accounted for utilizing the effective yield method. As of March 31, 2018, the Company had \$670,000 of tax credits remaining that will be recognized over 4.75 years. Tax credits of \$35,000 were recognized as a reduction of tax expense during the three months ended March 31, 2018 and 2017, respectively. Amortization of the investment included in other expenses on the Consolidated Statement of Income was \$27,000 and \$40,000 during the three months ended March 31, 2018 and 2017, respectively.

Note 5 – Investments

The amortized cost, gross unrealized gains and losses, and fair value of investment securities at March 31, 2018 and December 31, 2017 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2018				
Available-for-sale securities:				
U.S. agency securities	\$ 100,256	\$ 3	\$ (1,073) \$99,186
U.S. treasury securities	33,768	-	(656) 33,112
Obligations of state and political subdivisions	71,365	580	(413) 71,532
Corporate obligations	3,000	50	-	3,050
Mortgage-backed securities in government sponsored entities	45,336	3	(879) 44,460
Total available-for-sale securities	\$ 253,725	\$ 636	\$ (3,021) \$251,340

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Available-for-sale securities:				
U.S. agency securities	\$ 99,454	\$ 26	\$ (593) \$98,887
U.S. treasury securities	28,782	-	(178) 28,604
Obligations of state and political subdivisions	78,409	820	(139) 79,090
Corporate obligations	3,000	83	-	3,083
Mortgage-backed securities in				

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government sponsored entities	45,385	19	(377)	45,027
Equity securities in financial institutions	92	-	(1)	91
Total available-for-sale securities	\$ 255,122	\$ 948	\$ (1,288)	\$ 254,782

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The following table shows the Company's gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time, which individual securities have been in a continuous unrealized loss position, at March 31, 2018 and December 31, 2017 (in thousands). As of March 31, 2018, the Company owned 138 securities whose fair value was less than their cost basis.

March 31, 2018	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	\$70,435	\$ (824)	\$16,851	\$ (249)	\$87,286	\$ (1,073)
U.S. treasury securities	33,112	(656)	-	-	33,112	(656)
Obligations of state and political subdivisions	27,327	(298)	4,795	(115)	32,122	(413)
Mortgage-backed securities in government sponsored entities	28,993	(479)	12,817	(400)	41,810	(879)
Total securities	\$159,867	\$ (2,257)	\$34,463	\$ (764)	\$194,330	\$ (3,021)
December 31, 2017						
U.S. agency securities	\$74,952	\$ (421)	\$16,928	\$ (172)	\$91,880	\$ (593)
U.S. treasury securities	28,604	(178)	-	-	28,604	(178)
Obligations of states and political subdivisions	14,885	(85)	5,958	(54)	20,843	(139)
Mortgage-backed securities in government sponsored entities	27,154	(190)	13,822	(187)	40,976	(377)
Equity securities in financial institutions	91	(1)	-	-	91	(1)
Total securities	\$145,686	\$ (875)	\$36,708	\$ (413)	\$182,394	\$ (1,288)

As of March 31, 2018 and December 31, 2017, the Company's investment securities portfolio contained unrealized losses on agency securities issued or backed by the full faith and credit of the United States government or are generally viewed as having the implied guarantee of the U.S. government, U.S treasury securities, obligations of states and political subdivisions and mortgage backed securities issued by government sponsored entities. For fixed maturity investments management considers whether the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline and the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the Company does not intend to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings. The Company has concluded that any impairment of its investment securities portfolio outlined in the above table is not other than temporary and is the result of interest rate changes, sector credit rating changes, or issuer-specific rating changes that are not expected to result in the non-collection of principal and interest during the period.

Proceeds from sales of securities available-for-sale for the three months ended March 31, 2017 were \$18,766,000. There were no sales of available for sale securities during the three months ended March 31, 2018. The gross gains and losses were as follows (in thousands):

	Three Months Ended March 31, 2018	2017
Gross gains on available for sale securities	-	\$ 172
Gross losses on available for sale securities	-	-
Net gains	\$-	\$ 172

The following table presents the net gains on the Company's equity investments recognized in earnings during the three month period ended March 31, 2018, and the portion of unrealized gains for the period that relates to equity investments held at March 31, 2018.

Net gains recognized in equity securities during the period	\$	6
Less: Net gains realized on the sale of equity securities during the period		-
Net gains	\$	6

Investment securities with an approximate carrying value of \$242.9 million and \$243.4 million at March 31, 2018 and December 31, 2017, respectively, were pledged to secure public funds and certain other deposits.

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The amortized cost and fair value of debt securities (excludes equity securities) at March 31, 2018, by contractual maturity, are shown below (in thousands):

	Amortized Cost	Fair Value
Available-for-sale debt securities:		
Due in one year or less	\$ 37,488	\$ 37,579
Due after one year through five years	120,367	118,940
Due after five years through ten years	42,684	42,068
Due after ten years	53,186	52,753
Total	\$ 253,725	\$ 251,340

Note 6 – Loans

The Company grants loans primarily to customers throughout north central, central and south central Pennsylvania and the southern tier of New York. Although the Company had a diversified loan portfolio at March 31, 2018 and December 31, 2017, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within these regions. The following table summarizes the primary segments of the loan portfolio and how those segments are analyzed within the allowance for loan losses as of March 31, 2018 and December 31, 2017 (in thousands):

	Total Loans	Individually evaluated for impairment	Loans acquired with deteriorated credit quality	Collectively evaluated for impairment
March 31, 2018				
Real estate loans:				
Residential	\$215,349	\$ 1,234	\$ 31	\$214,084
Commercial	320,381	13,949	1,422	305,010
Agricultural	248,710	3,818	689	244,203
Construction	22,239	-	-	22,239
Consumer	9,672	-	-	9,672

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Other commercial loans	74,930	4,139	442	70,349
Other agricultural loans	40,396	1,380	-	39,016
State and political subdivision loans	100,061	-	-	100,061
Total	1,031,738	24,520	2,584	1,004,634
Allowance for loan losses	11,587	408	-	11,179
Net loans	\$1,020,151	\$ 24,112	\$ 2,584	\$993,455

	Total Loans	Individually evaluated for impairment	Loans acquired with deteriorated credit quality	Collectively evaluated for impairment
December 31, 2017				
Real estate loans:				
Residential	\$214,479	\$ 1,065	\$ 33	\$ 213,381
Commercial	308,084	13,864	1,460	292,760
Agricultural	239,957	3,901	702	235,354
Construction	13,502	-	-	13,502
Consumer	9,944	8	-	9,936
Other commercial loans	72,013	4,197	443	67,373
Other agricultural loans	37,809	1,363	-	36,446
State and political subdivision loans	104,737	-	-	104,737
Total	1,000,525	24,398	2,638	973,489
Allowance for loan losses	11,190	410	-	10,780
Net loans	\$989,335	\$ 23,988	\$ 2,638	\$ 962,709

Purchased loans acquired in The First National Bank of Fredericksburg (FNB) acquisition and the State College branch acquisition, were recorded at fair value on their purchase date without a carryover of the related allowance for loan losses. Upon acquisition, the Company evaluated whether an acquired loan was within the scope of ASC 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality. Purchased credit-impaired ("PCI") loans are loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Based upon management's review, there were no material increases or decreases in the expected cash flows of these loans between the acquisition date and March 31, 2018. The fair value of PCI loans, on the acquisition date, was determined, primarily based on the fair value of the loans' collateral. The carrying value of PCI loans was \$2,584,000 and \$2,638,000 at March 31, 2018 and December 31, 2017, respectively. The carrying value of the PCI loans was determined by projected discounted contractual cash flows.

Changes in the accretable yield for PCI loans were as follows for the three months ended March 31, 2018 and 2017, respectively (in thousands):

	Three months ended March 31, 2018	2017
Balance at beginning of period	\$106	\$389
Accretion	(24)	(114)
Balance at end of period	\$82	\$275

The following table presents additional information regarding loans acquired with specific evidence of deterioration in credit quality under ASC 310-30 (in thousands):

	March 31, 2018	December 31, 2017
Outstanding balance	\$5,284	\$ 5,295

Carrying amount	2,584	2,638
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The segments of the Company's loan portfolio are disaggregated into classes to a level that allows management to monitor risk and performance. Residential real estate mortgages consist primarily of 15 to 30 year first mortgages on residential real estate, while residential real estate home equity loans are consumer purpose installment loans or lines of credit with terms of 15 years or less secured by a mortgage which is often a second lien on residential real estate. Commercial real estate loans are business purpose loans secured by a mortgage on commercial real estate. Agricultural real estate loans are loans secured by a mortgage on real estate used in agriculture production. Construction real estate loans are loans secured by residential, commercial or agricultural real estate used during the construction phase of residential, commercial or agricultural projects. Consumer loans are typically unsecured or primarily secured by assets other than real estate and overdraft lines of credit are typically secured by customer deposit accounts. Other commercial loans are loans for commercial purposes primarily secured by non-real estate collateral. Other agricultural loans are loans for agricultural purposes primarily secured by non-real estate collateral. State and political subdivision loans are loans to state and local municipalities for capital and operating expenses or tax free loans used to finance commercial development.

Management considers other commercial loans, other agricultural loans, state and political subdivision loans, commercial real estate loans and agricultural real estate loans which are 90 days or more past due to be impaired. Management will also consider a loan impaired based on other factors it becomes aware of, including the customer's results of operations and cash flows or if the loan is modified in a troubled debt restructuring. In addition, certain residential mortgages, home equity and consumer loans that are cross collateralized with commercial relationships that are determined to be impaired may also be classified as impaired. Impaired loans are analyzed to determine if it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allocation of the allowance for loan losses or a charge-off to the allowance for loan losses.

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables by class, excluding PCI loans, with the associated allowance amount, if applicable (in thousands):

	Unpaid Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
March 31, 2018					
Real estate loans:					
Mortgages	\$ 1,227	\$ 268	\$ 870	\$ 1,138	\$ 22
Home Equity	112	39	57	96	16
Commercial	16,625	12,589	1,360	13,949	170
Agricultural	3,824	3,682	136	3,818	5
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
Other commercial loans	4,655	3,721	418	4,139	184
Other agricultural loans	1,419	1,249	131	1,380	11
State and political subdivision loans	-	-	-	-	-
Total	\$ 27,862	\$ 21,548	\$ 2,972	\$ 24,520	\$ 408
December 31, 2017					
Real estate loans:					
Mortgages	\$ 1,055	\$ 273	\$ 700	\$ 973	\$ 47
Home Equity	92	40	52	92	9
Commercial	16,363	13,154	710	13,864	94
Agricultural	5,231	3,283	618	3,901	3
Construction	-	-	-	-	-
Consumer	10	2	6	8	-
Other commercial loans	4,739	3,766	431	4,197	231
Other agricultural loans	1,397	1,238	125	1,363	26
State and political subdivision loans	-	-	-	-	-
Total	\$ 28,887	\$ 21,756	\$ 2,642	\$ 24,398	\$ 410

The following tables includes the average balance of impaired financing receivables by class and the income recognized on these receivables for the three month periods ended March 31, 2018 and 2017(in thousands):

	For the Three Months Ended March 31, 2018			March 31, 2017		
	Average Recorded Investmen	Interest Income Recognized	Interest Income Recognized Cash Basis	Average Recorded Investmen	Interest Income Recognized	Interest Income Recognized Cash Basis
Real estate loans:						
Mortgages	\$1,023	\$ 4	\$ -	\$894	\$ 3	\$ -
Home Equity	107	1	-	56	1	-
Commercial	13,795	122	5	5,793	24	3
Agricultural	4,086	51	-	3,382	31	-
Construction	-	-	-	-	-	-
Consumer	4	-	-	1	-	-
Other commercial loans	4,156	26	-	5,597	40	10
Other agricultural loans	1,370	10	-	1,627	23	-
State and political subdivision loans	-	-	-	-	-	-
Total	\$24,541	\$ 214	\$ 5	\$17,350	\$ 122	\$ 13

Credit Quality Information

For commercial real estate, agricultural real estate, construction, other commercial, other agricultural and state and political subdivision loans, management uses a nine grade internal risk rating system to monitor credit quality. The first five categories are considered not criticized and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The definitions of each rating are defined below:

Pass (Grades 1-5) – These loans are to customers with credit quality ranging from an acceptable to very high quality and are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral.

Special Mention (Grade 6) – This loan grade is in accordance with regulatory guidance and includes loans where a potential weakness or risk exists, which could cause a more serious problem if not corrected.

Substandard (Grade 7) – This loan grade is in accordance with regulatory guidance and includes loans that have a well-defined weakness based on objective evidence and be characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful (Grade 8) – This loan grade is in accordance with regulatory guidance and includes loans that have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.

Loss (Grade 9) – This loan grade is in accordance with regulatory guidance and includes loans that are considered uncollectible, or of such value that continuance as an asset is not warranted.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay the loan as agreed, the Company's loan rating process includes several layers of internal and external oversight. The Company's loan officers are responsible for the timely and accurate risk rating of the loans in each of their portfolios at origination and on an ongoing basis under the supervision of management. All commercial and agricultural loans are reviewed annually to ensure the appropriateness of the loan grade. In addition, the Company engages an external consultant on at least an annual basis to 1) review a minimum of 50% of the dollar volume of the commercial loan portfolio on an annual basis, 2) review new loans originated for over \$1.0 million in the last year, 3) review a majority of borrowers with commitments greater than or equal to \$1.0 million, 4) review selected loan relationships over \$750,000 which are over 30 days past due or classified Special Mention, Substandard, Doubtful, or Loss, and 5) such other loans which management or the consultant deems appropriate.

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The following tables represent credit exposures by internally assigned grades as of March 31, 2018 and December 31, 2017 (in thousands):

March 31, 2018	Pass	Special Mention	Substandard	Doubtful	Loss	Ending Balance
Real estate loans:						
Commercial	\$294,894	\$15,387	\$9,981	\$119	\$-	\$320,381
Agricultural	231,711	11,766	5,233	-	-	248,710
Construction	22,108	-	131	-	-	22,239
Other commercial loans	70,850	862	3,095	123	-	74,930
Other agricultural loans	38,697	341	1,358	-	-	40,396
State and political subdivision loans	89,480	-	10,581	-	-	100,061
Total	\$747,740	\$28,356	\$30,379	\$242	\$-	\$806,717

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Loss	Ending Balance
Real estate loans:						
Commercial	\$281,742	\$15,029	\$11,271	\$42	\$-	\$308,084
Agricultural	222,198	11,538	6,221	-	-	239,957
Construction	13,364	-	138	-	-	13,502
Other commercial loans	67,706	615	3,567	125	-	72,013
Other agricultural loans	34,914	1,325	1,570	-	-	37,809
State and political subdivision loans	94,125	-	10,612	-	-	104,737
Total	\$714,049	\$28,507	\$33,379	\$167	\$-	\$776,102

For residential real estate mortgages, home equity and consumer loans, credit quality is monitored based on whether the loan is performing or non-performing, which is typically based on the aging status of the loan and payment activity, unless a specific action, such as bankruptcy, repossession, death or significant delay in payment occurs to raise awareness of a possible credit event. Non-performing loans include those loans that are considered nonaccrual, described in more detail below, and all loans past due 90 or more days and still accruing. The following table presents the recorded investment in those loan classes based on payment activity as of March 31, 2018 and December 31, 2017 (in thousands):

March 31, 2018	Performing	Non-performing	PCI	Total
Real estate loans:				
Mortgages	\$154,274	\$1,501	\$31	\$155,806
Home Equity	59,444	99	-	59,543
Consumer	9,635	37	-	9,672
Total	\$223,353	\$1,637	\$31	\$225,021

December 31, 2017	Performing	Non-performing	PCI	Total
Real estate loans:				
Mortgages	\$152,820	\$1,492	\$33	\$154,345
Home Equity	60,022	112	-	60,134
Consumer	9,895	49	-	9,944
Total	\$222,737	\$1,653	\$33	\$224,423

Aging Analysis of Past Due Financing Receivables

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table includes an aging analysis of the recorded investment of past due financing receivables as of March 31, 2018 and December 31, 2017 (in thousands):

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	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	PCI	Total Financing Receivables	90 Days or Greater and Accruing
March 31, 2018								
Real estate loans:								
Mortgages	\$425	\$281	\$911	\$1,617	\$154,158	\$31	\$155,806	\$ 44
Home Equity	186	54	74	314	59,229	-	59,543	-
Commercial	4,276	241	4,647	9,164	309,795	1,422	320,381	-
Agricultural	112	-	159	271	247,750	689	248,710	-
Construction	-	-	127	127	22,112	-	22,239	-
Consumer	104	44	25	173	9,499	-	9,672	7
Other commercial loans	584	47	2,597	3,228	71,260	442	74,930	378
Other agricultural loans	91	36	-	127	40,269	-	40,396	-
State and political subdivision loans	-	-	-	-	100,061	-	100,061	-
Total	\$5,778	\$703	\$8,540	\$15,021	\$1,014,133	\$2,584	\$1,031,738	\$ 429
Loans considered non-accrual	\$375	\$446	\$8,111	\$8,932	\$2,501	\$-	\$11,433	
Loans still accruing	5,403	257	429	6,089	1,011,632	2,584	1,020,305	
Total	\$5,778	\$703	\$8,540	\$15,021	\$1,014,133	\$2,584	\$1,031,738	

	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	PCI	Total Financing Receivables	90 Days or Greater and Accruing
December 31, 2017								
Real estate loans:								
Mortgages	\$996	\$362	\$810	\$2,168	\$152,144	\$33	\$154,345	\$ 218
Home Equity	277	86	78	441	59,693	-	60,134	-
Commercial	1,353	1,010	3,865	6,228	300,396	1,460	308,084	162
Agricultural	242	-	205	447	238,808	702	239,957	30
Construction	-	-	133	133	13,369	-	13,502	-
Consumer	53	33	49	135	9,809	-	9,944	7
Other commercial loans	132	-	2,372	2,504	69,066	443	72,013	32
Other agricultural loans	-	42	106	148	37,661	-	37,809	106
State and political subdivision loans	-	-	-	-	104,737	-	104,737	-
Total	\$3,053	\$1,533	\$7,618	\$12,204	\$985,683	\$2,638	\$1,000,525	\$ 555

Loans considered non-accrual