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Potomac Bancshares, Inc. (OTC Pink - PTBS)

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Price:	\$8.75	EPS *	2015A:	\$ 0.76	P/E	2015A:	11.5x
52 Wk. Range:	\$7.82 - \$9.90	(FY: DEC)	2016E:	\$ 0.68		2016E:	12.9x
Div/Div Yld:	\$0.26 / 3.0%		2017E:	\$ 0.78		2017E:	11.2x
Shrs/Mkt Cap:	3.3 mm / \$29 mm	Book Value:		\$ 9.83	Price/Book Value:		0.89x

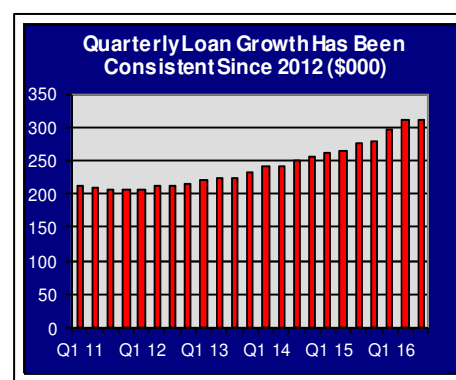
* Diluted.

Background

Founded in 1871, Potomac Bancshares, Inc. (the "Company") is a Charles Town, West Virginia bank holding company for the Bank of Charles Town. With approximately \$375 million in assets as of September 30, 2016, the Company conducts operations through its main office and branch office facilities in Jefferson and Berkeley Counties (WV), Washington County (MD) and Loudoun County (VA). The Bank provides various banking products and services for individuals, businesses, and local governments. Deposit products include noninterest-bearing and interest-bearing checking accounts, savings accounts, certificates of deposits, money market accounts, and individual retirement accounts. The Bank also offers loan products comprising commercial, financial, and agricultural loans; mortgage loans on real estate properties; secondary market and adjustable rate mortgage loans; equipment loans and construction financing products; and retail loan products consisting of home equity lines of credit. In addition, the Bank provides financial management, investment, trust, and brokerage services, as well as online banking services. The Company's shares are quoted on the OTC Pink Sheet marketplace under the symbol "PTBS."

Third Quarter Earnings Were Affected by Higher Provision

Potomac Bancshares reported earnings in the third quarter of 2016 that were below the year-ago level, although that drop was principally due to an increase in the provision for loan losses. While some of the increase in the provision related to a write-down of a nonperforming loan, it was also due to overall loan growth, the latter of which we obviously view as a positive. We expect earnings to pick back up in the final quarter of the year, particularly based on the favorable trend in net interest income, which continues to benefit from the resurgence in loan growth that began in 2013, as can be seen in the adjacent chart. (Although not shown, the trend in deposits is similarly favorable, although the pick-up in growth did not occur until 2014.)



ASSETS: \$375 MM

HQ: CHARLES TOWN, WV

CONTACT:
ROBERT F. BARONNER, CEO
DEAN J. COGNETTI, CFO
304-725-8431

3RD QUARTER HIGHLIGHTS:

EARNINGS WERE AFFECTED
BY THE HIGHER PROVISION

WHILE SOME OF THAT
INCREASE IN THE PROVISION
WAS DUE TO A LOAN WRITE-
DOWN, IT WAS ALSO DUE TO
STRONG LOAN GROWTH

EPS: \$0.14 vs. \$0.20

PRETAX INCOME BEFORE THE
PROVISION AND
NONRECURRING ITEMS WAS
UP 11%

Net income in the third quarter of 2016 was \$485,000, or \$0.14 per diluted share, versus \$685,000, or \$0.20 per diluted share, in 2015's third quarter. In addition to the higher provision for loan losses (which was \$261,000 in 2016's third quarter, versus no provision in the year-ago quarter), there were a few nonrecurring items that affected the bottom line results, most notably, OREO valuation adjustments and gains and losses on the sale of securities and OREO. If we exclude the provision and these nonrecurring items, we see that the pretax

	2015	2016
Quarterly Results (\$000s)	Q3	Q3
Net Income	685	485
Pretax Income	1,013	732
Adjustments:		
Provision (Add)	-	261
Security Gains (Deduct)	(28)	(45)
OREO Valuation	-	137
Gains/Losses on Sale of OREO (Add Gains)	(1)	7
Pretax Inc. Bef. Nonrec/Credit Charges	984	1,092

NET INTEREST INCOME WAS UP 11%

THIS GROWTH CAME FROM HIGHER AVERAGE EARNING ASSETS, AS MARGINS WERE SLIGHTLY LOWER

NINE MONTHS HIGHLIGHTS:

EPS: \$0.49 vs. \$0.54

BALANCE SHEET GROWTH REMAINS GOOD AS WELL

POTOMAC BANCSHARES' PERFORMANCE CONTINUES TO COMPARE FAVORABLY TO ITS PEERS

DESPITE THE SUPERIOR PERFORMANCE, IT HAS A HIGHER DIVIDEND YIELD AND LOWER VALUATION MULTIPLES

ITS LONG-TERM RETURN TO SHAREHOLDERS HAS BEEN HIGHER AS WELL

ASSET QUALITY REMAINS QUITE GOOD

NPAs/ASSETS: 0.53%

RESERVES/LOANS: 0.94%

EPS:
2015A: \$ 0.76
2016E: \$ 0.68
2017E: \$ 0.78

income before nonrecurring and credit charges was \$1,092,000, which was 11% higher than the year-ago comparable figure. Net interest income was up 11% to \$3,192,000 in 2016's third quarter, versus \$2,866,000 in the year-ago quarter, with strong average earning asset growth more than offsetting a modest drop in the margin. Core noninterest income was essentially unchanged from the year-ago level, while noninterest expense was up 12% to \$3,281,000 in 2016's third quarter, versus \$2,922,000 in the year-ago quarter.

First Nine Month Results Were Also Affected by the Higher Provision

For the first nine months of 2016, net income was \$1,631,000, or \$0.49 per diluted share, compared to \$1,828,000, or \$0.54 per diluted share, in the year-ago period. As was the case with the quarterly results, that decline was due to the increase in the provision for loan losses, which was \$565,000 in the first nine months of 2016, versus \$97,000 in the year-ago period. Balance sheet growth has remained strong as well. From September 30, 2015 to September 30, 2016, assets grew 12%, deposits were up 14%, and gross loans grew 13%. Stockholders' equity was \$32.9 million, or 8.8% of assets, at September 30, 2016.

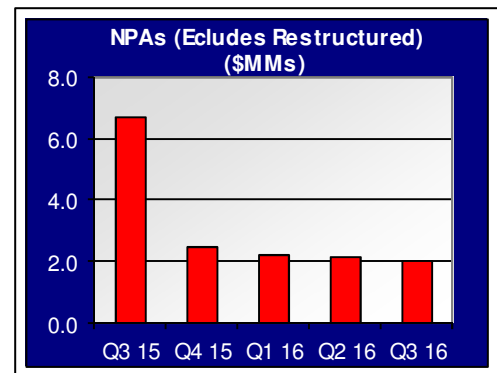
Peer Group Comparison Reflects Favorable Fundamentals and Value

Reflected below are some key performance and valuation metrics for Potomac Bancshares relative to a group of publicly traded banks in Maryland and West Virginia. As can be seen from the table, Potomac Bancshares had a higher ROAA and ROAE over the past 12 months than the median for the peer group, and also had better asset quality. Its dividend yield is nearly twice as high as the typical community bank in these states, and its ability to build value over time has been better as well, as measured by a total return that is also nearly twice the median. Despite the superior performance, the shares are actually trading at a slight discount to the median multiples, both on the basis of book value and trailing 12-month earnings. The compelling value is one of the reasons that insiders continue to buy stock, in addition to the Company repurchasing shares from time to time.

PEER GROUP COMPARISON: PTBS VS. WV AND MD PUBLIC BANKS UNDER \$2 BB							
	ROAA LTM	ROAE LTM	NPAs/ Assets	Dividend Yield	5 Year Total Return	Price/ LTM EPS	Price/Tang. Book Value
PTBS	0.67%	7.19%	0.53%	3.0%	125%	12.3x	0.89x
Peer Median	0.58%	6.17%	1.19%	1.6%	67%	15.3x	0.96x

Asset Quality Remains Quite Good

NPAs continue to trend lower. As of September 30, 2016, nonperforming assets (which we define as nonaccruing loans, over 90 day past due loans that are still accruing and OREO) were \$2.0 million, or 0.53% of assets, versus \$2.1 million, or 0.58% of assets, at June 30, 2016 and \$6.7 million, or 2.00% of assets, at September 30, 2015. (Excluded from these figures are restructured loans that are accruing.) The allowance for loan losses was \$2.9 million (0.94% of gross loans) at September 30, 2016, versus \$2.7 million (0.98% of gross loans) at the year-ago date.



Projections Lowered

Based on the third quarter results, we are lowering our 2016 earnings projection to \$2.3 million, or \$0.68 per diluted share. For 2017, we project earnings will increase to \$2.6 million, or \$0.78 per diluted share. These projections could vary widely depending on changing economic and credit conditions.

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