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## Potomac Bancshares, Inc. (OTC Pink - PTBS)

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**John A. (Buddy) Howard, CFA**  
**August 27, 2018**

<b>Price:</b>	\$15.36	<b>EPS *</b>	<b>2016A:</b>	\$ 0.66	<b>P/E</b>	<b>2016A:</b>	23.3x
<b>52 Wk. Range:</b>	\$12.30 - \$17.00	(FY: DEC)	<b>2017A:</b>	\$ 1.14		<b>2017A:</b>	13.5x
<b>Div/Div Yld:</b>	\$0.28 / 1.8%		<b>2018E:</b>	\$ 1.16		<b>2018E:</b>	13.2x
<b>Shrs/Mkt Cap:</b>	3.3 mm / \$51 mm	<b>Book Value:</b>		\$11.15	<b>Price/Book Value:</b>		1.38x

\* Diluted. 2017 EPS includes nonrecurring items, including a tax-related charge, life insurance proceeds and securities gains.

### 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 \$427 million in assets as of June 30, 2018, 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."

### Second Quarter Results Were Slightly Ahead of Estimates

For the second quarter of 2018, Potomac Bancshares reported earnings that were slightly above our projections. Moreover, while reported net income was down compared to the year-ago quarter, this was due to: 1) a large gain on the sale of securities in the second quarter of 2017, and 2) a provision for loan losses of \$78,000 in 2018's second quarter, versus none in the year-ago quarter. If we exclude both of these items, we see that the adjusted pretax income was actually up slightly from the year ago figures, which was all the more impressive given the Company's recent expansion activities (discussed later). Balance sheet growth was fairly stable, with commendable deposit growth, and asset quality improved both from the year-ago date and on a linked quarter basis.

Reported net income for the second quarter of 2018 was \$1,007,000, or \$0.30 per diluted share, as compared to \$1,082,000, or \$0.32 per diluted share, in the year-ago quarter. Earnings were up 12% from \$900,000, or \$0.27 per diluted share, from the linked first quarter of 2018. Backing out the security gain and a loss on OREO from the year-ago quarter, as well as the provision in the second quarter of 2018, pretax adjusted earnings increased roughly 1%. The increase in core earnings on an *after-tax* basis (which reflects the drop in the federal tax rate from the Tax Cuts and Jobs Act of 2017) was even higher, as core *net* income actually increased about 14%. Net interest income grew 5% to \$3,651,000 in 2018's second quarter from \$3,488,000 in the year-ago quarter. Margins remained steady compared to the year-ago quarter, so the growth came primarily from increased volume. Noninterest income, excluding the security gain, grew 18% to \$1,259,000 in

Quarterly Results (\$000s)	2017 Q2	2018 Q2
Net Income	1,082	1,007
Pretax Income	1,667	1,294
Adjustments:		
Gain on Sale of Securities (Deduct)	(302)	-
Provision (Add)	-	78
Gains on Sale of OREO/Other (Add Losses)	(9)	-
<b>Pretax Inc. Bef. Nonrec/Credit Charges</b>	<b>1,356</b>	<b>1,372</b>

ASSETS: \$427 MM

HQ: CHARLES TOWN, WV

CONTACT:  
ALICE FRAZIER, CEO  
DEAN J. COGNETTI, CFO

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2<sup>ND</sup> QUARTER HIGHLIGHTS:

YEAR-AGO EARNINGS INCLUDED  
A LARGE SECURITY GAIN

EPS WERE A PENNY ABOVE  
PROJECTIONS

EPS: \$0.30 vs. \$0.32

NET INTEREST INCOME WAS UP  
5% DUE TO HIGHER VOLUME

NET INCOME BEFORE THE YEAR-  
AGO SECURITY GAIN WAS UP  
14%

**NONINTEREST INCOME, EXCLUDING SECURITY GAINS IN THE YEAR-AGO QUARTER, INCREASED 18%**

**SIX MONTH HIGHLIGHTS:**

**EPS: \$0.57 vs. \$0.73**

**EXCLUDING NONRECURRING FACTORS IN THE YEAR-AGO PERIOD, EPS WAS \$0.47**

**BALANCE SHEET GROWTH SHOULD BENEFIT FROM EXPANSION**

**EQUITY/ASSETS: 8.7%**

**THERE ARE A NUMBER OF GROWTH INITIATIVES IN PLACE, SUCH AS NEW LOCATIONS, THE HIRING OF KEY PEOPLE AND A STOCK OFFERING**

**ASSET QUALITY HAS BEEN HOLDING UP WELL**

**NPAs/ASSETS: 0.32%, COMPARED TO THE PEER GROUP MEDIAN OF 0.86%**

**RESERVES/LOANS: 0.91%**

**EPS:  
2016A: \$ 0.66  
2017A: \$ 1.14 \*  
2018E: \$ 1.16**

**\* INCLUDES NONRECURRING ITEMS, SUCH AS A TAX-RELATED CHARGE, LIFE INSURANCE PROCEEDS AND SECURITY GAINS**

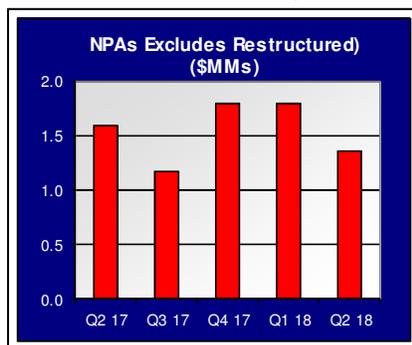
the second quarter of 2018 from \$1,067,000 in the year-ago quarter, due to notable increases in the Company's wealth management business and secondary market lending, which we will discuss further in one of our next reports. Finally, noninterest expense was up 11% to \$3,538,000 for the second quarter of 2018, as compared to \$3,190,000 in the year-ago quarter, mostly related to the recent expansion.

Results for the first half were likewise impacted by nonrecurring factors. For the six months ended June 30, 2018, Potomac Bancshares reported net income of \$1,907,000, or \$0.57 per diluted share, compared to \$2,436,000, or \$0.73 per share, in the same period of 2017. Excluding nonrecurring income from 2017 (BOLI proceeds and the security gain), adjusted *net* income for the first half of 2017 was \$1,567,000, or \$0.47 per diluted share, implying core net income growth of 22% from the \$1,907,000 reported in 2018's first six months. Net interest income was up 5%, noninterest income, excluding BOLI income and security gains, increased 11% and noninterest expense increased 9%. The provision for loan losses totaled \$144,000 for the first half of 2018, compared to \$180,000 in the year-ago first half. While balance sheet growth was led by deposits, we expect more broad based growth going forward. Some of this should occur as the new Purcellville branch matures and the Leesburg loan production office opens later this year. In terms of recent growth (from June 30, 2017 to June 30, 2018), total assets increased 4% and deposits were up 6%. While loans were down slightly compared to the year-ago date, this was partly due to a large payoff at the end of 2018's second quarter. Stockholders' equity was \$37.0 million, or 8.7% of assets, at June 30, 2018, and all of the Bank's regulatory capital ratios met "well capitalized" minimum requirements.

**Potomac Has Adopted Several Growth Initiatives**

Potomac has adopted a number of growth initiatives that should benefit long-term earnings. As was stated above, Potomac recently opened a new office in Purcellville, VA and plans to open a loan production office in Leesburg, VA. It is growing its mortgage area and SBA/USDA/government contract lending, and has added executives in some key slots, one recent one being the new Virginia market president. While the Company is well capitalized, it is preparing for an acceleration in growth, one example being that it has begun a private placement offering for up to \$10 million of its common stock, which is expected to conclude in the third quarter of 2018.

**NPAs Continue to Decline, and Were Down 15% From the Year-Ago Date**



Potomac Bancshares' asset quality has improved from the year-ago quarter, and also on a linked quarter basis, as can be seen from the adjacent chart. NPAs (which we define as nonaccruing loans, over 90 day past due loans that are still accruing and OREO) were \$1.4 million, or 0.32% of total assets, at June 30, 2018, which was down 24% from \$1.8 million, or 0.42% of assets, at March 31, 2018, and down 15% from \$1.6 million, or 0.37% of total assets, at the year-ago date. The allowance for loan losses was \$3.2 million, or 0.91 of gross loans, at June 30, 2018, versus \$3.4 million, or 0.97% of loans at June 30, 2017.

**Projections Maintained**

We are maintaining our 2018 earnings projections for Potomac Bancshares at \$3.9 million, or \$1.16 per diluted share. However, it should be noted that these projections have not been adjusted for the pro forma impact of the Company's stock offering, and therefore the projections will likely be adjusted once the offering is concluded. These projections could also vary widely depending on changing economic and credit conditions, especially given the income swings that sometimes accompanies SBA and USDA lending.

ADDITIONAL INFORMATION UPON REQUEST

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