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Potomac Bancshares, Inc. (OTC Pink - PTBS)

5003 Falls of Neuse Road

Raleigh
North Carolina
27609

919-876-8868 ph

www.equityresearch.com

John A. (Buddy) Howard, CFA
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Price:	\$11.93	EPS *	2015A:	\$ 0.76	P/E	2015A:	15.7x
52 Wk. Range:	\$8.27 - \$11.93	(FY: DEC)	2016A:	\$ 0.66		2016A:	18.1x
Div/Div Yld:	\$0.28 /2.3%		2017E: *	\$ 0.95		2017E:	12.6x
Shrs/Mkt Cap:	3.3 mm / \$40 mm	Book Value:		\$10.49	Price/Book Value:		1.14x

* Diluted. 2017 earnings estimate excludes \$0.20 per share in life insurance proceeds, as well as a \$0.06 securities gain.

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 \$411 million in assets as of June 30, 2017, 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 Quite Strong, Even Excluding the Securities Gain

Potomac Bancshares reported excellent second quarter results. While some of the strength in earnings was due to a \$302,000 gain on the sale of a security, earnings even excluding that gain were well above the year-ago numbers, as well as coming in above our projections. The quarter was also encouraging from the standpoint of overall balance sheet growth (which has been quite consistent), as well as from the standpoint of asset quality, which improved again in the quarter. Reflecting the positive fundamentals, the Board of Directors increased the Company's quarterly cash dividend. Finally, on a highly significant note, the Company hired a new CEO (Alice Frazier) to replace Bob Baronner, Jr., who died early this year.

Net income in the second quarter of 2017 was \$1,082,000, or \$0.32 per diluted share, up from \$658,000, or \$0.20 per diluted share, in 2016's second quarter. In addition to the securities gains mentioned above, the earnings comparisons were affected by the fact that there was a significant provision for loan losses in the year-ago quarter.

If we exclude both of these items, as well as gains on the sale of OREO in both quarters, we see that the pretax income before nonrecurring and credit-related charges increased 15% to \$1,356,000 in 2017's second quarter from \$1,184,000 in the year-ago quarter. Net interest income remained strong, increasing 11% to \$3,488,000 in 2017's second quarter from \$3,129,000 in the year-ago quarter, with all of that improvement coming from average earning asset growth, as margins decreased modestly. Noninterest income, excluding the security gain, was down 3% to \$1,067,000 in 2017's second quarter, versus \$1,105,000 in the year-ago quarter, while noninterest expense was up about 5% to \$3,190,000 in 2017's second quarter.

	2016 Q2	2017 Q2
Quarterly Results (\$000s)		
Net Income	658	1,082
Pretax Income	1,020	1,667
Adjustments:		
Gain on Sale of Securities	(34)	(302)
Provision (Add)	204	-
Gains on Sale of OREO/Other (Add Losses)	(6)	(9)
Pretax Inc. Bef. Nonrec/Credit Charges	1,184	1,356

ASSETS: \$411 MM

HQ: CHARLES TOWN, WV

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

304-725-8431

2ND QUARTER HIGHLIGHTS:

IT WAS A SIGNIFICANT QUARTER, WITH STRONG EARNINGS AND BALANCE SHEET GROWTH, A HIGHER DIVIDEND AND THE HIRING OF A NEW CEO

EARNINGS IN 2017'S SECOND QUARTER INCLUDED \$0.06 PER SHARE IN A SECURITY GAIN

EVEN EXCLUDING THIS GAIN, HOWEVER, EARNINGS WERE QUITE STRONG

NET INTEREST INCOME WAS STRONG, WHILE NONINTEREST INCOME DECLINED

FIRST HALF HIGHLIGHTS:

EPS: \$0.73 (\$0.47 EXCLUDING THE LIFE INSURANCE AND SECURITY GAIN) VS. \$0.34

BALANCE SHEET GROWTH HAS GENERALLY BEEN IN THE DOUBLE DIGITS

NEW CEO BRINGS A BROAD BASE OF EXPERIENCE IN BOTH OPERATIONS AND FINANCE

POTOMAC BANCSHARES STOCK HAS PERFORMED QUITE WELL OVER A ONE, THREE AND FIVE YEAR BASIS

THE DIVIDEND WAS RECENTLY INCREASED AND HAS BEEN AN IMPORTANT COMPONENT OF LONG-TERM RETURNS

ASSET QUALITY IS EXCELLENT

NPAs/ASSETS: 0.39%

RESERVES/LOANS: 0.97%

**EPS:
2015A: \$ 0.76
2016A: \$ 0.66
2017E: \$ 0.95 ***

EXCLUDES LIFE INSURANCE PROCEEDS OF ROUGHLY \$0.20 PER SHARE AND A SECURITY GAIN OF \$0.06 PER SHARE

First Half EPS Was Strong As Well

For the first six months of 2017, Potomac Bancshares reported net income of \$2,436,000, or 0.73 per diluted share, as compared to \$1,146,000, or \$0.34 per diluted share, in the year-ago period. Excluding roughly \$670,000 in life insurance proceeds that was received in 2017’s first quarter and the recent security gain, earnings growth was still quite impressive. Net income excluding both of these items increased 37% from the year-ago level to \$1,567,000, or \$0.47 per diluted share, in 2017’s first half. Net interest income was up 12%, noninterest income (excluding the life insurance proceeds and security gain) was essentially flat and noninterest expense rose 3%. Balance sheet growth remained quite strong as well. From June 30, 2016 to June 30, 2017, assets grew 11%, while loans and deposits increased 12%. Stockholders’ equity was \$35.1 million, or 8.5% of assets, at June 30, 2017. All of the Bank’s regulatory ratios exceed those necessary to be considered “well capitalized.”

New CEO Hired

One of the other significant events of the quarter was the hiring of a new CEO, Alice Frazier. Additionally, in August, Ms. Frazier was elected to both the Boards of Bank of Charles Town and Potomac Bancshares, Inc. Ms. Frazier was formerly the COO of Cardinal Financial Corporation (out of McLean, VA), but has also served as CFO of a community bank during her career, not to mention four years that she spent in public accounting. Both of the community banks she previously worked with were publicly traded as well. As a result, she has a very broad base of professional experience that should serve Potomac shareholders quite well. She is currently the Chair of the Virginia Association of Community Banks and has served in various capacities with the Independent Community Bankers Association.

Potomac’s Stock Returns Have Been Impressive; Dividend Increased

Potomac has done an excellent job of building shareholder value over the past five years. As can be seen from the adjacent table, the shares have appreciated 37% over the past year, 49% over the past three years and 174% over the past five years. The total returns (including cash dividends) are even higher, with the dividends accounting for a greater percentage of the total return as time increases. On a related note, the Board of Directors recently boosted the quarterly cash dividend to \$0.07 per share from \$0.065 per share, which is an increase of 8% and represents a current yield on the stock of 2.3%. This dividend level also represents a reasonable payout ratio of less than 30%, based on our 2017 EPS estimate of \$0.95. Over the years, management and the Board have been highly active in supporting shareholder value, not only through increasing cash dividends but also buying back stock.

Cumulative Returns Over:	Potomac (PTBS)			KBW NASDAQ Bank Index Increase
	Total Return	Annual Rate	Price Increase	
One Year	41%	41%	37%	39%
Three Years	61%	17%	49%	42%
Five Years	207%	25%	174%	109%

Asset Quality Remains Quite Good

As of June 30, 2017, nonperforming assets (which we define as nonaccruing loans, over 90 day past due loans that are still accruing and OREO) were \$1.6 million, or 0.39% of assets, versus \$2.5 million, or 0.61% of assets, at March 31, 2017 and \$2.2 million, or 0.58% of assets, at June 30, 2016. (Excluded from these figures are restructured loans that are accruing.) The allowance for loan losses was \$3.4 million (0.97% of gross loans) at June 30, 2017, versus \$2.7 million (0.87% of gross loans) at the year-ago date.

Projections Increased

Based on the strength of the second quarter results, we are increasing our 2017 earnings projections to \$3.1 million, or \$0.95 per diluted share (excludes the life insurance proceeds and recent security gain, which in aggregate total \$0.26 per share). These projections could vary widely depending on changing economic and credit conditions.

ADDITIONAL INFORMATION UPON REQUEST

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