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Potomac Bancshares, Inc. (OTC Pink - PTBS)

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Price:	\$10.60	EPS *	2015A:	\$ 0.76	P/E	2015A:	13.9x
52 Wk. Range:	\$8.27 - \$11.20	(FY: DEC)	2016A:	\$ 0.66		2016A:	16.1x
Div/Div Yld:	\$0.26 / 2.5%		2017E: *	\$ 0.80		2017E:	13.3x
Shrs/Mkt Cap:	3.3 mm / \$35 mm	Book Value:		\$10.27	Price/Book Value:		1.03x

* Diluted. 2017 earnings estimate excludes \$0.20 per share in life insurance proceeds.

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 \$409 million in assets as of March 31, 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."

First Quarter Results Were Excellent, Even Excluding One-Time Benefit

Potomac Bancshares reported first quarter earnings that were better than we had projected. While some of that stronger than expected performance was due to the receipt of life insurance proceeds that boosted earnings by \$670,000 (\$0.20 per share), we would note that earnings excluding that item were still a strong improvement over the year-ago figures and were better than we had modeled. The main contributors to that strength were impressive net interest income and noninterest income growth, combined with excellent expense control. It was also a great quarter from the standpoint that balance sheet growth (and loan growth in particular) was strong, which is one more sign that the Bank's expansion strategy is working. Finally, asset quality remained good. Although NPAs did increase from the linked quarter and year-ago levels, they remain low as a percentage of assets.

Net income in the first quarter of 2017 was \$1,354,000, or \$0.40 per diluted share, up from \$488,000, or \$0.15 per diluted share, in 2016's first quarter. As was stated above, included in the 2017's first quarter results were life insurance proceeds totaling \$670,000, or \$0.20 per diluted share. In addition to the insurance proceeds, the first quarter comparisons were affected by a higher provision in 2017's first quarter (\$180,000 in 2017's first quarter, versus \$100,000 in the year-ago quarter), as well as net gains on security and property sales in 2016 and a net OREO loss in 2017. Bottom line, if we make the adjustments for all of these items, we see that pretax adjusted earnings were still quite strong, increasing 66% to \$1,273,000 in the first quarter of 2017 from \$769,000 in 2016's first quarter.

	2016 Q1	2017 Q1
Quarterly Results (\$000s)		
Net Income	488	1,354
Pretax Income	744	1,748
Adjustments:		
Life Insurance Proceeds	-	(670)
Provision (Add)	100	180
Gains/Losses on Sale of OREO (Add Losses)	(75)	15
Pretax Inc. Bef. Nonrec/Credit Charges	769	1,273

ASSETS: \$409 MM

HQ: CHARLES TOWN, WV

CONTACT:
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CFO AND ACTING CEO
304-725-8431

1ST QUARTER HIGHLIGHTS:

EARNINGS IN 2017'S FIRST
QUARTER INCLUDED
ROUGHLY \$0.20 PER SHARE IN
LIFE INSURANCE PROCEEDS

THERE WERE ALSO NET GAINS
ON SECURITY AND PROPERTY
SALES IN 2016, AND A NET
OREO LOSS IN 2017

EPS: \$0.40 vs. \$0.15

EXCLUDING THE LIFE
INSURANCE PROCEEDS AND
OTHER NONRECURRING
ITEMS, PRETAX OPERATING
EARNINGS WERE STILL QUITE
STRONG, INCREASING 66%

NET INTEREST INCOME WAS UP 13%

COST CONTAINMENT WAS IMPRESSIVE AS WELL

LOAN GROWTH CONTINUES TO BE STRONG, WITH LOANS INCREASING 15% OVER THE PAST YEAR

GROWTH WAS COMPARABLE IN ASSETS AND DEPOSITS

POTOMAC BANCSHARES STACKS UP WELL RELATIVE TO PUBLICLY TRADED PEERS

THE STOCK TRADES AT A DISCOUNT TO THE GROUP, WHICH WE BELIEVE POSITIONS THE STOCK FOR BETTER THAN TYPICAL LONG-TERM RETURNS

NPAs INCREASED BUT ASSET QUALITY IS STILL GOOD

NPAs/ASSETS: 0.61%

RESERVES/LOANS: 0.97%

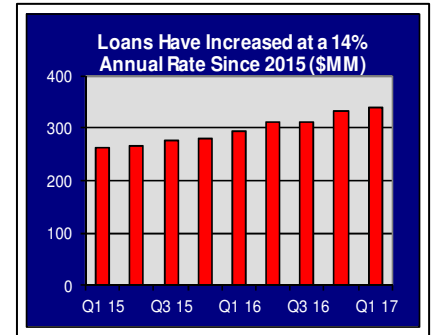
EPS:
2015A: \$ 0.76
2016A: \$ 0.66
2017E: \$ 0.80 *

EXCLUDES LIFE INSURANCE PROCEEDS OF ROUGHLY \$0.20 PER SHARE

Much of the strength in operating earnings came from net interest income, which grew 13% to \$3,345,000 in 2017's first quarter from \$2,963,000 in the year-ago quarter, with essentially all of that improvement coming from average earning asset growth, as margins increased about six basis points. Noninterest income, excluding the life insurance proceeds and security/OREO gains and losses, was up 14% to \$1,090,000 in 2017's first quarter, versus \$957,000 in the year-ago quarter. Finally, we would note that the Company continues to do an excellent job containing costs, as noninterest expense was essentially unchanged at \$3.2 million in both quarters.

Balance Sheet Growth Has Been in the Double Digits

Potomac Bancshares continues to do an excellent job of growing its balance sheet, and that growth has been fairly consistent for several years. Over the past year, gross loans increased 15%, while assets and deposits grew 14%. The fact that the Company has been able to maintain this type of growth rate is a testament to the economic vitality of its markets, as well as its organic growth initiative (the most recent branches being the Hagerstown, MD and Middleburg, VA offices, which were opened in 2014 and 2013, respectively). The Company remains in excellent shape from a capital standpoint to continue this growth, as stockholders' equity was \$34.3 million, or 8.4% of assets, at March 31, 2017, versus \$32.2 million, or 9.0% of assets, at the year-ago date.



Peer Group Comparison

As can be seen from the table below, Potomac Bancshares has higher profitability measures than its peer group, and also had better asset quality. Its dividend yield is higher than its peers, and its ability to build value over time has been better as well, as measured by a total return that is nearly twice the median. Despite the superior performance, Potomac shares trade at a discount to the median multiples, both on the basis of book value and trailing 12-month earnings. For this reason, we believe the valuation of Potomac shares is still quite attractive.

PEER GROUP COMPARISON: PTBS VS. WV AND MD PUBLIC BANKS FROM \$250 MM TO \$1.5 BB							
	ROAA LTM	ROAE LTM	NPAs/ Assets	Dividend Yield	5 Year Total Return	Price/ LTM EPS	Price/Tang. Book Value
PTBS *	0.64%	7.11%	0.61%	2.5%	167%	14.7x	1.03x
Peer Median	0.57%	6.05%	1.38%	1.5%	89%	16.2x	1.08x

* Earnings measures exclude life insurance proceeds

Asset Quality Remains Quite Good

Although NPAs increased in the first quarter, the ratio of NPAs to assets is still low, and compares favorably to its peers, as was mentioned above. As of March 31, 2017, nonperforming assets (which we define as nonaccruing loans, over 90 day past due loans that are still accruing and OREO) were \$2.5 million, or 0.61% of assets, versus \$1.9 million, or 0.49% of assets, at December 31, 2016 and \$2.2 million, or 0.61% of assets, at March 31, 2016. (Excluded from these figures are restructured loans that are accruing.) The allowance for loan losses was \$3.3 million (0.97% of gross loans) at March 31, 2017, versus \$2.6 million (0.87% of gross loans) at the year-ago date.

Projections Increased

Based on the strength of the first quarter results, we are slightly increasing our 2017 earnings projections to \$2.7 million, or \$0.80 per diluted share (excludes the life insurance proceeds of \$670,000, or \$0.20 per share). These projections could vary widely depending on changing economic and credit conditions.

ADDITIONAL INFORMATION UPON REQUEST

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