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

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**John A. (Buddy) Howard, CFA**  
**February 19, 2016**

<b>Price:</b>	\$9.00	<b>EPS *</b>	<b>2014A:</b>	\$ 0.64	<b>P/E</b>	<b>2014A:</b>	14.1x
<b>52 Wk. Range:</b>	\$7.07 - \$9.30	(FY: DEC)	<b>2015A:</b>	\$ 0.76		<b>2015A:</b>	11.8x
<b>Div/Div Yld:</b>	\$0.24 / 2.7%		<b>2016E:</b>	\$ 0.80		<b>2016E:</b>	11.3x
<b>Shrs/Mkt Cap:</b>	3.3 mm / \$30 mm	<b>Book Value:</b>		\$ 9.52	<b>Price/Book Value:</b>		0.95x

\* 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 \$352 million in assets as of December 31, 2015, 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".

### Fourth Quarter Results Were Excellent; Earnings Were Up 24% from the Year-Ago Quarter

Potomac Bancshares reported fourth quarter results that were better than we had projected. Moreover, the Bank continued to expand its presence in its markets and achieved strong growth in loans, deposits and assets. Asset quality also improved markedly at the end of the year, as we had anticipated and had discussed in our last report. Bottom line, momentum (in terms of balance sheet growth, earnings trends and asset quality) is quite good. Partly reflecting that favorable outlook, the Board of Directors recently increased the cash dividend. Also reflecting the strength of the Company's performance, the stock has appreciated 14% from where it was as of our initial report dated November 19, 2015.

In terms of specific results, Potomac Bancshares' net income in 2015's fourth quarter was \$752,000, or \$0.22 per diluted share, up 24% (22% on a per share basis) from \$608,000, or \$0.18 per diluted share, in the year-ago quarter. As has been the case over the past several quarters, most of the strength in earnings came from a combination of higher net interest income, along with a lower provision for loan losses. Net interest income increased 7% to \$2,894,000 in 2015's fourth quarter, up from \$2,713,000 in the year-ago quarter. Average earning assets were up about 8% in the quarter relative to the year-ago quarter, which more than offset a modest decline in the net interest margin. Earnings also benefitted from a lower provision, which was a credit for loan losses of \$37,000 in 2015's fourth quarter, versus a provision of \$61,000 in 2014's fourth quarter. Noninterest income also reflected strong improvement, increasing 12% to \$1,283,000 in the fourth quarter of 2015, as compared to \$1,148,000, in the year-ago quarter. Finally, noninterest expense was \$3,050,000 in 2015's fourth quarter, up 6% from \$2,870,000 in the year-ago quarter. Profitability ratios remained quite high; return on average equity was 9.45% in 2015's fourth quarter, while annualized return on average assets was 0.86%, versus year-ago figures of 7.75% and 0.76%, respectively.

**ASSETS: \$352 MM**

**HQ: CHARLES TOWN, WV**

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

**4<sup>TH</sup> QUARTER HIGHLIGHTS:**

**EPS: \$0.22 vs. \$0.18**

**NET INTEREST INCOME WAS UP 7%, MAINLY DUE TO GROWTH IN AVERAGE EARNING ASSETS**

**EARNINGS BENEFITTED FROM A CREDIT FOR LOAN LOSSES, VERSUS A PROVISION IN THE YEAR-AGO QUARTER**

**NONINTEREST INCOME POSTED A NICE INCREASE OF 12%**

**NONINTEREST EXPENSE INCREASED 6%**

**TWELVE-MONTH HIGHLIGHTS:**

**EPS: \$0.76 vs. \$0.64**

**ASSETS AND DEPOSITS GREW 10%, WHILE LOANS GREW 9%**

**EQUITY/ASSETS: 9.0%**

**CASH DIVIDEND WAS INCREASED 14%**

**YIELD IS NOW 2.7%, AND THE PAYOUT RATIO IS LOW ENOUGH TO ALLOW ROOM FOR FUTURE INCREASES**

**THE BOARD HAS ALSO SUPPORTED SHAREHOLDER VALUE BY BUYING BACK SHARES**

**SHARES ARE NOW TRADING CLOSER TO THE MEDIAN FOR WEST VIRGINIA BANKS BUT CERTAINLY DO NOT LOOK OVERVALUED**

**NPAS DROPPED BY 56% IN THE PAST QUARTER**

**NPAS/ASSETS: 0.70%**

**RESERVES/LOANS: 0.91%**

**EPS:  
2014A: \$ 0.64  
2015A: \$ 0.76  
2016E: \$ 0.80**

Full year earnings comparisons were also strong. For the full year of 2015, Potomac Bancshares' net income was \$2,580,000, or \$0.76 per diluted share, versus \$2,159,000, or \$0.64 per diluted share, in 2014. The biggest contributor to earnings was the drop in the provision for loan losses, which was \$60,000 in 2015, down from \$814,000 in 2014. However, earnings also benefitted from growth in net interest income, which increased 5%. Noninterest income was essentially unchanged at \$4.5 million, while noninterest expense increased 5%. In terms of balance sheet growth, gross loans increased 9% from December 31, 2014 to December 31, 2015, while assets and deposits grew 10%. The newer offices (Hagerstown, MD and Middleburg, VA) continue to contribute a good portion to this growth. As of December 31, 2015, stockholders' equity was \$31.8 million, or 9.0% of assets.

**Board of Directors Increases Cash Dividend 14%**

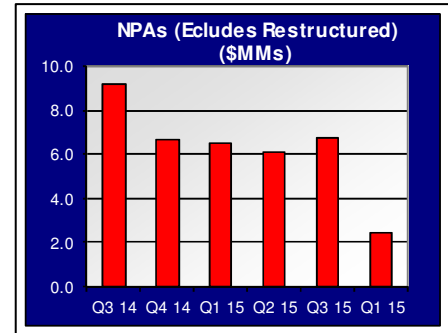
As we mentioned at the beginning of the report, the Board of Directors recently boosted the quarterly cash dividend to \$0.06 per share from \$0.0525 per share previously, which is an increase of 14%. Based on the current price of the stock, this equates to a yield of 2.7%. Given that earnings are expected to be approximately \$0.80 this year, the payout ratio (\$0.24/\$0.80) is still reasonably low at 30%, which bodes well for the Company to maintain dividend increases in the future. We would also note that over the past year, the Company repurchased more than 45,000 shares of stock. Since these repurchases occurred at prices below book value, they were accretive to book value per share. They were also accretive to EPS, and they evidence the Board's (and management's) optimism in the future value of the Company.

**Relative Value is Still Reasonable in our View**

As was mentioned at the outset of this report, PTBS shares are up about 14% since our initial report was written. Based on the most recent price, the shares are trading at 95% of tangible book value, and roughly 11.8x trailing 12 month earnings. That multiple of tangible book value is right in line with other West Virginia banks, but the multiple of earnings is still below the West Virginia median of 13.1x. Given Potomac's relatively high ROAE and solid fundamentals, we believe the outlook for the stock remains reasonably good, particularly over the long-term.

**NPAs Dropped by More than Half in the Past Quarter**

As we had expected, asset quality improved significantly in the past three months, as a large payment was received on a nonperforming loan early in the fourth quarter. As of December 31, 2015, total 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 0.70% of assets, down from \$6.7 million, or 2.01% of assets, at September 30, 2015 and \$6.7 million, or 2.07% of total assets, at December 31, 2014. (Excluded from these figures are restructured loans that are accruing.) The allowance for loan losses was \$2.5 million (0.91% of gross loans) at December 31, 2015, versus \$2.7 million (1.04% of gross loans) at the year-ago date



**Projections Maintained**

Although earnings were better than we had expected, we are, at this time, maintaining our earnings estimates. Specifically, we are estimating 2016 earnings of \$2.7 million, or \$0.80 per diluted share. However, we do believe the 2016 projection may be a touch conservative, and will consider increasing our earnings estimates once 2016's first quarter results are released. These projections could vary widely depending on changing economic and credit conditions.

**ADDITIONAL INFORMATION UPON REQUEST**

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