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Potomac Bancshares, Inc. (OTC Pink - PTBS)

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March 9, 2018

Price:	\$15.30	EPS *	2016A:	\$ 0.66	P/E	2016A:	23.2x
52 Wk. Range:	\$10.25 - \$15.30	(FY: DEC)	2017A:	\$ 1.14		2017A:	13.4x
Div/Div Yld:	\$0.28 / 1.8%		2018E:	\$ 1.25		2018E:	12.2x
Shrs/Mkt Cap:	3.3 mm / \$51 mm	Book Value:		\$10.78	Price/Book Value:		1.42x

* 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 \$425 million in assets as of December 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."

Fourth Quarter Earnings Were Affected by Tax Charge; Operating Results Were Strong

Potomac Bancshares reported strong operating results in 2017's fourth quarter. A nonrecurring deferred tax asset charge came about as a result of the recently enacted Tax Cuts and Jobs Act of 2017, which resulted in a revaluation of the Company's deferred tax assets. While this charge (of \$314,000) negatively impacted the quarterly and annual earnings, it will result in a significant drop in the Company's effective tax rate from 34% to 21% going forward. Many banks, due to a disproportionate percentage invested in tax-favored (i.e., municipal) bonds, have had relatively low effective tax rates, and will therefore receive limited near-term benefits from the new legislation. However, given Potomac Bancshares' fairly high effective tax rate (it was 34% in 2016 and 30% through the first nine months of this year), this drop in tax rates should boost the Company's earnings, which is part of the reason we have increased our 2018 earnings estimate. But back to the quarter, the results were quite commendable if we eliminate the nonrecurring tax-related charge. Moreover, asset quality held up reasonably well and balance sheet growth was good, particularly relative to the year-ago level. Finally, the stock continues to advance, and is up 18% from our last report dated November 26, 2017.

Reported net income for the fourth quarter of 2017 was \$422,000, or \$0.13 per diluted share, versus \$587,000, or \$0.18 per diluted share, in the year-ago quarter. Excluding the tax-related charge, net income was \$736,000, or \$0.22 per diluted share, in 2017's fourth quarter. The main factors contributing to the improved earnings (excluding the tax charge) were higher net interest income and a lower provision for loan losses. Net interest income increased 9% to \$3,599,000 in 2017's fourth quarter from \$3,287,000 in the year-ago quarter. Margins declined modestly, although strong average earning assets growth more than offset the margin impact. Earnings also benefitted from a lower provision for loan losses, as it was zero in 2017's fourth quarter, versus \$363,000 in the year-ago quarter. Noninterest income decreased 5% to \$1,080,000 in 2017's fourth quarter from \$1,135,000 in

ASSETS: \$425 MM

HQ: CHARLES TOWN, WV

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DEAN J. COGNETTI, CFO

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4TH QUARTER HIGHLIGHTS:

**EARNINGS WERE AFFECTED BY A
TAX-RELATED CHARGE**

**REPORTED EPS:
\$0.13 VS. \$0.18**

**EPS BEFORE THE TAX-RELATED
CHARGE IN 2017'S FOURTH
QUARTER WAS \$0.22 PER SHARE**

**NET INTEREST INCOME
INCREASED 9% DUE TO HIGHER
AVERAGE EARNING ASSETS**

**NONINTEREST INCOME
DECLINED 5%**

the year-ago quarter, while noninterest expense was up 13% to \$3,586,000 from \$3,169,000 over this period.

Full Year Operating Results Were Likewise Commendable

Earnings for the full year likewise included a number of nonrecurring factors. For the full year of 2017, net income was \$3,811,000, or \$1.14 per diluted share, versus \$2,218,000, or \$0.66 per diluted share, in 2016. Excluding nonrecurring gains and losses in both periods, life insurance proceeds that were received in 2017 and the provision for loan losses, adjusted pretax income was up 23% in 2017 versus 2016, as can be seen in the adjacent table. Net interest income grew 11% to \$13,990,000 in 2017 from \$12,571,000 in 2016, while noninterest income, excluding nonrecurring items, was up about 1%. Noninterest expense was up about 4% over this period. As was discussed earlier, balance sheet growth held up well also. From December 31, 2016 to December 31, 2017, assets grew 11%, deposits were up 12%, and gross loans grew 4%. Stockholders' equity was \$35.8 million, or 8.4% of assets, at December 31, 2017.

Annual Results (\$000s)	2016	2017
Net Income	2,218	3,811
Pretax Income	3,386	5,919
Adjustments:		
Gain on Sale of Securities (Deduct)	(121)	(302)
Provision (Add)	928	180
Life Insurance Proceeds (Deduct)	-	(670)
Gains on Sale of OREO/Other (Add Losses)	(26)	4
Pretax Inc. Bef. Nonrec/Credit Charges	4,167	5,131

FULL YEAR HIGHLIGHTS:

ANNUAL EARNINGS LIKEWISE INCLUDED A NUMBER OF UNUSUAL OR NONRECURRING ITEMS

EPS: \$1.14 vs. \$0.66

BALANCE SHEET GROWTH WAS SOLID AS WELL

POTOMAC'S STOCK PRICE HAS FAR OUTPERFORMED BROADER MARKET BENCHMARKS ON A 1-, 3- AND 5-YEAR BASIS

THE STOCK HAS AN ANNUAL RATE OF RETURN OF 24% OVER THE PAST 5 YEARS

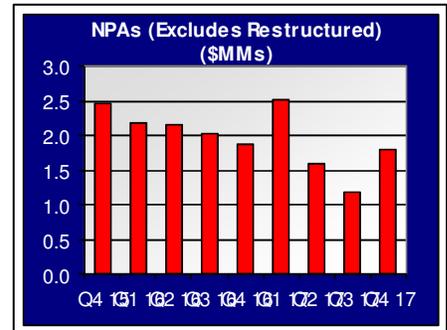
Potomac's Stock Continues to Advance

Potomac's performance has continued to attract buying interest in its stock, which has been manifested by a strong record of appreciation. As can be seen from the adjacent table, the shares have appreciated 38% over the past year, 86% over the past three years and 155% over the past five years. The total returns (including cash dividends) are even higher. These rates of appreciation far exceed those of broader market indices, such as the KBW Bank Index. Management and the Board continue to actively support shareholder value, not only through higher cash dividends but stock buybacks as well.

Cumulative Returns Over:	Potomac (PTBS)			KBW NASDAQ
	Total Return	Annual Rate	Price Increase	Bank Index Increase
One Year	41%	41%	38%	20%
Three Years	101%	26%	86%	58%
Five Years	188%	24%	155%	105%

Asset Quality Remains Quite Good

Although asset quality slipped a little relative to 2017's third quarter, it improved relative to the year-ago quarter and the longer term trend is still favorable, as evidenced by the adjacent chart. As of December 31, 2017, Potomac Bancshares' nonperforming assets (which we define as nonaccruing loans, over 90 day past due loans that are still accruing and OREO) totaled \$1.8 million, or 0.42% of assets, versus \$1.2 million, or 0.28% of total assets, at September 30, 2017, and \$1.9 million, or 0.49% of total assets, at December 31, 2016. (Note that these figures exclude restructured loans that are still accruing.) At December 31, 2017, the allowance for loan losses was \$3.6 million, or 1.04% of gross loans, up from \$3.2 million, 0.96% of gross loans, at the year-ago date.



ASSET QUALITY HAS BEEN HOLDING UP WELL

NPAs/ASSETS: 0.42%

RESERVES/LOANS: 1.04%

EPS:
2016A: \$ 0.66
2017A: \$ 1.14 *
2018E: \$ 1.25

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

Projections Increased

We are raising our 2018 earnings projections to \$4.1 million, or \$1.25 per diluted share. These projections could vary widely depending on changing economic and credit conditions.

ADDITIONAL INFORMATION UPON REQUEST

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