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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:	\$15.30	EPS *	2016A:	\$ 0.66	P/E	2016A:	23.2x
52 Wk. Range:	\$10.45 - \$17.00	(FY: DEC)	2017A:	\$ 1.14		2017A:	13.4x
Div/Div Yld:	\$0.28 /1.8%		2018E:	\$ 1.16		2018E:	13.2x
Shrs/Mkt Cap:	3.3 mm / \$51 mm	Book Value:		\$10.93	Price/Book Value:		1.40x

* 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 \$432 million in assets as of March 31, 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."

First Quarter Results Were Strong; Year-Ago Figures Included Nonrecurring BOLI Income

Potomac Bancshares reported another strong quarter in the three months ended March 31, 2018. Although reported earnings were down relative to the year-ago quarter, the year-ago figures included significant Bank Owned Life Insurance ("BOLI") income, the absence of which would have led to an earnings increase in 2018's first quarter. The quarter was also encouraging in that balance sheet continued to expand and asset quality remained good. Expansion plans into the markets of Purcellville, VA (full service branch) and Leesburg, VA (initially, a loan production office) over the next quarter or two should help to bolster those balance sheet growth rates. Finally, we would note that the stock continues to perform well, and has a one-year return of 42%

Reported net income for the first quarter of 2018 was \$900,000, or \$0.27 per diluted share, versus \$1,354,000, or \$0.40 per diluted share, in the year-ago quarter. Excluding the BOLI income, which totaled \$670,000 and resulted from life insurance proceeds paid on a former executive officer, the year-ago net income was \$684,000, or \$0.20 per diluted share. The strength of the operating earnings was mainly due to net interest income, which increased 6% to \$3,537,000 in 2018's first quarter from \$3,345,000 in the year-ago quarter. Margins were down about 20 basis points to 3.43% from 3.63% in the year-ago quarter, with solid average earning assets growth in the quarter (up 11%) more than offsetting the softness in margins. Earnings also benefitted from a lower provision for loan losses, as it was \$66,000 in 2018's first quarter, versus \$180,000 in the year-ago quarter. Noninterest income, excluding the nonrecurring BOLI income from the year-ago quarter, decreased 2% to \$1,058,000 in 2018's first quarter from \$1,075,000 in the year-ago quarter. Finally, noninterest expense was up 7% to \$3,375,000 in 2018's first quarter from \$3,162,000 in the year-ago period. Core profitability

Profitability Ratios at a Glance

	2017	2018
Core EPS	\$ 0.20	\$ 0.27
Core ROAA (%)	0.71	0.86
Core ROAE (%)	8.23	10.07

ASSETS: \$432 MM

HQ: CHARLES TOWN, WV

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

304-725-8431

1ST QUARTER HIGHLIGHTS:

THE YEAR-AGO EARNINGS
INCLUDED NONRECURRING
INCOME

EXCLUDING THAT YEAR-AGO
NONRECURRING INCOME,
EARNINGS INCREASED SHARPLY
IN 2018'S FIRST QUARTER

CORE EPS: \$0.27 VS. \$0.20

NET INTEREST INCOME
INCREASED 6% DUE TO HIGHER
AVERAGE EARNING ASSETS

NONINTEREST INCOME,
EXCLUDING THE YEAR-AGO
NONRECURRING INCOME,
DECREASED 2%

ANNUALIZED ROAE: 10.07%

ANNUALIZED ROAA: 0.86%

POTOMAC HAS GROWN ITS DEPOSIT BASE IN EACH OF THE FOUR COUNTIES IN WHICH IT OPERATES

MARKET SHARE HAS INCREASED IN ALL OF THEM EACH YEAR FOR THE PAST THREE YEARS

THE BANK IS OPENING NEW OFFICES IN LOUDOUN COUNTY (VA), WHICH SHOULD HELP TO FURTHER BOOST MARKET SHARE IN THAT COUNTY

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 19% OVER THE PAST 5 YEARS

ASSET QUALITY HAS BEEN HOLDING STEADY

NPAS/ASSETS: 0.42%

RESERVES/LOANS: 1.06%

**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**

metrics were also impressive. As can be seen in the previous table, core annualized ROAA was 0.86% in the first quarter of 2018, while core annualized ROAE was 10.07%. Both percentages were well above year-ago figures. Balance sheet growth has generally been in the low to middle single digit range. Specifically, from March 31, 2017 to March 31, 2018, assets grew 6%, deposits were up 7%, and gross loans increased 2%. Stockholders' equity was \$36.3 million, or 8.4% of assets, at March 31, 2018.

Market Share Continues to Grow; New Markets Targeted

Potomac has done an excellent job of building its presence in each of its markets. Market share statistics are updated once a year (using June numbers) by the FDIC and we find it sometimes instructive to consider the trends in a bank's ability to grow its deposit presence, as this is a key measure of franchise value. In considering Potomac, we see that in each of the counties in which it currently operates (Jefferson and Berkeley Counties in WV; Washington County in MD and Loudoun in VA), it has not only grown its

absolute dollar amount of deposits for the past three years, but it has also increased its market share. In fact, market share increased in each county every year,

Market	PTBS Deposits (\$MM)			PTBS Market Share (%)		
	Q2 '15	Q2 '16	Q2 '17	Q2 '15	Q2 '16	Q2 '17
Jefferson (WV)	216.9	240.9	260.0	26.19%	30.49%	31.88%
Berkeley (WV)	49.1	57.5	74.1	3.90%	4.56%	5.50%
Washington (MD)	10.6	19.6	20.5	0.52%	0.90%	0.93%
Loudoun (VA)	1.5	2.8	4.1	0.03%	0.04%	0.06%
Total Deposits	278.1	320.8	358.7			

which is a notable achievement given the competitive environment within these markets. Recently, Potomac's management announced its intention to expand into Purcellville, VA (Loudoun County) and has a team of bankers prepared to build upon Potomac's existing presence in Loudoun County. The Company is also launching a loan production office in Leesburg, VA (also Loudoun County) and recently hired two 20-year banking veterans to head up this mortgage and business lending initiative. Both offices are expected to open in the second or third quarters of this year. The Company also recently hired a new Chief Lending Officer with strong ties to the Virginia lending market.

Stock Price Update

Potomac's stock performance has been impressive. As can be seen from the adjacent table, the shares have appreciated 39% over the past year, 94% over the past three years and 113% 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	42%	42%	39%	20%
Three Years	110%	28%	94%	43%
Five Years	140%	19%	113%	79%

Asset Quality Has Been Holding Steady

As of March 31, 2018, 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, unchanged from \$1.8 million, or 0.42% of assets, at year-end 2017 and \$2.5 million, or 0.61% of assets, at March 31, 2017. At March 31, 2018, the allowance for loan losses was \$3.7 million, or 1.06% of gross loans, up from \$3.3 million, 0.97% of gross loans, at the year-ago date.

Projections

Based on our expectation for there to be some pressure on short-term expenses from new branch openings, we are lowering our 2018 earnings projection to \$3.9 million, or \$1.16 per diluted share. These projections could vary widely depending on changing economic and credit conditions.

ADDITIONAL INFORMATION UPON REQUEST

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