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Potomac Bancshares, Inc. (OTC Pink - PTBS)

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Price:	\$10.95	EPS *	2015A:	\$ 0.76	P/E	2015A:	14.4x
52 Wk. Range:	\$8.27 - \$11.00	(FY: DEC)	2016A:	\$ 0.66		2016A:	16.6x
Div/Div Yld:	\$0.26 /2.4%		2017E:	\$ 0.78		2017E:	14.0x
Shrs/Mkt Cap:	3.3 mm / \$37 mm	Book Value:		\$ 9.92	Price/Book Value:		1.10x

* 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 \$383 million in assets as of December 31, 2016, 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 Comparisons Were Stronger Than Implied by the Bottom Line

Potomac Bancshares finished 2016 with a strong quarter. Although reported earnings were lower than in the year-ago quarter, that shortfall was mainly attributable to: 1) a higher provision for loan losses, the increase in which was due to strong underlying loan growth at the Bank and 2) an interest recovery (and associated fees) on a nonperforming loan in the year-ago quarter. Operationally, the Company's performance looked quite strong in 2016's fourth quarter, with solid balance sheet growth, improving asset quality and favorable comparisons in key income statement areas. The stock has also shown nice strength, increasing 25% from our last report dated November 18, 2016.

Net income in the fourth quarter of 2016 was \$587,000, or \$0.18 per diluted share, versus \$752,000, or \$0.22 per diluted share, in 2015's fourth quarter. As was stated above, most of the decline occurred as a result of a higher provision, which increased to \$363,000 in 2016's fourth quarter from a credit for loan losses of \$37,000 in the year-ago quarter. If we exclude the provision, as well as interest/fee recovery of \$243,000 and some OREO losses from 2015's fourth quarter, we see that normalized pretax income was actually up about 38%.

	2015	2016
Quarterly Results (\$000s)	Q4	Q4
Net Income	752	587
Pretax Income	1,164	890
Adjustments:		
Prior Year Interest /Fee Recovery (Deduct)	(243)	-
Provision (Add)	(37)	363
Gains/Losses on Sale of OREO (Add Losses)	24	-
Pretax Inc. Bef. Nonrec/Credit Charges	908	1,253

The strength in normalized earnings was mainly based on net interest income, which grew 14% to \$3,287,000 in 2016's fourth quarter from \$2,894,000 in the year-ago quarter. Net interest income benefitted from both higher average earning assets (up 10%), as well as a higher net interest margin (the net interest margin was 3.65% in 2016's fourth quarter, versus 3.55% in the year-ago quarter.)

ASSETS: \$383 MM

HQ: CHARLES TOWN, WV

CONTACT:
ARCH A. MOORE III,
ACTING PRESIDENT
DEAN J. COGNETTI, CFO
304-725-8431

4TH QUARTER HIGHLIGHTS:

EPS: \$0.18 vs. \$0.22

EARNINGS COMPARISONS
WERE AFFECTED BY A HIGHER
PROVISION AND A RECOVERY
IN THE YEAR-AGO QUARTER
REFLECTED IN NONINTEREST
INCOME

ALTHOUGH NET INCOME WAS
LOWER THAN IN THE YEAR-
AGO QUARTER, PRETAX
NORMALIZED INCOME WAS
ACTUALLY UP 38%

NET INTEREST INCOME WAS
UP 14%

NONINTEREST INCOME WAS UP ABOUT 7% EXCLUDING NONRECURRING ITEMS

Total noninterest income was actually down, although that was due to the inclusion of the previously mentioned income associated with a loan recovery which was included as other income. Excluding the recovery and losses on the sale of securities in the year-ago quarter, noninterest income was up about 7% to \$1,135,000 in 2016's fourth quarter, versus \$1,064,000 in the year-ago quarter. Noninterest expense was up modestly (4%) to \$3,169,000 in 2016's fourth quarter, versus \$3,050,000 in the year-ago quarter.

FULL YEAR HIGHLIGHTS:

EPS: \$0.66 vs. \$0.76

BALANCE SHEET GROWTH WAS SOLID, WITH ASSETS UP 9%

LOAN GROWTH, AT 19%, WAS NOTABLY STRONG

Full Year Operating Results Were Likewise Commendable

For the full year of 2016, net income was \$2,218,000, or \$0.66 per diluted share, as compared to \$2,580,000, or \$0.76 per diluted share, in 2015. Earnings benefitted from a significant increase in net interest income, which grew 11% to \$12,571,000 in 2016 from \$11,301,000 in 2015. That improvement was partly offset by an increase in the provision for loan losses, which was \$928,000 in the 2016, versus \$60,000 in 2015. Reported noninterest income was slightly lower for the full year, although it increased modestly if we exclude the year-ago recovery which, as was the case with the quarterly results, was included as "other income." As was discussed earlier, balance sheet growth held up well also, with the most pronounced increase in loans. From December 31, 2015 to December 31, 2016, assets grew 9%, deposits were up 10%, and gross loans grew 19%. Stockholders' equity was \$33.2 million, or 8.7% of assets, at December 31, 2016.

A Salute to Robert F. Baronner, Jr.

UNDER ROBERT BARONNER'S LEADERSHIP, THE COMPANY MORE THAN DOUBLED ITS SIZE

On January 22, 2017, Robert F. Baronner, Jr. (the Company's former President and CEO) died, following a lengthy illness. Mr. Baronner joined the Bank as CEO in 2001. During his tenure, he oversaw a long period of consistent growth at the Bank. The Company had less than \$150 million in assets when he took over as CEO in 2001 and had \$383 million in assets at the end of 2016. Over that period, there were only two years in which assets did not increase from the prior year, and only two years in which the Bank did not report a profit, the latter being quite an achievement given the severity and protracted duration of the Great Recession. Key metrics over this 16 year period were impressive as well, with an average ROAE of 8.2% and an average ROAA of 0.83%. Finally, the total return on Potomac Bancshares stock over this period was 296%, more than twice the 144% total return for the S&P 500 and quadruple the 71% return for the SNL Financial US Bank Index. The Company's Acting President is Arch A. Moore III.

MR. BARONNER HELPED OVERSEE CONSISTENT GROWTH, SUSTAINED PROFITABILITY AND HIGHER SHAREHOLDER VALUE

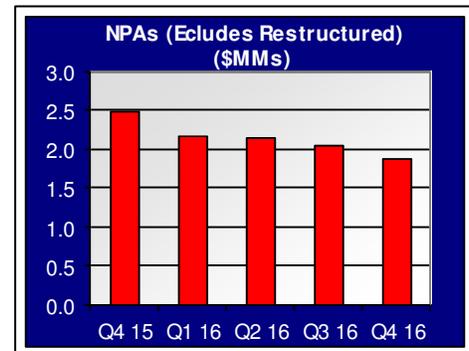
Asset Quality Remains Excellent

Asset quality remains favorable. As of December 31, 2016, nonperforming assets (which we define as nonaccruing loans, over 90 day past due loans that are still accruing and OREO) were \$1.9 million, or 0.49% of assets, versus \$2.0 million, or 0.53% of assets, at September 30, 2016 and \$2.5 million, or 0.70% of assets, at December 31, 2015. (Excluded from these figures are restructured loans that are accruing.) The allowance for loan losses was \$3.2 million (0.96% of gross loans) at December 31, 2016, versus \$2.5 million (0.91% of gross loans) at the year-ago date.

NPAs CONTINUE TO TRACK LOWER

NPAs/ASSETS: 0.49%

RESERVES/LOANS: 0.96%



Projections Maintained

Based on the fourth quarter results, we are maintaining 2017 earnings projections at \$2.6 million, or \$0.78 per diluted share. These projections could vary widely depending on changing economic and credit conditions.

EPS:
2015A: \$ 0.76
2016A: \$ 0.66
2017E: \$ 0.78

ADDITIONAL INFORMATION UPON REQUEST

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