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

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**John A. (Buddy) Howard, CFA**  
**August 13, 2016**

<b>Price:</b>	\$8.75	<b>EPS *</b>	<b>2014A:</b>	\$ 0.64	<b>P/E</b>	<b>2014A:</b>	13.7x
<b>52 Wk. Range:</b>	\$7.20 - \$9.90	(FY: DEC)	<b>2015A:</b>	\$ 0.76		<b>2015A:</b>	11.5x
<b>Div/Div Yld:</b>	\$0.26 / 3.0%		<b>2016E:</b>	\$ 0.80		<b>2016E:</b>	10.9x
<b>Shrs/Mkt Cap:</b>	3.3 mm / \$29 mm	<b>Book Value:</b>		\$ 9.77	<b>Price/Book Value:</b>		0.90x

\* 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 \$371 million in assets as of June 30, 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."

### Second Quarter Right in Line With Projections; EPS Up 18%

Potomac Bancshares reported excellent second quarter results. Earnings were right in line with projections, balance sheet growth was solid and asset quality continued to improve, both relative to the year-ago and linked quarter figures. We continue to be particularly impressed with loan growth, which has been quite consistent over the past year. The Bank also continued to enhance its branch network, most recently relocating one of its branches (Middleburg, VA) to a much better location and expanding its product and service offerings there. Based on the Company's strong results and solid capital position, the Board of Directors boosted the quarterly cash dividend for the second time in the past year. From a relative valuation standpoint, we continue to believe the shares are quite attractively priced, particularly given the return on average equity, underlying balance sheet growth and management's focus on shareholder value. Several insiders, incidentally, continue to buy shares.

Net income in the second quarter of 2016 was \$658,000, or \$0.20 per diluted share, versus \$584,000, or \$0.17 per diluted share, in 2015's second quarter. Net interest income was up 11% (better than we had anticipated) and benefitted principally from average earning asset growth, as margins were largely unchanged relative to the year-ago quarter at 3.64%. Offsetting most of this strength, however, was an increase in the provision for loan losses, which was \$204,000 in the second quarter of 2016, versus \$65,000 in the year-ago quarter. Importantly, all of this increase was based on the strength of loan growth, as asset quality improved. Noninterest income was up 3% to \$1,139,000 in the second quarter of 2016 from \$1,106,000, in the year-ago quarter, while noninterest expense was likewise up 3% to \$3,044,000 in 2016's second quarter, versus \$2,963,000 in the year-ago quarter. Profitability ratios were commendable as well. Annualized ROAE in the second quarter of 2016 was 8.11%, versus 7.59% in the year-ago quarter, while the annualized ROAA figures were 0.73% and 0.72%, respectively. Those percentages are higher than the typical West Virginia public bank (with less than \$5 billion in assets), which had a median ROAE of 7.0% and median ROAA of 0.66%.

**ASSETS: \$371 MM**

**HQ: CHARLES TOWN, WV**

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

**2<sup>ND</sup> QUARTER HIGHLIGHTS:**

**EPS: \$0.20 vs. \$0.17**

**NET INTEREST INCOME WAS UP 11%**

**THE INCREASE IN NET INTEREST INCOME HAS BEEN DRIVEN BY HIGHER AVERAGE EARNING ASSETS**

**NONINTEREST INCOME INCREASED 3%, AS DID NONINTEREST EXPENSE**

**ROAA AND ROAE WERE ABOVE PEER MEDIANS**

### First Half EPS Was Up Slightly

For the first six months of 2016, Potomac Bancshares reported net income of \$1,146,000, or 0.34 per diluted share, compared to \$1,143,000, or \$0.33 per diluted share, in the year-ago period. The fact that EPS increased slightly more than aggregate earnings is largely due to the effects of stock repurchases over the past year, and illustrate the appropriateness of that strategy at current prices (in our view). Earnings in the first half of 2016 did include some nonrecurring charges and an increase in the loan loss provision (to keep pace with loan growth), which was the main reason the year-to-date results were largely flat. Net interest income was up 10%, noninterest income increased 1% and noninterest expense rose 6%. Balance sheet growth over the past year was strong, and was led by loans. From June 30, 2015 to June 30, 2016, assets grew 14%, deposits were up 16%, and gross loans grew 18%. Stockholders' equity was \$32.7 million, or 8.8% of assets, at June 30, 2016. All of the Bank's regulatory ratios exceed those necessary to be considered "well capitalized."

### Cash Dividend Was Increased 8%

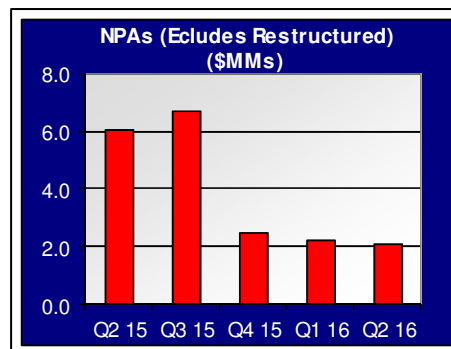
The Board of Directors recently boosted the quarterly cash dividend to \$0.065 per share from \$0.06 per share, which is an increase of 8%. That is the second time in the past year that it has been increased, the previous time being when it was increased to \$0.06 from \$0.0525 per share. The dividend now provides a yield of 3% based on the current price of the stock, and represents a reasonable payout ratio of about 33%, based on our 2016 EPS estimate of \$0.80. Management and the Board have done an excellent job adopting initiatives to support the value of the stock, including the cash dividends but also stock buybacks. We would also note that the entire senior management team owns stock and many members purchase shares on a regular basis.

### Relative Value is Still Attractive in our View

Based on the most recent price, Potomac Bancshares' stock is trading at 90% of book value, and roughly 11.5x trailing 12 month earnings. Both of these multiples are below the median ratios for West Virginia banks with less than \$5 billion in assets, which had respective ratios of 98% of book value and 14.6x trailing 12-month earnings. Given Potomac Bancshares' above average ROAE, the positive earnings momentum and appealing dividend yield, we view the current valuation as attractive from a long-term return standpoint.

### Asset Quality Further Improved in the Second Quarter

NPAs declined from the year-ago level and the most recent linked quarter. As of June 30, 2016, nonperforming assets (which we define as nonaccruing loans, over 90 day past due loans that are still accruing and OREO) were \$2.1 million, or 0.58% of assets, versus \$2.2 million, or 0.61% of assets, at March 31, 2016 and \$6.1 million, or 1.87% of assets, at June 30, 2015. (Excluded from these figures are restructured loans that are accruing.) The allowance for loan losses was \$2.7 million (0.87% of gross loans) at June 30, 2016, versus \$2.7 million (1.00% of gross loans) at the year-ago date.



### Projections Maintained

Based on the second quarter results, we are maintaining our 2016 earnings projection at \$2.7 million, or \$0.80 per diluted share. We are projecting a significant increase in the loan loss provision in 2016 relative to 2015, due to the Bank's rapid loan growth. Pretax income before the provision in 2016 is expected to be up 16% from 2015. These projections could vary widely depending on changing economic and credit conditions.

### ADDITIONAL INFORMATION UPON REQUEST

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#### SIX MONTHS HIGHLIGHTS:

EPS: \$0.34 vs. \$0.33

YEAR-TO-DATE RESULTS WERE AFFECTED BY SOME NONRECURRING CHARGES IN THE FIRST QUARTER

BALANCE SHEET GROWTH HAS BEEN EXCELLENT

CASH DIVIDEND WAS INCREASED FOR THE SECOND TIME IN THE PAST YEAR

SHAREHOLDER VALUE HAS BEEN SUPPORTED THROUGH CASH DIVIDENDS AND BUYBACKS

WE BELIEVE THE SHARES ARE ATTRACTIVELY VALUED FROM A LONG-TERM APPRECIATION STANDPOINT, PARTICULARLY GIVEN EARNINGS MOMENTUM

ASSET QUALITY REMAINS QUITE GOOD

NPAs/ASSETS: 0.58%

RESERVES/LOANS: 0.87%

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