

# 2006 FINANCIAL REPORT



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## Analysis Of Earning Assets And Interest Bearing Liabilities

In Thousands of Dollars

	2006			2005		
	Avg. Balance	Interest	Yield/Rate	Avg. Balance	Interest	Yield/Rate
<b>ASSETS</b>						
<b>Loans</b>						
Commercial (1)	\$ 13,414	\$ 1,112	8.29%	\$ 10,775	\$ 798	7.41%
Real Estate	249,582	17,585	7.05%	222,010	15,332	6.91%
Installment (2)	11,639	964	8.28%	11,551	956	8.28%
Total Loans	<u>\$ 274,635</u>	<u>\$ 19,661</u>	<u>7.16%</u>	<u>\$ 244,336</u>	<u>\$ 17,086</u>	<u>6.99%</u>
Securities (3)						
Taxable	118,116	5,349	4.53%	134,827	4,929	3.66%
Tax-Exempt (4)	5,850	421	7.20%	5,176	368	7.11%
Total Securities	<u>\$ 123,966</u>	<u>\$ 5,770</u>	<u>4.65%</u>	<u>\$ 140,003</u>	<u>\$ 5,297</u>	<u>3.78%</u>
Federal Funds Sold	35,436	1,741	4.91%	54,638	1,680	3.07%
<b>Total Earning Assets</b>	<u>\$ 434,037</u>	<u>\$ 27,172</u>	<u>6.26%</u>	<u>\$ 438,977</u>	<u>\$ 24,063</u>	<u>5.48%</u>
Cash and Due from Banks	18,239			19,972		
Premises and Equipment, Net	933			973		
Other Assets	2,895			3,453		
Allowance for Loan Losses	(2,862)			(4,111)		
<b>Total Assets</b>	<u>\$ 453,242</u>			<u>\$ 459,264</u>		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
<b>Interest Bearing Deposits</b>						
Super NOW and MMDA	\$ 100,723	\$ 1,455	1.44%	\$ 111,675	\$ 1,265	1.13%
Savings	19,659	196	1.00%	21,745	217	1.00%
Time	226,635	9,718	4.29%	221,867	6,213	2.80%
<b>Total Interest Bearing Deposits</b>	<u>\$ 347,017</u>	<u>\$ 11,369</u>	<u>3.28%</u>	<u>\$ 355,287</u>	<u>\$ 7,695</u>	<u>2.17%</u>
Long-Term Borrowings	<u>0</u>	<u>0</u>	<u>0%</u>	<u>0</u>	<u>0</u>	<u>0%</u>
<b>Total Interest Bearing Liabilities</b>	<u>\$ 347,017</u>	<u>\$ 11,369</u>	<u>3.28%</u>	<u>\$ 355,287</u>	<u>\$ 7,695</u>	<u>2.17%</u>
Noninterest Bearing Deposits	47,594			47,594		
Accrued Expenses and Other Liabilities	1,950			1,550		
<b>Equity</b>	<u>59,915</u>			<u>54,833</u>		
<b>Total Liabilities and Equity</b>	<u>\$ 453,242</u>			<u>\$ 459,264</u>		
Net Interest Margin	\$ 434,037	\$ 15,803	3.64%	\$ 438,977	\$ 16,368	3.73%

(1) Includes loans on nonaccrual status.

(2) Net of unearned interest.

(3) Represents amortized value.

(4) Tax-exempt income converted to a fully tax-equivalent basis assuming a federal tax rate of 34% and a state tax rate of 9%.

**Rate Sensitivity Analysis As Of December 31, 2006**

In Thousands of Dollars

<b>REPRICING INTERVAL</b>	<b>Three Months Or Less</b>	<b>Three To Twelve Months</b>	<b>One To Three Years</b>	<b>Three To Five Years</b>	<b>Five To Fifteen Years</b>	<b>Over Fifteen Years</b>
<b>ASSETS</b>						
Total Loans (1)	\$ 48,504	\$ 7,406	\$ 43,833	\$ 45,951	\$ 78,387	\$ 63,841
Investment Securities (2)	25,840	27,584	49,802	16,020	2,051	2,484
Federal Funds Sold	<u>25,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Selected Assets	\$ 99,344	\$ 34,990	\$ 93,635	\$ 61,971	\$ 80,438	\$ 66,325
<b>LIABILITIES</b>						
Interest Bearing Deposits (3)	\$151,332	\$ 66,195	\$ 19,261	\$ 100	\$ 0	\$ 0
Borrowed Funds	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Selected Liabilities	\$151,332	\$ 66,195	\$ 19,261	\$ 100	\$ 0	\$ 0
Differences	<u>(51,988)</u>	<u>(31,205)</u>	<u>74,374</u>	<u>61,871</u>	<u>80,438</u>	<u>66,325</u>
Cumulative Differences	<u>\$(51,988)</u>	<u>\$(83,193)</u>	<u>\$ (8,819)</u>	<u>\$ 53,052</u>	<u>\$133,490</u>	<u>\$ 199,815</u>

(1) Does not include loans on nonaccrual status.

(2) Does not include Federal Reserve Stock or securities on nonaccrual status. Reported HTM securities at amortized cost and AFS securities at fair value.

(3) Does not include Super NOW, Money Market Deposit Accounts or traditional savings deposits.

## Management's Discussion and Analysis of Financial Condition and Results of Operation

### Summary

During 2006 Putnam Bancshares, Inc. and its sole subsidiary, Putnam County Bank, reflected another year of strong and healthy financial performance. This image was a reflection of the nation's banking industry. For the second year in a row, the FDIC reported no banking failures. The U. S. economy continued to show signs of expansion. The prime rate increased four times during the first six months of 2006 and remained neutral the following six months. Putnam County Bank continued to address the following issues: information technology (IT) improvements, regulatory and compliance concerns, the introduction of new and innovative products to attract and retain customers, and a tightening net interest margin. In addition, through outreach programs such as Religious Coalition for Community Renewal, American Bankers – Get Smart About Money and other such programs, the Bank continues to provide financial education for checking and savings accounts, homeownership and ways to recognize and prevent identity theft.

The following description of the operating outcome and financial condition of Putnam Bancshares, Inc. (referred throughout as "the Company") should be read in conjunction with the Consolidated Balance Sheets, Statements of Income, Changes in Shareholders' Equity, Statements of Cash Flows, and Notes to Consolidated Financial Statements (beginning on page F11 and ending on page F28). References also will be made to Putnam Bancshares' wholly-owned subsidiary, Putnam County Bank ("the Bank"). In addition, various graphs, charts and analyses have been provided throughout the Annual Report to support Management's Discussion and Analysis.

The Bank's "peer group #3" consists of all commercial banks having assets between \$300 million to \$1 billion. There are a total of 15 peer groups with Peer Group #1 being the largest (in excess of \$3 billion). The Financial Institutions Examination Council (FFIEC) is a governmental organization represented by the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency. The federal regulatory bodies gather financial data from commercial banks' quarterly Call Reports and Summary of Deposits reports and compile the statistics on the banks and their related peer group culminating in a quarterly Uniform Bank Performance Report (UBPR). As of December 31, 2006, there were 1,147 banks in Putnam County Bank's peer group. This was an increase of 72 banks since December

2005. Out of the 1,147, only three other banks (26 branches) are actually located in West Virginia. When analyzing the peer group in comparison to the Bank it is fundamentally necessary to analyze each bank and the particular components of its assets, liabilities, and owners equity along with the economic environment and their operating philosophy in conjunction with other available reports--10-K and/or external auditors' reports--which can affect their financial information and thus cause their ratios to be above or below that of their peer group. A UBPR report can be obtained on 7,922 banks through the FFIEC website at [www.ffiec.gov](http://www.ffiec.gov) for December 2006.

### Net Interest Margin

Net interest margin compression seemed to be a major concern in the banking industry for 2006. Banks were under pressure to offer higher rates on their deposits and under even more pressure to offer competitive loan rates. Competition continues to be quite rigid, with more and more individuals going online to do their comparison shopping. Net interest margin is the difference between tax equivalent interest income and interest expense divided by average earning assets and is used to gauge the Company's profitability. Interest income represented 98.94% of Putnam County Bank's total revenue during 2006. The net interest margin decreased from 3.73% in 2005 to 3.64% in 2006, or nine basis points. The decrease was attributable to pressure to raise deposit interest rates at a faster pace and competition to maintain loan interest rates at a much less dramatic increase. The Bank's cost of funds increased from 2.17% in 2005 to 3.28% in 2006. The cost of funds is calculated by dividing the tax equivalent of interest expense from deposit accounts by the year-to-date average of deposit accounts balances. With the exception of year 2005, the Bank has traditionally incurred a higher cost of funds compared to peers. The peer group's average cost of funds was 2.26% in 2005 and 3.27% in 2006 according to the UBPR for the fourth quarter of 2006. The net interest margin for Peer Group # 3 was 4.24% for 2005 and 4.21% for 2006 which was only a decrease of three basis points.

### Interest Income

Interest income increased \$3.1 million or 12.9% from year-end 2005 to year-end 2006. The Federal Open Market Committee (FOMC) raised the overnight fed funds rates four separate times during the first half of 2006 with a 25 basis

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increase each time. This was half of the total increases during 2005. The Bank has approximately 18% of the total loan portfolio tied to the Wall Street Journal Prime rate which was indirectly increased each time the fed funds overnight rate was increased. The average outstanding loan balance increased 12.4% or \$30.3 million during 2006 compared to an 8% or \$18 million for 2005. This increase was a reflection of a more knowledgeable, experienced, and diligent loan personnel working in a very competitive market. Once again, interest income from the loan portfolio produced the largest increase within the total interest income. The 2006 loan interest income increased \$2.6 million, or 15.1%, from the prior year-end of 2005. Unfortunately, the increase in the average loan portfolio was not enough to offset the decrease of the total average earning assets of \$4.9 million or slightly more than 1%. Thanks to a rising rate environment, the total income from average earning assets increased \$3.1 million or 12.9% between 2005 and 2006.

Despite a slow down in the housing market nationwide, Putnam County Bank saw the greatest increase (87.5%) of loan interest income, in terms of dollars, within the real estate secured lending. Real estate lending increased \$2.3 million, or 14.7% during 2006. The increase in real estate secured lending is a sign of continuing growth within Putnam County and the surrounding area. In addition, the Bank had began to realize new growth outside of its traditional lending area, thanks in part to networking, a marketing campaign, and, of course, the arrival of Putnam County Bank's website, [www.putcobk.com](http://www.putcobk.com). While the methods of obtaining new real estate secured loans may have changed some during the last few years due to technology, Putnam County Bank is still committed to lending the old fashion way, also. Each loan customer gets personal service tailored to meet their needs and the majority of new loans are originated from current customers or by word of mouth to potential new customers.

Income on commercial lending incurred the largest percentage increase of 39.3% or \$314 thousand from year end 2005 to 2006. Most of the increase was derived from an increase in the average outstanding balance of commercial loans of \$2.6 million or 24.5%. This was in contrast to the \$1.2 million decrease, or 9.9% decrease during 2005 of the average commercial loan balance. While rising rates were one reason for the increase in income on commercial lending, another reason for the increase in commercial lending was due to the ability of our

loan personnel to accelerate the loan closing process allowing the commercial customer to spend less time worrying about finances and more time concentrating on their businesses. This type of service is another way of keeping and creating new relationships within our customer base. Income on consumer lending increased less than 1%, or \$8 thousand, during 2006. While rather small, the increase was a welcoming change compared to the past several years where consumer lending has been declining. For instance, during 2005, the Bank saw outstanding consumer loan balances decline 12.8% with the income from these loans decreasing 35.2%. With credit card companies offering 0% incentives for the first six months or so and the automotive industry offering 0% financing in many cases, Putnam County Bank faces its most unique competition in this sector. Due to the nature of most of the consumer loans—either unsecured or secured with depreciating collateral—the Bank generally imposes higher rates on consumer loans due to the higher risk involved with these loans. However, consumer lending was actually one area where the yield on average balance remained unchanged from year-end 2005 to year-end 2006. The average yield for both years was 8.3%.

Income on the investment portfolio increased almost 9% or the tax equivalent of \$473 thousand despite a decrease in the average investment portfolio balance of 11.5% or slightly over \$16 million. This decrease was similar to the decrease of the portfolio during 2005 where the average balance declined \$3.6 million (2.5%) and the income increased \$348 thousand (7%). Again, this scenario is to be expected when the FOMC raises rates on multiple occasions during the year. The investment balance decrease was used to help fund the increase in the loan volume for both years, where the average yield was 7.16% compared to the average yield on investment portfolio of 4.65% during 2006. Putnam County Bank continues its tradition of purchasing U. S. Treasury and Agency securities and steering clear of various options utilized by many of its peers as can be noted on the latest UBPR. Some of the available investment opportunities include, but are not limited to, futures and forwards, interest rate contracts, derivative contracts, etc. In addition to their complexity, the Bank is not willing to accept the risks involved with these types of investments at this time. The Bank purchases Treasury bills in three- and six-month maturities on a weekly basis at the Treasury's auction. The income on Federal Funds Sold increased \$62 thousand or 3.7% during 2006. The average balance of Federal Funds Sold decreased \$19.2 million or 35.1% between 2005 and

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2006. This was consistent with a \$20.6 million decrease or 27.4% for 2005. The Bank has steadily reduced some of the excess liquidity in order to fund the lending sector and, therefore, earning a higher return on assets. The average yield on Federal Funds Sold was 4.9% for 2006 and 3.1% during 2005. With an average Federal Fund Sold balance of \$35.4 million, Putnam County Bank still remains above the ninety percentile compared to the peer group levels. Federal funds sold represent excess liquidity and are sold to correspondent banks at an interest rate which changes daily. As of year-end 2006, all municipal securities are West Virginia issues which are investment quality and rated A+ or better by Standard and Poors and A1 or better by Moody's. Of these municipal securities, 19.5% are general obligations while the remaining issues are revenue obligations.

### Interest Expense

Interest expense on deposit accounts increased \$3.7 million or 47.7% from year-end 2005 to 2006. The average cost of deposits increased from 2.17% to 3.28%, or 111 basis points, in the same period. The average yield on time deposits alone increased almost 150 basis points. Passbook savings accounts consistently reported another year of 1% yield. The average balance of interest bearing deposits decreased \$8.2 million, or 2.3% during 2006. Of the 2006 decrease, Super Now and MMDA decreased \$10.9 million (9.8%) and Passbook Savings Accounts decreased \$2.1 million (9.6%), whereas Time Deposits actually increased \$4.8 million during the same time period. The average deposit erosion slowed to almost half of the decrease realized during 2005, which was \$19.1 million or 5.1%. While yields have noticeably gone up in the past couple of years, the Bank's 3.28% yield on total average deposits was considered average at the fifty percentile ranking with that of the peer grouping. With the exception of 2005, the Bank has traditionally paid higher than the peer group. The Bank does not actively advertise for deposits in its marketing area and does not solicit deposits from brokers.

The Bank did not require borrowings to fund its operations in 2006. This has been due to ample liquidity in federal funds sales and in the investment portfolio. As of year-end 2006, the Company has no outstanding debt and there are no plans to incur debt in the immediate future.

### Asset and Liability Management (Interest Rate Sensitivity and Liquidity)

Putnam County Bank's Asset/Liability Committee is slated to meet on a quarterly basis. The ALCO Committee is comprised of senior officers and four outside members of the Board of Directors who review and revise current plans and projections in order to maintain a stable, and yet profitable, interest rate environment. In addition, the Bank's liquidity risk, credit risk, and market risk are also monitored in order to avoid focusing on the bottom line only and review other important aspects of the Bank's needs. To properly understand and interpret the Bank's financial asset and liability management, management has to comprehend the character of the Bank's assets and liabilities, its economic environment and customer base. Putnam County Bank's ALCO Committee is provided with historical, current, and anticipated trends analysis generated internally and externally in order to provide the most reliable information for the Committee to make decisions affecting the Bank's interest rate sensitivity and liquidity. The expertise and different backgrounds of the non-bank directors is used to obtain a fresh understanding of how the customers might react based on decisions made by the Committee and/or management. Some of the items generally on the agenda for discussion include anticipated loan and deposit growth (or shrinkage), the impact of raising or lowering rates, how much liquidity should be maintained, strongest competition, trends in the economy, and etc.

As an effort to monitor the interest rate sensitivity, management has to gauge the inherent interest rate risk and the effects upon the financial statements. The variables include the maturity of instruments, repricing characteristics, and the "imprecise" knowledge of prepayments on loans and/or withdrawals from interest bearing deposits. The Rate Sensitivity Chart provided earlier (F2) provides for the maturity of instruments and takes into consideration the repricing characteristics, but not the possible prepayments or withdrawal scenarios. While not reflected within the chart, the analysis and assumptions used in regards to prepayments/withdrawals are discussed within the monthly ALCO meetings.

Once again, liquidity levels in the Bank decreased in 2006 as they did in 2005 due to increased loan demand, which for 2006 was a 12.4% increase on the average balance compared to an increase of 8.0% during 2005. Countering the loan balance increase and, thus, reducing liquidity was a decrease of 18.1% (\$35 million) in short-term investments,



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available for sale securities, and federal funds sold. The Bank's loan-to-deposit ratio increased from 65.39% at year-end 2005 to 72.82% at year-end 2006. The peer ratio for the same time period was 85.43% and 86.84%, respectively. While the peer grouping has remained fairly static, the Bank's loan-to-deposit ratio continues to come closer in narrowing the gap with that of the peer group. The Bank continues to have ample liquidity remaining within federal funds sold and investments in order to provide for this difference. If the Bank would continue to exhaust the current source of liquidity within the investment portfolio, the Bank has the option of raising interest rates on deposit accounts to entice more deposits and/or utilizing capital reserves in order to fund future loan growth. The Bank continues to be very conservative in regards to investments and invests in United States Government and Agency Securities and "in-state" originated municipals. The Bank also does not participate in or acquire brokered deposits.

Another common measure of liquidity involves the Bank's net non-core funding dependence ratio. The significance of this ratio is that it measures how much of our long-term assets are funded with non-core funds. Non core funds for Putnam County Bank consists of time deposits of \$100 thousand or greater and are usually considered more volatile than core deposits. The composition for the peer group can be a little more complex and include additional items such as borrowed money, foreign office deposits, and brokered deposits. As of year-end 2006, Putnam County Bank had a net non-core dependence of 15.17% compared to a 6.06% for 2005. While the trend for the Bank has been increasing for the last consecutive four years, the ratio continues to remain below that of the peer group which was 24.45 for 2006 and 22.29 for 2005.

### Nonperforming Assets

Nonperforming assets includes all loans which are past due ninety days or more and any loans in nonaccrual status. Loans are required to be reported in nonaccrual status when principal and interest has been in default for 90 days or longer unless the loan is both well secured and in process of collection. Loans in nonaccrual status are generally those where payment of principal and interest is in question due to the deterioration of the financial condition of the borrower and any payments are reflected on a cash basis. The total of nonperforming loans at the end of 2006 was almost \$2 million or .68% of total loans outstanding. This was a large increase compared to \$107 thousand or .04% of total loans

in 2005. This compares with peer bank ratios of .55% at year-end 2006 and .49% at year-end 2005. The increase came from three real estate secured loans placed on nonaccrual status during the first half of 2006. The Bank has seen much improvement during the last few years in regards to past due and nonaccrual loans which can be attributed to improved lending strategy within the Bank with emphasis placed upon producing excellent credit quality loans. Another reason for the improved balances can be credited to improved economic conditions in general. The Bank's percentile ranking with that of its peers fell from the 13th percentile in 2005 to the 66th percentile for 2006.

The Bank did not have a balance in other real estate owned at the end of 2006 or in 2005.

### Provision and Allowance for Loan Losses

The Bank made one provision to the allowance for loan loss in the amount of \$150 thousand during 2006. This compared to no provisions made during 2005. During 2005, the Bank actually reduced the allowance loan loss by \$1.4 million due to an excess amount in the allowance. The recoveries for 2006 totaled \$550 thousand compared to \$115 thousand for 2005. Most of the 2006 recoveries were due to the sale of real estate properties previously written off. The 2006 charge-offs increased \$437 thousand for a balance of \$670, or 188% compared to a decrease of \$470 thousand, or 67%, during 2005 for a balance of \$233 thousand.

Net loan losses were \$120 thousand in 2006 compared to \$118 thousand during 2005. The Bank's ratio of .04% of net losses to average total loans stood in contrast with the peer ratio of .11% placing the Bank in the 40% of all banks in our peer group. In 2005, the Bank ranked in the 38th percentile of the peer group. As of December 31, 2006, the allowance for loan loss was a little over \$2.7 million or .94% of total loans. This compares to an even \$2.7 million or 1.02% of total loans on December 31, 2005. Peer banks show ratios of 1.20% in 2006 and 1.23% in 2005. It appears that the banking industry, as a whole, is seeing an improvement of asset quality as evidenced by the steady decline in the allowance for loan losses reflected in the Uniform Bank Performance Reports. With added personnel and improved technology, Putnam County Bank is in a better position to more closely monitor loan loss history, collateral values and general economic conditions and, therefore, maintain the allowance for loan loss at a more reasonable

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level. In addition to having a very qualified loan staff, the Bank also has a loan committee consisting of senior officers and members of the board of directors who meet on a monthly basis to further discuss the loan portfolio and possible scenarios that may affect loan quality. The adequacy of the allowance is subject to review by the Company's internal auditors, external auditors, Federal Reserve Bank and the West Virginia Division of Banking. The bank is required to following Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan* (FAS 114).

### Noninterest Income

Total noninterest sources of income totaled \$286 thousand in 2006 (excluding gross gains on securities transactions) compared with \$276 thousand in 2005 or less than a 2% increase. While the net effect of the combined accounts amounted to an increase, the Company saw a large percentage of the accounts report decreased income. Most of these income accounts are tied to services charges on non-time deposit accounts which decreased almost \$19 million or 10.7% between year-end 2005 to year-end 2006. The net effect was positive due to a 42% increase, or \$28.6 thousand, in Visa Checkcard fees and other interchange fees due to increased usage.

The Bank has historically been a low-cost provider of banking services and continues to do so. The percentage of noninterest income to average assets at the end of 2006 was .06% compared with 0.83% for peer institutions. While the Bank's percentage has remained fairly static, the peer group has seen a steady decline of a few basis points for the last several years.

### Noninterest Expense

Total noninterest expense (excluding gross securities losses) increased \$604 thousand or 8.3% for 2006 compared with a \$314 thousand increase (5%) between 2004 and 2005. Noninterest expenses primarily relate to personnel, occupancy and other miscellaneous operating expenses.

Total personnel expenses increased \$495 thousand or 12.6% from 2005 to 2006. Officer and employee salary expense increased \$402 thousand or 13.4%. This was twice the increase reflected on the 2005 financials of \$195 thousand or 7%. The increase reflects the traditional cost of

living salary increases for Bank personnel and added staffing. Employer-sponsored group health costs increased \$67 thousand or 17.1% during 2006. While health care costs have seen a dramatic increase during the past few years, the Bank also began to help defray employee family health insurance costs by paying 60% of the premiums. In the past, the Bank paid 100% of the employee coverage and the employees would pay for the extra family coverage. Retirement funding increased almost \$30 thousand or 14%. This increase was due to market fluctuations, group experience, and projected payouts. The retirement plan is administered through the West Virginia Bankers Association as a noncontributory plan whereby the plan's actuary assigns the value of contribution to be made by its members. On a positive note, Workers Compensation, now being privately insured by BrickStreet of Charleston, WV, saw a 56.8% decrease or almost \$16 thousand.

Total occupancy expense decreased \$24 thousand or 4.6% from 2005 to 2006. This compared to an increase of \$2 thousand or less than 1% during 2005. The bulk of the decrease can be attributed to a decrease in maintenance and repairs of \$24 thousand. The Bank continues to operate three locations: 2761 Main Street in Hurricane; 300 Hurricane Creek Road in Hurricane; and 3058 Mount Vernon Road in Hurricane.

Other operating expenses netted an increase of \$131 thousand or 5.0% for 2006. This was a little more than half of the \$213 thousand or slightly less than 9% increase during 2005. Those categories largely responsible for the increase include office supplies/printing (\$42 thousand); charitable contributions (\$31 thousand); computer supplies (\$22 thousand). Putnam County Bank incorporated a new logo during the first part of 2006 and, therefore, new office stationary and various other supplies were ordered sporting the new logo and increasing office supplies and printing expenses. While charitable contributions increased 21%, most of the contributions were typical of prior years--area schools (\$33 thousand) local museums (\$20 thousand), YMCA (\$20 thousand), county fairs (\$29 thousand), Habitat for Humanity (\$20 thousand), local churches (\$18 thousand). The Bank paid out almost \$180 thousand in charitable donations alone during 2006.

At the other end of the spectrum, some of the major decreases within other operating expenses included loss on fraudulent checks (\$13.5 thousand); business franchise tax (\$10 thousand), professional fees (\$6 thousand), FDIC Assessments (\$6 thousand), and fidelity/d&o insurance (\$6



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thousand). Loss on fraudulent checks was unusually high during 2005 at \$15 thousand when taking into consideration that the Bank reported a total of \$24 thousand for the past four years combined. Being a community bank, it's generally easier to spot unusual customer behavior or transactions and, therefore, avoid most fraudulent situations. Professional fees had a net decrease of \$6 thousand with Fees to Attorneys and Consultants increasing \$30 thousand and Fees to Accountants decreasing \$36 thousand. With increased accounting staff, less accounting services were outsourced and therefore reducing costs. The FDIC premium continues to go down. Based on the Federal Deposit Insurance Reform Act of 2005, most FDIC insured banks will be sharing in a \$4.7 million credit on their premiums beginning July 2007. Putnam County Bank's portion of this credit will be \$445 thousand which will be used to credit future premiums.

The Bank's total overhead expense ratio was 1.68% compared 2.84% placing us in the 5 percentile. Granted, the ratio has gradually increased during the past few years, most of the increase has been directed towards attracting and maintaining talented personnel. The Bank has traditionally maintained a lower overhead rate than that of the peer group with the majority of the cost going to personnel expense. The Bank also saw an increase in its efficiency ratio from 42.20% in 2005 to 47.36% for year-end 2006 placing us in the 15 percentile during 2006 compared to the 8 percentile for 2005. The peer efficiency ratio was 59.05% for 2006 and 58.57% for 2005. The efficiency ratio calculation shows how well a company is in managing its total overhead expenses in relationship to net interest income plus noninterest income.

The Company reported a net loss of \$167 thousand on the sale of securities held as available for sale in 2006 compared with a \$700 thousand loss for 2005. Gains and losses are derived from the sale of transactions on investments classified as "available for sale". These securities are reflected on the financial statements at their fair market value and may be sold at any time at the discretion of management. The Bank incurred the 2006 loss on the sale of a \$5 million U.S. Treasury Note during the middle of the year. The Bank had no other loss or gain sales during 2006. Management must consider several points before the decision to sell, such as changing interest rates, liquidity, availability and alternative investments with the projected change on the Bank's asset/liability structure. All sales are carefully evaluated by management and reviewed by the Board. The Company does not speculate by "trading" in the portfolio and does not utilize any interest rate hedging or derivative products in its investment strategies.

### Taxes

Putnam Bancshares' federal and state income tax provision decreased \$808 thousand during 2006 compared to the increase of \$718 thousand from year-end 2004 to year-end 2005. The current year's decrease was a direct result of the prior year's increase which was due to a \$1.4 million reversal of the allowance for loan loss which dramatically increased net income for 2005. The Company reported a combined overpayment of taxes of \$161 thousand on the 2006 combined federal and state income tax returns. The overpayment decreased 52% compared to the \$332 overpayment for 2005. The Company's related deferred tax benefit, excluding the deferred taxes on the unrealized gains/losses on available-for-sale securities, increased \$55 thousand from 2005 to 2006 for a balance of \$567 thousand.

The Company invests in municipal securities issued in West Virginia, which are "bank qualified" investments and, as such, are exempt from federal taxation.

Please refer to "Note 7 – Income Taxes" in the Consolidated Financial Statements for further discussion.

### Equity and Capital Ratios

Putnam Bancshares' equity increased \$4.1 million or 7.1 % between 2005 and 2006 for a balance of \$61.4 million. This was the result of net income of \$5.1 million, a decrease in other comprehensive income of \$21 thousand, and payment of dividends of \$1.0 million. The book value of Putnam Bancshares, Inc. common stock at the end of 2006 based on 600,000 shares outstanding was \$102.31 compared to \$95.52 at year end 2005, representing a 7.1% increase. The Company's return on average equity for 2006 was 8.68%.

Banking regulatory bodies mandate the risk-weighting of assets and off-balance sheet items to more accurately assess capital adequacy. Tier 1 capital (equity capital less the tax equivalent of unrealized gains or losses on available for sale securities) and total risk-based capital (Tier 1 plus the allowable portion of the allowance for loan losses) comprise two vital measures of capital adequacy. As of year-end 2006, the Bank's tier one risk-based-capital to risk-weighted-assets was 23.89% compared to 24.32% at year-end 2005. The peer banks' ratios were 11.75% in 2006 and 11.79% in 2005. In addition, the Bank's total risk-based-capital to

## Management's Discussion and Analysis of Financial Condition and Results of Operation

risk-weighted-assets was 24.95% in 2006 and 25.47% in 2005. This compares with peer bank ratios of 12.90% in 2006 and 12.95% in 2005. Using the federal guidelines, the Bank is considered well capitalized which explains the Bank's ranking in the 97th percentile with its peers based on numbers used for the December 2006 Uniform Bank Performance Report (UBPR).

### Dividends

The Company paid dividends totaling \$1,020 thousand in 2006 compared with \$900 thousand in 2005. The 2006 dividends increased 13.33% from the prior year. This equates to a cash dividends to net operating income payout ratio of 19.93% in 2006 and 13.86% in 2005. This compares with peer ratios of 40.39% in 2006 and 36.48% in 2005. This conservative dividend policy has enhanced retained earnings. Regular dividends to shareholders are paid on a semi-annual basis: June and December.

For further discussion of dividend, please refer to "Note 13 – Dividend and Capital Restrictions" and the Consolidated Statements of Changes in Shareholders' Equity in the Consolidated Financial Statements.

### Statement of Management Responsibility

The financial statements, related financial data and other information found in this report are the responsibility of the management of Putnam Bancshares, Inc and its sole subsidiary, Putnam County Bank. The financial statements have been prepared in conformance with generally accepted accounting principles appropriate for the circumstances to mirror, in all material respects, reportable events and transactions.

The accounting systems of Putnam Bancshares, Inc. and its wholly-owned subsidiary, Putnam County Bank, record, summarize and report financial data. The Bank uses internal controls and procedures to provide reasonable assurance (the cost involved should not exceed related benefits) to the reliability of the financial records. Reliance on the accounting system and internal controls by management is enhanced with written policies, internal audits and continuous training of accounting personnel in order to present fair and accurate statements.

The Audit Committee of Putnam County Bank, composed solely of outside directors, meets on a monthly basis to review various issues relating to audit, including coverage, findings and responses. The selection of Rollins, Cleavenger and Rollins as the Company's external auditors is recommended by the Board of Directors and ratified by the shareholders of Putnam Bancshares, Inc.

## Independent Auditors' Report

To the Board of Directors and Shareholders  
Putnam Bancshares, Inc. and Subsidiary  
Hurricane, West Virginia

We have audited the accompanying consolidated balance sheets of Putnam Bancshares, Inc. and Subsidiary (a West Virginia corporation) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Putnam Bancshares, Inc. and Subsidiary as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.



Certified Public Accountants

March 26, 2007

**Consolidated Balance Sheets****DECEMBER 31, 2006 AND 2005**

	<b>2006</b>	<b>2005</b>
<b>ASSETS</b>		
Cash and Due from Banks	\$ 17,814,524	\$ 21,435,000
Federal Funds Sold	25,000,000	51,000,000
Available for Sale Securities	85,181,793	81,161,918
Held to Maturity Securities	38,598,917	38,670,652
Loans - Less Allowance for Credit Losses of \$2,730,387 and \$ 2,700,000, Respectively	287,261,802	260,743,261
Bank Premises and Equipment	904,555	960,791
Federal Reserve Bank Stock, at Cost	39,000	39,000
Other Assets	3,069,911	3,275,109
Total Assets	<u>\$457,870,502</u>	<u>\$457,285,731</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits:		
Noninterest Bearing	\$ 44,595,491	\$ 48,549,087
Interest Bearing	349,890,455	350,184,726
Total Deposits	\$394,485,946	\$398,733,813
Other Liabilities	1,997,621	1,241,454
Total Liabilities	<u>\$396,483,567</u>	<u>\$399,975,267</u>
Commitments and Contingent Liabilities (Note 11)		
<b>SHAREHOLDERS' EQUITY:</b>		
Common Stock, \$.50 Par Value, 1,200,000 Shares Authorized, 600,000 Shares Issued and Outstanding	\$ 300,000	\$ 300,000
Surplus	1,000,000	1,000,000
Retained Earnings	60,334,380	56,236,627
Accumulated Other Comprehensive Income	(247,445)	(226,163)
Total Shareholders' Equity	<u>\$ 61,386,935</u>	<u>\$ 57,310,464</u>
Total Liabilities and Shareholders' Equity	<u>\$457,870,502</u>	<u>\$457,285,731</u>

The accompanying notes are an integral part of these consolidated financial statements

**Consolidated Statements Of Income****FOR YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004**

	2006	2005	2004
<b>INTEREST INCOME:</b>			
Interest and Fees on Loans	\$19,660,919	\$17,086,628	\$15,365,450
Interest on Available for Sale Securities	3,791,469	3,991,334	4,345,682
Interest on Held to Maturity Securities	1,812,443	1,160,325	501,653
Interest Income on Federal Funds Sold	<u>1,741,299</u>	<u>1,679,516</u>	<u>952,805</u>
Total Interest Income	<u>\$27,006,130</u>	<u>\$23,917,803</u>	<u>\$21,165,590</u>
<b>INTEREST EXPENSE:</b>			
Interest on Deposits	<u>\$11,368,845</u>	<u>\$ 7,695,093</u>	<u>\$ 6,610,483</u>
Net Interest Income	\$15,637,285	\$16,222,710	\$14,555,107
Provision for Possible Loan Losses	<u>150,000</u>	<u>(1,388,519)</u>	<u>-0-</u>
Net Interest Income after Provision for Possible Credit Losses	<u>\$15,487,285</u>	<u>\$17,611,229</u>	<u>\$14,555,107</u>
<b>OTHER INCOME:</b>			
Service Charges and Commissions	\$ 270,891	\$ 262,370	\$ 236,754
Net Realized Gains on Sales of Available for Sale Securities	-0-	289,506	534,000
Other Operating Income	<u>15,702</u>	<u>13,614</u>	<u>14,781</u>
Total Other Income	<u>\$ 286,593</u>	<u>\$ 565,490</u>	<u>\$ 785,535</u>
<b>OTHER EXPENSES:</b>			
Salaries and Employee Benefits	\$ 4,409,210	\$ 3,911,762	\$ 3,811,700
Expenses of Premises and Equipment	509,296	533,864	532,257
Net Realized Losses on Sales of Available for Sale Securities	167,416	990,188	492,009
Other Operating Expenses	<u>2,721,323</u>	<u>2,589,736</u>	<u>2,376,987</u>
Total Other Expenses	<u>\$ 7,807,245</u>	<u>\$ 8,025,550</u>	<u>\$ 7,212,953</u>
Income before Income Taxes	\$ 7,966,633	\$10,151,169	\$ 8,127,689
Provision for Income Taxes	<u>2,848,880</u>	<u>3,656,943</u>	<u>2,939,433</u>
Net Income	<u>\$ 5,117,753</u>	<u>\$ 6,494,226</u>	<u>\$ 5,188,256</u>

The accompanying notes are an integral part of these consolidated financial statements

## Consolidated Statements Of Changes In Shareholders' Equity

FOR YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
BALANCES – January 1, 2004	\$ 300,000	\$ 1,000,000	\$46,294,145	\$ 2,789,086	\$50,383,231
COMPREHENSIVE INCOME					
Net Income			5,188,256		5,188,256
Other Comprehensive Income - Net of Tax:					
Change in Unrealized Gain (Loss) on Securities Available for Sale, Net of Deferred Income Tax (Benefit) of (\$1,047,726)				(1,811,789)	(1,811,789)
Less: Reclassification Adjustment, Net of Income Taxes of \$15,386				(26,605)	(26,605)
Total Comprehensive Income					3,349,862
Cash Dividends (\$1.40 Per Share)			(840,000)		(840,000)
BALANCES – December 31, 2004	\$ 300,000	\$ 1,000,000	\$ 50,642,401	\$ 950,692	\$52,893,093
COMPREHENSIVE INCOME					
Net Income			6,494,226		6,494,226
Other Comprehensive Income - Net of Tax:					
Change in Unrealized Gain (Loss) on Securities Available for Sale, Net of Deferred Income Tax (Benefit) of (\$937,285)				(1,620,807)	(1,620,807)
Add: Reclassification Adjustment, Net of Income Tax Benefits of \$256,730				443,952	443,952
Total Comprehensive Income					5,317,371
Cash Dividends (\$1.50 Per Share)			(900,000)		(900,000)
BALANCES – December 31, 2005	\$ 300,000	\$ 1,000,000	\$56,236,627	\$ (226,163)	\$57,310,464
COMPREHENSIVE INCOME					
Net Income			5,117,753		5,117,753
Other Comprehensive Income - Net of Tax:					
Change in Unrealized Gain (Loss) on Securities Available for Sale, Net of Deferred Income Tax (Benefit) of (\$73,648)				(127,357)	(127,357)
Add: Reclassification Adjustment, Net of Income Tax Benefits of \$61,341				106,075	106,075
Total Comprehensive Income					5,096,471
Cash Dividends (\$1.70 Per Share)			(1,020,000)		(1,020,000)
BALANCES – December 31, 2006	\$ 300,000	\$ 1,000,000	\$ 60,334,380	\$ 247,445	\$61,386,935

The accompanying notes are an integral part of these consolidated financial statements



## Consolidated Statements Of Cash Flows

### FOR YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004

	2006	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net Income	\$ 5,117,753	\$ 6,494,226	\$ 5,188,256
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation	181,150	188,532	195,699
Provision for Credit Losses	150,000	(1,388,518)	-0-
Provision for Deferred Taxes	(54,950)	508,775	11
Net (Gain) Loss on Sale of Fixed Assets	-0-	5,476	-0-
Net Realized (Gains) Losses on Available for Sale Securities	167,416	700,682	(41,992)
Net (Gains) Losses on Sale of Other Real Estate	-0-	-0-	127,610
Increase in Cash Value - Life Insurance	(10,013)	(12,673)	(7,698)
Amortization of Premiums and (Accretion) of Discounts on Available for Sale Securities - Net	7,566	425,416	982,761
(Increase) Decrease in Interest Receivable	47,015	(42,598)	73,468
(Increase) Decrease in Prepaid Expenses	235,454	(283,501)	13,496
(Increase) Decrease in Repossessions	-0-	18,210	(18,221)
Increase (Decrease) in Accrued Interest	629,100	273,317	(73,219)
Increase (Decrease) in Other Liabilities	<u>128,284</u>	<u>(31,891)</u>	<u>39,858</u>
 Net Cash Provided by Operating Activities	 <u>\$ 6,598,775</u>	 <u>\$ 6,855,453</u>	 <u>\$ 6,480,029</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
(Increase) Decrease in Federal Funds Sold	\$ 26,000,000	\$ 21,000,000	\$ 3,000,000
Proceeds from Sales and Maturities of Available for Sale Securities	15,389,063	74,746,879	45,802,929
Proceeds from Maturities of Held to Maturity Securities	102,187,557	102,839,675	105,498,350
Proceeds from Sales of Other Real Estate	-0-	94,941	280,000
Purchases of Available for Sale Securities	(19,617,509)	(60,984,395)	(37,340,030)
Purchase of Held to Maturity Securities	(102,115,822)	(102,690,653)	(105,395,547)
Purchase of Bank Premises and Equipment	(124,914)	(152,639)	(166,051)
Net (Increase) Decrease in Loans	<u>(26,668,541)</u>	<u>(29,540,582)</u>	<u>(10,715,428)</u>
 Net Cash Provided by (Used in) Investing Activities	 <u>\$ (4,950,166)</u>	 <u>\$ 5,313,226</u>	 <u>\$ 964,223</u>

The accompanying notes are an integral part of these consolidated financial statements

**Consolidated Statements Of Cash Flows****FOR YEARS ENDED DECEMBER 31, 2006, 2005, AND 2004 (Continued)**

	2006	2005	2004
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net Increase (Decrease) in Demand and Savings Deposits	(\$ 18,968,347)	(\$ 7,152,540)	\$ 131,691
Net Increase (Decrease) in Certificates of Deposit	14,719,262	(6,755,786)	(5,939,803)
Dividends Paid	<u>(1,020,000)</u>	<u>(900,000)</u>	<u>(840,000)</u>
Net Cash Used in Financing Activities	(\$ 5,269,085)	(\$ 14,808,326)	(\$ 6,648,112)
Net Increase (Decrease) in Cash and Cash Equivalents	(\$ 3,620,476)	(\$ 2,639,647)	\$ 796,140
Cash and Cash Equivalents at Beginning of Year	<u>21,435,000</u>	<u>24,074,647</u>	<u>23,278,507</u>
Cash and Cash Equivalents at End of Year	<u>\$ 17,814,524</u>	<u>\$ 21,435,000</u>	<u>\$ 24,074,647</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Cash Paid During the Year for:			
Interest	<u>\$ 10,739,745</u>	<u>\$ 7,421,775</u>	<u>\$ 6,683,702</u>
Income Taxes	<u>\$ 2,730,000</u>	<u>\$ 3,447,000</u>	<u>\$ 2,900,000</u>
<b>SUPPLEMENTAL SCHEDULE OF SIGNIFICANT NONCASH ACTIVITIES:</b>			
Transfer from Loans to Other Real Estate Owned	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 122,610</u>

The accompanying notes are an integral part of these consolidated financial statements

## Notes To Consolidated Financial Statements For Years Ended December 31, 2006, 2005, And 2004

### Note 1

#### Summary of Significant Accounting Policies:

The accounting and reporting policies of Putnam Bancshares, Inc. and its wholly-owned subsidiary conform to generally accepted accounting principles and general practices within the banking industry. Following is a summary of the more significant accounting policies:

#### Nature of Operations

Putnam County Bank operates under a state bank charter and provides full banking services, with the exception of trust services. As a state bank, the Bank is subject to regulation of the West Virginia Division of Banking, the Federal Reserve System, and the Federal Deposit Insurance Corporation. The area served by Putnam County Bank is Putnam County and its neighboring counties with services provided by the main office and two branch offices.

#### Principles of Consolidation

The consolidated statements include the accounts of Putnam Bancshares, Inc. and its wholly-owned subsidiary, Putnam County Bank. All significant intercompany balances and transactions have been eliminated.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Investment Securities

Securities that management has both the positive intent and ability to hold to maturity are classified as securities held to maturity and are carried at cost, adjusted for amortization of premium or accretion of discount using the interest method. Securities that may be sold prior to maturity for asset/liability management purposes, or that may be sold in response to changes in interest rates, changes in prepayment risk, to increase regulatory capital or other similar factors, are classified as securities available for sale and carried at fair value with any adjustments to fair value, after tax, reported as a separate component of shareholders' equity.

Interest and dividends on securities, including the amortization of premiums and the accretion of discounts, are reported in interest and dividends on securities using the interest method. Gains and losses on securities are determined using specific-identification method.

Declines in the fair value of individual held to maturity and available for sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. The Bank had no such losses for the years ended December 31, 2006, 2005, and 2004.

#### Revenue Recognition

Interest on loans is accrued and credited to operations based upon the principal amount outstanding. The accrual of interest income generally is discontinued when a loan becomes 90 days past due as to principal or interest. When interest accruals are discontinued, unpaid interest credited to income in the current year is reversed, and interest accrued in prior years is charged to the allowance for credit losses. Management may elect to continue the accrual of interest when the estimated net realizable value of collateral is sufficient to cover the principal balance and accrued interest, and the loan is in the process of collection.

Credit life insurance commissions on loans (principally short-term installment loans) are being recognized as collected. The use of this method of recognition does not produce results which are materially different from that which would have been produced if such commissions were deferred and amortized as an adjustment of loan yield over the life of the related loan.

#### Comprehensive Income

Effective January 1, 1999, the Bank adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." Pursuant to this rule, the Consolidated Statements of Changes in Shareholders' Equity now include a new measure called "Comprehensive Income," which includes net income as well as certain items that are reported within a separate component of shareholders' equity that bypass net income. Currently, the Bank's only component of other comprehensive income is its unrealized gains (losses) on securities available for sale.

## Notes To Consolidated Financial Statements For Years Ended December 31, 2005, 2004, And 2003 (Continued)

### Allowance for Credit Losses

The allowance for credit losses is maintained at a level considered adequate to provide for potential credit losses. The allowance is increased by provisions charged to operating expense and reduced by net charge offs. The level of the allowance is based on management's evaluation of potential losses in the loan portfolio, as well as prevailing and anticipated economic conditions.

Effective January 1, 1995, the Bank adopted Financial Accounting Standards (FAS) No. 114 (as amended by FAS No. 118), "Accounting by Creditors for Impairment of a Loan." Under this standard, a loan is considered impaired, based on current information and events, if it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. The reserve for possible credit losses related to loans that are identified for evaluation, in accordance with FAS No. 114, is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. If the valuation is less than the recorded value of the loan, an impairment reserve must be established for the difference. The adoption of this standard did not have, and is not expected to have, a material effect on the Bank's financial position, results of operations, accounting policies or the determination of the adequacy of the allowance for credit losses.

### Bank Premises and Equipment

Bank premises and equipment are carried at original cost, less accumulated depreciation computed primarily on the modified accelerated cost recovery system over the estimated useful lives of the assets. Maintenance and repairs and minor improvements are charged to expense. Gains and losses on premises and equipment retired or sold are recognized currently in the statements of income.

### Other Real Estate

Real estate acquired through foreclosure is carried at the lower of cost or market value determined at the date of acquisition. Any excess of the loan balance over the fair market value is charged to the allowance for credit losses. Expenses incurred in connection with other real estate subsequent to acquisition are charged to operating expense.

### Income Taxes

The Bank follows the practice of accruing federal income taxes based on income reported for financial statement purposes. In the event income or expenses are recognized in different periods for tax, as opposed to financial purposes, deferred taxes are provided on such timing differences.

### Pension Plan

The Bank accounts for its pension plan in accordance with Statement of Financial Accounting Standards No. 132, "Employer's Accounting for Pensions." Pension accounting information is disclosed in Note 8 to the consolidated financial statements.

### Cash and Cash Equivalents

For the purpose of presentation in the statements of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "Cash and Due from Banks."

### Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable.

## Note 2 Restrictions on Cash and Due from Banks:

Federal Reserve regulations require depository institutions to maintain cash reserves with the Federal Reserve Bank. The average amounts of required reserve balances were approximately \$5,783,000 and \$7,718,000 for the years ended December 31, 2006 and 2005, respectively.

## Notes To Consolidated Financial Statements

### For Years Ended December 31, 2006, 2005, And 2004 (Continued)

#### Note 3 Investment Securities:

The carrying amounts and approximate market values of investment securities at December 31, 2006 and 2005, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2006</b>				
Available for Sale Securities -				
U.S. Government and Agency Securities	\$ 79,933,392	\$ 206,824	(\$ 591,779)	\$ 79,548,437
State and Municipal Securities	5,638,940	34,365	(39,949)	5,633,356
Totals	<u>\$ 85,572,332</u>	<u>\$ 241,189</u>	<u>(\$ 631,728)</u>	<u>\$ 85,181,793</u>
Held to Maturity Securities -				
U.S. Government and Agency Securities	<u>\$ 38,598,917</u>	<u>\$ 15,458</u>	<u>\$ -0-</u>	<u>\$ 38,614,375</u>
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2005</b>				
Available for Sale Securities -				
U.S. Government and Agency Securities	\$ 75,242,593	\$ 252,274	(\$ 593,304)	\$ 74,901,563
State and Municipal Securities	6,276,274	36,179	(52,098)	6,260,355
Totals	<u>\$ 81,518,867</u>	<u>\$ 288,453</u>	<u>(\$ 645,402)</u>	<u>\$ 81,161,918</u>
Held to Maturity Securities -				
U.S. Government and Agency Securities	<u>\$ 38,670,652</u>	<u>\$ 8,475</u>	<u>(\$ 1,627)</u>	<u>\$ 38,677,500</u>

Investment securities with carrying amounts of \$36,683,945 and \$35,436,337 and market values of \$36,611,506 and \$35,616,723, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law at December 31, 2006 and 2005.

Gross realized gains and gross realized losses on sales of available for sale securities for the years ended December 31, 2006, 2005, and 2004, are as follows:

	2006	2005	2004
Gross Realized Gains:			
U.S. Government and Agency Securities	<u>\$ -0-</u>	<u>\$ 289,506</u>	<u>\$ 534,000</u>
Gross Realized Losses:			
U.S. Government and Agency Securities	<u>\$ 167,416</u>	<u>\$ 990,188</u>	<u>\$ 492,009</u>

The amortized cost and estimated market value of debt securities at December 31, 2006, by contractual maturities, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or repayment penalties.

	Available for Sale Securities		Held to Maturity Securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in One Year or Less	\$ 14,956,168	\$ 14,825,000	\$ 38,598,917	\$ 38,614,375
Due from One Year to Five Years	66,102,191	65,821,695	-0-	-0-
Due from Five Years to Ten Years	1,318,462	1,322,240	-0-	-0-
Due after Ten Years	<u>3,195,511</u>	<u>3,212,858</u>	<u>-0-</u>	<u>-0-</u>
Totals	<u>\$ 85,572,332</u>	<u>\$ 85,181,793</u>	<u>\$ 38,598,917</u>	<u>\$ 38,614,375</u>

## Notes To Consolidated Financial Statements

### For Years Ended December 31, 2006, 2005, And 2004 (Continued)

#### Note 4 Loans:

Total loans at December 31, 2006 and 2005, by major loan categories are summarized as follows:

	2006	2005
Commercial	\$ 16,948,387	\$ 13,426,993
Real Estate - Construction and Mortgage	261,357,058	238,340,256
Installment	<u>11,832,766</u>	<u>11,940,172</u>
Gross Loans	\$ 290,138,211	\$ 263,707,421
Unearned Discount	<u>(146,022)</u>	<u>(264,160)</u>
Total Loans	\$ 289,992,189	\$ 263,443,261
Allowance for Credit Losses	<u>(2,730,387)</u>	<u>(2,700,000)</u>
Loans, Net	<u>\$ 287,261,802</u>	<u>\$ 260,743,261</u>

An analysis of the change in the allowance for credit losses follows:

	2006	2005	2004
Beginning Balances - January 1,	\$ 2,700,000	\$ 4,206,248	\$ 4,000,000
Loans Charged Off	(669,877)	(233,329)	(703,437)
Recoveries of Loans			
Previously Charged Off	550,264	115,600	909,685
Provision to Expense for Credit Losses	<u>150,000</u>	<u>(1,388,519)</u>	<u>-0-</u>
Ending Balances - December 31,	<u>\$ 2,730,387</u>	<u>\$ 2,700,000</u>	<u>\$ 4,206,248</u>

The provision for credit losses charged to expense is based upon credit loss experience and an evaluation of potential losses in the current loan and lease portfolio, including the evaluation of impaired loans under SFAS No. 's 114 and 118 (collectively, SFAS No. 114), "Accounting by Creditors for Impairment of a Loan" and "Accounting by Creditors for Impairment of a Loan- Income Recognition and Disclosures." All nonaccrual loans on which a specific reserve calculation is required and significant troubled debt restructurings are considered impaired. Impairment is primarily measured based on the fair value of the loan's collateral. Impairment losses are included in the provision for credit losses. Loans collectively evaluated for impairment include certain smaller balance commercial loans, consumer loans and residential real estate loans. SFAS No. 114 does not apply to large groups of smaller balance homogeneous loans that are collectively evaluated for impairment, except for those loans restructured under a troubled debt restructuring. A loan is considered restructured when certain concessions are made to a financially troubled debtor that are not normally considered.

The following summarizes impaired loan information at December 31, 2006, 2005, and 2004:

	2006	2005	2004
Impaired Loans with Related Allowance	\$ -0-	\$ -0-	\$ 268,484
Impaired Loans with no Related Allowance	<u>1,969,477</u>	<u>-0-</u>	<u>770,809</u>
Total Impaired Loans	<u>\$ 1,969,477</u>	<u>\$ -0-</u>	<u>\$ 1,039,293</u>
Allowance on Impaired Loans	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 109,306</u>
Average Impaired Loans	<u>\$ 1,500,374</u>	<u>\$ 504,467</u>	<u>\$ 867,123</u>
Interest Income Recognized on Impaired Loans	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 22,465</u>



## Notes To Consolidated Financial Statements

### For Years Ended December 31, 2006, 2005, And 2004 (Continued)

Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amounts is fully assured, in which case interest is recognized on the cash basis. Interest may be recognized on the accrual basis for certain troubled debt restructurings which are included in the impaired loan data above.

In the normal course of business, the Bank makes loans to executive officers and directors and related business interests on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectibility.

The following presents the activity with respect to loans to related parties for 2006 and 2005:

	2006	2005
Balances - January 1,	\$ 13,780,894	\$ 8,248,183
New Loans	3,614,936	6,657,598
Repayments	<u>(2,158,949)</u>	<u>(1,124,887)</u>
Balances - December 31,	<u>\$ 15,236,881</u>	<u>\$ 13,780,894</u>

## Note 5

### Bank Premises and Equipment:

Major classifications of bank premises and equipment at December 31, 2006 and 2005, are summarized as follows:

	2006	2005
Buildings and Improvements	\$ 1,856,588	\$ 1,856,588
Furniture and Fixtures	<u>1,307,302</u>	<u>1,195,420</u>
	\$ 3,163,890	\$ 3,052,008
Less: Accumulated Depreciation	<u>2,459,795</u>	<u>2,291,677</u>
	\$ 704,095	\$ 760,331
Land	<u>200,460</u>	<u>200,460</u>
Bank Premises and Equipment, Net	<u>\$ 904,555</u>	<u>\$ 960,791</u>

Depreciation expense for the years ended December 31, 2006, 2005, and 2004, was \$181,150, \$188,532, and \$195,699, respectively, and is included in expenses of premises and equipment on the statements of income.

Putnam County Bank has entered into a noncancellable lease agreement (operating lease) with a related party for its Teays Valley branch. The minimum annual rental commitment under this lease, exclusive of taxes and other charges payable by the lessee at December 31, 2006, is as follows:

Year	Amount
2007	<u>\$ 47,767</u>
Total	<u>\$ 47,767</u>

## Notes To Consolidated Financial Statements

### For Years Ended December 31, 2006, 2005, And 2004 (Continued)

#### Note 6 Deposits:

The major categories of deposits at December 31, 2006 and 2005, are as follows:

	2006	2005
Noninterest Bearing	<u>\$ 44,595,491</u>	<u>\$ 48,549,087</u>
Interest Bearing:		
Money Market	\$ 94,289,302	\$ 107,276,660
Savings	18,713,972	20,733,045
Time and Certificates of Deposit	104,206,115	101,756,795
Certificates of Deposit over \$100,000	<u>132,681,066</u>	<u>120,418,226</u>
Total Interest Bearing Deposits	<u>\$349,890,455</u>	<u>\$ 350,184,726</u>
Total Deposits	<u>\$394,485,946</u>	<u>\$ 398,733,813</u>

Scheduled maturities of time and certificates of deposits at December 31, 2006, are as follows:

2007	\$217,321,707
2008	14,859,989
2009	4,605,485
2010 and Thereafter	<u>100,000</u>
Total	<u>\$236,887,181</u>

The Bank has received deposits in the normal course of business from directors and officers of the Bank and their associates. Such related party deposits were accepted on substantially the same terms including interest rates and maturities as those prevailing at the time for comparable transactions with unrelated parties. The aggregate dollar amount of these deposits was approximately \$40,776,041 and \$37,308,905 at December 31, 2006 and 2005, respectively.

#### Note 7 Income Taxes:

The income tax provisions (benefits) included in the consolidated statements of income are summarized as follows:

	2006	2005	2004
Currently Payable:			
Federal	\$ 2,574,789	\$ 2,790,662	\$ 2,597,055
State	<u>329,042</u>	<u>357,506</u>	<u>342,367</u>
Totals	<u>\$ 2,903,831</u>	<u>\$ 3,148,168</u>	<u>\$ 2,939,422</u>
Deferred (Benefit):			
Federal	\$ (48,951)	\$ 453,232	\$ 10
State	<u>(5,999)</u>	<u>55,543</u>	<u>1</u>
Totals	<u>\$ (54,950)</u>	<u>\$ 508,775</u>	<u>\$ 11</u>
Total Applicable Income Taxes	<u>\$ 2,848,880</u>	<u>\$ 3,656,943</u>	<u>\$ 2,939,433</u>

## Notes To Consolidated Financial Statements

### For Years Ended December 31, 2006, 2005, And 2004 (Continued)

Timing differences in the recognition of income and expenses for tax and financial reporting purposes created the following components of deferred income taxes (benefit):

	2006	2005	2004
Bad Debts	\$ (54,960)	\$ 508,754	\$ -0-
Discount on Investment Securities	<u>10</u>	<u>21</u>	<u>11</u>
Totals	<u>\$ (54,950)</u>	<u>\$ 508,775</u>	<u>\$ 11</u>

The following is a reconciliation of consolidated federal income tax to the amount computed at the statutory rate:

	2006		2005		2004	
	Amount	%	Amount	%	Amount	%
Tax on Income before Income Tax at the Top Statutory Income Tax Rate	\$2,708,655	34.00%	\$3,451,398	34.00%	\$2,763,414	34.00%
Increase (Decrease) Resulting from:						
State Income Tax, Net of Federal Benefit	213,209	2.68	272,611	2.69	225,963	2.78
Nontaxable Interest Income	(86,436)	(1.08)	(75,031)	(.74)	(59,756)	(.73)
Nondeductible Interest Expense	9,998	.13	5,926	.06	3,895	.05
Other Items	<u>3,454</u>	<u>.04</u>	<u>2,039</u>	<u>.02</u>	<u>5,917</u>	<u>.07</u>
Tax on Income	<u>\$2,848,880</u>	<u>35.77%</u>	<u>\$3,656,943</u>	<u>36.03%</u>	<u>\$2,939,433</u>	<u>36.17%</u>

The approximate tax (benefit) effects of the net investment securities gains (losses) were (\$61,341), (\$256,730), and \$15,386 for the years 2006, 2005, and 2004, respectively.

## Notes To Consolidated Financial Statements

### For Years Ended December 31, 2006, 2005, And 2004 (Continued)

#### Note 8

##### Pension Plan:

The Bank is a participant in a multiple employer non-contributory defined benefit pension plan covering the majority of employees. The retirement benefits are based on length of service and the employee's compensation during his/her time of service.

The following table shows the plan's funded status at December 31, 2006 and 2005:

	2006	2005
Accumulated Pension Benefit Obligation	\$ 3,585,999	\$3,476,252
Value of Future Salary Projections	<u>356,661</u>	<u>349,495</u>
Total Projected Pension Benefit Obligation	\$ 3,942,660	\$3,825,747
Fair Value of Plan Assets	<u>2,701,858</u>	<u>2,358,137</u>
Plan Assets in Excess (Deficient) of Projected Benefit Obligation	(\$ 1,240,802)	(\$1,467,610)
Unrecognized Prior Service Cost	(1,970)	(6,965)
Unrecognized Net Loss or (Gain)	1,316,116	1,594,990
Unrecognized Net Transition Liability or (Asset)	-0-	-0-
Accumulated Other Comprehensive Income	<u>(957,485)</u>	<u>(1,238,530)</u>
Unfunded (Accrued) or Prepaid Pension Cost	<u>(\$ 884,141)</u>	<u>(\$1,118,115)</u>

The components of pension (expense) income for the years ended December 31, 2006, 2005, and 2004, are as follows:

	2006	2005	2004
Service Cost-Benefits Earned			
During Year	(\$ 194,178)	(\$ 137,972)	(\$ 119,931)
Interest Cost on Projected Benefit Obligation	(216,215)	(209,848)	(193,575)
Actual Return on Assets	218,730	206,583	190,912
Amortization of Net Gain (Loss)	(91,484)	(57,776)	(35,765)
Net Amortization and Deferral	<u>4,995</u>	<u>7,692</u>	<u>12,554</u>
Net Periodic Pension (Cost) Benefit	<u>(\$ 278,152)</u>	<u>(\$ 191,321)</u>	<u>(\$ 145,805)</u>
Actuarial Assumptions:			
Weighted Average Discount Rate for Projected Benefit Obligation	5.75%	6.50%	6.50%
Weighted Average Rate of Compensation Increase	3.00%	3.50%	3.50%
Expected Long-Term Rate of Return on Plan Assets	8.50%	8.50%	8.50%

**Notes To Consolidated Financial Statements**  
**For Years Ended December 31, 2006, 2005, And 2004** (Continued)

**Note 9**  
**Parent Company Condensed Financial Information:**

	CONDENSED BALANCE SHEETS	
	December 31,	
	2006	2005
<b>ASSETS</b>		
Investment in Subsidiary	\$61,383,822	\$57,534,930
Cash	<u>3,112</u>	<u>1,697</u>
Total Assets	<u>\$61,386,934</u>	<u>\$57,536,627</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Total Liabilities	\$ <u>-0-</u>	\$ <u>-0-</u>
Shareholders' Equity	<u>\$61,386,934</u>	<u>\$57,536,627</u>
Total Liabilities and Shareholders' Equity	<u>\$61,386,934</u>	<u>\$57,536,627</u>

	CONDENSED STATEMENTS OF INCOME		
	For Years Ended December 31,		
	2006	2005	2004
<b>INCOME</b>	\$ <u>1,047,592</u>	\$ <u>915,379</u>	\$ <u>854,794</u>
<b>EXPENSES:</b>			
Operating Expenses	\$ <u>43,585</u>	\$ <u>29,097</u>	\$ <u>26,640</u>
Income before Income Tax Benefit and Equity in Undistributed Earnings of Subsidiary	\$ 1,004,007	\$ 886,282	\$ 828,154
Applicable Income Taxes (Benefit)	<u>(17,408)</u>	<u>(11,621)</u>	<u>(10,640)</u>
Income before Equity in Undistributed Earnings of Subsidiary	\$ 1,021,415	\$ 897,903	\$ 838,794
Equity in Undistributed Earnings of Subsidiary	<u>4,096,337</u>	<u>5,596,323</u>	<u>4,349,462</u>
Net Income	<u>\$5,117,752</u>	<u>\$ 6,494,226</u>	<u>\$ 5,188,256</u>

**Notes To Consolidated Financial Statements**  
**For Years Ended December 31, 2006, 2005, And 2004** (Continued)

**CONDENSED STATEMENTS OF CASH FLOWS**  
**For Years Ended December 31,**

	2006	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net Income	\$ 5,117,752	\$ 6,494,226	\$ 5,188,256
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Equity in Undistributed Earnings of Subsidiary	<u>(4,096,337)</u>	<u>(5,596,323)</u>	<u>(4,349,462)</u>
Net Cash Provided by Operating Activities	<u>\$ 1,021,415</u>	<u>\$ 897,903</u>	<u>\$ 838,794</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Dividends Paid	<u>(\$ 1,020,000)</u>	<u>(\$ 900,000)</u>	<u>(\$ 840,000)</u>
Net Cash Used in Financing Activities	<u>(\$ 1,020,000)</u>	<u>(\$ 900,000)</u>	<u>(\$ 840,000)</u>
Net Change in Cash and Cash Equivalents	\$ 1,415	(\$ 2,097)	(\$ 1,206)
Cash and Cash Equivalents at Beginning of Year	<u>1,697</u>	<u>3,794</u>	<u>5,000</u>
Cash and Cash Equivalents at End of Year	<u>\$ 3,112</u>	<u>\$ 1,697</u>	<u>\$ 3,794</u>

**Note 10**  
**Related Party Transactions:**

Some officers and directors (including their affiliates, families and related entities) of Putnam Bancshares, Inc. and its subsidiary are customers of the subsidiary and have had, and are expected to have, transactions with the subsidiary in the ordinary course of business. In addition, some officers and directors are also officers and directors of corporations which are customers of the Bank and have had, and are expected to have, transactions with the Bank in the ordinary course of business. In the opinion of management, such transactions are consistent with prudent banking practices and are within applicable banking regulations.



## Notes To Consolidated Financial Statements For Years Ended December 31, 2006, 2005, And 2004 (Continued)

### Note 11 Commitments and Contingent Liabilities:

The Bank's consolidated financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of business and that involve elements of credit risk, interest rate risk, and liquidity risk. These commitments and contingent liabilities are commitments to extend credit, commercial letters of credit, and standby letters of credit. A summary of the Bank's commitments and contingent liabilities at December 31, 2006, is as follows:

	<b>Notional Amount</b>
Commitments to Extend Credit	\$ 28,015,000
Commercial Letters of Credit	-0-
Standby Letters of Credit	671,000

Commitments to extend credit, commercial letters of credit, and standby letters of credit all include exposure to some credit loss in the event of nonperformance of the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extension of credit that are recorded on the consolidated balance sheets. Because these instruments generally have fixed maturity dates, they do not generally present any significant liquidity risk to the Bank.

In the ordinary course of business, Putnam Bancshares, Inc. and its subsidiary are sometimes parties to various legal proceedings and claims. While any litigation contains an element of uncertainty, management is unaware of any legal proceedings at December 31, 2006, of which the result would have a material adverse effect upon the consolidated financial statements.

### Note 12 Concentrations of Credit Risk:

Cash due from correspondent banks, based on bank balances, exceeded federally insured limits by approximately \$8,017,000 at December 31, 2006. Federal funds sold are generally unsecured by the correspondent banks.

The majority of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The rest are to customers from the area that have since relocated to other areas. Most of such customers are depositors of the Bank. Investments in state and municipal securities and loans to governmental entities are within the Bank's home state. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers.

### Note 13 Regulatory Matters:

Putnam Bancshares, Inc.'s principal source of funds for future dividend payments to shareholders will be from dividend payments received from its wholly-owned subsidiary, Putnam County Bank.

The Bank, as a state chartered member bank of the Federal Reserve System, is subject to the dividend restrictions set forth by the West Virginia Division of Banking as well as the Federal Reserve Board. Under such restrictions, the Bank may not, without the prior approval of the West Virginia Division of Banking and the Federal Reserve Board, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained net profits (as defined) from the prior two years. The Bank normally restricts dividends to a lesser amount. The dividends as of December 31, 2006, that the Bank could declare without the approval of the West Virginia Division of Banking and the Federal Reserve Board, amounted to approximately \$9,692,000.

The Bank is also subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet the minimum capital requirements can initiate certain actions by regulators that, if undertaken, could have a material effect on the Bank and the consolidated financial statements. Capital adequacy guidelines require minimum ratios of 4.00% for Tier 1 risk-based capital, 8.00% for total risk-based capital, and 4.00% for Tier 1 leverage capital. To be considered well capitalized under the regulatory framework for prompt corrective actions, the ratios must be at least 6.00%, 10.00%, and 5.00%, respectively.

Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weighting of assets and certain off-balance sheet items, and other factors. As of December 31, 2006 and 2005, the Bank has met all capital adequacy requirements and had regulatory capital ratios in excess of the levels established for well capitalized institutions. There are no conditions or events since the most recent notification that management believes have changed the Bank's prompt corrective action category.

## Notes To Consolidated Financial Statements For Years Ended December 31, 2006, 2005, And 2004 (Continued)

The Bank's actual ratios as well as a comparison of the period-end capital balances with the related amounts established by the regulatory agencies are as follows:

	Ratios	Capital Amounts		
		Actual	Minimum	Well Capitalized
<b>As of December 31, 2006:</b>				
Tier 1 Risk-Based Capital	23.89%	\$61,634,000	\$10,320,000	\$15,480,000
Total Risk-Based Capital	24.95	64,364,000	20,640,000	25,800,000
Tier 1 Leverage Capital	13.43	61,634,000	18,362,000	22,953,000
<b>As of December 31, 2005:</b>				
Tier 1 Risk-Based Capital	24.32%	\$57,537,000	\$9,462,000	\$14,192,000
Total Risk-Based Capital	25.47	60,237,000	18,923,000	23,654,000
Tier 1 Leverage Capital	12.56	57,537,000	18,324,000	22,905,000

The Bank executed a written agreement on November 19, 2003, with the Federal Reserve Bank of Richmond and the West Virginia Division of Banking to take corrective measures to enhance and improve its programs and procedures for complying with the Bank Secrecy Act of the U.S. Department of the Treasury and with the anti-money laundering provisions of the Board of Governors of the Federal Reserve System.

### Note 14 Disclosures about Fair Value of Financial Instruments:

At December 31, 1995, the Bank adopted Financial Accounting Standards Board Statement No. 107, which requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent market settlement of the instruments. Statement 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank.

The following methods and assumptions were used by the Bank in estimating its fair value disclosures for financial instruments.

**Cash and Due from Banks:** The carrying amount reported in the balance sheet for cash and due from banks approximates that asset's fair value.

**Federal Funds Sold:** The carrying amount reported in the balance sheet for federal funds sold approximates that asset's fair value.

**Investment Securities:** Fair values for investment securities are based on quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of similar instruments.

**Loans:** The fair values of fixed rate commercial, real estate, and consumer loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

**Deposits:** The estimated fair values of demand deposits (i.e. interest and noninterest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to their carrying amounts. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates, currently being offered on certificates, to a schedule of aggregated expected monthly maturities on time deposits.

**Notes To Consolidated Financial Statements**  
**For Years Ended December 31, 2006, 2005, And 2004 (Continued)**

The estimated fair values of the Bank's financial instruments at December 31, 2006 and 2005, are as follows:

	2006		2005	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
<b>Financial Assets:</b>				
Cash and Due from Banks	\$ 17,814,524	\$ 17,814,524	\$ 21,435,000	\$ 21,435,000
Federal Funds Sold	25,000,000	25,000,000	51,000,000	51,000,000
Investment Securities	123,780,710	123,796,168	119,832,570	136,722,286
Loans	289,992,190	274,295,444	263,443,261	268,712,126
<b>Financial Liabilities:</b>				
Deposits	\$ 394,489,058	\$ 394,996,453	\$398,733,813	\$398,892,784