

Financial Contents



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Analysis Of Earning Assets And Interest Bearing Liabilities

In Thousands of Dollars

ASSETS	2008			2007		
	Avg. Balance	Interest	Yield/Rate	Avg. Balance	Interest	Yield/Rate
Loans						
Commercial (1)	\$ 18,393	\$ 1,148	6.24%	\$ 16,265	\$ 1,326	8.15%
Real Estate	290,721	19,355	6.66%	275,375	19,480	7.07%
Installment (2)	11,352	914	8.05%	11,932	968	8.11%
Total Loans	\$ 320,466	\$ 21,417	6.68%	\$ 303,572	\$ 21,774	7.17%
Securities (3)						
Taxable	104,070	3,828	3.68%	106,464	4,925	4.63%
Tax-Exempt (4)	7,468	590	7.90%	6,342	458	7.22%
Total Securities	\$ 111,538	\$ 4,418	3.96%	\$ 112,806	\$ 5,383	4.77%
Federal Funds Sold	37,842	751	1.98%	31,378	1,563	4.98%
Total Earning Assets	\$ 469,846	\$ 26,586	5.66%	\$ 447,756	\$ 28,720	6.41%
Cash and Due from Banks	16,231			17,573		
Premises and Equipment, Net	919			1,003		
Other Assets	3,530			3,253		
Allowance for Loan Losses	(2,555)			(3,015)		
Total Assets (5)	\$ 487,971			\$ 466,570		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest Bearing Deposits						
Super NOW and MMDA	\$ 88,999	\$ 959	1.08%	\$ 90,967	\$ 1,373	1.51%
Savings	18,986	113	0.60%	18,527	185	1.00%
Time	264,403	10,666	4.03%	247,497	12,257	4.95%
Total Interest Bearing Deposits	\$ 372,388	\$ 11,738	3.15%	\$ 356,991	\$ 13,815	3.87%
Long-Term Borrowings	0	0	0.00%	0	0	0.00%
Total Interest Bearing Liabilities	\$ 372,388	\$ 11,738	3.15%	\$ 356,991	\$ 13,815	3.87%
Noninterest Bearing Deposits	46,014			43,844		
Accrued Expenses and Other Liabilities	2,477			2,498		
Equity	67,092			63,237		
Total Liabilities and Equity	\$ 487,971			\$ 466,570		
Net Interest Margin	\$ 469,846	\$ 14,848	3.16%	\$ 447,756	\$ 14,905	3.33%

(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 8.75%.

(5) Net of SFAS 105 Market Value

Rate Sensitivity Analysis As Of December 31, 2008

In Thousands of Dollars

REPRICING INTERVAL	Three Months Or Less	Three To Twelve Months	One To Three Years	Three To Five Years	Five To Fifteen Years	Over Fifteen Years
ASSETS						
Total Loans (1)	\$ 63,030	\$ 15,195	\$ 40,607	\$ 67,554	\$ 70,032	\$ 74,287
Investment Securities (2)	31,014	28,530	17,198	22,509	18,533	3,368
Federal Funds Sold	<u>19,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Selected Assets	\$ 113,044	\$ 43,725	\$ 57,805	\$ 90,063	\$ 88,565	\$ 77,655
LIABILITIES						
Interest Bearing Deposits (3)	\$ 158,747	\$ 83,866	\$ 26,108	\$ 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	\$ 158,747	\$ 83,866	\$ 26,108	\$ 100	\$ 0	\$ 0
Differences	<u>(45,703)</u>	<u>(40,141)</u>	<u>31,697</u>	<u>89,963</u>	<u>88,565</u>	<u>77,655</u>
Cumulative Differences	<u>\$ (45,703)</u>	<u>\$ (85,844)</u>	<u>\$ (54,147)</u>	<u>\$ 35,816</u>	<u>\$ 124,381</u>	<u>\$ 202,036</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

Putnam Bancshares, Inc., and its wholly owned subsidiary, Putnam County Bank, exhibited favorable growth in various financial indicators in 2008.

The year was consumed by a great deal of stress on the national economy as brought about by the subprime mortgage debacle. This has caused the meltdown of many mortgage loan companies as liquidity in the market for purchases of mortgages has been dramatically changed. Many mortgages originated and sold in the secondary markets were of poor credit quality and some caused by fraudulent broker and underwriting practices. These mortgages were the source of significant income to those institutions and were the reason why they pushed to originate these loans. The previous four sentences were presented in the Summary last year. Continued ill effects have continued into 2008. Washington lawmakers and policymakers are working hard to find an answer; however the breadth of the problem is massive.

The direct effect of this crisis was averted by many community banks. Credit underwriting standards of federally and state-chartered banks came under considerable scrutiny for the types of loan products offered and, as a result, were not largely responsible in the origination of such credits. Nonetheless, the impact of greater stress brought about by the mortgage crisis in the economy, increasing foreclosures and a general shut-down of business and consumer spending has exacted great pain on the national economy.

Statewide, West Virginia is feeling the severe effects of this national crisis. While West Virginia has not seen the wide variances in real estate values that other states have experienced, the state has seen staffing cuts and layoffs as a result. West Virginia will also continue to be challenged in promoting "clean coal" technologies to preserve the state's coal industry. Local highway construction continues to be a bright spot as the development of U. S. Route 35 is continuing with portions slated for completion in 2009.

West Virginia's unemployment rate averaged 4.3% for 2008. West Virginia's rate for the month of December was 4.9% compared to the national rate of 7.2%. Putnam County's unemployment rate was 3.2%. However, rates for the beginning of 2009 have risen. By February, the state's unemployment rate had risen to 7.5% and the nation had risen to 8.1%. Putnam County's rate moved to 6.2% in February.

A major single impact was made by the closing of Century Aluminum in Ravenswood. While the plant employed almost 3,000, Putnam County residents accounted for 43 of these jobs.

The following description of the operating income and financial condition of Putnam Bancshares, Inc. (referred to 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 F1 and ending on page F27). 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 supplement management's analysis.

The Federal Financial Institutions Examination Council (FFIEC) is a governmental organization comprised of 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 collect financial data from commercial banks through their quarterly Call Reports and Summary of Deposits reports. The compilation of this data and resulting statistical analysis is culminated in a Uniform Bank Performance Report ("UBPR") which also designates a national "peer group" based upon asset size and number of branches. The Bank's "peer group" consists of all commercial banks having assets between \$300 million and \$1 billion. As of December 31, 2008, there were 1,191 banks in the same group as the Bank. Of the banks in this group, three are based in West Virginia. When analyzing peer group statistics, it is necessary to view each bank's economic environment and operating philosophy as well as other available information (such as their Annual Reports) which may indicate how their statistical information compares to peers. Uniform Bank Performance Reports may be obtained on any financial institution by accessing www.ffiec.gov.

Net Interest Margin

The compression of net interest margins continued to be a common theme in banking circles in 2008. Competitive pressures continued to fuel the need to pay loan and deposit rates to maintain their market share. Aggressive competition among financial services companies gives consumers a wide array of options. The net interest margin is the difference between the tax equivalent interest income and interest expense divided by the average earning assets, and is a primary way to gauge profitability. The Company's net interest margin declined

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from 3.33% in 2007 to 3.16% in 2008. The peers' net interest margin was 4.02% in 2007 and 3.79% in 2008. The reason for this decline was higher rates paid on deposit accounts combined with paying market rates for loans. The Company's cost of funds was 3.87% in 2007 compared with 3.15% in 2008. The cost of funds is calculated by dividing the interest expense by the annual average of total deposits. The peer group's cost of funds was 3.76% in 2007 and 2.87% in 2008. The yield on earning assets was 5.66% in 2008 and 6.41% in 2007. Compared with peers, these spreads have historically been the trend over the last few years. Not surprisingly, due to the bank's conservative approach to investments the yield on investment securities decreased considerably in 2008 from 4.77% in 2007 to 3.96%, compared to a modest decrease in our overall peer group.

Interest Income

Interest income decreased \$2.1 million or 7% from year-end 2007 to year-end 2008. The Federal Open Market Committee (FOMC) lowered the target fed funds rate beginning in September 2007 a total of 100 basis points over the remainder of 2007. This trend continued in 2008 with seven additional cuts for a total of 400 basis points. Concerns over financial markets, tighter credit and uncertainty in the economy led the Committee to continue these actions. The Bank had 21% of its loan portfolio indexed to the Wall Street Journal prime rate as of year-end 2008. The average total loans increased \$16.9 million or 6% from year-end 2007 to year-end 2008. This compares with a \$28.9 million or 11% increase during the prior year. This continued increase reflects dedicated efforts of the lending group to provide credit in an efficient manner with a focus on customer needs. Continued growth does not reflect a weakening of credit standards to generate income. Total income from loans remained steady for the year, compared with a \$2.1 million increase at year-end 2007. The reason for no increase in loan income despite the growth in total outstanding loans is attributed to the decreasing rates as earlier described. The Company's average earning assets increased \$22.1 million or 5% from year-end 2007 to year-end 2008. The income on average earning assets decreased \$2.1 million or 7% from year-end 2007 to year-end 2008. This contrasts with a \$1.5 million or 6% increase for the period between year-end 2006 and year-end 2007.

Real estate lending continues to be a very viable business in our market. Average total real estate loans increased \$15.3 million or 6% in 2008 compared with \$25.8 million or 10% in

2007. A consistent growth in real estate is evident; however, lower rates in 2008 account for no growth in income. The Bank considers such lending to be very competitive so efficient turnaround and closing is a very important piece that is marketed. In addition, the Bank does not book their loans with the intent to sell them in the secondary market.

Income on commercial lending declined \$178 thousand or 13% in 2008, compared with an increase of \$214 thousand or 19% in 2007. Average total commercial loans increased \$2.1 million or 13% in 2007 compared with \$2.8 million or 21% in 2007. As with real estate lending, a consistent growth in commercial lending is evident; however the lower rates in 2008 account for a reduction in income.

Income on consumer lending fell \$54 thousand in 2008 compared with a \$4 thousand increase in 2007. The average total of consumer loans in 2008 decreased \$580 thousand or 5%. In 2007, the average total increased \$293 thousand. While there remains to be a highly competitive market for consumer lending, such as automobile loans, the Bank has been successful in cultivating customer relationships to maintain this segment of lending.

Income on investments (on a tax effective basis) declined \$965 thousand or 18% from year-end 2007 to year-end 2008. In addition, average total investments declined \$1 million or 1% in the same period. This compares to 2007 showing a decrease in investment income of \$387 thousand or 7%. Also during this period, average total investments declined \$11 million or 9%. The decline in income was related to maturing investments being replaced with lower yielding investments. The Company's tax equivalent yield on investments declined significantly between 2007 and 2008. The Bank's yield continues to be lower than peer institutions because of the composition of the portfolio. The portfolio continues to be highly composed of U. S. Treasury and U. S. Federal Agency securities. This is a strategy which has not changed since 2006. The Bank also continues to invest in three- and six-month Treasury Bills in the Treasury's weekly auction. The income on Federal Funds Sold at year-end 2008 declined \$812 thousand or 52% with average total balances increasing \$6 million or 21%. As with the other types of investments, the yield on Federal Funds Sold declined significantly between the years of 2007 and 2008. While the percentage of funds sold to average assets remains high in comparison to peers, the volume of such funds has declined in the past four years. Federal funds represent excess liquidity which the Bank is

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able to sell to correspondent banks at an interest rate which is subject to daily change. At year-end 2008, all municipals were West Virginia securities. In 2008, the Bank invested in a municipal security issued by The County Commission of Ohio County, West Virginia, with a carrying value (fair market value) of \$1.2 million at December 31, 2008. Though non-rated, other resources were used to ensure that this security fell within our policy for creditworthiness. In 2007, The Bank invested in two municipal securities issues of the Putnam County Building Commission with a current carrying value of \$1.3 million. These are revenue securities to fund the refinance and improvements to Teays Valley Manor, a home for low-income senior citizens and those with disabilities in Scott Depot. While these revenue securities are non-rated, they still meet the Bank's tests for creditworthiness. In addition, the investment in this project represents an opportunity for the Bank to address community needs, as mandated in the federal Community Reinvestment Act of 1977. Of the remainder of the Bank's municipal securities, \$3.5 million are investment grade A or better by Moody's and/or Standard and Poor's ratings services with the balance of \$500 thousand downgraded during 2008 to a rating of Baa1 which are considered as medium grade obligations. Of the municipal securities portfolio, 14% are general obligations with the remainder being revenue obligations.

Interest Expense

Interest expense on deposits decreased \$2.1 million or 15% from year-end 2007 to 2008. This compares with an increase of \$2.4 million or 21% in the previous year. The yield on total deposits was 3.15% for 2008 representing a decrease of 72 basis points from 2007. For our peer group, the yield is 2.87% for 2008 representing a decrease of 89 basis points. The yield in 2008 puts us in the 64th percentile compared to the 54th percentile in 2007 of our peer group. However, with respect to large time deposits (over \$100 thousand) the Bank's yield has moved to the 61st percentile of the peer group in 2008 compared with the 79th percentile in 2007. The average total of deposits increased \$18 million or 4% in the current year compared to \$10 million or 3% in the previous year. The competitive pricing of deposits has resulted in net interest margin compression in many financial institutions nationwide. Management has made adjustments in an effort to better control deposit pricing mechanisms in an effort to prevent further declines in the margin. Nonetheless, the Bank has historically paid higher rates to depositors. The Bank does not

actively solicit deposits from outside its market area and does not solicit brokered deposits.

Asset and Liability Management (Interest Rate Sensitivity and Liquidity)

Putnam County Bank's Asset/Liability Committee (ALCO) meets on a quarterly basis and is comprised of four outside directors and members of senior management. Reports are presented depicting historical and projected findings concerning profitability and risk, such as market risk, credit risk and liquidity risk. The experience and views of outside directors bring a perspective of how the customer may view pricing strategies. In addition, an officers' ALCO meets on a monthly basis to analyze similar data and discussions are forwarded to the board's ALCO. Some of the items on the agenda for discussion include projected loan and deposit growth or decline, the impact of rate changes, liquidity maintenance and trends in the economy and competition.

In an effort to monitor interest rate sensitivity, management must gauge interest rate risk and its effects upon financial statements. The variables include the maturities of instruments, repricing characteristics and the "imprecise" effects of prepayments on loans and withdrawals on deposits. The Rate Sensitivity Report (See page F2) provides for the maturity of instruments and takes into consideration the repricing characteristics, but not possible repayment or withdrawal scenarios. Assumptions related to changes in interest rates will affect prepayments and withdrawals and are discussed in the ALCO meetings.

While there exist several sources of liquidity, growth in lending during 2008 was funded primarily by increases in customers' deposits and a slight decline in investments and Federal Funds sold. The Bank's loan-to-deposit ratio continued to increase to 78.97% in 2008 from 76.04% in 2007. The peer group ratio was 89.37% in 2008 and 89.45% in 2007. Federal Funds sold and short-term investments remain the primary areas for liquidity. The Bank continues to be comparatively conservative with regards to investments as it invests in U. S. Treasury and Government Agency securities and "in state" municipal securities. The Bank does not participate in brokered deposits.

Another measure of liquidity is the Bank's net non-core funding dependence ratio. This measures how much of the Bank's

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long-term assets are funded with non-core funding. Non-core funding is characterized as time deposits in excess of \$100 thousand which are considered to be more sensitive to rate changes than other deposits. As of year-end 2008, the ratio was 19.40% compared with 14.28% at year-end 2007. This is well below the peer group ratios of 30.39% and 25.68%, respectively.

Nonperforming Assets

Nonperforming assets include 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 are in default for ninety days or more, unless the loan is well secured and in process of collection. Loans are in nonaccrual status due to loss of the primary source of repayment and all payments are reflected on a cash basis. The total of nonperforming loans at the end of 2008 was \$4.7 million or 1.42% of total loans compared with \$3 million or .97% at year-end 2007. This compares with peer ratios of 2.06% and 1.03% respectively. The increase in nonperforming was largely due to an increase in nonaccrual loans from nearly \$2 million in 2007 to \$4.1 million in 2008. The increase in nonaccrual loans related to a local construction company and real estate developer whose loans totaled \$3.2 million. The borrower is currently in bankruptcy; however, recovery prospects appear favorable. Approximately \$1.8 million in loans to a single borrower was returned to accruing status during 2008.

The Bank had no other real estate owned at year-end 2008 and a balance of \$90 thousand year-end 2007.

Provision and Allowance for Loan Losses

The Bank made total provisions to the allowance for loan losses totaling \$1.1 million in 2007. In 2008, the Bank incurred net negative provision totaling \$1.1 million. The negative provision was a result of an excess amount in the Allowance for Loan Losses as measured by management. This condition in 2008 was caused by recoveries of \$560 thousand with gross loan losses of \$555 thousand. Loan loss recoveries in 2007 totaled \$352 thousand while gross loan losses were \$801 thousand. The majority of this loss was related to a single business related to the building industry.

Net loan losses/(recoveries) were \$(5) thousand in 2008 and \$449 thousand in 2007. Lower net losses in 2008 were due to decreased losses combined with higher recoveries. For

2008, the Bank's ratio of net loss to average total loans was 0% compared to .50% for the peer group. In addition, the ratio of recoveries to total loans compares significantly higher than peer (.17% compared to .04%). As of year-end 2008, the allowance for loan loss was \$2.3 million or .68% of total loans compared to \$3.4 million or 1.09% of total loans at year-end 2007. The peer ratios of allowance to total loans were 1.40% in 2008 and 1.21% in 2007. While the Bank's ratios are lower than peer, the allowance level is reflective of many factors which include underwriting practices, local economic conditions and quality of collateral evaluations. While many factors must be assessed in determining the adequacy of the allowance, each institution's evaluation is specialized to its own unique characteristics. Along with a well-qualified loan staff, the Bank also has a Loan Committee composed of outside Directors meeting with senior officers to discuss topics involving the loan portfolio on a monthly basis. 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.

Noninterest Income

Total noninterest income (excluding gross securities gains) totaled \$365 thousand representing an increase of \$40 thousand or 12% in 2008 over 2007. Noninterest income grew \$39 thousand or 14% between 2006 and 2007. The most significant increase was in VISA debit card income as a result of our customers' increased usage of the Bank's VISA debit cards. Other sources of noninterest income remained relatively unchanged.

The Bank continues to be a low-cost provider of banking services. In 2008, the percentage of noninterest income to average assets for the Bank was .08% compared to the peer ratio of .78%. In 2007, the Bank's ratio was .07% with the peer ratio being .82%.

Noninterest Expense

Total noninterest expense (excluding gross securities losses) increased \$948 thousand or 12% from year-end 2007 to year-end 2008 compared with an increase of \$39 thousand or less than one percent between years ending 2007 and 2006. Noninterest expenses are composed of expenses relating to personnel, occupancy and other operating costs.

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Total personnel expenses increased \$190 thousand or 4% in 2008 compared with \$367 thousand or an 8% increase in 2007. Officer and employee salary expense increased \$320 thousand or 9% in 2008 compared with a \$108 thousand increase or 3% in 2007. Salary increases typically represent increases for existing Bank personnel. Staffing levels for the Bank were 77 in 2008 and 78 in 2007. Employee group health and life insurance increased \$40 thousand or 8% in 2008 and is commensurate with medical inflation rates nationwide. This compares with an increase of \$59 thousand or 13% in 2007. Management has been working to provide cost-effective insurance programs which still provide good service to our employees. The most significant personnel expense decrease was found in employee retirement funding. This expense increased from \$242 thousand in 2006 to \$439 thousand in 2007. This expense declined by \$178 thousand in 2008. The Bank's retirement plan is administered by the West Virginia Bankers Association as a noncontributory pension plan with independent actuaries making the determination of contributions made by its members. Management is continually assessing alternatives to the existing plan.

Total occupancy expense includes the costs to maintain the Bank's premises and equipment. These expenses increased \$209 thousand in 2008 compared with an increase of \$14 thousand in 2007. Of the increase, \$206 thousand related to renovations made at the Henderson Building, which is behind the Loan Center. The facility has been used for storage and meetings, and plans are to develop office space. The Bank continues to operate facilities at 2761 Main Street, 300 Hurricane Creek Road and 3058 Mount Vernon Road.

Total other operating expense increased from \$2.4 million in 2007 to \$2.9 million in 2008. The most significant increase is found in FDIC insurance premiums. In 2007, a significant decline in expense was related to a rebate of FDIC insurance premiums to the Bank in the amount of \$444 thousand as a result of deposit insurance reforms due to excess amounts in the deposit insurance fund. At the end of 2008, the Bank had a remaining credit of \$95 thousand. In 2008, due to the nationwide increase in bank failures, the Bank incurred \$256 thousand in premium expense. As nationwide bank failures have continued to accelerate, the FDIC has proposed a one-time assessment (in addition to regular assessments) that it has deemed necessary to keep the FDIC insurance fund solvent. A 20-basis point increase would cost Putnam County Bank approximately \$800 thousand in additional expense in 2009. As national concern from bankers mounts, the FDIC

has proposed borrowing from the Treasury and a 10-basis point increase. This increase would amount to an estimated \$400 thousand increase to expense in 2009. This one-time assessment is expected to take place during the third quarter of 2009. Another area of increase involved fees to attorneys, which is considered necessary to protect the Bank's interests. The increased use of attorneys has been a result of disputes and bankruptcies that the Bank has encountered in the lending area. Wise use of legal counsel protects the Bank from greater loss and helps the Bank maximize its collection efforts. Another area of increase was in data processing expense. The Bank began offering internet access and bill payment services to its customers in 2006. These services are provided free to our customers. The Bank promotes this service to assure accuracy of the Bank's records and prevent fraud. The growth of these services has caused its related processing expense to rise by \$28 thousand in 2008 over 2007. The financial institutions in the Bank's market area generally offer these as free services. Also, this product has become an expected offering for new as well as existing customers. Another data processing related expense showing increase was related to telecommunications lines provided to the Bank. In 2008, the Bank changed its telecommunications design with respect to its network administration. While this resulted in a \$28 thousand increase during 2008, the results were greater reliability, built-in redundancy and greater ability should a single office be affected by a disaster. Significant decreases were noted in business franchise taxes from an overpayment in 2007 resulting in a \$75 thousand reduction in expense. Also significant was a reduction in office supplies and printing amounting to a savings of \$41 thousand in 2008. Continued reductions in printed forms and paper products as a result of more disclosures which are computer-generated has been a leading reason for reductions. Expenses related to data processing services from our core provider were relatively unchanged between 2007 and 2008.

The Company reported \$1 thousand in net gains on the sale of securities held as available for sale in 2008 compared with a net gain of \$8 thousand in 2007. Gains and losses are derived from the sale of securities classified as "available for sale" which are reflected on the financial statements at the fair market value and may be sold at any time at the discretion of management. Management considers several factors before making a 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. All of the Company's investment in U. S. Treasury

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Bills is classified as "held to maturity" and the remainder of the portfolio is classified as "available for sale." 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

The Company's federal and state tax provision increased from \$2.2 million in 2007 to \$2.7 million in 2008. The increase was due to higher taxable income and a higher level of deferred tax expense. In 2008, the deferred tax benefit of \$353 thousand moved to a deferred tax expense of \$410 thousand.

The Bank invests in municipal securities issued in West Virginia which are "bank qualified" and are exempt from federal and state taxation.

Equity and Capital Ratios

Putnam Bancshares' equity increased \$4.9 million or 7% in 2008 to nearly \$70 million. The change in equity during 2008 was reflective of \$4.9 million in net income less \$1.3 million in dividends and an increase of \$1.3 million in comprehensive income. The book value per outstanding share rose from \$108.43 in 2007 to \$116.54 in 2008. The Company's return on average equity was 7.24% in 2008.

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 capital plus the allowable portion of the allowance for loan losses) comprise two vital measures of capital adequacy. As of year-end 2008, the Bank's Tier 1 risk-based capital-to-total risk-weighted assets were 23.02% compared to 22.98% in 2007. The peer bank ratios were 11.47% and 11.62% in 2008 and 2007 respectively. As of year-end 2008, the Bank's total risk-based capital-to-total risk-weighted assets were 23.79% compared to 24.19% in 2007. The peer bank ratios were 12.65% and 12.73% in 2008 and 2007 respectively. Both measures rank the Bank in the 97th percentile in comparison with peers. Using the federal guidelines for capital adequacy, these ratios suggest the Bank is well-capitalized.

Dividends

The Company paid dividends of \$1.3 million in 2008 compared with \$1.2 million in 2007, reflective of an 8% increase. This equates to a dividend payout (dividends to net income) ratio of 28%. The peer ratio for 2008 was 57%. This conservative dividend payment strategy has produced a stronger equity base for the Company. Regular dividends were paid in June and December of 2008.

For a further discussion of dividends, please refer to "Note 13 – Regulatory Matters" 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 quarterly 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, 2008 and 2007, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the three years in the period ended December 31, 2008. 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, 2008 and 2007, and the results of its operations and its cash flows for the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.



Certified Public Accountants

March 2, 2009

Consolidated Balance Sheets

DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Cash and Due from Banks	\$ 17,477,492	\$ 18,500,610
Federal Funds Sold	19,000,000	35,000,000
Available for Sale Securities	82,222,331	68,390,099
Held to Maturity Securities	38,929,453	38,703,017
Loans - Less Allowance for Credit Losses of \$2,267,273 and \$ 3,401,326, Respectively	332,595,513	309,509,071
Bank Premises and Equipment	822,749	1,101,244
Federal Reserve Bank Stock, at Cost	39,000	39,000
Investment in Unconsolidated Subsidiary	23,471	0
Other Assets	2,651,952	3,332,152
Total Assets	<u>\$ 493,761,961</u>	<u>\$ 474,575,193</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest Bearing	\$ 46,498,911	\$ 42,492,034
Interest Bearing	374,664,446	364,545,855
Total Deposits	\$ 421,163,357	\$ 407,037,889
Other Liabilities	2,672,747	2,480,437
Total Liabilities	<u>\$ 423,836,104</u>	<u>\$ 409,518,326</u>
Commitments and Contingent Liabilities (Note 11)		
SHAREHOLDERS' EQUITY:		
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	66,711,781	63,173,414
Accumulated Other Comprehensive Income	1,914,076	583,453
Total Shareholders' Equity	<u>\$ 69,925,857</u>	<u>\$ 65,056,867</u>
Total Liabilities and Shareholders' Equity	<u>\$ 493,761,961</u>	<u>\$ 474,575,193</u>

Consolidated Statements Of Income

FOR YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
INTEREST INCOME:			
Interest and Fees on Loans	\$ 21,416,380	\$ 21,773,955	\$ 19,660,919
Interest on Available for Sale Securities	3,323,470	3,354,525	3,791,469
Interest on Held to Maturity Securities	872,246	1,861,295	1,812,443
Interest Income on Federal Funds Sold	751,113	1,562,719	1,741,299
Interest Income on Federal Reserve Bank	<u>12,314</u>	<u>0</u>	<u>0</u>
Total Interest Income	<u>\$ 26,375,523</u>	<u>\$ 28,552,494</u>	<u>\$ 27,006,130</u>
INTEREST EXPENSE:			
Interest on Deposits	<u>\$ 11,737,145</u>	<u>\$ 13,815,003</u>	<u>\$ 11,368,845</u>
Net Interest Income	<u>\$ 14,638,378</u>	<u>\$ 14,737,491</u>	<u>\$ 15,637,285</u>
Provision for Possible Credit Losses	<u>(1,138,341)</u>	<u>1,120,335</u>	<u>150,000</u>
Net Interest Income after Provision for Possible Credit Losses	<u>\$ 15,776,719</u>	<u>\$ 13,617,156</u>	<u>\$ 15,487,285</u>
OTHER INCOME:			
Service Charges and Commissions	<u>\$ 336,187</u>	<u>\$ 307,505</u>	<u>\$ 270,891</u>
Realized Gains on Sales of Available for Sale Securities	811	79,801	0
Equity in Earnings of Subsidiary	(2,029)	0	0
Other Operating Income	<u>31,320</u>	<u>18,069</u>	<u>15,702</u>
Total Other Income	<u>\$ 366,289</u>	<u>\$ 405,375</u>	<u>\$ 286,593</u>
OTHER EXPENSES:			
Salaries and Employee Benefits	<u>\$ 4,966,623</u>	<u>\$ 4,776,402</u>	<u>\$ 4,409,210</u>
Expenses of Premises and Equipment	732,251	523,175	509,296
Realized Losses on Sales of Available for Sale Securities	0	72,224	167,416
Other Operating Expenses	<u>2,927,446</u>	<u>2,378,989</u>	<u>2,721,323</u>
Total Other Expenses	<u>\$ 8,626,320</u>	<u>\$ 7,750,790</u>	<u>\$ 7,807,245</u>
Income before Income Taxes	<u>\$ 7,516,688</u>	<u>\$ 6,271,741</u>	<u>\$ 7,966,633</u>
Provision for Income Taxes	<u>2,658,321</u>	<u>2,232,707</u>	<u>2,848,880</u>
Net Income	<u>\$ 4,858,367</u>	<u>\$ 4,039,034</u>	<u>\$ 5,117,753</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, 2008, 2007, AND 2006

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
BALANCES – JANUARY 1, 2006	\$ 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					<u>5,096,471</u>
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
COMPREHENSIVE INCOME:					
Net Income			4,039,034		4,039,034
Other Comprehensive Income - Net of Tax:					
Change in Unrealized Gain (Loss) on Securities Available for Sale, Net of Deferred Income Tax of \$483,270				835,700	835,700
Less: Reclassification Adjustment, Net of Income Tax of (\$2,776)				(4,802)	(4,802)
Total Comprehensive Income					<u>4,869,932</u>
Cash Dividends (\$2.00 Per Share)			(1,200,000)		(1,200,000)
BALANCES – DECEMBER 31, 2007	\$ 300,000	\$ 1,000,000	\$63,173,414	\$ 583,453	\$ 65,056,867
COMPREHENSIVE INCOME:					
Net Income			4,858,367		4,858,367
Other Comprehensive Income - Net of Tax:					
Change in Unrealized Gain (Loss) on Securities Available for Sale, Net of Deferred Income Tax of \$769,773				1,331,137	1,331,137
Less: Reclassification Adjustment, Net of Income Tax of (\$297)				(514)	(514)
Total Comprehensive Income					<u>6,188,990</u>
Cash Dividends (\$2.20 Per Share)			(1,320,000)		(1,320,000)
BALANCES – DECEMBER 31, 2008	<u>\$ 300,000</u>	<u>\$ 1,000,000</u>	<u>\$66,711,781</u>	<u>\$ 1,914,076</u>	<u>\$ 69,925,857</u>

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

Consolidated Statements Of Income

FOR YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

	<u>2008</u>	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	\$ 4,858,367	\$ 4,039,034	\$ 5,117,753
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation	190,123	202,175	181,150
Provision for Credit Losses	(1,138,341)	1,120,334	150,000
Provision for Deferred Taxes	410,183	(352,928)	(54,950)
Undistributed (Earnings) Loss of Affiliate	2,029	0	0
Net Realized (Gains) Losses on Available for Sale Securities	(811)	(7,576)	167,416
Increase in Cash Value - Life Insurance	(9,673)	(9,870)	(10,013)
Amortization of Premiums and (Accretion) of Discounts on Available for Sale Securities - Net	250,933	5,189	7,566
(Increase) Decrease in Interest Receivable	6,333	2,582	47,015
(Increase) Decrease in Prepaid Expense	8,186	(289,657)	235,454
(Increase) Decrease in Other Assets	2,862	(2,862)	0
Increase (Decrease) in Accrued Interest	(330,474)	345,190	629,100
Increase (Decrease) in Other Liabilities	(74,383)	137,625	128,284
Net Cash Provided by Operating Activities	<u>\$ 4,175,334</u>	<u>\$ 5,189,236</u>	<u>\$ 6,598,775</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
(Increase) Decrease in Federal Funds Sold	\$ 16,000,000	\$ (10,000,000)	\$ 26,000,000
Proceeds from Sales and Maturities of Available for Sale Securities	26,440,000	24,903,125	15,389,063
Proceeds from Maturities of Held to Maturity Securities	103,127,754	102,138,706	102,187,557
Proceeds from Sales of Other Real Estate	90,000	0	0
Purchases of Available for Sale Securities	(38,422,255)	(6,797,650)	(19,617,509)
Purchase of Held to Maturity Securities	(103,354,190)	(102,242,805)	(102,115,822)
Investment in Unconsolidated Subsidiary	(25,500)	0	0
Reclassification of Construction in Progress	189,000	0	0
Purchase of Bank Premises and Equipment	(100,627)	(398,864)	(124,914)
Net (Increase) Decrease in Loans	(21,948,101)	(23,457,603)	(26,668,541)
Net Cash Used in Investing Activities	<u>\$ (18,003,919)</u>	<u>\$ (15,855,091)</u>	<u>\$ (4,950,166)</u>

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

Consolidated Statements Of Cash Flows

FOR YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006 (continued)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net Increase (Decrease) in			
Demand and Savings Deposits	\$ 4,872,976	\$ (10,207,995)	\$ (18,968,347)
Increase (Decrease) in			
Certificates of Deposit	9,252,491	22,759,936	14,719,262
Dividends Paid	<u>(1,320,000)</u>	<u>(1,200,000)</u>	<u>(1,020,000)</u>
Net Cash Provided by (Used in)			
Financing Activities	<u>\$ 12,805,467</u>	<u>\$ 11,351,941</u>	<u>\$ (5,269,085)</u>
Net Increase (Decrease) in Cash			
and Cash Equivalents	\$ (1,023,118)	\$ 686,086	\$ (3,620,476)
Cash and Cash Equivalents			
at Beginning of Year	<u>18,500,610</u>	<u>17,814,524</u>	<u>21,435,000</u>
Cash and Cash Equivalents			
at End of Year	<u>\$ 17,477,492</u>	<u>\$ 18,500,610</u>	<u>\$ 17,814,524</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash Paid During the Year for:

Interest	<u>\$ 12,067,619</u>	<u>\$ 13,469,813</u>	<u>\$ 10,739,745</u>
Income Taxes	<u>\$ 2,425,000</u>	<u>\$ 2,357,000</u>	<u>\$ 2,730,000</u>

SUPPLEMENTAL SCHEDULE OF SIGNIFICANT NONCASH ACTIVITIES:

Transfer from Loans to Other			
Real Estate Owned	<u>\$ 0</u>	<u>\$ 90,000</u>	<u>\$ 0</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006

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 is a member of the Federal Reserve System providing full banking services, with the exception of trust services. As such, 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.

Investment in Limited Liability Company

During the year ended December 31, 2008, Putnam Bancshares, Inc. entered into an agreement with other entities to form Putnam County Title Insurance Agency, LLC. Putnam Bancshares, Inc. has a controlling interest in the LLC, owning 51% of the units. The equity method was used in accounting for the LLC. This is reflected in Note 9.

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.

The determination of the adequacy of the allowance for credit losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Bank's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgements about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Investment Securities

Debt Securities are classified as held-to-maturity when the Bank has the positive intent and ability to hold the securities to maturity. Securities held-to-maturity are carried at amortized cost. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the period to maturity.

Debt securities not classified as held-to-maturity are classified as available-for-sale. Securities available-for-sale are carried at fair value with unrealized gains and losses reported in other comprehensive income. Realized gains (losses) on securities available-for-sale are included in other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Gains and losses on sales of securities are determined on the specific-identification method.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

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. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Bank had no such losses for the years ended December 31, 2008, 2007, and 2006.

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. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. 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.

Allowance for Credit Losses

The allowance for credit losses is established as losses are estimated to have occurred through a provision for credit losses charged to earnings. Credit losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for credit losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

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 properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for credit losses. After foreclosure, valuations are periodically performed by management and property held for sale is carried at the lower of the new cost basis or fair value less cost to sell. Impairment losses on property to be held and used are measured as the amount by which the carrying amount of a property exceeds its fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. The portion of interest costs relating to development of real estate is capitalized. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell.

Income Taxes

Income taxes are provided for the tax effects of the transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of the allowances for credit losses. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Putnam Bancshares, Inc. files consolidated income tax returns with its subsidiary.

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 \$6,112,000 and \$6,017,000 for the years ended December 31, 2008 and 2007, respectively.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

Note 3

Investment Securities:

The carrying amounts and approximate market values of investment securities at December 31, 2008 and 2007, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2008				
Available for Sale Securities -				
U.S. Government and Agency Securities	\$ 71,409,716	\$ 4,273,096	\$ 0	\$ 75,682,812
State and Municipal Securities	7,791,662	29,905	(1,282,048)	6,539,519
Totals	<u>\$ 79,201,378</u>	<u>\$ 4,303,001</u>	<u>\$ (1,282,048)</u>	<u>\$ 82,222,331</u>
Held to Maturity Securities -				
U.S. Government and Agency Securities	\$ 38,929,453	\$ 64,699	\$ (1,027)	\$ 38,993,125
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2007				
Available for Sale Securities -				
U.S. Government and Agency Securities	\$ 60,216,812	\$ 895,688	\$ 0	\$ 61,112,500
State and Municipal Securities	7,252,433	44,343	(19,177)	7,277,599
Totals	<u>\$ 67,469,245</u>	<u>\$ 940,031</u>	<u>\$ (19,177)</u>	<u>\$ 68,390,099</u>
Held to Maturity Securities -				
U.S. Government and Agency Securities	\$ 38,703,017	\$ 47,132	\$ (774)	\$ 38,749,375

Investment securities with carrying amounts of \$48,767,855 and \$43,095,613 and market values of \$50,882,543 and \$43,678,483, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law at December 31, 2008 and 2007.

Gross realized gains and gross realized losses on sales of available for sale securities for the years ended December 31, 2008, 2007, and 2006, are as follows:

	2008	2007	2006
Gross Realized Gains: U.S. Government and Agency Securities	\$ 0	\$ 79,801	\$ 0
Gross Realized Gains: Municipal Securities	\$ 811	\$ 0	\$ 0
Gross Realized Losses: U.S. Government and Agency Securities	\$ 0	\$ 72,224	\$ 167,416

The amortized cost and estimated market value of debt securities at December 31, 2008, 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	\$ 20,054,401	\$ 20,614,062	\$ 38,929,453	\$ 38,993,125
Due from One Year to Five Years	37,444,869	39,706,801	0	0
Due from Five Years to Ten Years	15,799,548	17,280,956	0	0
Due after Ten Years	5,902,560	4,620,512	0	0
Totals	<u>\$ 79,201,378</u>	<u>\$ 82,222,331</u>	<u>\$ 38,929,453</u>	<u>\$ 38,993,125</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

Note 4

Loans:

Total loans at December 31, 2008 and 2007, by major loan categories are summarized as follows:

	<u>2008</u>	<u>2007</u>
Commercial	\$ 19,456,894	\$ 16,611,988
Real Estate - Construction and Mortgage	303,732,444	285,299,933
Installment	<u>11,718,414</u>	<u>11,071,618</u>
Gross Loans	\$ 334,907,752	\$ 312,983,539
Unearned Discount	<u>(44,966)</u>	<u>(73,142)</u>
Total Loans	\$ 334,862,786	\$ 312,910,397
Allowance for Credit Losses	<u>(2,267,273)</u>	<u>(3,401,326)</u>
Loans, Net	<u>\$ 332,595,513</u>	<u>\$ 309,509,071</u>

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Beginning Balances - January 1,	\$ 3,401,326	\$ 2,730,387	\$ 2,700,000
Loans Charged Off	(404,986)	(801,351)	(669,877)
Recoveries of Loans Previously Charged Off	409,274	351,955	550,264
Provision to Expense for Credit Losses	<u>(1,138,341)</u>	<u>1,120,335</u>	<u>150,000</u>
Ending Balances - December 31,	<u>\$ 2,267,273</u>	<u>\$ 3,401,326</u>	<u>\$ 2,730,387</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, 2008, 2007, and 2006:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Impaired Loans with Related Allowance	\$ 5,658,399	\$ 0	\$ 0
Impaired Loans with no Related Allowance	<u>2,159,910</u>	<u>1,944,695</u>	<u>1,969,477</u>
Total Impaired Loans	\$ 7,818,309	\$ 1,944,695	\$ 1,969,477
Allowance on Impaired Loans	<u>\$ 889,023</u>	<u>\$ 0</u>	<u>\$ 0</u>
Average Impaired Loans	<u>\$ 8,056,271</u>	<u>\$ 1,944,381</u>	<u>\$ 1,500,374</u>
Interest Income Recognized on Impaired Loans	<u>\$ 599,144</u>	<u>\$ 0</u>	<u>\$ 0</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (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 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Balances - January 1,	\$ 15,196,414	\$ 15,236,880
New Loans	7,713,924	707,011
Repayments	(5,044,513)	(747,477)
	<u>\$ 17,865,825</u>	<u>\$ 15,196,414</u>
Balances - December 31,		

Note 5

Bank Premises and Equipment:

Major classifications of bank premises and equipment at December 31, 2008 and 2007, are summarized as follows:

	<u>2008</u>	<u>2007</u>
Buildings and Improvements	\$ 1,856,589	\$ 2,045,588
Furniture and Fixtures	1,560,528	1,497,979
	<u>\$ 3,417,117</u>	<u>\$ 3,543,567</u>
Less: Accumulated Depreciation	2,794,828	2,642,783
	<u>\$ 622,289</u>	<u>\$ 900,784</u>
Land	200,460	200,460
	<u>\$ 822,749</u>	<u>\$ 1,101,244</u>
Bank Premises and Equipment, Net		

Depreciation expense for the years ended December 31, 2008, 2007, and 2006, was \$190,123, \$202,175, and \$181,150, 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, 2008, is as follows:

<u>Year</u>	<u>Amount</u>
2009	\$ 55,894
2010	57,821
2011	59,826
2012	56,587
2013	0
	<u>0</u>
Total	<u>\$ 230,128</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

Note 6 Deposits:

The major categories of deposits at December 31, 2008 and 2007, are as follows:

	<u>2008</u>	<u>2007</u>
Noninterest Bearing	\$ 46,498,911	\$ 42,492,034
Interest Bearing:		
Money Market	\$ 86,802,665	\$ 86,785,441
Savings	18,967,527	18,114,134
Time and Certificates of Deposit	113,882,684	110,457,165
Certificates of Deposit over \$100,000	<u>155,011,570</u>	<u>149,189,115</u>
Total Interest Bearing Deposits	<u>\$ 374,664,446</u>	<u>\$ 364,545,855</u>
Total Deposits	<u>\$ 421,163,357</u>	<u>\$ 407,037,889</u>

Scheduled maturities of time and certificates of deposits at December 31, 2008, are as follows:

2009	\$ 242,685,833
2010	23,525,636
2011	2,582,785
2012 and Thereafter	<u>100,000</u>
Total	<u>\$ 268,894,254</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 \$27,580,347 and \$27,218,528 at December 31, 2008 and 2007, respectively.

Note 7 Income Taxes:

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Currently Payable:			
Federal	\$ 1,978,564	\$ 2,284,336	\$ 2,574,789
State	<u>269,574</u>	<u>301,299</u>	<u>329,041</u>
Totals	<u>\$ 2,248,138</u>	<u>\$ 2,585,635</u>	<u>\$ 2,903,830</u>
Deferred (Benefit):			
Federal	\$ 375,031	\$ (320,814)	\$ (48,951)
State	<u>35,152</u>	<u>(32,114)</u>	<u>(5,999)</u>
Totals	<u>\$ 410,183</u>	<u>\$ (352,928)</u>	<u>\$ (54,950)</u>
Total Applicable Income Taxes	<u>\$ 2,658,321</u>	<u>\$ 2,232,707</u>	<u>\$ 2,848,880</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (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):

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Bad Debts	\$ 410,240	\$ (352,939)	\$ (54,960)
Discount on Investment Securities	(57)	11	10
Totals	<u>\$ 410,183</u>	<u>\$ (352,928)</u>	<u>\$ (54,950)</u>

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

	<u>2008</u>		<u>2007</u>		<u>2006</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Tax on Income before Income Tax at the Top Statutory Income Tax Rate	\$ 2,555,675	34.00%	\$ 2,132,392	34.00%	\$ 2,708,655	34.00%
Increase (Decrease) Resulting from:						
State Income Tax, Net of Federal Benefit	201,119	2.68	177,662	2.83	213,209	2.68
Nontaxable Interest Income	(115,767)	(1.54)	(94,785)	(1.51)	(86,436)	(1.08)
Nondeductible Interest Expense	13,130	.17	13,181	.21	9,998	.13
Other Items	4,164	.06	4,257	.07	3,454	.04
Tax on Income	<u>\$ 2,658,321</u>	<u>35.37%</u>	<u>\$ 2,232,707</u>	<u>35.60%</u>	<u>\$ 2,848,880</u>	<u>35.77%</u>

The approximate tax (benefit) effects of the net investment securities gains (losses) were \$297, \$2,776, and (\$61,341) for the years 2008, 2007, and 2006, respectively.

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, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Accumulated Pension Benefit Obligation	\$ 4,163,816	\$ 3,751,776
Value of Future Salary Projections	338,056	354,169
Total Projected Pension Benefit Obligation	<u>\$ 4,501,872</u>	<u>\$ 4,105,945</u>
Fair Value of Plan Assets	<u>2,445,660</u>	<u>3,358,329</u>
Plan Assets in Excess (Deficient) of Projected Benefit Obligation	\$ (2,056,212)	\$ (747,616)
Unrecognized Net Loss or (Gain)	2,374,834	1,005,877
Accumulated Other Comprehensive Income	0	(651,708)
Unfunded (Accrued) or Prepaid Pension Cost	<u>\$ 318,622</u>	<u>\$ (393,447)</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

The components of pension (expense) income for the years ended December 31, 2008, 2007, and 2006, are as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Service Cost-Benefits			
Earned During Year	\$ (180,481)	\$ (179,889)	\$ (194,178)
Interest Cost on Projected			
Benefit Obligation	(252,640)	(236,418)	(216,215)
Actual Return on Assets	273,651	239,208	218,730
Amortization of Net Gain (Loss)	(69,652)	(86,530)	(91,484)
Net Amortization and Deferral	0	1,970	4,995
Adjustment Due to Change in Measurement Date	(38,187)	0	0
Total Recognized in Other Comprehensive Income	<u>(1,368,957)</u>	<u>0</u>	<u>0</u>
Total Recognized in Net Benefit Cost and Other Comprehensive Income	<u>\$ (1,636,266)</u>	<u>\$ (261,659)</u>	<u>\$ (278,152)</u>
Actuarial Assumptions:			
Weighted Average Discount Rate for Projected Benefit Obligation	6.25%	6.00%	5.75%
Weighted Average Rate of Compensation Increase	3.00%	3.00%	3.00%
Expected Long-Term Rate of Return on Plan Assets	8.50%	8.50%	8.50%

Note 9

Parent Company Condensed Financial Information:

CONDENSED BALANCE SHEETS

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
ASSETS		
Investment in Subsidiary	\$ 69,899,075	\$ 65,055,421
Investment in Putnam County Title Insurance Agency	23,471	0
Cash	<u>3,311</u>	<u>1,446</u>
Total Assets	<u>\$ 69,925,857</u>	<u>\$ 65,056,867</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Total Liabilities	<u>\$ 0</u>	<u>\$ 0</u>
Shareholders' Equity	<u>\$ 69,925,857</u>	<u>\$ 65,056,867</u>
Total Liabilities and Shareholders' Equity	<u>\$ 69,925,857</u>	<u>\$ 65,056,867</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

CONDENSED STATEMENTS OF INCOME

	For Years Ended December 31,		
	2008	2007	2006
INCOME	\$ 1,375,850	\$ 1,225,234	\$ 1,047,592
EXPENSES:			
Operating Expenses	\$ 48,635	\$ 44,666	\$ 43,584
Income before Income Tax Benefit and Equity in Undistributed Earnings of Subsidiaries	\$ 1,327,215	\$ 1,180,568	\$ 1,004,008
Applicable Income Taxes (Benefit)	(20,150)	(17,766)	(17,408)
Income before Equity in Undistributed Earnings of Subsidiaries	\$ 1,347,365	\$ 1,198,334	\$ 1,021,416
Equity in Undistributed Earnings of Subsidiaries	3,511,003	2,840,700	4,096,337
Net Income	\$ 4,858,368	\$ 4,039,034	\$ 5,117,753

CONDENSED STATEMENTS OF CASH FLOWS

	For Years Ended December 31,		
	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	\$ 4,858,368	\$ 4,039,034	\$ 5,117,752
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Equity in Undistributed Earnings of Subsidiary	(3,511,003)	(2,840,700)	(4,096,337)
Net Cash Provided by Operating Activities	\$ 1,347,365	\$ 1,198,334	\$ 1,021,415
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in Subsidiary	\$ (25,500)	\$ 0	\$ 0
Net Cash Used in Investing Activities	\$ (25,500)	\$ 0	\$ 0
CASH FLOWS FROM FINANCING ACTIVITIES:			
Dividends Paid	\$ (1,320,000)	\$ (1,200,000)	\$ (1,020,000)
Net Cash Used in Financing Activities	\$ (1,320,000)	\$ (1,200,000)	\$ (1,020,000)
Net Change in Cash and Cash Equivalents	\$ 1,865	\$ (1,666)	\$ 1,415
Cash and Cash Equivalents at Beginning of Year	1,446	3,112	1,697
Cash and Cash Equivalents at End of Year	\$ 3,311	\$ 1,446	\$ 3,112

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

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.

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, 2008, is as follows:

	<u>Notional Amount</u>
Commitments to Extend Credit	\$ 19,419,000
Commercial Letters of Credit	0
Standby Letters of Credit	43,460

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, 2008, 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 \$2,076,000 at December 31, 2008. 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.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

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, 2008, that the Bank could declare without the approval of the West Virginia Division of Banking and the Federal Reserve Board, amounted to approximately \$6,377,000.

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, 2008 and 2007, 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.

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:

		Capital Amounts		
	Ratios	Actual	Minimum	Well Capitalized
As of December 31, 2008:				
Tier 1 Risk-Based Capital	23.03%	\$ 68,012,000	\$ 11,811,000	\$ 17,716,000
Total Risk-Based Capital	23.80	70,279,000	23,621,000	29,527,000
Tier 1 Leverage Capital	13.71	68,012,000	19,839,000	24,799,000
As of December 31, 2007:				
Tier 1 Risk-Based Capital	22.98%	\$ 64,473,000	\$ 11,223,000	\$ 16,834,000
Total Risk-Based Capital	24.19	67,874,000	22,446,000	28,057,000
Tier 1 Leverage Capital	13.54	64,473,000	19,048,000	23,811,000

Notes To Consolidated Financial Statements

For Years Ended December 31, 2008, 2007, And 2006 (continued)

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. This agreement was terminated by Federal Reserve System and West Virginia Division of Banking on November 6, 2007, by a letter dated November 13, 2007.

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.

The estimated fair values of the Bank's financial instruments at December 31, 2008 and 2007, are as follows:

	2008		2007	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
Financial Assets:				
Cash and Due from Banks	\$ 17,477,492	\$ 17,477,492	\$ 18,500,610	\$ 18,500,610
Federal Funds Sold	19,000,000	19,000,000	35,000,000	35,000,000
Investment Securities	121,151,784	121,215,457	107,093,116	107,139,474
Loans	334,862,786	332,506,736	312,910,397	299,814,207
Financial Liabilities:				
Deposits	\$ 421,166,667	\$ 422,309,344	\$ 407,039,335	\$ 407,834,880