

2009 Financial Report

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Analysis Of Earning Assets And Interest Bearing Liabilities

In Thousands of Dollars

| | 2009 | | | 2008 | | |
|---|-------------------|------------------|--------------|-------------------|------------------|--------------|
| | Avg. Balance | Interest | Yield/Rate | Avg. Balance | Interest | Yield/Rate |
| ASSETS | | | | | | |
| Loans | | | | | | |
| Commercial (1) | \$ 19,995 | \$ 1,066 | 5.33% | \$ 18,393 | \$ 1,148 | 6.24% |
| Real Estate | 310,291 | 18,634 | 6.01% | 290,721 | 19,355 | 6.66% |
| Installment (2) | 9,575 | 841 | 8.78% | 11,352 | 914 | 8.05% |
| Total Loans | <u>\$ 339,861</u> | <u>\$ 20,541</u> | <u>6.04%</u> | <u>\$ 320,466</u> | <u>\$ 21,417</u> | <u>6.68%</u> |
| Securities (3) | | | | | | |
| Taxable | 107,216 | 3,121 | 2.91% | 104,070 | 3,828 | 3.68% |
| Tax-Exempt (4) | 7,891 | 624 | 7.91% | 7,468 | 590 | 7.90% |
| Total Securities | <u>\$ 115,107</u> | <u>\$ 3,745</u> | <u>3.25%</u> | <u>\$ 111,538</u> | <u>\$ 4,418</u> | <u>3.96%</u> |
| Federal Funds Sold | 36,003 | 54 | 0.15% | 37,842 | 751 | 1.98% |
| Total Earning Assets | <u>\$ 490,971</u> | <u>\$ 24,340</u> | <u>4.96%</u> | <u>\$ 469,846</u> | <u>\$ 26,586</u> | <u>5.66%</u> |
| Cash and Due from Banks | 15,480 | | | 16,231 | | |
| Premises and Equipment, Net | 790 | | | 919 | | |
| Other Assets | 3,836 | | | 3,530 | | |
| Allowance for Loan Losses | (2,780) | | | (2,555) | | |
| Total Assets (5) | <u>\$ 508,297</u> | | | <u>\$ 487,971</u> | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | |
| Interest Bearing Deposits | | | | | | |
| Super NOW and MMDA | \$ 91,095 | \$ 828 | 0.91% | \$ 88,999 | \$ 959 | 1.08% |
| Savings | 20,050 | 82 | 0.41% | 18,986 | 113 | 0.60% |
| Time | 278,874 | 8,165 | 2.93% | 264,403 | 10,666 | 4.03% |
| Total Interest Bearing Deposits | <u>\$ 390,019</u> | <u>\$ 9,075</u> | <u>2.33%</u> | <u>\$ 372,388</u> | <u>\$ 11,738</u> | <u>3.15%</u> |
| Long-Term Borrowings | 0 | 0 | 0.00% | 0 | 0 | 0.00% |
| Total Interest Bearing Liabilities | <u>\$ 390,019</u> | <u>\$ 9,075</u> | <u>2.33%</u> | <u>\$ 372,388</u> | <u>\$ 11,738</u> | <u>3.15%</u> |
| Noninterest Bearing Deposits | 47,475 | | | 46,014 | | |
| Accrued Expenses and Other Liabilities | 1,991 | | | 2,477 | | |
| Equity | <u>68,812</u> | | | <u>67,092</u> | | |
| Total Liabilities and Equity | <u>\$ 508,297</u> | | | <u>\$ 487,971</u> | | |
| Net Interest Margin | \$ 490,971 | \$ 15,265 | 3.11% | \$ 469,846 | \$ 14,848 | 3.16% |

(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% for 2008.

(5) Net of SFAS 105 Market Value

Rate Sensitivity Analysis As Of December 31, 2009

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) | \$ 42,764 | \$ 16,663 | \$ 44,235 | \$ 81,070 | \$ 64,984 | \$ 87,183 |
| Investment Securities (2) | 23,996 | 25,781 | 17,030 | 37,703 | 2,502 | 4,039 |
| Federal Funds Sold | <u>38,000</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> |
| Total Selected Assets | \$ 104,760 | \$ 42,444 | \$ 61,265 | \$ 118,773 | \$ 67,486 | \$ 91,222 |
| LIABILITIES | | | | | | |
| Interest Bearing Deposits (3) | \$ 171,387 | \$ 94,790 | \$ 18,432 | \$ 0 | \$ 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 | \$ 171,387 | \$ 94,790 | \$ 18,432 | \$ 0 | \$ 0 | \$ 0 |
| Differences | <u>(66,627)</u> | <u>(52,346)</u> | <u>42,833</u> | <u>118,773</u> | <u>67,486</u> | <u>91,222</u> |
| Cumulative Differences | <u>\$ (66,627)</u> | <u>\$ (118,973)</u> | <u>\$ (76,140)</u> | <u>\$ 42,633</u> | <u>\$ 110,119</u> | <u>\$ 201,341</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, encountered a challenging year in 2009.

In 2008, a series of events led to Treasury stepping in and providing significant aid to the banking industry. Among the leading causes was a decline in liquidity in financial markets as a result of deterioration in real estate mortgages. This theme continued in 2009. Compounding stress in financial markets was an increase in unemployment and the related effects on consumer spending. This had a significant effect upon the automotive industry. The Federal Reserve has led efforts to keep interest rates low and Treasury has made efforts to aid in the mortgage crisis by providing liquidity to those threatened by foreclosure. Washington lawmakers and policymakers are working hard to find an answer, however the breadth of the problem is massive.

Statewide, West Virginia has not felt the severe effects of the national mortgage crisis in an overall respect. States which have seen wide variances in real estate values and have experienced significant changes in employment have felt great pain. West Virginia continues to promote "clean coal" technologies as a way of promoting the industry. However, several threats to coal have been made through alternative "green" sources, such as wind power. Continued improvements in the local system of highways are a priority and are necessary to advance the state's economic standing. Locally, the development of U. S. Route 35 has resulted in the opening of a major section during 2009 and additional portions are under construction.

West Virginia averaged 7.9% unemployment during 2009 rising from 6.7% in January to 8.6% in December. While West Virginia is comparatively lower than the national average (average nationally 9.3%), early 2010 statistics show unemployment rising in the state. The average unemployment for Putnam County was 6.3% in 2009.

The following description of the operating income 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 F-9 and ending on page F- 27). 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, the 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, 2009 there were 1,198 banks in the same group as the Bank. 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 was a common theme in banking circles in 2009. Interest rates continued to be at record lows and financial institutions continued to compete aggressively for loans and deposits. 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 from 3.16% in 2008 to 3.11% in 2009. The peer's net interest margin was 3.79% in 2008 and 3.70% in 2009. The reason for this decline was higher rates paid on deposit accounts combined with lower yields on earning assets. Among earning assets, investment yields were lower than peer and loan yields were priced closely to market. In addition, investment yields are generally lower than peer due to their higher quality and lower risk. The Company's cost of funds was 3.15% in 2008 compared with 2.33% in 2009. 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 2.87% in 2008 and 1.98% in 2009. The yield on earning assets was 5.66% in 2008 and 4.96% in 2009. While total loan yields declined from 6.68% in 2008 to 6.04% in 2009. The yield on investment securities declined from 3.96% in 2008 to 3.25% in 2009.

Management's Discussion and Analysis Of Financial Condition And Results Of Operation

Interest Income

Interest income declined \$2 million or 9% from year-end 2008 to year-end 2009. The Federal Open Market Committee (FOMC) has held the federal funds target rate between zero and .25% through 2009. The intent was to provide support for mortgage lending and housing markets. The Bank had 20% of its loan portfolio indexed to the Wall Street Journal prime rate as of year-end 2009. The average total loans increased \$19 million or 6% from year-end 2008 to year-end 2009. This compares with nearly \$17 million or 6% 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 and does not reflect a weakening of credit standards to generate income. Total income from loans decreased \$876 thousand or 4% at year-end 2009 while remaining relatively unchanged between 2007 and 2008. The decline in loan income, despite loan growth, has been a result of a low interest rate environment. The Company's average earning assets increased \$21 million or 4% from year-end 2008 to year-end 2009. The income on average earning assets decreased \$2 million or 8% from year-end 2008 to year-end 2009. This was relatively the same decrease as the prior comparative period. Low market rates during the year were responsible for the decline in income.

Real estate lending continues to be a very viable business in our market. Average total real estate loans grew \$19 million or 7% during 2009 compared with growth of \$15 million or 6% in 2008. Interest income on real estate loans declined \$721 thousand or 4% in 2009 compared with relatively no change in 2008. 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 \$82 thousand or 7% in 2009, compared with a decline of \$178 thousand or 13% in 2008. Average total commercial loans increased \$1.6 million or 9% in 2009 compared with \$2 million or 13% in 2008. A consistent growth in commercial lending is evident; however lower rates in 2009 accounts for a reduction in income.

Income on consumer lending declined \$73 thousand in 2009 compared with a decline of \$54 thousand in 2008. The average total of consumer loans in 2009 decreased nearly \$2 million or 16%. In 2008, the average total decreased \$580 thousand or 5%. The decline in this area of lending may be indicative

of consumer sentiment given the present economic situation. Nonetheless, automotive finance units have been aggressive in marketing low rate financing with cash back options to incent consumers the purchase new automobiles.

Income on investments (on a tax effective basis) declined \$673 thousand or 15% from year-end 2008 to year-end 2009. In addition, average total investments increased over \$3 million or 3% in the same period. This is in contrast to 2008 showing a decline in investment income of nearly \$1 million or 18%. Also during this period, average total investments declined \$1 million or 1%. The decline in income was related to securities which matured and subsequent reinvestment in a declining interest rate market. The Company's tax equivalent yield on investments declined between 2008 and 2009. The Bank's yield on investments continues to be lower than peer institutions. The reason is that the portfolio continues to be highly composed of U. S. Treasury and U. S. Federal Agency securities. The Bank continues to invest in three- and six-month Treasury Bills in the Treasury's weekly auction. While this strategy presents lower credit risk, it also results in lower investment yields. The income on Federal Funds Sold at year-end 2009 declined \$697 thousand with average total balances declining \$2 million or 5%. The yield on Federal Funds Sold dropped dramatically between the years of 2008 and 2009. These yields in the peer group have dropped almost 200 basis points between 2008 and 2009 and the Bank has recognized the same effect. 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 able to sell to correspondent banks at an interest rate which is subject to daily change. At year-end 2009, all municipal investments are West Virginia securities. In 2009, the Bank held two municipal issues of the Putnam County Building Commission with a carrying value of \$1.3 million at the end of the year. These issues 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. In 2009, the Bank held a municipal security issue of Ohio County, West Virginia Commission with a carrying value of \$1.7 million at the end of the year. Despite being non-rated, this security complied with the Bank's measures for creditworthiness. The remaining municipal securities (\$4.9 million) are rated investment grade

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by Moody's and/or Standard and Poor's ratings services. Of the municipal securities portfolio, 14% are general obligations with the remainder being revenue obligations.

Interest Expense

Interest expense on deposits decreased \$2.7 million or 23% from year-end 2008 to 2009. This compares to a similar decrease in the previous one-year period. The yield on total deposits was 2.33% for 2009 representing a decrease of 83 basis points from 2008. For our peer group, the yield is 1.98% for 2009 representing a decrease of 89 basis points. The Bank's cost of funds compare higher than peer, primarily due to rates paid on Super NOW accounts. The average total of deposits increased \$18 million or 5% in the current year compared with a similar amount in the previous year. The competitive pricing of deposits during the year has resulted in net interest margin concerns 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 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.

There exists several sources of liquidity. The Bank's loan-to-deposit ratio was 77% in 2009 and 79% in 2008. The peer group ratio was 83% in 2009 and 89% in 2008. 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 West Virginia 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 long-term assets are funded with non-core funding. Non-core funding is characterized as time deposits in excess of \$100,000 which are considered to be more sensitive to rate changes than other deposits. As of year-end 2009, the ratio was 17% compared with 19% at year-end 2008. This is well below the peer group ratios of 25% and 30%, 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 2009 was \$11.1 million or 3.19% of total loans compared with \$4.7 million or 1.42% at year-end 2008. This compares with peer ratios of 3.15% and 2.07% respectively. The increase in nonperforming loans was related to a multifamily residential real estate project in Winston-Salem, NC (\$5 million) and a Putnam County local real estate development (\$3 million). These loans appear to be well secured and are in active process of collection.

The Bank had a balance of \$655 thousand in other real estate owned at year-end 2009 compared with a zero balance in 2008.

Management's Discussion and Analysis Of Financial Condition And Results Of Operation

Provision and Allowance for Loan Losses

The Bank made total provisions to the allowance for loan losses totaling \$3.1 million in 2009 compared to a negative provision of \$1.1 million in 2008. The increased provisions in 2009 were related to losses incurred in construction real estate projects. Loan loss recoveries in 2009 totaled \$81 thousand compared with \$560 thousand in 2008. Recoveries in 2009 were due to the liquidation of properties which were previously long-term workouts. Gross loan losses increased from \$555 thousand in 2008 to \$1.5 million in 2009. The highest single loss was to a local home builder in which fraud was involved. The second highest single loss involved a participation loan involving a real estate development project in Wilmington, North Carolina where fraud has been suspected.

Net loan losses were \$1.4 million in 2009 and (\$5) thousand in 2008. Higher net losses were due to increased losses combined with a lower volume of recoveries. The Bank's ratio of net loss to average total loans was .42% compared to 1.08% for the peer group. As of year-end 2009, the allowance for loan loss was \$4 million or 1.15% of total loans compared to \$2.3 million or .68% of total loans at year-end 2008. The peer ratios of allowance to total loans were 1.82% in 2009 and 1.42% in 2008. 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 and equity in earnings of subsidiary) totaled \$450 thousand representing an increase of \$82 thousand or 22% in 2009 over 2008. Noninterest income grew \$42 thousand or 13% between 2007 and 2008. The most significant increase was a gain on the sale of other real estate owned. An increase in income on VISA debit card income offset declines in nonsufficient check and overdraft charges. Other sources of noninterest income remained relatively unchanged.

The Bank continues to be a low-cost provider of banking services. In 2009, the percentage of noninterest income to average assets for the Bank is .09% compared to the peer ratio of .74%. In 2008, the Bank's ratio was .08% with the peer ratio being .77%.

Equity in earnings of subsidiary increased from a loss of \$2 thousand in 2008 to a gain of \$63 thousand. This relates to the 51% investment in Putnam County Title Insurance Agency LLC by Putnam Bancshares, Inc. which was formed in 2008. The Agency benefitted from a full year of operation in 2009 and a robust local real estate market.

Noninterest Expense

Total noninterest expense (excluding gross securities losses) increased \$1.3 million or 15% from year-end 2008 to year-end 2009 compared with an increase of \$948 thousand or 12% between years ending 2007 and 2008. Noninterest expenses are composed of expenses relating to personnel, occupancy and other operating expenses. Total noninterest expense to average assets was 1.93% in 2009 compared with 1.76% in 2008. The peer group ratios showed 2.96% in 2009 and 2.91% in 2008. Earnings historically have benefitted from lower noninterest expenses, relative to the Bank's size.

Total personnel expenses increased \$634 thousand or 13% in 2009 compared with \$190 thousand or a 4% increase in 2008. The most significant personnel expense increase was found in employee retirement funding. This expense increased from \$261 thousand in 2008 to \$820 thousand in 2009. In July, the Bank made a special assessment of \$560 thousand to keep the plan fully funded, as required by the plan managers. 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 has interviewed alternative companies to manage the Bank's retirement plan and a change in 2010 is anticipated. The next highest increase in personnel expense was found in group health and life insurance. This expense increased from \$531 thousand in 2008 to \$767 thousand in 2009, a 44% increase. The Bank's medical insurance is a self-funded plan and higher expense has been a result of increased utilization. Management has initiated several strategies to cut costs in coverage, such as elimination of a plan option, raising deductibles and copayments, elimination of the Bank's health

Management's Discussion and Analysis Of Financial Condition And Results Of Operation

reimbursement account and selection of a new third-party administrator. Employee salary increases were frozen in 2009 and will be reconsidered in 2010. While personnel costs have increased significantly, the Bank's costs as a percentage of average assets compare favorably. At the end of 2009, the Bank's ratio was 1.10% compared with the peer bank ratio of 1.45%

Total occupancy expense includes the costs to maintain the Bank's premises and equipment. These expenses declined from \$732 thousand in 2008 to \$523 thousand in 2009. In 2008, \$206 thousand was attributed to remodeling of the Henderson Building on Second Street. The Bank continues to operate facilities at 2761 Main Street (including the Loan Center at 2762 Main Street), 300 Hurricane Creek Road and 3058 Mount Vernon Road.

Total other operating expense increased from \$2.9 million in 2008 to \$3.8 million in 2009. The most significant increase is found in FDIC insurance premiums. In 2009, these premiums increased nearly \$700 thousand over 2008. A special assessment (in addition to regular assessments) was placed on all FDIC institutions because of stress on the insurance fund from bank failures. To the Bank, the assessment was \$221 thousand in June. In late 2009, the FDIC proposed that Banks prepay their next three years of premiums. The resulting effect was a cash payment to the FDIC of \$2.3 million at year-end. Another area of increase involved expenses related to the maintenance of other real estate owned, particularly repossessed properties. These expenses relate to the maintenance of the property to prepare for sale. These expenses increased \$73 thousand in 2009. Major decreases in expense were found in data processing to Computer Services, Inc. (\$36 thousand) and Federal Reserve Bank services (\$38 thousand). Reductions in expense in these areas relate to better utilization of data processing services to the Bank. With major increases in operating expenses, the Bank still performs favorably in comparison to peers. At the end of 2009, the Bank's ratio of other operating expenses to average assets was .73% compared with the peer's ratio of 1.09%

The Bank reported \$4 thousand in net losses on the sale of securities held as available for sale in 2009 compared with a net gain of \$1 thousand in 2008. 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 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 decreased from \$2.7 million in 2008 to \$803 thousand in 2009. The decline was due to lower taxable income and a higher level of deferred tax benefit. In 2008, the deferred tax expense of \$410 thousand moved to a deferred tax benefit of \$666 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 declined \$136 thousand or .2% to remain nearly \$70 million. The change in equity during 2009 was reflective of \$1.7 million in net income less \$1.3 million in dividends and a decline of \$486 thousand in comprehensive income. The book value per outstanding share declined slightly from \$116.54 in 2008 to \$116.32 in 2009. The Company's return on average equity was 2.37% in 2009. Peer banks in 2009 posted a return on average equity of 1.24%

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 2009, the Bank's Tier 1 risk-based capital-to-total risk-weighted assets were 21.98% compared to 23.02% in 2008. The peer bank ratios were 11.96% and 11.40% in 2009 and 2008 respectively. As of year-end 2009, the Bank's total risk-based capital-to-total risk-weighted assets were 23.23% compared to 23.79% in 2008. The peer bank ratios were 13.23% and 12.60% in 2009 and 2008 respectively. Both measures rank the Bank in the

Management's Discussion and Analysis Of Financial Condition And Results Of Operation

97th percentile in comparison with peers. Using the federal guidelines for capital adequacy, these ratios indicate the Bank is well-capitalized.

Dividends

The Company paid dividends of \$1.3 million in 2009 and 2008. This equates to a dividend payout (dividends to net operating income) ratio of 82% in 2009 and 28% in 2008. The peer ratio for 2009 was 49% and 58% in 2008. Regular dividends were paid in June and December of 2009.

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, 2009 and 2008, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the three years in the period ended December 31, 2009. 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, 2009 and 2008, and the results of its operations and its cash flows for the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in blue ink that reads "Rollins, Cleavenger and Rollins". The signature is written in a cursive, flowing style.

Certified Public Accountants

March 11, 2010

Consolidated Balance Sheets

DECEMBER 31, 2009 AND 2008

| | <u>2009</u> | <u>2008</u> |
|--|-----------------------|-----------------------|
| ASSETS | | |
| Cash and Due from Banks | \$ 15,927,143 | \$ 17,477,492 |
| Federal Funds Sold | 38,000,000 | 19,000,000 |
| Available for Sale Securities | 72,065,259 | 82,222,331 |
| Held to Maturity Securities | 38,986,503 | 38,929,453 |
| Loans - Less Allowance for Credit Losses of \$4,002,286 and \$2,267,273, Respectively | 344,611,528 | 332,595,513 |
| Bank Premises and Equipment | 747,811 | 822,749 |
| Federal Reserve Bank Stock, at Cost | 39,000 | 39,000 |
| Investment in Unconsolidated Subsidiary | 9,808 | 23,471 |
| Other Assets | 5,530,926 | 2,651,952 |
| Total Assets | <u>\$ 515,917,978</u> | <u>\$ 493,761,961</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| LIABILITIES: | | |
| Deposits: | | |
| Noninterest Bearing | \$ 47,396,205 | \$ 46,498,911 |
| Interest Bearing | 397,338,965 | 374,664,446 |
| Total Deposits | \$ 444,735,170 | \$ 421,163,357 |
| Other Liabilities | 1,393,374 | 2,672,747 |
| Total Liabilities | <u>\$ 446,128,544</u> | <u>\$ 423,836,104</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 | 67,061,609 | 66,711,781 |
| Accumulated Other Comprehensive Income | 1,427,825 | 1,914,076 |
| Total Shareholders' Equity | <u>\$ 69,789,434</u> | <u>\$ 69,925,857</u> |
| Total Liabilities and Shareholders' Equity | <u>\$ 515,917,978</u> | <u>\$ 493,761,961</u> |

Consolidated Statements Of Income

FOR YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|---|----------------------|----------------------|----------------------|
| INTEREST INCOME: | | | |
| Interest and Fees on Loans | \$ 20,540,639 | \$ 21,416,380 | \$ 21,773,955 |
| Interest on Available for Sale Securities | 3,354,438 | 3,323,470 | 3,354,525 |
| Interest on Held to Maturity Securities | 154,584 | 872,246 | 1,861,295 |
| Interest Income on Federal Funds Sold | 53,679 | 751,113 | 1,562,719 |
| Interest Income on Federal Reserve Bank | <u>19,661</u> | <u>12,314</u> | <u>0</u> |
| Total Interest Income | <u>\$ 24,123,001</u> | <u>\$ 26,375,523</u> | <u>\$ 28,552,494</u> |
| INTEREST EXPENSE: | | | |
| Interest on Deposits | <u>\$ 9,075,325</u> | <u>\$ 11,737,145</u> | <u>\$ 13,815,003</u> |
| Net Interest Income | <u>\$ 15,047,676</u> | <u>\$ 14,638,378</u> | <u>\$ 14,737,491</u> |
| Provision for Possible Credit Losses | <u>3,163,967</u> | <u>(1,138,341)</u> | <u>1,120,335</u> |
| Net Interest Income after Provision for Possible Credit Losses | <u>\$ 11,883,709</u> | <u>\$ 15,776,719</u> | <u>\$ 13,617,156</u> |
| OTHER INCOME: | | | |
| Service Charges and Commissions | <u>\$ 339,241</u> | <u>\$ 336,187</u> | <u>\$ 307,505</u> |
| Realized Gains on Sales of Available for Sale Securities | 0 | 811 | 79,801 |
| Equity in Earnings of Subsidiary | 62,837 | (2,029) | 0 |
| Other Operating Income | <u>110,440</u> | <u>31,320</u> | <u>18,069</u> |
| Total Other Income | <u>\$ 512,518</u> | <u>\$ 366,289</u> | <u>\$ 405,375</u> |
| OTHER EXPENSES: | | | |
| Salaries and Employee Benefits | <u>\$ 5,600,555</u> | <u>\$ 4,966,623</u> | <u>\$ 4,776,402</u> |
| Expenses of Premises and Equipment | 523,300 | 732,251 | 523,175 |
| Realized Losses on Sales of Available for Sale Securities | 3,912 | 0 | 72,224 |
| Other Operating Expenses | <u>3,795,643</u> | <u>2,927,446</u> | <u>2,378,989</u> |
| Total Other Expenses | <u>\$ 9,923,410</u> | <u>\$ 8,626,320</u> | <u>\$ 7,750,790</u> |
| Income before Income Taxes | <u>\$ 2,472,817</u> | <u>\$ 7,516,688</u> | <u>\$ 6,271,741</u> |
| Provision for Income Taxes | <u>802,989</u> | <u>2,658,321</u> | <u>2,232,707</u> |
| Net Income | <u>\$ 1,669,828</u> | <u>\$ 4,858,367</u> | <u>\$ 4,039,034</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, 2009, 2008, AND 2007

| | Common Stock | Surplus | Retained Earnings | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|---|-----------------|--------------|----------------------|---|----------------------------------|
| BALANCES – JANUARY 1, 2007 | \$ 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 | \$ 300,000 | \$ 1,000,000 | \$66,711,781 | \$ 1,914,076 | \$ 69,925,857 |
| COMPREHENSIVE INCOME: | | | | | |
| Net Income | | | 1,669,828 | | 1,669,828 |
| Other Comprehensive Income - Net of Tax: | | | | | |
| Change in Unrealized Gain (Loss) on Securities Available for Sale, Net of Deferred Income Tax (Benefit) of (\$282,623) | | | | (488,730) | (488,730) |
| Add: Reclassification Adjustment, Net of Income Tax Benefits of \$1,433 | | | | 2,479 | 2,479 |
| Total Comprehensive Income | | | | | <u>1,183,577</u> |
| Cash Dividends (\$2.20 Per Share) | | | (1,320,000) | | (1,320,000) |
| BALANCES – DECEMBER 31, 2009 | \$ 300,000 | \$ 1,000,000 | \$67,061,609 | \$ 1,427,825 | \$ 69,789,434 |

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

Consolidated Statements Of Cash Flows

FOR YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|--|------------------------|------------------------|------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net Income | \$ 1,669,828 | \$ 4,858,367 | \$ 4,039,034 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | | |
| Depreciation | 134,824 | 190,123 | 202,175 |
| Provision for Credit Losses | 3,163,967 | (1,138,341) | 1,120,334 |
| Provision for Deferred Taxes | (665,613) | 410,183 | (352,928) |
| Undistributed (Earnings) Loss of Affiliate | (62,837) | 2,029 | 0 |
| Net (Gain) Loss on Sale of OREO | (89,770) | 0 | 0 |
| Net Realized (Gains) Losses on Available for Sale Securities | 3,912 | (811) | (7,576) |
| Increase in Cash Value - Life Insurance | (9,407) | (9,673) | (9,870) |
| Amortization of Premiums and (Accretion) of Discounts on Available for Sale Securities - Net | 351,377 | 250,933 | 5,189 |
| Decrease in Interest Receivable | 110,865 | 6,333 | 2,582 |
| (Increase) Decrease in Prepaid Expense | (1,975,675) | 8,186 | (289,657) |
| (Increase) Decrease in Other Assets | 0 | 2,862 | (2,862) |
| Increase (Decrease) in Accrued Interest | (543,895) | (330,474) | 345,190 |
| Increase (Decrease) in Other Liabilities | (138,311) | (74,383) | 137,625 |
| Net Cash Provided by Operating Activities | <u>\$ 1,949,265</u> | <u>\$ 4,175,334</u> | <u>\$ 5,189,236</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| (Increase) Decrease in Federal Funds Sold | \$ (19,000,000) | \$ 16,000,000 | \$ (10,000,000) |
| Proceeds from Sales and Maturities of Available for Sale Securities | 20,210,000 | 26,440,000 | 24,903,125 |
| Proceeds from Maturities of Held to Maturity Securities | 105,845,416 | 103,127,754 | 102,138,706 |
| Proceeds from Sales of Other Real Estate | 724,119 | 90,000 | 0 |
| Purchases of Available for Sale Securities | (11,175,657) | (38,422,255) | (6,797,650) |
| Purchase of Held to Maturity Securities | (105,902,466) | (103,354,190) | (102,242,805) |
| Investment in (Payments from) Unconsolidated Subsidiary | 76,500 | (25,500) | 0 |
| Reclassification of Construction in Progress | 0 | 189,000 | 0 |
| Purchase of Bank Premises and Equipment | (59,887) | (100,627) | (398,864) |
| Net Increase in Loans | (16,469,452) | (21,948,101) | (23,457,603) |
| Net Cash Used in Investing Activities | <u>\$ (25,751,427)</u> | <u>\$ (18,003,919)</u> | <u>\$ (15,855,091)</u> |

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

Consolidated Statements Of Cash Flows

FOR YEARS ENDED DECEMBER 31, 2009, 2008, AND 2007 (continued)

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|---|-----------------------|-----------------------|----------------------|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net Increase (Decrease) in | | | |
| Demand and Savings Deposits | \$ 7,680,158 | \$ 4,872,976 | \$ (10,207,995) |
| Increase in Certificates of Deposit | 15,891,655 | 9,252,491 | 22,759,936 |
| Dividends Paid | <u>(1,320,000)</u> | <u>(1,320,000)</u> | <u>(1,200,000)</u> |
| Net Cash Provided by Financing Activities | <u>\$ 22,251,813</u> | <u>\$ 12,805,467</u> | <u>\$ 11,351,941</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | <u>\$ (1,550,349)</u> | <u>\$ (1,023,118)</u> | <u>\$ 686,086</u> |
| Cash and Cash Equivalents at Beginning of Year | <u>17,477,492</u> | <u>18,500,610</u> | <u>17,814,524</u> |
| Cash and Cash Equivalents at End of Year | <u>\$ 15,927,143</u> | <u>\$ 17,477,492</u> | <u>\$ 18,500,610</u> |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | | |
| Cash Paid During the Year for: | | | |
| Interest | <u>\$ 9,619,220</u> | <u>\$ 12,067,619</u> | <u>\$ 13,469,813</u> |
| Income Taxes | <u>\$ 1,441,000</u> | <u>\$ 2,425,000</u> | <u>\$ 2,357,000</u> |
| SUPPLEMENTAL SCHEDULE OF SIGNIFICANT NONCASH ACTIVITIES: | | | |
| Transfer from Loans to Other Real Estate Owned | <u>\$ 1,289,471</u> | <u>\$ 0</u> | <u>\$ 90,000</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007

Note 1

Summary of Significant Accounting Policies:

The accounting and reporting policies of Putnam Bancshares, Inc. and its 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, 2009, 2008, And 2007 (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, 2009, 2008, and 2007.

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, 2009, 2008, And 2007 (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 \$5,949,000 and \$6,112,000 for the years ended December 31, 2009 and 2008, respectively.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (continued)

Note 3

Investment Securities:

The carrying amounts and approximate market values of investment securities at December 31, 2009 and 2008, are as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---------------------------------------|----------------------|------------------------------|-------------------------------|----------------------|
| December 31, 2009 | | | | |
| Available for Sale Securities - | | | | |
| U.S. Government and Agency Securities | \$ 61,228,627 | \$ 2,911,583 | \$ (64,169) | \$ 64,076,041 |
| State and Municipal Securities | 8,583,120 | 28,883 | (622,785) | 7,989,218 |
| Totals | <u>\$ 69,811,747</u> | <u>\$ 2,940,466</u> | <u>\$ (686,954)</u> | <u>\$ 72,065,259</u> |
| Held to Maturity Securities - | | | | |
| U.S. Government and Agency Securities | <u>\$ 38,986,503</u> | <u>\$ 4,514</u> | <u>\$ (400)</u> | <u>\$ 38,990,617</u> |
| 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 | <u>\$ 38,929,453</u> | <u>\$ 64,699</u> | <u>\$ (1,027)</u> | <u>\$ 38,993,125</u> |

Investment securities with carrying amounts of \$54,790,136 and \$48,767,855 and market values of \$57,238,107 and \$50,882,543, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law at December 31, 2009 and 2008.

Gross realized gains and gross realized losses on sales of available for sale securities for the years ended December 31, 2009, 2008, and 2007, are as follows:

| | 2009 | 2008 | 2007 |
|--|-----------------|---------------|------------------|
| Gross Realized Gains: U.S. Government and Agency Securities | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 79,801</u> |
| Gross Realized Gains: Municipal Securities | <u>\$ 0</u> | <u>\$ 811</u> | <u>\$ 0</u> |
| Gross Realized Losses: U.S. Government and Agency Securities | <u>\$ 3,912</u> | <u>\$ 0</u> | <u>\$ 72,224</u> |

The amortized cost and estimated market value of debt securities at December 31, 2009, 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 | \$ 10,516,658 | \$ 10,791,500 | \$ 38,986,503 | \$ 38,990,617 |
| Due from One Year to Five Years | 52,138,045 | 54,733,012 | 0 | 0 |
| Due from Five Years to Ten Years | 482,182 | 482,537 | 0 | 0 |
| Due after Ten Years | 6,674,862 | 6,058,210 | 0 | 0 |
| Totals | <u>\$ 69,811,747</u> | <u>\$ 72,065,259</u> | <u>\$ 38,986,503</u> | <u>\$ 38,990,617</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (continued)

Note 4

Loans:

Total loans at December 31, 2009 and 2008, by major loan categories are summarized as follows:

| | <u>2009</u> | <u>2008</u> |
|---|-----------------------|-----------------------|
| Commercial | \$ 22,581,327 | \$ 19,456,894 |
| Real Estate - Construction and Mortgage | 316,562,555 | 303,732,444 |
| Installment | <u>9,499,365</u> | <u>11,718,414</u> |
| Gross Loans | \$ 348,643,247 | \$ 334,907,752 |
| Unearned Discount | <u>(29,433)</u> | <u>(44,966)</u> |
| Total Loans | \$ 348,613,814 | \$ 334,862,786 |
| Allowance for Credit Losses | <u>(4,002,286)</u> | <u>(2,267,273)</u> |
| Loans, Net | <u>\$ 344,611,528</u> | <u>\$ 332,595,513</u> |

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

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|--|---------------------|---------------------|---------------------|
| Beginning Balances - January 1, | \$ 2,267,273 | \$ 3,401,326 | \$ 2,730,387 |
| Loans Charged Off | (1,510,016) | (404,986) | (801,351) |
| Recoveries of Loans Previously Charged Off | 81,062 | 409,274 | 351,955 |
| Provision to Expense for Credit Losses | <u>3,163,967</u> | <u>(1,138,341)</u> | <u>1,120,335</u> |
| Ending Balances - December 31, | <u>\$ 4,002,286</u> | <u>\$ 2,267,273</u> | <u>\$ 3,401,326</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, 2009, 2008, and 2007:

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|--|----------------------|---------------------|---------------------|
| Impaired Loans with Related Allowance | \$ 12,554,389 | \$ 5,658,399 | \$ 0 |
| Impaired Loans with No Related Allowance | <u>5,214,041</u> | <u>2,159,910</u> | <u>1,944,695</u> |
| Total Impaired Loans | \$ 17,768,430 | \$ 7,818,309 | \$ 1,944,695 |
| Allowance on Impaired Loans | <u>\$ 3,677,919</u> | <u>\$ 889,023</u> | <u>\$ 0</u> |
| Average Impaired Loans | <u>\$ 15,521,157</u> | <u>\$ 8,056,271</u> | <u>\$ 1,944,381</u> |
| Interest Income Recognized on Impaired Loans | <u>\$ 295,049</u> | <u>\$ 599,144</u> | <u>\$ 0</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (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 2009 and 2008:

| | <u>2009</u> | <u>2008</u> |
|-------------------------|----------------------|----------------------|
| Balances - January 1, | \$ 17,865,825 | \$ 15,196,414 |
| New Loans | 3,654,656 | 7,713,924 |
| Repayments | <u>(5,787,810)</u> | <u>(5,044,513)</u> |
| Balances - December 31, | <u>\$ 15,732,671</u> | <u>\$ 17,865,825</u> |

Note 5

Bank Premises and Equipment:

Major classifications of bank premises and equipment at December 31, 2009 and 2008, are summarized as follows:

| | <u>2009</u> | <u>2008</u> |
|----------------------------------|---------------------|---------------------|
| Buildings and Improvements | \$ 1,856,589 | \$ 1,856,589 |
| Furniture and Fixtures | 1,620,415 | 1,560,528 |
| | <u>\$ 3,477,004</u> | <u>\$ 3,417,117</u> |
| Less: Accumulated Depreciation | 2,929,653 | 2,794,828 |
| | <u>\$ 547,351</u> | <u>\$ 622,289</u> |
| Land | 200,460 | 200,460 |
| | <u>\$ 747,811</u> | <u>\$ 822,749</u> |
| Bank Premises and Equipment, Net | | |

Depreciation expense for the years ended December 31, 2009, 2008, and 2007, was \$134,824, \$190,123, and \$202,175, 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, 2009, is as follows:

| <u>Year</u> | <u>Amount</u> |
|-------------|-------------------|
| 2010 | \$ 57,821 |
| 2011 | 59,826 |
| 2012 | 56,587 |
| 2013 | 0 |
| 2014 | <u>0</u> |
| Total | <u>\$ 174,234</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (continued)

Note 6

Deposits:

The major categories of deposits at December 31, 2009 and 2008, are as follows:

| | <u>2009</u> | <u>2008</u> |
|--|-----------------------|-----------------------|
| Noninterest Bearing | \$ 47,396,205 | \$ 46,498,911 |
| Interest Bearing: | | |
| Money Market | \$ 92,326,546 | \$ 86,802,665 |
| Savings | 20,223,297 | 18,967,527 |
| Time and Certificates of Deposit | 117,111,297 | 113,882,684 |
| Certificates of Deposit over \$100,000 | <u>167,677,825</u> | <u>155,011,570</u> |
| Total Interest Bearing Deposits | <u>\$ 397,338,965</u> | <u>\$ 374,664,446</u> |
| Total Deposits | <u>\$ 444,735,170</u> | <u>\$ 421,163,357</u> |

Scheduled maturities of time and certificates of deposits at December 31, 2009, are as follows:

| | |
|---------------------|-----------------------|
| 2010 | \$ 266,357,191 |
| 2011 | 14,845,136 |
| 2012 | 3,586,795 |
| 2013 and Thereafter | <u>0</u> |
| Total | <u>\$ 284,789,122</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 \$44,143,907 and \$27,580,347 at December 31, 2009 and 2008, respectively.

Note 7

Income Taxes:

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

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|-------------------------------|---------------------|---------------------|---------------------|
| Currently Payable: | | | |
| Federal | \$ 1,290,116 | \$ 1,978,564 | \$ 2,284,336 |
| State | <u>178,486</u> | <u>269,574</u> | <u>301,299</u> |
| Totals | <u>\$ 1,468,602</u> | <u>\$ 2,248,138</u> | <u>\$ 2,585,635</u> |
| Deferred (Benefit): | | | |
| Federal | \$ (596,162) | \$ 375,031 | \$ (320,814) |
| State | <u>(69,451)</u> | <u>35,152</u> | <u>(32,114)</u> |
| Totals | <u>\$ (665,613)</u> | <u>\$ 410,183</u> | <u>\$ (352,928)</u> |
| Total Applicable Income Taxes | <u>\$ 802,989</u> | <u>\$ 2,658,321</u> | <u>\$ 2,232,707</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (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>2009</u> | <u>2008</u> | <u>2007</u> |
|-----------------------------------|---------------------|-------------------|---------------------|
| Bad Debts | \$ (665,749) | \$ 410,240 | \$ (352,939) |
| Discount on Investment Securities | <u>136</u> | <u>(57)</u> | <u>11</u> |
| Totals | <u>\$ (665,613)</u> | <u>\$ 410,183</u> | <u>\$ (352,928)</u> |

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

| | <u>2009</u> | | <u>2008</u> | | <u>2007</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 | \$ 840,758 | 34.00% | \$ 2,555,675 | 34.00% | \$ 2,132,392 | 34.00% |
| Increase (Decrease) Resulting from: | | | | | | |
| State Income Tax, Net of Federal Benefit | 71,963 | 2.91 | 201,119 | 2.68 | 177,662 | 2.83 |
| Nontaxable Interest Income | (123,386) | (4.99) | (115,767) | (1.54) | (94,785) | (1.51) |
| Nondeductible Interest Expense | 10,251 | .41 | 13,130 | .17 | 13,181 | .21 |
| Other Items | <u>3,403</u> | <u>.14</u> | <u>4,164</u> | <u>.06</u> | <u>4,257</u> | <u>.07</u> |
| Tax on Income | <u>\$ 802,989</u> | <u>32.47%</u> | <u>\$ 2,658,321</u> | <u>35.37%</u> | <u>\$ 2,232,707</u> | <u>35.60%</u> |

The approximate tax (benefit) effects of the net investment securities gains (losses) were \$1,433, \$297, and \$2,776 for the years 2009, 2008, and 2007, 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, 2009 and 2008:

| | <u>2009</u> | <u>2008</u> |
|---|-------------------|-------------------|
| Accumulated Pension Benefit Obligation | \$ 4,654,765 | \$ 4,163,816 |
| Value of Future Salary Projections | <u>520,601</u> | <u>338,056</u> |
| Total Projected Pension Benefit Obligation | \$ 5,175,366 | \$ 4,501,872 |
| Fair Value of Plan Assets | <u>3,696,426</u> | <u>2,445,660</u> |
| Plan Assets in Excess (Deficient) of Projected Benefit Obligation | \$ (1,478,940) | \$ (2,056,212) |
| Unrecognized Net Loss or (Gain) | 2,335,058 | 2,374,834 |
| Accumulated Other Comprehensive Income | <u>0</u> | <u>0</u> |
| Unfunded (Accrued) or Prepaid Pension Cost | <u>\$ 856,118</u> | <u>\$ 318,622</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (continued)

The components of pension (expense) income for the years ended December 31, 2009, 2008, and 2007, are as follows:

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|--|---------------------|-----------------------|---------------------|
| Service Cost-Benefits | | | |
| Earned During Year | \$ (203,259) | \$ (180,481) | \$ (179,889) |
| Interest Cost on Projected | | | |
| Benefit Obligation | (273,761) | (252,640) | (236,418) |
| Actual Return on Assets | 287,966 | 273,651 | 239,208 |
| Amortization of Net Gain (Loss) | (93,142) | (69,652) | (86,530) |
| Net Amortization and Deferral | 0 | 0 | 1,970 |
| Adjustment Due to Change in Measurement Date | 0 | (38,187) | 0 |
| Total Recognized in Other Comprehensive Income | <u>39,776</u> | <u>(1,368,957)</u> | <u>0</u> |
| | | | |
| Total Recognized in Net Benefit Cost and Other Comprehensive Income | <u>\$ (242,420)</u> | <u>\$ (1,636,266)</u> | <u>\$ (261,659)</u> |
| | | | |
| Actuarial Assumptions: | | | |
| Weighted Average Discount Rate for Projected Benefit Obligation | 6.25% | 6.25% | 6.00% |
| Weighted Average Rate of Compensation Increase | 3.00% | 3.00% | 3.00% |
| Expected Long-Term Rate of Return on Plan Assets | 8.00% | 8.50% | 8.50% |

Note 9

Parent Company Condensed Financial Information:

CONDENSED BALANCE SHEETS

| | <u>December 31,</u> | |
|--|----------------------|----------------------|
| | <u>2009</u> | <u>2008</u> |
| ASSETS | | |
| Investment in Subsidiary | \$ 69,712,034 | \$ 69,899,075 |
| Investment in Putnam County Title Insurance Agency | 9,808 | 23,471 |
| Cash | <u>73,756</u> | <u>3,311</u> |
| | | |
| Total Assets | <u>\$ 69,795,598</u> | <u>\$ 69,925,857</u> |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| | | |
| Total Liabilities | <u>\$ 6,164</u> | <u>\$ 0</u> |
| | | |
| Shareholders' Equity | <u>\$ 69,789,434</u> | <u>\$ 69,925,857</u> |
| | | |
| Total Liabilities and Shareholders' Equity | <u>\$ 69,795,598</u> | <u>\$ 69,925,857</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (continued)

CONDENSED STATEMENTS OF INCOME

| | For Years Ended December 31, | | |
|--|------------------------------|---------------------|---------------------|
| | 2009 | 2008 | 2007 |
| INCOME | <u>\$ 1,360,000</u> | <u>\$ 1,375,850</u> | <u>\$ 1,225,234</u> |
| EXPENSES: | | | |
| Operating Expenses | <u>\$ 46,055</u> | <u>\$ 48,635</u> | <u>\$ 44,666</u> |
| Income before Income Tax Benefit and Equity in Undistributed Earnings of Subsidiaries | <u>\$ 1,313,945</u> | <u>\$ 1,327,215</u> | <u>\$ 1,180,568</u> |
| Applicable Income Taxes (Benefit) | <u>6,164</u> | <u>(20,150)</u> | <u>(17,766)</u> |
| Income before Equity in Undistributed Earnings of Subsidiaries | <u>\$ 1,307,781</u> | <u>\$ 1,347,365</u> | <u>\$ 1,198,334</u> |
| Equity in Undistributed Earnings of Subsidiaries | <u>362,047</u> | <u>3,511,002</u> | <u>2,840,700</u> |
| Net Income | <u>\$ 1,669,828</u> | <u>\$ 4,858,367</u> | <u>\$ 4,039,034</u> |

CONDENSED STATEMENTS OF CASH FLOWS

| | For Years Ended December 31, | | |
|--|------------------------------|-----------------------|-----------------------|
| | 2009 | 2008 | 2007 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net Income | <u>\$ 1,669,828</u> | <u>\$ 4,858,367</u> | <u>\$ 4,039,034</u> |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | | |
| Equity in Undistributed Earnings of Subsidiary | <u>(355,883)</u> | <u>(3,511,002)</u> | <u>(2,840,700)</u> |
| Net Cash Provided by Operating Activities | <u>\$ 1,313,945</u> | <u>\$ 1,347,365</u> | <u>\$ 1,198,334</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Investment in Subsidiary | <u>\$ 116,500</u> | <u>\$ (25,500)</u> | <u>\$ 0</u> |
| Net Cash Used in Investing Activities | <u>\$ 116,500</u> | <u>\$ (25,500)</u> | <u>\$ 0</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Dividends Paid | <u>\$ (1,360,000)</u> | <u>\$ (1,320,000)</u> | <u>\$ (1,200,000)</u> |
| Net Cash Used in Financing Activities | <u>\$ (1,360,000)</u> | <u>\$ (1,320,000)</u> | <u>\$ (1,200,000)</u> |
| Net Change in Cash and Cash Equivalents | <u>\$ 70,445</u> | <u>\$ 1,865</u> | <u>\$ (1,666)</u> |
| Cash and Cash Equivalents at Beginning of Year | <u>3,311</u> | <u>1,446</u> | <u>3,112</u> |
| Cash and Cash Equivalents at End of Year | <u>\$ 73,756</u> | <u>\$ 3,311</u> | <u>\$ 1,446</u> |

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (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, 2009, is as follows:

| | <u>Notional Amount</u> |
|------------------------------|------------------------|
| Commitments to Extend Credit | \$ 21,070,051 |
| Commercial Letters of Credit | 0 |
| Standby Letters of Credit | 650,285 |

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, 2009, 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 \$1,234,457 at December 31, 2009. 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, 2009, 2008, And 2007 (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, 2009, that the Bank could declare without the approval of the West Virginia Division of Banking and the Federal Reserve Board, amounted to approximately \$3,878,000.

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, 2009 and 2008, 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 Federal Reserve's request for 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:

| | Ratios | Capital Amounts | | |
|---------------------------------|--------|-----------------|---------------|------------------|
| | | Actual | Minimum | Well Capitalized |
| As of December 31, 2009: | | | | |
| Tier 1 Risk-Based Capital | 22.00% | \$ 68,362,000 | \$ 12,428,000 | \$ 18,642,000 |
| Total Risk-Based Capital | 23.25 | 72,247,000 | 24,856,000 | 31,069,000 |
| Tier 1 Leverage Capital | 13.06 | 68,362,000 | 20,930,000 | 26,163,000 |
| 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 |

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.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2009, 2008, And 2007 (continued)

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, 2009 and 2008, are as follows:

| | 2009 | | 2008 | |
|-------------------------|------------------|----------------|------------------|----------------|
| | Carrying Amounts | Fair Value | Carrying Amounts | Fair Value |
| Financial Assets: | | | | |
| Cash and Due from Banks | \$ 15,927,143 | \$ 15,927,143 | \$ 17,477,492 | \$ 17,477,492 |
| Federal Funds Sold | 38,000,000 | 38,000,000 | 19,000,000 | 19,000,000 |
| Investment Securities | 111,051,762 | 111,051,762 | 121,151,784 | 121,151,784 |
| Loans | 348,613,814 | 343,537,018 | 334,862,786 | 332,506,736 |
| Financial Liabilities: | | | | |
| Deposits | \$ 444,735,170 | \$ 445,922,926 | \$ 421,166,667 | \$ 422,309,344 |

Note 15

Subsequent Events:

In preparing these financial statements, the company has evaluated events and transactions for potential recognition or disclosure through March 11, 2010, the date the financial statement was issued.