



Growing Our Community

pco ★
PutnamCountyBank

2012 ANNUAL REPORT

Annual Meeting

The annual meeting of shareholders
of Putnam Bancshares, Inc. will be

Thursday, June 13, 2013

10:30 a.m.

Putnam County Bank Boardroom

2761 Main Street

Hurricane, West Virginia

All shareholders are invited to attend.

Shareholder Services

Please call (304) 562-9931

or write

Putnam Bancshares, Inc.

Shareholder Services

P. O. Box 308

Hurricane, WV 25526



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Officers and Employees

Board of Directors



Letter to Shareholders

We present to you the financial results of Putnam Bancshares, Inc. and its wholly-owned subsidiary, Putnam County Bank, for 2012. Earnings showed decline in 2012, principally due to a decline in net interest earnings and an increase in operating expenses. The decline in net interest was principally due to the decline in market interest rates during the year and its effects upon the repricing of loans and investments. While interest income declined, interest expense remained relatively unchanged. Operating expenses were affected by an increase in personnel retirement expenses. Changes have been implemented during 2012 to effectively manage these expenses. In 2012 we continue to see improvement in asset quality as the Bank's percentages continue to be within those of our peer banks.

In 2012, net loans increased \$6 million or 2% in 2012 compared to an \$18 million of 5% decline in 2011. In 2012, the Bank has undergone many changes to the loan administration function and to strengthen the credit administration function. We feel these changes will help us to better evaluate lending situations and better serve our customers. This will be important given the highly competitive environment we are in. The Company's capital base grew to over \$76 million at year-end 2012.

During 2012, the nation continued to deal with an economy continuing to recover from the effects of high unemployment and low consumer and business spending. While real estate markets are beginning to recover, it has been slow. While signs of recovery have shown, they have been challenged by cuts in government spending and employment. While there has been stress in the banking industry, there has also been improvement. The bank failure rate was 51 in 2012 which continues an annual decline with 92 in 2011 and 157 in 2010. The FDIC problem bank list showed 694 in 2012 compared to 813 in 2011 and 884 in 2010. During the year, changes in banking regulation as mandated by the Dodd-Frank Act have begun to be implemented. An ongoing concern will be the effects upon the consumer and increased costs to administer these changes.

While the nation has been in a recovery mode, the same can be said of our state. While the area has seen some gains in the natural gas industry, the coal industry has felt some stress. The same factors, such as unemployment and reduced spending, have also been evident in our local economy. While there are signs of new construction in our local market, such has not been at the pace of past years. Also, some developments have slowed.

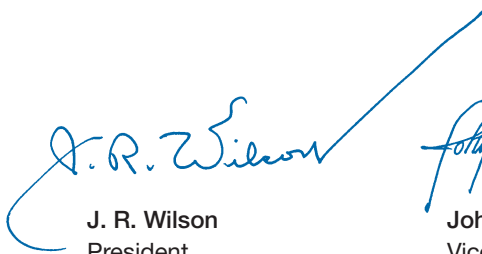
As a leader in community development, Putnam County Bank is in a position to help in the growth of our local economy. We have demonstrated this ability before with lending and investment projects throughout our community. While we understand this has been a challenging economy, we know we need to maintain availability to credit and services to help our communities.

Putnam County Bank will continue to provide a level of service that we hope customers will appreciate. We understand that our customer satisfaction is critical in our business and we cannot forget this. While we may not offer every service, those we provide are cost-effective and secure.


In 2012, the Bank had several valuable members of our staff to retire. Our 2012 retirees represented 78 years of banking experience. Lora Virginia Hart retired with 26 years of experience and was Branch Manager at the Interstate Office. George Wallace served the Bank as Loan Collection Officer for 22 years. Rebecca J. Foster retired with 14 years of service employed at the Interstate Office. John B. Lawman retired with 16 years of experience and was employed at the Main Office. All served significant roles in the Bank and their contribution will not be forgotten. We wish Ginny, George, Becky and John the best in the future.

Putnam County Bank will continue to remember the community it serves in terms of investments, financial support and time we spend to make it better for all residents.

If you should have any questions or comments, please call us at (304) 562-9931.



J. R. Wilson
President



John R. Wilson, Jr.
Vice President

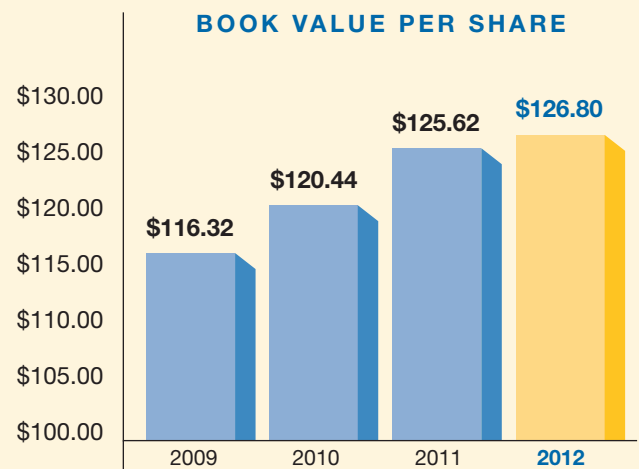
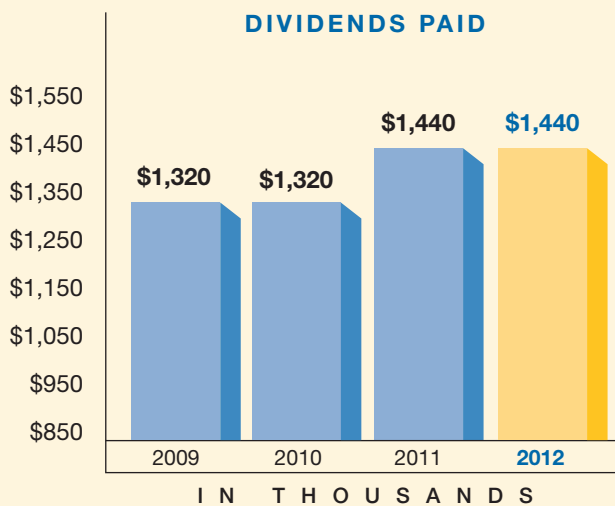
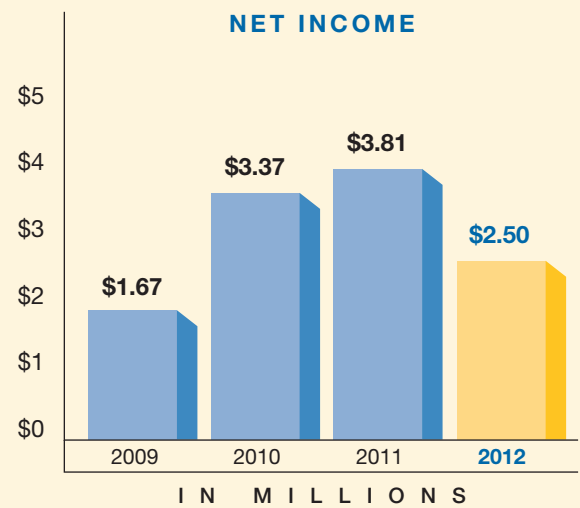
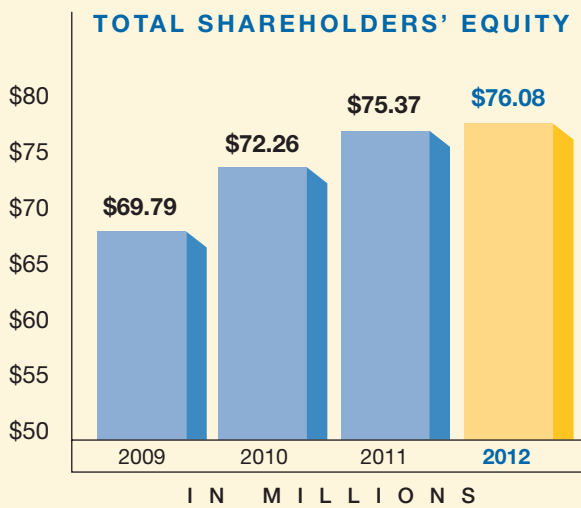
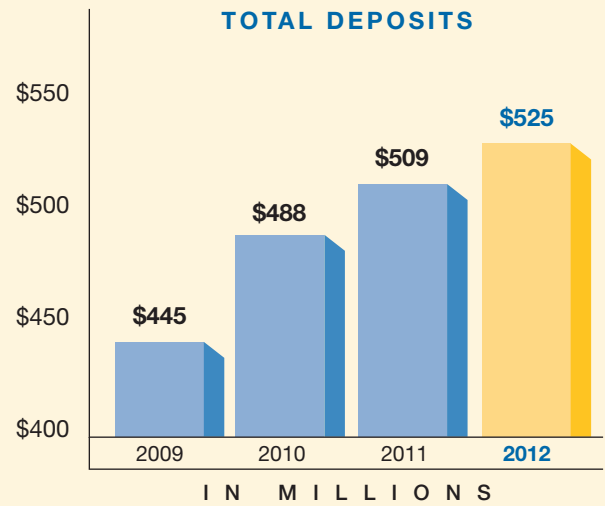
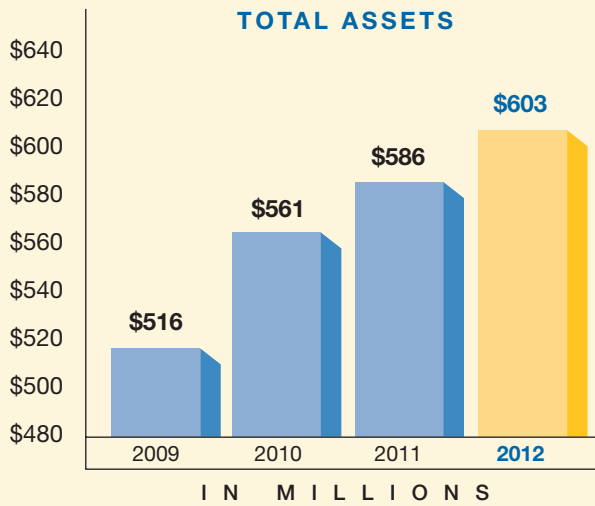
We understand that our customer satisfaction is critical in our business and we cannot forget this. While we may not offer every service, those we provide are cost-effective and secure.

Selected Financial Summary

In Thousands of Dollars

Four-Year Summary

	2012	2011	2010	2009
YEAR-END BALANCE SHEET SUMMARY				
Loans, Net	\$ 318,516	\$ 312,371	\$ 330,223	\$ 344,612
Investment Securities	161,418	134,714	106,708	111,062
Total Assets	603,201	585,592	561,271	515,918
Deposits	525,406	508,914	487,653	444,735
Shareholders' Equity	76,078	75,375	72,261	69,789
AVERAGE BALANCE SHEET SUMMARY				
Loans, Net	\$ 315,837	\$ 319,415	\$ 346,939	\$ 337,081
Investment Securities	144,493	121,423	107,558	117,694
Total Assets	599,906	569,709	538,854	510,885
Deposits	520,806	492,739	464,080	437,495
Shareholders' Equity	76,060	74,322	72,086	70,451
SELECTED RATIOS				
Return On Average Assets	0.42%	0.67%	0.63%	0.33%
Return On Average Equity	3.29%	5.13%	4.68%	2.37%
Dividends Declared As a Percentage Of Net Income	57.55%	37.78%	39.16%	79.05%
SUMMARY OF OPERATIONS				
Interest Income	\$ 21,103	\$ 22,099	\$ 23,843	\$ 24,123
Interest Expense	6,485	6,490	6,572	9,075
Net Interest Income	14,618	15,609	17,271	15,048
Provision for Loan Losses	840	738	3,832	3,164
Noninterest Income	778	448	570	513
Noninterest Expense	10,814	9,486	8,859	9,923
Net Income	2,502	3,812	3,371	1,670
PER SHARE DATA				
Net Income	\$ 4.17	\$ 6.35	\$ 5.62	\$ 2.78
Cash Dividends	2.40	2.40	2.20	2.20
Book Value	126.80	125.62	120.44	116.32





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Analysis Of Earning Assets And Interest Bearing Liabilities

In Thousands of Dollars

ASSETS	2012			2011		
	Avg. Balance	Interest	Yield/Rate	Avg. Balance	Interest	Yield/Rate
Loans						
Commercial	\$ 22,706	\$ 1,279	5.63%	\$ 22,488	\$ 1,278	5.68%
Real Estate	291,680	16,310	5.59%	296,415	17,344	5.85%
Consumer (2)	5,466	516	9.44%	5,281	508	9.62%
Total Loans (1)	<u>\$ 319,852</u>	<u>\$ 18,105</u>	<u>5.66%</u>	<u>\$ 324,184</u>	<u>\$ 19,130</u>	<u>5.90%</u>
Securities (3)						
Taxable	135,066	2,466	1.83%	108,830	2,404	2.21%
Tax-Exempt (4)	8,406	414	4.93%	8,544	697	8.16%
Mutual Funds	1,021	31	3.04%	529	24	4.54%
Total Securities	<u>144,493</u>	<u>2,911</u>	<u>2.01%</u>	<u>117,903</u>	<u>3,125</u>	<u>2.65%</u>
Interest Bearing Deposit						
in Banks	9,696	16	0.17%	10,300	20	0.19%
Federal Funds Sold	115,147	69	0.06%	104,288	91	0.09%
Total Earning Assets	<u>\$ 589,188</u>	<u>\$ 21,101</u>	<u>3.58%</u>	<u>\$ 556,675</u>	<u>\$ 22,366</u>	<u>4.02%</u>
Cash and Due from Banks	7,040			6,238		
Premises and Equipment, Net	636			717		
Other Assets	7,054			7,327		
Allowance for Loan Losses	(4,015)			(4,769)		
Total Assets (5)	<u>\$ 599,903</u>			<u>\$ 566,188</u>		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest Bearing Deposits						
Super NOW and MMDA	\$ 106,391	\$ 378	0.36%	\$ 101,096	\$ 453	0.45%
Savings	24,727	37	0.15%	23,058	46	0.20%
Time	334,923	6,069	1.81%	314,569	5,991	1.90%
Total Interest Bearing Deposits	<u>\$ 466,041</u>	<u>\$ 6,484</u>	<u>1.39%</u>	<u>\$ 438,723</u>	<u>\$ 6,490</u>	<u>1.48%</u>
Long-Term Borrowings	<u>0</u>	<u>0</u>	<u>0.00%</u>	<u>0</u>	<u>0</u>	<u>0.00%</u>
Total Interest Bearing Liabilities	<u>\$ 466,041</u>	<u>\$ 6,484</u>	<u>1.39%</u>	<u>\$ 438,723</u>	<u>\$ 6,490</u>	<u>1.48%</u>
Noninterest Bearing Deposits	54,767			54,016		
Accrued Expenses and Other Liabilities	3,035			2,647		
Equity	<u>76,060</u>			<u>74,322</u>		
Total Liabilities and Equity	<u>\$ 599,903</u>			<u>\$ 569,708</u>		
Net Interest Margin	\$ 589,188	\$ 14,617	2.48%	\$ 556,675	\$ 15,876	2.85%

(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 8.50%.

(5) Net of SFAS 107 Market Value

Rate Sensitivity Analysis As Of December 31, 2012

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)	\$ 34,899	\$ 22,866	\$ 51,192	\$ 42,542	\$ 82,215	\$ 82,283
Investment Securities (2)	25,996	23,343	31,783	71,619	2,587	5,068
Federal Funds Sold	<u>104,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Selected Assets	\$ 164,895	\$ 46,209	\$ 82,975	\$ 114,161	\$ 84,802	\$ 87,451
LIABILITIES						
Interest Bearing Deposits (3)	\$ 296,609	\$ 144,125	\$ 31,001	\$ 10	\$ 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	\$ 296,609	\$ 144,125	\$ 31,001	\$ 10	\$ 0	\$ 0
Differences	<u>(131,714)</u>	<u>(97,916)</u>	<u>51,974</u>	<u>114,151</u>	<u>84,802</u>	<u>87,451</u>
Cumulative Differences	<u>\$ (131,714)</u>	<u>\$ (229,630)</u>	<u>\$ (177,656)</u>	<u>\$ (63,505)</u>	<u>\$ 21,297</u>	<u>\$ 108,748</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, through the year of 2012 continued to see a challenging economic environment.

The national economy continues to recover from the effects of the financial crisis of 2008. The effects include greater regulation in the form of the Dodd-Frank Act which has impacted the products and services banks provide. Further, the effects of efforts to balance the federal budget through cuts in government jobs and services as well as possible tax reform places the business community in uncertainty and somewhat hesitant to make major long-term investments. Federal Reserve Board policy continues to promote buying of long-term bonds to hold-down long-term interest rates and also to keep short-term interest rates near zero: both in an effort to encourage spending and investment. While unemployment has shown improvement, some challenge if this is progress or those falling-off the roles as they have exhausted their benefits. While there is been some progress, consistent progress continues to be elusive.

Statewide, the effects are similar to the national environment. Losses in government employment and spending truly impact West Virginia. The coal industry continues to incur challenges as national policy relative to the environment places coal at a disadvantage. However, coal exports remain relevant. While the effects of the Marcellus gas reserves continue to be significant, declines in natural gas prices have forced cuts in production. Long-term, natural gas will continue to place a significant role in the economy of the state. While there has been business downsizing in the state, there has also been interest in redevelopment of vacant commercial property in some of the larger metropolitan areas. While highway building has also been a bright spot for the state, some highway funding continues to become difficult to acquire.

The average annual unemployment rate for West Virginia was 7.3% in 2012 compared to 7.8% in 2011. The monthly average of state unemployment in 2012 ranged from 7% in February and March to 7.6% in July and August. The unemployment rate for Putnam County was 7% for February of 2013. The national average annual unemployment rate fell from 8.9% in 2011 to 8.1% in 2012.

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 F9 and ending on page F38). 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, 2012 there were 1,199 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 banking industry continues to operate in a low interest rate environment as declining net interest margins continue to be an industry concern in 2012. Interest rates continued to be at record lows and competition among financial institutions for loans continued as demand declined and deposits rose. 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 decreased from 2.83% in 2011 to 2.52% in 2012. The peer's net interest margin was 3.60% in 2011 and 3.56% in 2012. Compression of the Bank's margin was a result of asset yields which declined at a greater rate than deposit costs. Among earning assets, investment yields were lower than peer and loan yields were priced closely to market. Greater funding moved into investments as loan growth declined. While investment yields are generally lower than peer, they have a large composition in U. S Government and Agency securities which are generally higher quality and lower risk. The Company's cost of funds was 1.39% in 2012 compared with 1.48 in 2011. The cost of funds is calculated by dividing the interest expense by the

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

annual average of total deposits. The peer group's cost of funds declined from 1.03% in 2011 to .76% in 2012. The yield on earning assets declined to 3.62% in 2012 from 4.02% in 2011. Total loan yields declined from 5.90% in 2011 to 5.66% in 2012. The yield on investment securities declined from 2.65% in 2011 to 2.01% in 2012.

Interest Income

Interest income declined \$1 million or 5% from year-end 2011 to year-end 2012. The Federal Open Market Committee (FOMC) has held the federal funds target rate between zero and .25% through 2012. The justification for the low target rate is current high unemployment picture, low utilization, and to control threats of inflation. The Bank had 16% of its loan portfolio indexed to the Wall Street Journal prime rate as of year-end 2012. The average total loans decreased \$4 million or 1% from year-end 2011 to year-end 2012. This compares with a decrease of \$27 million or 8% during the prior year. The lending group continues in its efforts to provide credit in an efficient manner with a focus on customer needs. Total income from loans decreased \$1 million or 5% at year-end 2012 while decreasing nearly \$2 million or 9% at year-end 2011. The decrease in loan income has been driven by a decrease in loan volume through the year. The Company's average earning assets increased \$32 million or 6% by year-end 2012 compared with \$41 million or 8% at year-end 2011. The income on average earning assets decreased \$1 million from year-end 2011 to year-end 2012. Despite higher volume, low market rates during the year were responsible for the decline in income.

While not at the same rate as the previous year, real estate lending continued to decline in 2012. Average total real estate loans declined \$5 million in 2012 compared with \$20 million in 2011. Interest income on real estate loans decreased \$1 million or 6% in 2012 compared with \$1.5 million or 8% in 2011. The low rate environment combined with the competition in mortgage lending has resulted in a very competitive market. While residential development saw indications of recovering, it has not been consistent. The Bank promotes its mortgage lending through timely turnaround and closing. The Bank does not originate loans with the intent to sell in the secondary market.

Income on commercial lending was relatively unchanged between 2011 and 2012. This was in contrast to a decrease of \$228 thousand between 2010 and 2011. Average total commercial loans increased \$218 thousand in 2012 compared with a decline of \$3.3 million in 2011. The increase in average total loans reflects upturn in demand which is encouraging for the future.

Income on consumer lending increased \$8 thousand in 2012 compared with a decline of \$81 thousand in 2011. The average total of consumer loans in 2012 increased \$185 thousand in 2012 contrasting a decrease of nearly \$2.8 million in 2011. Consumer lending continues to be highly competitive, especially with automotive finance units who market low rate financing with cash back options. The Bank continues to compete in this area through cross-selling existing customers and effective service.

Income on investments (on a tax effective basis) increased \$42 thousand at year-end 2012 over 2011. In addition, average total investments increased over \$26 million or 22% in the same period. The increase in income was related to the volume of securities purchases combined with securities which matured and subsequent reinvestment occurring in a declining interest rate market. The Company's tax equivalent yield on investments declined from 2.65% in 2011 to 2.01% in 2012. The Bank's yield on investments continues to be lower than peer institutions. At year-end 2012, the investment portfolio was 95% 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 and higher safety of principal, it also results in lower investment yields. The income on Federal Funds Sold at year-end 2012 declined \$22 thousand with average balances increasing \$11 million. 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 2012, all municipal investments are West Virginia securities. In 2012, the Bank held two municipal issues of the Putnam County Building Commission with a carrying value of \$1.5 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 2012, the Bank held a municipal security issue of Ohio County, West Virginia Commission with a carrying value of \$2 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 (\$4.1 million) are rated investment grade by Moody's and/or Standard and Poor's ratings services.

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

Interest Expense

Interest expense on deposits remained relatively unchanged, decreasing by \$5 thousand from year-end 2011 to 2012. The cost on total deposits was 1.39% for 2012 representing a decrease of nine basis points from 2011. For our peer group, the cost is .76% for 2012 representing a decrease of 27 basis points from 2011. The Bank's cost of funds compare higher than peer, primarily due to higher rates paid on deposit accounts. The average total of deposits increased \$29 million or 6% in the current year compared with \$27 million or 6% in the previous year. The low market rate environment has dropped bank deposit rates to near zero in some accounts. This has been necessary to offer competitive loans rates and prevent declines in net interest margins. The Bank has historically paid higher interest rates on deposits, understanding the effects upon net is. The Bank has historically paid higher interest rates on deposits, understanding the effects upon net interest margins. The Bank has elected its deposit pricing strategy for its local market. 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 monthly basis and is comprised of three 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. 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 exist several sources of liquidity. The Bank's loan-to-deposit ratio was 61% in 2012 and 2011. The peer group ratio was 74% in 2012 and 75% in 2011. 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 solicit 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 2012, the ratio was 15% compared with 7% at year-end 2011. The ratio is comparable to the peer group ratio of 14% in 2012 and below the peer at 17%, 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 2012 was \$5.7 million or 1.76% of total loans compared with \$7.6 million or 2.38% at year-end 2011. This compares with peer ratios of 2.05% and 2.79% respectively. The majority of the nonperforming loans were composed of a commercial real estate development in Winston-Salem, NC (\$2.5 million) and two local real estate developments (\$1.1 million and \$823 thousand).

The Bank had a balance of \$1.3 million in other real estate owned at year-end 2012 compared with \$2.9 million in 2011. The majority of the decline was related to the sale of a local real estate development.

Provision and Allowance for Loan Losses

The Bank made total provisions to the allowance for loan losses totaling \$840 thousand in 2012 compared to a provision of \$738 thousand in 2011. The majority of the provision in 2012 was related to a write-down of a local real estate development to market value. Loan loss recoveries in 2012 totaled \$77 thousand compared with \$78 thousand in 2011. Recoveries in 2012 were principally due to the sale of commercial real estate. Gross loan losses increased

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

from \$790 thousand in 2011 to \$1.5 million in 2012. The highest single loss was due to the write-down to market value of a local residential real estate development.

Net loan losses were \$1.5 million in 2012 and \$705 thousand in 2011. The Bank's ratio of net loss to average total loans was .46% compared to .51% for the peer group. As of year-end 2012, the allowance for loan loss was \$4.5 million or 1.20% of total loans compared to \$4.5 million or 1.42% of total loans at year-end 2011. The peer ratios of allowance to total loans were 1.74% in 2012 and 1.90% in 2011. While the Bank's ratios are lower than peer, the allowance level is reflective of many factors which include loss history, 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 Financial Institutions.

Noninterest Income

Total noninterest income (excluding gross securities gains and equity in earnings of subsidiary) totaled \$464 thousand representing an increase of \$22 thousand or 5% in 2012 over 2011. Income from VISA debit transactions increased by \$8 thousand and service charges on deposit accounts increased \$7 thousand from 2011 to 2012. The Bank also recognized \$15 thousand from the sale of fixed assets in 2012. These increases offset declines in nonsufficient check and overdraft charges. Other sources of noninterest income remained relatively unchanged. In 2011, the Dodd-Frank amendment called for changes in interchange fees which had the potential of substantially reducing VISA debit card income. The Bank has not seen a significant reduction at this time.

The Bank continues to be a low-cost provider of banking services. In 2012, the percentage of noninterest income to average assets for the Bank is .12% compared to the peer ratio of .78%. In 2011, the Bank's ratio was .07% with the peer ratio being .71%.

Equity in earnings of the subsidiary increased from \$27 thousand in 2011 to \$38 thousand in 2012. This relates to the 51% investment in Putnam County Title Insurance Agency LLC by Putnam Bancshares, Inc., which was formed in 2008.

Noninterest Expense

Total noninterest expense (excluding gross securities losses) increased \$1 million or 11% from year-end 2011 to year-end 2012 compared with a decrease of \$627 thousand or 7% between years ending 2010 and 2011. Noninterest expenses are composed of expenses relating to personnel, occupancy, and other operating expenses. Total noninterest expense to average assets was 1.80% in 2012 compared with 1.66% in 2011. The peer group ratios showed 2.93% in 2012 and 2011. Earnings historically have benefitted from lower noninterest expenses, relative to the Bank's size.

Total personnel expenses increased by \$907 thousand or 18% in 2012 compared with an increase of \$144 thousand or 3% in 2011. The most significant personnel expense increases were found in employee retirement funding. Retirement expense increased \$831 thousand in 2012, compared to an increase of \$446 thousand in 2011. The Bank's retirement plan was administered by the West Virginia Bankers Association, but in 2010 administration of the plan was changed to a new company. This plan was a noncontributory pension plan with independent actuaries making the determination of contributions made by its members. In 2012, with guidance from the new administrator, the noncontributory pension plan was frozen and a 401-K plan was introduced on January 1, 2013. Management is confident with new administration and a new retirement plan which can provide flexibility for the employee and provide for greater cost effectiveness for the Bank. The next highest increase in personnel expense was employee salaries, which increased \$140 thousand or 7% from 2011. Most of this increase may be found in augmenting staff in credit administration and compliance areas of the Bank. The Bank's personnel costs as a percentage of average assets compare favorably. At the end of 2012, the Bank's ratio was .98% compared with the peer bank ratio of 1.56%.

Total occupancy expense includes the costs to maintain the Bank's premises and equipment. These expenses declined \$93 thousand in 2012 compared with a decline of \$583 thousand in 2011. This decline was found primarily in depreciation expense on equipment. Also significant in 2012 was an increase in maintenance and repair expenses of \$60 thousand over 2011. In May, the Bank performed significant remodeling and renovations to the Loan Center to provide more privacy for loan officers and their customers with an improved customer waiting area and improved operations work space. The Bank's occupancy expense as a percentage of average assets was .08% in 2012 compared with .36% for peer banks. The Bank continues to operate facilities

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

at 2761 Main Street (including the Loan Center at 2767 Main Street), 300 Hurricane Creek Road and 3058 Mount Vernon Road.

Total other operating expense (expenses other than personnel and occupancy expenses) increased \$203 thousand from 2011 to 2012, in contrast to \$400 thousand from 2010 to 2011. The most significant increases are found in other real estate expenses and fees to attorneys. In 2012, other real estate expenses increased \$334 thousand over 2011. The majority of the expense (\$220 thousand) involved the payment of taxes related to a real estate development in Winston-Salem, NC. The Bank is actively pursuing repayment through the Bankruptcy Court. Fees to attorneys increased \$155 thousand from 2011 to 2012. The increase was related to the Bankruptcy proceeding involving a real estate development in Winston-Salem, NC which totaled \$149 thousand. Other operating expenses increased \$178 thousand in 2012. The majority of this increase involved a settlement of out-of-court legal dispute which totaled \$184 thousand. Several areas which saw declines included loss on the sale of other real estate (\$104 thousand), fees to accountants (\$69 thousand), repossession expense (\$69 thousand) and data processing (\$28 thousand). Expenses related to our core data processing provider represents the second largest expense item in this category and expenses in this area declined 4% from 2011 to 2012. Savings in data processing are related to the Bank's use of more efficient technology offerings to process data. With respect to operating expenses, the Bank still performs favorably in comparison to peers. At the end of 2012, the Bank's ratio of other operating expenses to average assets was .74% compared with the peer's ratio of .99%.

The Bank reported \$1,908 in net losses on the sale of securities held as available for sale in 2012 compared with net losses of \$731 in 2011. 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 million in 2011 to \$1.2 million in 2012. The decrease was due to lower taxable income.

The Bank invests in municipal securities issued in West Virginia which are "bank qualified" and are exempt from federal and state taxation, with the exception of one Putnam County, WV Building Commission Revenue Bond with a par value of \$140 thousand, which is taxable.

Equity and Capital Ratios

Putnam Bancshares' equity increased \$703 thousand or 9% to \$76 million. The change in equity during 2012 was reflective of \$2.5 million in net income less \$1.4 million in dividends and a decrease of \$359 thousand in comprehensive income. The decrease in comprehensive income was the result of the change in unrealized gains and losses on available for sale securities from year-end 2011 to 2012. The book value per outstanding share increased from \$126.80 in 2012 to \$125.62 in 2011. The Company's net income as a percentage of average equity was 3.30% in 2012. Peer banks in 2012 posted net income as a percentage of average equity of 8.68%

Banking regulatory bodies mandate the risk-weighting of assets and off-balance sheet items to more accurately assess capital adequacy. Tier 1 capital (equity capital less the tax equivalent of unrealized gains or losses on available for sale securities) and total risk-based capital (Tier 1 capital plus the allowable portion of the allowance for loan losses) comprise two vital measures of capital adequacy. As of year-end 2012, the Bank's Tier 1 risk-based capital-to-total risk-weighted assets were 24.94% compared to 24.77% in 2011. The peer bank ratios were 14.41% and 13.92% in 2012 and 2011 respectively. As of year-end 2012, the Bank's total risk-based capital-to-total risk-weighted assets were 26.19% compared to 26.03% in 2011. The peer bank ratios were 15.62% and 15.18% in 2012 and 2011 respectively. Both measures rank the Bank in the 96th percentile in comparison with peers. Using the federal guidelines for capital adequacy, these ratios indicate the Bank is well-capitalized.

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

Dividends

The Company paid dividends of \$1.4 million in 2012 and in 2011. This equates to a dividend payout (dividends to net income) ratio of 58% in 2012 and 38% in 2011. The peer Bank ratio for 2012 was 32% and 37% in 2011. Regular dividends were paid in June and December of 2012.

For a further discussion of dividends, please refer to "Note 14 – 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 Auditor's Report

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

We have audited the accompanying consolidated financial statements of Putnam Bancshares, Inc. and Subsidiaries (a West Virginia corporation), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements; whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 Subsidiaries as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2012, in accordance with accounting principles generally accepted in the United States of America.



Certified Public Accountants

Charleston, West Virginia
March 14, 2013

Consolidated Balance Sheets

DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Cash and Due from Banks	\$ 15,107,465	\$ 18,491,410
Federal Funds Sold	104,000,000	113,000,000
Securities Available for Sale, at Fair Value	122,424,686	95,718,064
Securities Held to Maturity, at Amortized Cost (Estimated Fair Value of \$38,994,537 and \$38,997,618, Respectively)	38,989,705	38,996,274
Loans - Less Allowance for Loan Losses of \$3,879,299 and \$4,492,337, Respectively	318,515,839	312,370,722
Bank Premises and Equipment, Net	606,312	643,228
Federal Reserve Bank Stock, at Cost	39,000	39,000
Investment in Unconsolidated Subsidiary	3,821	109
Other Assets	<u>3,514,153</u>	<u>6,333,480</u>
Total Assets	<u>\$ 603,200,981</u>	<u>\$ 585,592,287</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest Bearing	\$ 53,420,355	\$ 57,711,658
Interest Bearing	<u>471,985,424</u>	<u>451,202,833</u>
Total Deposits	\$ 525,405,779	\$ 508,914,491
Other Liabilities	<u>1,717,699</u>	<u>1,303,200</u>
Total Liabilities	<u>\$ 527,123,478</u>	<u>\$ 510,217,691</u>
Commitments and Contingencies (Note 12)		
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	72,546,659	71,484,675
Accumulated Other Comprehensive Income	<u>2,230,844</u>	<u>2,589,921</u>
Total Shareholders' Equity	<u>\$ 76,077,503</u>	<u>\$ 75,374,596</u>
Total Liabilities and Shareholders' Equity	<u>\$ 603,200,981</u>	<u>\$ 585,592,287</u>

Consolidated Statements Of Income

FOR YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>
INTEREST INCOME:			
Loans (Including Fees)	\$ 18,104,935	\$ 19,130,308	\$ 21,004,555
Securities Available for Sale	2,873,121	2,813,319	2,675,126
Securities Held to Maturity	39,576	44,075	67,710
Federal Funds Sold	68,959	91,243	80,668
Federal Reserve Bank	<u>16,203</u>	<u>20,408</u>	<u>14,727</u>
Total Interest Income	<u>\$ 21,102,794</u>	<u>\$ 22,099,353</u>	<u>\$ 23,842,786</u>
INTEREST EXPENSE:			
Interest on Deposits	<u>\$ 6,485,372</u>	<u>\$ 6,490,305</u>	<u>\$ 6,572,258</u>
Net Interest Income	<u>\$ 14,617,422</u>	<u>\$ 15,609,048</u>	<u>\$ 17,270,528</u>
Provision for Loan Losses	<u>840,195</u>	<u>737,860</u>	<u>3,832,370</u>
Net Interest Income after Provision for Loan Losses	<u>\$ 13,777,227</u>	<u>\$ 14,871,188</u>	<u>\$ 13,438,158</u>
OTHER INCOME:			
Service Charges and Fees	\$ 361,851	\$ 364,462	\$ 365,920
Equity in Earnings of Subsidiary	38,393	27,110	36,121
Other Operating Income	<u>63,853</u>	<u>50,644</u>	<u>93,301</u>
Total Other Income	<u>\$ 464,097</u>	<u>\$ 442,216</u>	<u>\$ 495,342</u>
OTHER EXPENSES:			
Salaries and Employee Benefits	\$ 5,869,172	\$ 4,961,641	\$ 4,817,800
Occupancy and Equipment Expense	490,099	583,309	497,764
Data Processing Expense	721,453	748,991	672,737
FDIC Insurance Expense	752,919	615,194	653,602
Net Cost of Operations of Other Real Estate	400,932	478,649	68,173
Net Realized Losses on Sales of Securities	1,908	731	1,356
Legal and Professional Fees	357,886	202,377	232,634
Other Operating Expenses	<u>1,905,529</u>	<u>1,889,703</u>	<u>1,840,462</u>
Total Other Expenses	<u>\$ 10,499,898</u>	<u>\$ 9,480,595</u>	<u>\$ 8,784,528</u>
Income before Income Taxes	<u>\$ 3,741,426</u>	<u>\$ 5,832,809</u>	<u>\$ 5,148,974</u>
Provision for Income Taxes	<u>1,239,442</u>	<u>2,020,945</u>	<u>1,777,772</u>
Net Income	<u>\$ 2,501,984</u>	<u>\$ 3,811,864</u>	<u>\$ 3,371,202</u>

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

Consolidated Statements Of Comprehensive Income

FOR YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010

December 31, 2010

Net Income		\$ 3,371,202
Other Comprehensive Income:		
Unrealized Gain on Securities Available for Sale (Net of Tax of \$242,614)	\$ 419,543	
Reclassification Adjustment (Net of Tax of \$497)	<u>859</u>	
Total Other Comprehensive Income		<u>420,402</u>
Total Comprehensive Income		<u>\$ 3,791,604</u>

December 31, 2011

Net Income		\$ 3,811,864
Other Comprehensive Income:		
Unrealized Gain on Securities Available for Sale (Net of Tax of \$428,641)	\$ 741,231	
Reclassification Adjustment (Net of Tax of \$268)	<u>463</u>	
Total Other Comprehensive Income		741,694
Total Comprehensive Income		<u>\$ 4,553,558</u>

December 31, 2012

Net Income		\$ 2,501,984
Other Comprehensive Income:		
Unrealized Gain/(Loss) on Securities Available for Sale (Net of Tax Benefit of \$208,347)	\$ (360,286)	
Reclassification Adjustment (Net of Tax of \$699)	<u>1,209</u>	
Total Other Comprehensive Income		<u>(359,077)</u>
Total Comprehensive Income		<u>\$ 2,142,907</u>

Consolidated Statements Of Changes In Shareholders' Equity

FOR YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010

	Common Stock	Surplus	Retained Earnings	Unrealized Gain/(Loss) on Securities	Total Shareholders' Equity
BALANCES – December 31, 2009	\$ 300,000	\$ 1,000,000	\$67,061,609	\$ 1,427,825	\$ 69,789,434
Net Income			3,371,202		3,371,202
Change in Unrealized Gain/(Loss) on Securities Available for Sale				419,543	419,543
Reclassification Adjustment				859	859
Cash Dividends (\$2.20 Per Share)			(1,320,000)		(1,320,000)
BALANCES – DECEMBER 31, 2010	\$ 300,000	\$ 1,000,000	\$69,112,811	\$ 1,848,227	\$ 72,261,038
Net Income			3,811,864		3,811,864
Change in Unrealized Gain/(Loss) on Securities Available for Sale				741,231	741,231
Reclassification Adjustment				463	463
Cash Dividends (\$2.40 Per Share)			(1,440,000)		(1,440,000)
BALANCES – DECEMBER 31, 2011	\$ 300,000	\$ 1,000,000	\$71,484,675	\$ 2,589,921	\$ 75,374,596
Net Income			2,501,984		2,501,984
Change in Unrealized Gain/(Loss) on Securities Available for Sale				(360,286)	(360,286)
Reclassification Adjustment				1,209	1,209
Cash Dividends (\$2.40 Per Share)			(1,440,000)		(1,440,000)
BALANCES – DECEMBER 31, 2012	<u>\$ 300,000</u>	<u>\$ 1,000,000</u>	<u>\$72,546,659</u>	<u>\$ 2,230,844</u>	<u>\$ 76,077,503</u>

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

Consolidated Statements Of Cash Flows

FOR YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	\$ 2,501,984	\$ 3,811,864	\$ 3,371,202
Adjustments to Reconcile Net Income to Net Cash Provided by (Used In)			
Operating Activities:			
Depreciation	102,792	238,928	91,056
Provision for Loan Losses	840,195	737,860	3,832,370
Provision for Deferred Income Tax Expense (Benefit)	95,911	(108,624)	(231,719)
Change in Carrying Value in Other Real Estate	(79,287)	0	0
Undistributed (Earnings) Loss of Affiliate	(38,393)	(27,110)	(36,121)
(Gain)/Loss on Sale of OREO	(51,907)	360,639	(5,375)
(Gain)/Loss on Sale of Fixed Assets	(15,465)	0	0
(Gain)/Loss on Sale of Securities	1,908	731	1,356
Cash Surrender Value Life Insurance	(5,621)	(8,781)	(9,101)
Net (Accretion)/Amortization on Securities	956,588	507,136	338,662
(Increase) Decrease in Interest Receivable	129,366	(54,994)	219,718
(Increase) Decrease in Prepaid Expense	1,161,768	460,452	526,107
(Increase) Decrease in Other Assets	0	45,452	(45,452)
Increase (Decrease) in Other Liabilities	414,499	(53,325)	(36,847)
Net Cash Provided by Operating Activities	<u>\$ 6,014,338</u>	<u>\$ 5,910,228</u>	<u>\$ 8,015,856</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net (Increase) Decrease in Federal Funds Sold	\$ 9,000,000	\$ (12,000,000)	\$ (63,000,000)
Proceeds from Sales and Maturities of Available for Sale Securities	10,690,000	5,695,000	10,670,000
Proceeds from Maturities of Held to Maturity Securities	103,960,424	103,955,925	103,932,290
Purchases of Available for Sale Securities	(38,921,843)	(33,023,074)	(6,008,500)
Purchases of Held to Maturity Securities	(103,953,855)	(103,967,112)	(103,930,874)
Proceeds from Sale of Equipment	43,666	0	0
Purchases of Bank Premises and Equipment	(94,076)	(200,265)	(25,136)
Net (Increase) Decrease in Loans	(7,356,482)	14,884,109	8,776,097
(Investment in) Payments from Unconsolidated Subsidiary	34,680	22,950	49,980
Proceeds from Sales of Other Real Estate Owned	<u>2,147,915</u>	<u>400,462</u>	<u>987,011</u>
Net Cash (Used in) Investing Activities	<u>\$ (24,449,571)</u>	<u>\$ (24,232,005)</u>	<u>\$ (48,549,132)</u>

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

Consolidated Statements Of Cash Flows

FOR YEARS ENDED DECEMBER 31, 2012, 2011, AND 2010 (continued)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net Increase (Decrease) in Demand Deposits	\$ (3,375,005)	\$ 13,773,344	\$ 12,950,948
Net Increase (Decrease) in Time Deposits	19,866,293	7,487,758	29,967,270
Dividends Paid	<u>(1,440,000)</u>	<u>(1,440,000)</u>	<u>(1,320,000)</u>
Net Cash Provided by Financing Activities	<u>\$ 15,051,288</u>	<u>\$ 19,821,102</u>	<u>\$ 41,598,218</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>\$ (3,383,945)</u>	<u>\$ 1,499,325</u>	<u>\$ 1,064,942</u>
Cash and Cash Equivalents at Beginning of Year	<u>18,491,410</u>	<u>16,992,085</u>	<u>15,927,143</u>
Cash and Cash Equivalents at End of Year	<u>\$ 15,107,465</u>	<u>\$ 18,491,410</u>	<u>\$ 16,992,085</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash Paid During the Year for:			
Interest on Deposits and Borrowings	<u>\$ 6,412,019</u>	<u>\$ 6,392,168</u>	<u>\$ 6,822,344</u>
Income Taxes	<u>\$ 736,000</u>	<u>\$ 2,284,000</u>	<u>\$ 2,013,000</u>
SUPPLEMENTAL SCHEDULE OF SIGNIFICANT NONCASH ACTIVITIES:			
Loans Transferred to Other Real Estate Owned	<u>\$ 371,170</u>	<u>\$ 2,230,155</u>	<u>\$ 1,780,214</u>

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

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010

Note 1

Summary of Significant Accounting Policies:

Nature of Operations

Putnam Bancshares, Inc. (the "Company") is a West Virginia corporation headquartered in Hurricane, West Virginia. The Company owns all of the outstanding shares of common stock of Putnam County Bank. Putnam County Bank (the "Bank") is a West Virginia state-chartered commercial bank that provides consumer and commercial loans and deposit services principally to individuals and small businesses in Putnam County, West Virginia, and the surrounding areas. The Bank has three banking offices, all located in Hurricane, West Virginia.

Basis of Presentation

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The following is a summary of the more significant accounting policies.

Principles of Consolidation

The consolidated financial 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, the Company entered into an agreement with other entities to form Putnam County Title Insurance Agency, LLC. The Company has a controlling interest in the LLC, owning 51%. The equity method was used in accounting for the LLC. See Note 10 for additional information.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expense during the reporting periods. Actual results could differ from those estimates.

The determination of the adequacy of the allowance for loan 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.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents includes cash on hand, cash items, and amounts due from correspondent banks. Cash flows from demand deposits, money market accounts, savings accounts, and federal funds sold are reported net since their original maturities are less than three months.

Investment Securities

Debt securities are classified as "held to maturity" when the Bank has the intent and ability to hold the security to maturity. Securities held to maturity are carried at amortized cost, adjusted for amortization of premiums and accretion of discounts using methods approximating the interest method over the period to maturity.

Securities not classified as "held to maturity" are classified as "available for sale." Securities classified as available for sale are those securities the Bank intends to hold for an indefinite period of time, but not necessarily to maturity. Available for sale securities 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.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Any security that has experienced a decline in value, which management believes is deemed other-than-temporary, is reduced to its estimated 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. Realized gains and losses on security transactions are computed using the specific-identification method. The Bank had no such losses for the years ended December 31, 2012, 2011, and 2010. Amortization of premiums and discounts is included in interest and dividend income. Discounts and premiums related to debt securities are amortized using the effective interest rate method.

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 contractually due amounts 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 Loan Losses

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Loans deemed to be uncollectable are charged against the allowance for loan losses, while recoveries of previously charged-off amounts are credited to the allowance for loan losses. When a loan or a portion of a loan is identified to contain a loss, a charge-off recommendation is directed to management to charge-off all or a portion of that loan.

The allowance for loan 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 loan loss 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. There were no material changes to the accounting policy or methodology related to the allowance for loan losses in 2012.

A loan is considered impaired when based on current information and events; it is probable that the Bank will be unable to collect all amounts due in accordance with 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. 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. Impaired loans are required to be measured 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 less any associated selling costs if the loan is collateral dependent. The method selected to measure impairment is made on a loan-by-loan basis, unless foreclosure is deemed to be probable, in which case the fair value of the collateral method is used.

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.

Bank Premises and Equipment

Bank premises and equipment are carried at original cost less accumulated depreciation. Depreciation is computed primarily on the modified accelerated cost recovery system (MACRS) over the estimated useful lives of the assets. Repairs and maintenance and minor improvements are charged to expense as incurred. Major improvements and additions to premises and equipment are capitalized. Gains and losses on premises and equipment retired or sold are recognized in the consolidated statements of income, when applicable.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Other Real Estate Owned

At December 31, 2012 and 2011, other real estate owned (OREO) included in other assets in the consolidated balance sheets was \$1,277,204 and \$2,922,754, respectively. 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 loan 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.

Advertising

Advertising costs are expensed as incurred and included in other operating expenses in the consolidated statements of income. Advertising expense was \$128,786, \$118,121 and \$143,642 for the years ended December 31, 2012, 2011, and 2010, respectively.

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 loan 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 subsidiaries.

Pension Plan

The Bank accounts for its pension plan in accordance with FASB Accounting Standards Codification (ASC) Topic 715, "Employer's Accounting for Pensions." More information on the pension plan is disclosed in Note 9.

The Bank adopted a 401(k) plan effective January 1, 2013, and its defined benefit pension plan was frozen as of October 31, 2012. The Bank will still be accountable for past pension obligations and will continue to fund the pension plan as needed.

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. See Note 12 for further detail.

Comprehensive Income

Comprehensive income consists of certain changes in stockholders' equity not related to transactions with stockholders. They include net income and certain other items that are not presented on the consolidated statements of income and, instead, are recorded directly in the stockholders' equity, net of the related tax effect. These items include unrealized gains and losses on sales of certain securities.

Earnings Per Share

Earnings per share is calculated by dividing net income by the weighted-average number of shares of common stock outstanding for the respective period.

	2012	2011	2010
Net Income	\$ 2,501,984	\$ 3,811,864	\$ 3,371,202
Average Shares Outstanding	600,000	600,000	600,000
Earnings per Common Share	\$ 4.17	\$ 6.35	\$ 5.62
Dividends paid per Common Share	\$ 2.40	\$ 2.40	\$ 2.20

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Reclassifications

Certain items in the notes have been reclassified to conform to current year classifications.

Date of Management's Review

Management has evaluated subsequent events and transactions for potential recognition or disclosure in the consolidated financial statements for the year ended December 31, 2012, through March 14, 2013, the date the financial statements were available to be issued.

Note 2

Cash and Due from Banks:

Certain reserves are required to be maintained at the Federal Reserve Bank. The requirement as of December 31, 2012 and 2011, was \$5,503,000 and \$6,869,000, respectively. At December 31, 2012 and 2011, the Bank had accounts at correspondent banks, excluding the Federal Reserve Bank, which exceeded the FDIC insurable limit of \$250,000 by \$2,872,343 and \$1,947,558, respectively.

Note 3

Investment Securities:

The amortized costs and estimated fair values of investment securities at December 31, 2012 and 2011, are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2012				
Available for Sale Securities				
U.S. Government and Agency Securities	\$ 110,345,239	\$ 3,297,457	\$ (35,691)	\$ 113,607,005
State and Municipal Securities	7,558,545	268,227	(26,820)	7,799,952
Mutual Funds	1,000,000	19,070	(1,341)	1,017,729
Totals	<u>\$ 118,903,784</u>	<u>\$ 3,584,754</u>	<u>\$ (63,852)</u>	<u>\$ 122,424,686</u>
Held to Maturity Securities				
U.S. Government and Agency Securities	<u>\$ 38,989,705</u>	<u>\$ 4,900</u>	<u>\$ (68)</u>	<u>\$ 38,994,537</u>
December 31, 2011				
Available for Sale Securities				
U.S. Government and Agency Securities	\$ 82,377,656	\$ 4,001,156	\$ (27,507)	\$ 86,351,305
State and Municipal Securities	8,252,779	181,843	(78,297)	8,356,325
Mutual Funds	1,000,000	15,349	(4,915)	1,010,434
Totals	<u>\$ 91,630,435</u>	<u>\$ 4,198,348</u>	<u>\$ (110,719)</u>	<u>\$ 95,718,064</u>
Held to Maturity Securities				
U.S. Government and Agency Securities	<u>\$ 38,996,274</u>	<u>\$ 1,538</u>	<u>\$ (194)</u>	<u>\$ 38,997,618</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

The following table shows the proceeds from maturities, sales, and calls of available for sale securities and the gross realized gains and losses on sales and calls of those securities that have been included in earnings as a result of any sales and calls. Gains and losses on such transactions were recognized by the specific-identification method.

	2012	2011	2010
Proceeds from Maturities, Sales, and Calls	\$ 10,690,000	\$ 5,695,000	\$ 10,670,000
Gross Realized Gains	\$ 0	\$ 0	\$ 0
Gross Realized Losses	\$ 1,908	\$ 731	\$ 1,356

The amortized cost and estimated fair value of securities at December 31, 2012, 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	\$ 11,049,876	\$ 11,367,494	\$ 38,989,705	\$ 38,994,537
Due from One Year to Five Years	106,513,908	109,716,776	0	0
Due from Five Years to Ten Years	0	0	0	0
Due after Ten Years	1,340,000	1,340,416	0	0
Totals	\$ 118,903,784	\$ 122,424,686	\$ 38,989,705	\$ 38,994,537

Investment securities with carrying values of \$59,499,999 and \$59,553,438 and market values of \$63,140,753 and \$62,699,070, respectively, were pledged to secure public deposits and for the other purposes as required or permitted by law at December 31, 2012 and 2011.

The Bank had four available for sale securities and one held to maturity security with an unrealized loss position at December 31, 2012. These unrealized losses are due to overall market interest rate fluctuations and are not due to any underlying credit concerns of the issuers. The Bank has the intent and ability to hold such investments until maturity or market price recovery. Accordingly, the Bank has concluded that none of the securities in its investment portfolio are other-than-temporarily impaired at December 31, 2012. The following is a summary of the fair value of securities with gross unrealized losses and an aging of those gross unrealized losses at December 31, 2012 and 2011.

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2012:						
Available for Sale Securities						
U.S. Government and Agency Securities	\$ 0	\$ 0	\$10,977,535	\$ (35,691)	\$10,977,535	\$ (35,691)
State and Municipal Securities	0	0	758,640	(26,820)	758,640	(26,820)
Mutual Funds	498,660	(1,341)	0	0	498,660	(1,341)
Totals	\$ 498,660	\$ (1,341)	\$11,736,175	\$ (62,511)	\$12,234,835	\$ (63,852)
Held to Maturity Securities						
U.S. Government and Agency Securities	\$ 999,507	\$ (68)	\$ 0	\$ 0	\$ 999,507	\$ (68)

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2011:						
Available for Sale Securities						
U.S. Government and Agency Securities	\$10,876,160	\$ (27,507)	\$ 0	\$ 0	\$10,876,160	\$ (27,507)
State and Municipal Securities	110,342	(260)	2,050,419	(78,037)	2,160,761	(78,297)
Mutual Funds	495,085	(4,915)	0	0	495,085	(4,915)
Totals	<u>\$11,481,587</u>	<u>\$ (32,682)</u>	<u>\$ 2,050,419</u>	<u>\$ (78,037)</u>	<u>\$13,532,006</u>	<u>\$ (110,719)</u>
Held to Maturity Securities						
U.S. Government and Agency Securities	<u>\$ 8,999,067</u>	<u>\$ (194)</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 8,999,067</u>	<u>\$ (194)</u>

Note 4

Loans:

Total loans at December 31, 2012 and 2011, by major loan categories are summarized as follows:

	2012	2011
Commercial	\$ 120,563,055	\$ 127,854,910
Real Estate	176,146,484	163,097,210
Construction	20,017,517	20,481,963
Other	<u>5,668,082</u>	<u>5,428,976</u>
Total Loans	\$ 322,395,138	\$ 316,863,059
Less: Allowance for Loan Losses	<u>(3,879,299)</u>	<u>(4,492,337)</u>
Net Loans	<u>\$ 318,515,839</u>	<u>\$ 312,370,722</u>

Loans are generally stated at the amount of unpaid principal, reduced by unearned discount and allowance for loan losses. Interest is accrued daily on the outstanding balances. Unearned discount on installment loans is netted with the gross amount in Other loans in the table above. The total unearned discount on loans for the years ended December 31, 2012 and 2011 equaled \$7,305 and \$11,493, respectively.

Management monitors the credit quality of its loans on an ongoing basis. Any loan that is 30 days past payment is considered past due and is included in the past due tables on the next page. Past due loans are examined to identify loans for nonaccrual status, which are normally loans that are 90 days past due, unless special circumstances exist. Loans may be returned to accrual status when repayment is reasonably assured and there has been demonstrated performance under the terms of the loan.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

The following table presents the contractual aging of the recorded investment in past due loans by class as of December 31, 2012 and 2011.

Dollars in Thousands	At December 31, 2012						
	Past Due			Total	Current	Total Loans	>90 Days and Accruing
	30-59 Days	60-89 Days	>90 Days				
Commercial	\$ 6,415	\$ 450	\$ 5,022	\$ 11,887	\$ 108,676	\$ 120,563	\$ 14
Real Estate	1,205	0	108	1,313	174,833	176,146	108
Construction	0	252	558	810	19,208	20,018	0
Other	31	0	0	31	5,637	5,668	0
Totals	\$ 7,651	\$ 702	\$ 5,688	\$ 14,041	\$ 308,354	\$ 322,395	\$ 122

Dollars in Thousands	At December 31, 2011						
	Past Due			Total	Current	Total Loans	>90 Days and Accruing
	30-59 Days	60-89 Days	>90 Days				
Commercial	\$ 143	\$ 783	\$ 6,868	\$ 7,794	\$ 120,061	\$ 127,855	\$ 778
Real Estate	151	351	327	829	162,268	163,097	327
Construction	0	0	365	365	20,117	20,482	0
Other	0	0	12	12	5,417	5,429	12
Totals	\$ 294	\$ 1,134	\$ 7,572	\$ 9,000	\$ 307,863	\$ 316,863	\$ 1,117

The following table presents the nonaccrual loans, segregated by class of loans for 2012 and 2011:

	2012	2011
Commercial	\$ 5,007,964	\$ 6,090,315
Real Estate	0	0
Construction	557,980	364,571
Other	0	0
Totals	\$ 5,565,944	\$ 6,454,886

Loans are separated into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Loans are analyzed individually by classifying the loans as to credit risk, which is completed at the time of the loan origination. The Bank assigns credit quality indicators of Pass, Special Mention, Substandard, and Doubtful to its loans. The following definitions are used for risk grades.

Pass: Loans graded as Pass are loans to borrowers of acceptable credit quality and risk. They are higher quality loans that do not fit any of the other categories described below.

Special Mention: Loans classified as Special Mention have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loans or in the Bank's credit position at some future date.

Substandard: Loans categorized as Substandard are inadequately protected by the borrower's equity and ability to repay or collateral pledged to secure the loan. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. They require more intensive supervision by management.

Doubtful: Loans categorized as Doubtful have all the weaknesses inherent in those loans classified as substandard, with the added elements that the full collection of the loan is improbable and the probability of loss is high. Loans classified as doubtful are considered impaired.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

The credit quality indicators information, by class of loans at December 31, 2012 and 2011, are summarized below:

Credit Quality Indicators December 31, 2012

	Commercial	Real Estate	Construction	Other	Total
Grade:					
Pass	\$ 102,611,412	\$ 165,374,101	\$ 15,261,868	\$ 5,603,011	\$ 288,850,392
Special Mention	4,117,092	2,048,476	139,822	13,916	6,319,306
Substandard	13,834,551	8,723,907	4,615,827	51,155	27,225,440
Doubtful	0	0	0	0	0
Totals	\$ 120,563,055	\$ 176,146,484	\$ 20,017,517	\$ 5,668,082	\$ 322,395,138

Credit Quality Indicators December 31, 2011

	Commercial	Real Estate	Construction	Other	Total
Grade:					
Pass	\$ 104,035,854	\$ 151,555,827	\$ 9,749,056	\$ 5,314,061	\$ 270,654,798
Special Mention	7,906,369	5,123,375	3,493,740	18,066	16,541,550
Substandard	15,912,687	6,418,008	7,239,167	96,849	29,666,711
Doubtful	0	0	0	0	0
Totals	\$ 127,854,910	\$ 163,097,210	\$ 20,481,963	\$ 5,428,976	\$ 316,863,059

Both commercial and consumer loans are deemed impaired upon being contractually modified in a troubled debt restructuring ("TDR"). TDRs typically result from loss mitigation activities and occur when the Bank grants a concession to a borrower who is experiencing financial difficulty in order to minimize the loss. Once restructured in a TDR, a loan is generally considered impaired until its maturity, regardless of whether the borrower performs under the modified terms. Although such a loan may be returned to accrual status if all principal and interest are paid to date, the loan would continue to be evaluated for an asset-specific allowance for loan losses.

The following table presents troubled debt restructurings, modified by class at December 31, 2012 and 2011:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2012			
Commercial	2	\$ 8,466,180	\$ 4,544,582
Real Estate	6	1,268,142	1,255,517
Construction	1	1,202,432	557,980
Other	0	0	0
Totals	9	\$ 10,936,754	\$ 6,358,079

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2011			
Commercial	5	\$ 9,458,969	\$ 6,086,969
Real Estate	5	1,603,216	1,603,216
Construction	1	1,202,432	1,202,432
Other	0	0	0
Totals	11	\$ 12,264,617	\$ 8,892,617

As of December 31, 2012 and 2011, respectively, none of the Bank's TDRs had subsequently defaulted after concessions were granted. Two of the Bank's TDRs as of December 31, 2011, were paid off in 2012 and no additional loans were placed into TDR in 2012. The Bank had a commitment to advance an additional \$71,418 to a loan that was considered to be a TDR as of December 31, 2012.

Interest payments on impaired loans are typically applied to principal unless collectability 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 TDRs which are included in the impaired loan tables.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

The following summarizes impaired loan information at December 31, 2012, 2011, and 2010:

	2012	2011	2010
Impaired Loans with a Related Allowance	\$ 1,523,027	\$ 2,079,674	\$ 5,660,094
Impaired Loans with No Related Allowance	7,419,612	9,954,369	1,312,702
Total Impaired Loans	\$ 8,942,639	\$ 12,034,043	\$ 6,972,796
Allowance on Impaired Loans	\$ 221,520	\$ 150,335	\$ 655,160
Average Impaired Loans	\$ 10,376,318	\$ 8,999,620	\$ 8,253,813
Interest Income Recognized on Impaired Loans	\$ 411,419	\$ 293,936	\$ 210,756

The following is a summary of impaired loan by class at December 31, 2012 and 2011:

	December 31, 2012				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized While Impaired
With a Related Allowance					
Commercial	\$ 3,200,000	\$ 1,229,000	\$ 205,700	\$ 777,980	\$ 0
Real Estate	294,000	294,027	15,820	292,130	42,898
Construction	0	0	0	654,171	0
Other	0	0	0	0	0
Totals with a Related Allowance	\$ 3,494,000	\$ 1,523,027	\$ 221,520	\$ 1,724,281	\$ 42,898
With No Related Allowance					
Commercial	\$ 8,452,999	\$ 5,629,577	\$ 0	\$ 6,994,975	\$ 258,470
Real Estate	1,469,000	1,232,055	0	1,104,644	78,287
Construction	1,425,000	557,980	0	552,418	31,764
Other	0	0	0	0	0
Totals with No Related Allowance	\$ 11,346,999	\$ 7,419,612	\$ 0	\$ 8,652,037	\$ 368,521
Total					
Commercial	\$ 11,652,999	\$ 6,858,577	\$ 205,700	\$ 7,772,955	\$ 258,470
Real Estate	1,763,000	1,526,082	15,820	1,396,774	121,185
Construction	1,425,000	557,980	0	1,206,589	31,764
Other	0	0	0	0	0
Totals	\$ 14,840,999	\$ 8,942,639	\$ 221,520	\$ 10,376,318	\$ 411,419

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

December 31, 2011

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized While Impaired
With a Related Allowance					
Commercial	\$ 0	\$ 0	\$ 0	\$ 2,556,362	\$ 79,860
Real Estate	784,000	759,579	107,025	432,529	21,582
Construction	1,425,000	1,320,095	43,310	1,598,159	66,109
Other	0	0	0	0	0
Totals with a Related Allowance	\$ 2,209,000	\$ 2,079,674	\$ 150,335	\$ 4,587,050	\$ 167,551
With No Related Allowance					
Commercial	\$ 13,032,499	\$ 8,728,441	\$ 0	\$ 3,582,464	\$ 92,218
Real Estate	995,000	861,357	0	430,713	34,167
Construction	365,000	364,571	0	399,393	0
Other	0	0	0	0	0
Totals with No Related Allowance	\$ 14,392,499	\$ 9,954,369	\$ 0	\$ 4,412,570	\$ 126,385
Total					
Commercial	\$ 13,032,499	\$ 8,728,441	\$ 0	\$ 6,138,826	\$ 172,078
Real Estate	1,779,000	1,620,936	107,025	863,242	55,749
Construction	1,790,000	1,684,666	43,310	1,997,552	66,109
Other	0	0	0	0	0
Totals	\$ 16,601,499	\$ 12,034,043	\$ 150,335	\$ 8,999,620	\$ 293,936

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 collectability.

The following presents the activity with respect to loans to related parties for 2012, 2011, and 2010:

	2012	2011	2010
Balances - January 1,	\$ 14,784,511	\$ 19,478,036	\$ 15,732,671
New Loans	1,953,859	3,133,990	8,621,439
Repayments	(4,858,286)	(7,827,515)	(4,876,074)
Balances - December 31,	\$ 11,880,084	\$ 14,784,511	\$ 19,478,036

Note 5

Allowance for Loan Loss:

An analysis of the change in the allowance for loan losses for the years ended December 31, 2012, 2011, and 2010, is as follows:

	2012	2011	2010
Beginning Balances - January 1,	\$ 4,492,337	\$ 4,458,996	\$ 4,002,286
Loans Charged-Off	(1,530,219)	(782,750)	(4,009,102)
Recoveries of Loans Previously Charged Off	76,986	78,231	633,442
Provision to Expense for Loan Losses	840,195	737,860	3,832,370
Ending Balances - December 31,	\$ 3,879,299	\$ 4,492,337	\$ 4,458,996

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Activity in the allowance for loan losses by loan class during 2012 and 2011 is as follows:

2012	Commercial	Real Estate	Construction	Other	Total
Allowance for Loan Losses:					
Beginning Balance	\$ 818,436	\$ 2,235,850	\$ 1,375,196	\$ 62,855	\$ 4,492,337
Charge-offs	(726,537)	(57,605)	(743,140)	(2,937)	(1,530,219)
Recoveries	73,940	896	1,750	400	76,986
Provision	2,344,010	(1,607,401)	141,676	(38,090)	840,195
Ending Balance	\$ 2,509,849	\$ 571,740	\$ 775,482	\$ 22,228	\$ 3,879,299
Allowance Related to:					
Loans Individually					
Evaluated for Impairment	\$ 205,700	\$ 15,820	\$ 0	\$ 0	\$ 221,520
Loans Collectively					
Evaluated for Impairment	2,304,149	555,920	775,482	22,228	3,657,779
Totals	\$ 2,509,849	\$ 571,740	\$ 775,482	\$ 22,228	\$ 3,879,299
Loans:					
Loans Individually					
Evaluated for Impairment	\$ 6,858,577	\$ 1,526,082	\$ 557,980	\$ 0	\$ 8,942,639
Loans Collectively					
Evaluated for Impairment	113,704,478	174,620,402	19,459,537	5,668,082	313,452,499
Totals	\$ 120,563,055	\$ 176,146,484	\$ 20,017,517	\$ 5,668,082	\$ 322,395,138
2011					
	Commercial	Real Estate	Construction	Other	Total
Allowance for Loan Losses:					
Beginning Balance	\$ 530,831	\$ 1,697,835	\$ 2,183,245	\$ 47,085	\$ 4,458,996
Charge-offs	(458,165)	(17,943)	(289,897)	(16,745)	(782,750)
Recoveries	68,611	300	7,802	1,518	78,231
Provision	677,159	555,658	(525,954)	30,997	737,860
Ending Balance	\$ 818,436	\$ 2,235,850	\$ 1,375,196	\$ 62,855	\$ 4,492,337
Allowance Related to:					
Loans Individually					
Evaluated for Impairment	\$ 0	\$ 107,025	\$ 43,310	\$ 0	\$ 150,335
Loans Collectively					
Evaluated for Impairment	818,436	2,128,825	1,331,886	62,855	4,342,002
Totals	\$ 818,436	\$ 2,235,850	\$ 1,375,196	\$ 62,855	\$ 4,492,337
Loans:					
Loans Individually					
Evaluated for Impairment	\$ 8,728,441	\$ 1,620,936	\$ 1,684,666	\$ 0	\$ 12,034,043
Loans Collectively					
Evaluated for Impairment	119,126,469	161,476,274	18,797,297	5,428,976	304,829,016
Totals	\$ 127,854,910	\$ 163,097,210	\$ 20,481,963	\$ 5,428,976	\$ 316,863,059

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Note 6

Bank Premises and Equipment:

Major classifications of bank premises and equipment at December 31, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Buildings and Improvements	\$ 1,856,589	\$ 1,856,589
Furniture and Fixtures	1,624,783	1,658,249
	<u>\$ 3,481,372</u>	<u>\$ 3,514,838</u>
Less: Accumulated Depreciation	3,075,520	3,072,070
	<u>\$ 405,852</u>	<u>\$ 442,768</u>
Land	200,460	200,460
	<u>\$ 606,312</u>	<u>\$ 643,228</u>
Bank Premises and Equipment, Net		

Depreciation expense for the years ended December 31, 2012, 2011, and 2010, totaled \$102,792, \$238,928, and \$91,056, respectively, and is included in occupancy and equipment expense on the statements of income.

The Bank has entered into a noncancelable lease agreement with a related party for its Teays Valley branch. Rent expense for noncancelable operating lease approximated \$61,911, \$59,826, and \$57,821 for the years ended December 31, 2012, 2011, and 2010, respectively. The minimum annual rental commitment under this lease, exclusive of taxes and other charges, payable by the lessee at December 31, 2012, for the next five years is as follows:

<u>Year</u>	<u>Amount</u>
2013	\$ 64,080
2014	66,335
2015	68,680
2016	71,120
2017	<u>67,318</u>
Total	<u>\$ 337,533</u>

Note 7

Deposits:

The major categories of deposits at December 31, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Noninterest Bearing	\$ 53,420,355	\$ 57,711,658
Interest Bearing:		
Time Deposits under \$100,000	114,948,242	118,102,442
Time Deposits over \$100,000	<u>227,154,095</u>	<u>204,135,038</u>
Total Time Deposits	\$ 342,102,337	\$ 322,237,480
Money Market Savings	104,989,718	105,383,178
	<u>24,893,369</u>	<u>23,582,175</u>
Total Interest Bearing Deposits	\$ 471,985,424	\$ 451,202,833
Total Deposits	<u>\$ 525,405,779</u>	<u>\$ 508,914,491</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Scheduled maturities of time and certificates of deposits at December 31, 2012, are as follows:

Year	Amount
2013	\$ 310,918,994
2014	24,275,208
2015	6,908,135
Total	<u>\$ 342,102,337</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 \$52,168,438 and \$51,689,783 at December 31, 2012 and 2011, respectively.

Note 8

Income Taxes:

The income tax provisions (benefits) included in the consolidated statements of income for December 31, 2012, 2011, and 2010, are summarized as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current Expense:			
Federal	\$ 1,014,773	\$ 1,867,950	\$ 1,762,001
State	128,758	261,619	247,490
Totals	<u>\$ 1,143,531</u>	<u>\$ 2,129,569</u>	<u>\$ 2,009,491</u>
Deferred Expense (Benefit):			
Federal	\$ 85,440	\$ (96,764)	\$ (206,423)
State	10,471	(11,860)	(25,296)
Totals	<u>\$ 95,911</u>	<u>\$ (108,624)</u>	<u>\$ (231,719)</u>
Total Applicable Income Taxes	<u>\$ 1,239,442</u>	<u>\$ 2,020,945</u>	<u>\$ 1,777,772</u>

Deferred income taxes are recorded based upon the differences between the financial statement and tax basis of assets and liabilities, and available tax credit carryforwards. Temporary differences between the financial statement and tax values of assets and liabilities give rise to deferred tax expense (benefit). The significant components of deferred income taxes at December 31, 2012, 2011 and 2010, are as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Allowance for Loan Losses	\$ 95,313	\$ (109,196)	\$ (231,991)
Discount on Investment Securities	598	572	272
Totals	<u>\$ 95,911</u>	<u>\$ (108,624)</u>	<u>\$ (231,719)</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

The difference between income taxes computed by applying the statutory federal income tax rate and the provision for income taxes in the financial statements is reconciled as follows:

	2012		2011		2010	
	Amount	%	Amount	%	Amount	%
Income Tax Expense at Federal Statutory Rate	\$ 1,272,085	34.00%	\$ 1,983,155	34.00%	\$ 1,750,651	34.00%
Increase (Decrease) Resulting from:						
State Income Tax, Net	91,891	2.46	164,842	2.83	146,648	2.85
Nontaxable Interest Income	(135,287)	(3.62)	(139,032)	(2.38)	(130,973)	(2.54)
Nondeductible Interest Expense	5,975	.16	6,575	.11	6,876	.13
Other Items	4,778	.13	5,405	.09	4,570	.09
Tax on Income	\$ 1,239,442	33.13%	\$ 2,020,945	34.65%	\$ 1,777,772	34.53%

The approximate tax (benefit) effects of the net investment securities gains (losses) were (\$699), (\$268), and (\$497) for the years 2012, 2011, and 2010, respectively.

As of December 31, 2012 and 2011, there were no net operating loss carryforwards for income tax purposes.

In accordance with ASC Topic 740, "Income Taxes," the Bank has concluded that there were no significant uncertain tax positions requiring recognition in the consolidated financial statements for the tax years ended 2009, 2010, 2011, and 2012. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2009 through 2012. The Company and its subsidiaries state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2009 through 2012.

The Bank recognizes interest and penalties accrued related to unrecognized tax benefits, if applicable, in other operating expenses in the consolidated statements of income. During the years ended December 31, 2012, 2011, and 2010, the Bank recognized \$4,850, \$7,239, and \$61 in interest or penalties.

Note 9

Pension Plan:

The Bank is a participant in a multiple employer non-contributory defined benefit pension plan that covers former and current employees only. Pension benefits are based on length of service and the employee's compensation during his/her tenure. Contributions by the Bank are intended to provide only for benefits attributed as of October 31, 2012, the date the plan was frozen. The Bank switched to a defined contribution plan effective January 1, 2013.

The following table shows the Plan's funded status at December 31, 2012 and 2011:

	2012	2011
Accumulated Benefit Obligation	\$ 6,875,998	\$ 6,108,847
Value of Future Salary Projections	0	297,889
Total Projected Benefit Obligation	\$ 6,875,998	\$ 6,406,736
Fair Value of Plan Assets	5,077,147	3,890,295
Plan Assets in Excess (Deficient) of Projected Benefit Obligation	\$ (1,798,851)	\$ (2,516,441)
Accumulated Other Comprehensive Income	3,190,259	3,383,974
Unfunded (Accrued)/Prepaid Expense	\$ 1,391,408	\$ 867,533

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

The components of pension expense for the years ended December 31, 2012, 2011, and 2010, are as follows:

	2012	2011	2010
Service Cost	\$ (391,676)	\$ (260,276)	\$ (229,896)
Interest Cost	(280,921)	(327,296)	(303,048)
Expected Return on Assets	363,324	319,224	320,545
Amortization of Unrecognized Gain/(Loss)	<u>(217,624)</u>	<u>(130,428)</u>	<u>(130,153)</u>
Net Periodic Benefit (Cost)	\$ <u>(526,897)</u>	\$ <u>(398,776)</u>	\$ <u>(342,552)</u>
Total Recognized in Other Comprehensive Income	\$ <u>193,715</u>	\$ <u>(305,270)</u>	\$ <u>(743,646)</u>
Total Recognized in Net Periodic Benefit Cost and Accumulated Other Comprehensive Income	\$ <u>(333,182)</u>	\$ <u>(704,046)</u>	\$ <u>(1,086,198)</u>
Actuarial Assumptions:			
Discount Rate	4.50%	5.54%	6.00%
Rate of Compensation Increase	0.00%	3.00%	3.00%
Expected Long-Term Rate of Return on Plan Assets	8.00%	8.00%	8.00%

The estimated future benefit payments expected in each of the next five fiscal years and thereafter at December 31, 2012, are as follows:

Year	Amount
2013	\$ 339,417
2014	377,339
2015	375,360
2016	369,523
2017	359,509
2018 and Thereafter	<u>1,865,675</u>
Total	<u>\$ 3,686,823</u>

Benefits paid totaled \$313,708 and \$266,744 for the years ended December 31, 2012 and 2011, respectively. Estimated contributions expected to be made in 2013 approximated \$89,668.

Asset allocation for the pension plan as of the measurement date, by asset category, is as follows:

Plan Assets	Target Allocation 2012	Allowable Allocation Range	Percentage of Plan Assets at	
			December 31, 2012	December 31, 2011
Equity Securities	50%	40-60%	50%	52%
Debt Securities	50%	40-60%	49%	47%
Other		0-3%	1%	1%
Totals			<u>100%</u>	<u>100%</u>

The primary long-term objective for the plan is to maintain assets at a level that will sufficiently cover future beneficiary obligations. The plan is overseen by Pentegra Retirement Services, who will invest the assets of the plan in a diversified combination of asset classes, investment strategies, and pooled vehicles. The asset allocation guidelines displayed in the table above reflect the Bank's risk tolerance and long-term objectives and is reviewed periodically to meet the above target allocations. The expected long-term rate of return for the plan's total assets is based on the expected return of each of the above categories, weighted based on the median of the target allocation for each class.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

In accordance with the ASC Topic 715, the following is a description of the valuation methodologies used to measure the plan assets at fair value. (See Note 16.)

Cash and Cash Equivalents: These underlying assets are of highly liquid U.S. government obligations. The fair value of cash and cash equivalents approximates cost (Level 1).

Debt Securities: These securities of the U.S. government, municipalities, private issuers and corporations are valued at the closing price reported in the active market in which the individual security is traded (Level 1).

Common Stock: These securities are valued at the closing price on the respective stock exchange (Level 1). However, certain equities are valued by the fund administrator using pricing models that considers observable market data (Level 2).

Mutual Funds: Generally, these securities are valued at the closing price reported in the active market in which the individual mutual fund is traded (Level 1).

The following tables present the balances of the plan assets, by fair value, as of December 31, 2012 and 2011:

December 31, 2012	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Cash and Cash Equivalents	\$ 43,787	\$ -	\$ -	\$ 43,787
Fixed Income Mutual Funds:				
Domestic	1,110,436	-	-	1,110,436
Alternative	1,399,259	-	-	1,399,259
Equity Securities:				
Common Stock	-	525,707	-	525,707
Equity Mutual Funds:				
Domestic Equity Large Cap	873,552	-	-	873,552
Domestic Equity Small Cap	502,947	-	-	502,947
International Equity	621,459	-	-	621,459
Totals	\$ 4,551,440	\$ 525,707	\$ -	\$ 5,077,147

December 31, 2011	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Cash and Cash Equivalents	\$ 31,117	\$ -	\$ -	\$ 31,117
Fixed Income Mutual Funds:				
Domestic	908,779	-	-	908,779
Alternative	934,423	-	-	934,423
Equity Securities:				
Common Stock	-	672,537	-	672,537
International Stock	-	198,080	-	198,080
Equity Mutual Funds:				
Domestic Equity Large Cap	504,009	-	-	504,009
Domestic Equity Small Cap	440,621	-	-	440,621
International Equity	200,729	-	-	200,729
Totals	\$ 3,019,678	\$ 870,617	\$ -	\$ 3,890,295

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Note 10

Putnam Bancshares, Inc. (Parent Company Only) Financial Information:

CONDENSED BALANCE SHEETS

	December 31,	
	2012	2011
ASSETS		
Cash	\$ 69,118	\$ 63,254
Investment in Putnam County Bank	76,006,171	75,306,066
Investment in Putnam County Title Insurance Agency	3,821	109
Prepaid Expenses	0	5,167
Total Assets	<u>\$ 76,079,110</u>	<u>\$ 75,374,596</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Income Taxes Payable	\$ 1,607	\$ 0
Total Liabilities	<u>\$ 1,607</u>	<u>\$ 0</u>
Shareholders' Equity	<u>\$ 76,077,503</u>	<u>\$ 75,374,596</u>
Total Liabilities and Shareholders' Equity	<u>\$ 76,079,110</u>	<u>\$ 75,374,596</u>

CONDENSED STATEMENTS OF INCOME

	For Years Ended December 31,		
	2012	2011	2010
INCOME	<u>\$ 1,440,000</u>	<u>\$ 1,440,000</u>	<u>\$ 1,320,000</u>
EXPENSES:			
Operating Expenses	<u>\$ 33,983</u>	<u>\$ 37,913</u>	<u>\$ 39,355</u>
Income before Income Tax Benefit and Equity in Undistributed Earnings of Subsidiaries	<u>\$ 1,406,017</u>	<u>\$ 1,402,087</u>	<u>\$ 1,280,645</u>
Applicable Income Taxes (Benefit)	<u>1,607</u>	<u>(3,976)</u>	<u>(1,191)</u>
Income before Equity in Undistributed Earnings of Subsidiaries	<u>\$ 1,404,410</u>	<u>\$ 1,406,063</u>	<u>\$ 1,281,836</u>
Equity in Undistributed Earnings of Subsidiaries	<u>1,097,574</u>	<u>2,405,801</u>	<u>2,089,366</u>
Net Income	<u>\$ 2,501,984</u>	<u>\$ 3,811,864</u>	<u>\$ 3,371,202</u>

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

CONDENSED STATEMENTS OF CASH FLOWS

	For Years Ended December 31,		
	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	\$ 2,501,984	\$ 3,811,864	\$ 3,371,202
Adjustments to Reconcile Net Income to Net Cash Provided by (Used in) Operating Activities:			
Equity in Undistributed Earnings of Subsidiaries	(1,097,574)	(2,405,801)	(2,089,366)
(Increase) Decrease in Prepaid Expenses	5,167	(3,976)	(1,191)
Increase (Decrease) in Income Taxes Payable	1,607	0	(6,164)
Net Cash Provided by Operating Activities	\$ 1,411,184	\$ 1,402,087	\$ 1,274,481
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in Subsidiary	\$ 34,680	\$ 22,950	\$ 49,980
Net Cash Provided by Investing Activities	\$ 34,680	\$ 22,950	\$ 49,980
CASH FLOWS FROM FINANCING ACTIVITIES:			
Dividends Paid	\$ (1,440,000)	\$ (1,440,000)	\$ (1,320,000)
Net Cash (Used in) Financing Activities	\$ (1,440,000)	\$ (1,440,000)	\$ (1,320,000)
Net Change in Cash	\$ 5,864	\$ (14,963)	\$ 4,461
Cash at Beginning of Year	63,254	78,217	73,756
Cash at End of Year	\$ 69,118	\$ 63,254	\$ 78,217

Note 11

Related Party Transactions:

In the normal course of business, the Company and its subsidiary, Putnam County Bank, have loans, deposits and other transactions with its executive officers, directors and certain business organizations and individuals with which such persons are associated. In the opinion of management, such transactions are consistent with prudent banking practices and are within applicable banking regulations.

Note 12

Commitments and Contingencies:

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and commercial and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

A summary of the notional amounts of the financial instruments with off-balance sheet risk at December 31, 2012 and 2011, is as follows:

Contract Amount	<u>2012</u>	<u>2011</u>
Commitments to Extend Credit	\$ 25,271,761	\$ 15,311,122
Commercial and Standby Letters of Credit	<u>15,512</u>	<u>28,972</u>
Totals	<u>\$ 25,287,273</u>	<u>\$ 15,340,094</u>

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and commercial and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the counterpart. Collateral requirements vary but may include accounts receivable, inventory, property, plant and equipment, or real estate.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans.

In the ordinary course of business, the Company is subject to various legal proceedings and claims. While any litigation contains an element of uncertainty, management is unaware of any legal proceedings at December 31, 2012, of which the result would have a material adverse effect upon the consolidated financial statements.

Note 13

Concentrations of Credit Risk:

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. Others have since relocated, but continue to be depositors of the Bank. Investments in state and municipal securities and loans to governmental entities are within the Bank's home state. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers.

Note 14

Regulatory Matters:

Putnam Bancshares, Inc.'s principal source of funds for future dividend payments to shareholders is 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 Financial Institutions as well as the Federal Reserve Board. Under such restrictions, the Bank may not, without the prior approval of the West Virginia Division of Financial Institutions and the Federal Reserve Board, declare dividends in excess of the sum of the current year's net income, as defined, plus the retained net profits from the two preceding years. The Bank normally restricts dividends to a lesser amount. The dividends as of December 31, 2012, that the Bank could declare without the approval of the West Virginia Division of Financial Institutions and the Federal Reserve Board, amounted to approximately \$3,433,848.

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 capital, 8.00% for total risk-based capital, and 4.00% for Tier 1 leverage capital. To be well capitalized under the regulatory framework for prompt corrective actions, the ratios must be at least 6.00%, 10.00%, and 5.00%, respectively.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

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, 2012 and 2011, the Bank exceeded all capital adequacy requirements to which it is subject 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 would impact their well-capitalized status.

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, 2012:				
Tier 1 Capital (to Risk-Weighted Assets)	24.97%	\$ 73,846,000	\$ 11,831,000	\$ 17,747,000
Total Risk-Based Capital (to Risk-Weighted Assets)	26.22	77,546,000	23,662,000	29,578,000
Tier 1 Leverage Capital (to Average Assets)	12.12	73,846,000	24,371,000	30,464,000
As of December 31, 2011:				
Tier 1 Capital (to Risk-Weighted Assets)	24.80%	\$ 72,785,000	\$ 11,736,000	\$ 17,607,000
Total Risk-Based Capital (to Risk-Weighted Assets)	26.06	76,463,000	23,476,000	29,345,000
Tier 1 Leverage Capital (to Average Assets)	12.55	72,785,000	23,194,000	28,993,000

Note 15

Financial Instruments:

ASC Topic 825, "Financial Instruments," requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The following summarizes the methods and significant assumptions used by the Bank in estimating its fair value disclosures for financial instruments.

Cash and Due from Banks: The carrying values of cash and due from banks approximate their estimated fair value (Level 1).

Federal Funds Sold: The carrying values of federal funds sold approximate their fair value (Level 1).

Investment Securities: Estimated fair values of investment securities are based on quoted market prices, where available (Level 1). If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities (Level 2).

Loans: The estimated fair values for loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality (Level 2).

Accrued Interest Receivable and Payable: The carrying values of accrued interest receivable and payable approximate their estimated fair values (Level 1).

Deposits: The estimated fair values of demand deposits are equal to their carrying values. Fair values for time deposits are estimated using a discounted cash flow calculation at rates currently offered for deposits with similar remaining maturities (Level 2).

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

The carrying values and estimated fair values of the Bank's financial instruments at December 31, 2012 and 2011, are summarized as follows:

	2012		2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial Assets:				
Cash and Due from Banks	\$ 15,107,465	\$ 15,107,465	\$ 18,491,410	\$ 18,491,410
Federal Funds Sold	104,000,000	104,000,000	113,000,000	113,000,000
Securities Available for Sale	122,424,686	122,424,686	95,718,064	95,718,064
Securities Held to Maturity	38,989,705	38,994,537	38,996,274	38,997,618
Loans	318,515,839	321,394,720	312,370,722	314,473,197
Accrued Interest Receivable	1,404,863	1,404,863	1,534,229	1,534,229
Totals	<u>\$ 600,442,558</u>	<u>\$ 603,326,271</u>	<u>\$ 580,110,699</u>	<u>\$ 582,214,518</u>
Financial Liabilities:				
Deposits	\$ 525,405,779	\$ 525,651,132	\$ 508,914,491	\$ 509,246,265
Accrued Interest Receivable	1,119,055	1,119,055	1,045,702	1,045,702
Totals	<u>\$ 526,524,834</u>	<u>\$ 526,770,187</u>	<u>\$ 509,960,193</u>	<u>\$ 510,291,967</u>

Note 16

Fair Value Measurement:

ASC Topic 820, "Fair Value Measurement and Disclosures," defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: Unadjusted quoted market prices in active markets for identical assets or liabilities that the reporting entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Accordingly, available for sale securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Bank may be required to record other assets at fair value on a nonrecurring basis. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

A description of the valuation methodologies used for assets and liabilities recorded at fair value follows, as well as the classification of such instruments within the valuation hierarchy.

Securities Available For Sale: Securities are classified within Level 1 where quoted market prices are available in an active market. Inputs include securities that have quoted prices in active markets for identical assets. If quoted market prices are not available, fair value is estimated using quoted prices of securities with similar characteristics, at which point the securities would be classified with Level 2 of the hierarchy. Level 2 securities include mortgage-backed securities issued by government sponsored entities, mortgage-backed securities, and municipal bonds.

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Impaired Loans: Loans are measured for impairment using the methods permitted by ASC Topic 310, "Receivables." Fair value of impaired loans is measured by either the loans obtainable market price, if available (Level 1), the fair value of the collateral if the loan is collateral dependent (Level 2), or the present value of expected future cash flows, discounted at the loan's effective interest rate (Level 3). Fair value of the collateral is determined by appraisals or by independent valuation.

Other Real Estate Owned: Properties are recorded at the balance of the loan or at estimated fair value less estimated selling costs, whichever is less, at the date acquired. Fair values of other real estate owned ("OREO") at December 31, 2012, are determined by sales agreement or appraisal, and costs to sell are based on estimation per the terms and conditions of the sales agreement or amounts commonly used in real estate transactions. Inputs include appraisal values on the properties or recent sales activity for similar assets in the property's market, and thus OREO measured at fair value would be classified within Level 2 of the hierarchy.

Assets at Fair Value on a Recurring Basis

December 31, 2012	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Available for Sale Securities				
U.S. Government and Agency Securities	\$ -	\$ 113,607,005	\$ -	\$ 113,607,005
State and Municipal Securities	-	7,799,952	-	7,799,952
Mutual Funds	-	1,017,729	-	1,017,729
Totals	\$ -	\$ 122,424,686	\$ -	\$ 122,424,686

December 31, 2011	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Available for Sale Securities				
U.S. Government and Agency Securities	\$ -	\$ 86,351,305	\$ -	\$ 86,351,305
State and Municipal Securities	-	8,356,325	-	8,356,325
Mutual Funds	-	1,010,434	-	1,010,434
Totals	\$ -	\$ 95,718,064	\$ -	\$ 95,718,064

Notes To Consolidated Financial Statements

For Years Ended December 31, 2012, 2011, And 2010 (continued)

Assets Recorded at Fair Value on a Nonrecurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. The following table measures financial assets measured at fair value on a nonrecurring basis as of December 31, 2012 and 2011:

December 31, 2012	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Impaired Loans	\$ -	\$ 9,382,102	\$ -	\$ 9,382,102
OREO	\$ -	\$ 1,277,204	\$ -	\$ 1,277,204

December 31, 2011	Fair Value Measurement Using			Total
	Level 1	Level 2	Level 3	
Impaired Loans	\$ -	\$ 12,978,769	\$ -	\$ 12,978,769
OREO	\$ -	\$ 2,922,754	\$ -	\$ 2,922,754

ASC Topic 825 provides the Company with an option to report selected financial assets and liabilities at fair value. The fair value option established by this statement permits the Company to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each reporting date subsequent to implementation.

The Company has chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with accounting principles generally accepted in the United States, and as such has not included any gains or losses in earnings for the year ended December 31, 2012.

Officers and Employees

Jack Wilson President & Chief Executive Officer
Robert S. Duckworth Executive Vice President
John R. Wilson, Jr. Vice President & Chief Financial Officer
Matthew C. Sosebee Vice President & Chief Operations Officer
Jerry P. Brown Cashier
Deborah L. Phillips Auditor
Clara B. Carmichael Assistant Cashier & Loan Officer
Phyllis J. Canterbury Assistant Vice President
Don C. Chapman Bank Secrecy Officer
Karolee K. Burton Compliance Officer
Allison W. Jones Human Resource Officer/Interim Controller
Leigh A. Shirkey Assistant Auditor
George E. Woodward Branch Manager
Tyrone Y. Perry Information Technology Manager
Angela G. Melton Assistant Branch Manager
Janice K. Miller Special Projects Manager
Debra G. Casey Paying & Receiving
Rebecca L. Foster Vault Manager
Tina M. Leadmon Paying & Receiving
Claudia S. Leadman Loan Operations
Denise D. Edwards Electronic Banking
Teresa K. White Paying & Receiving
Jeffrey R. Davis Loan Officer
Linda L. Bird Paying & Receiving
Rhonda L. Cunningham Electronic Banking
Penny L. Collier Proof Operations
Diana L. Handley Assistant Cashier
Deborah R. Milton Paying & Receiving
Donna J. Stowers Paying & Receiving
Marsha D. Eggleton Paying & Receiving
Tammy J. Sovine Data Process Verification
Tina M. Ellison Bank Secrecy Assistant
Kelly L. Shaw Paying & Receiving
Joy M. Persinger Paying & Receiving
Rita K. Thomasson Bookkeeping Manager

Betty J. Morris Paying & Receiving
Loraine S. Rappold Bookkeeping
Suzanne A. Craigo Proof Operations
Margie M. Shirkey Loan Operations
Gregory M. Mick Assistant Cashier
Beth J. Carnefix Paying & Receiving
Barbara G. Wyant Bookkeeping
John E. Childers Building Manager
Kera D. Taylor Proof Operations
Cheryl L. Halstead Paying & Receiving
Trisa K. Radcliffe Accounting
Bryan J. McCallister Research and Records
Retha A. Lemon Paying & Receiving
Kimberly M. Helper Paying & Receiving
Cathy M. Lippert Loan Operations
Amanda A. McCallister Paying and Receiving
Whitney B. Harris Paying and Receiving
Kaye Turley Proof Operations
Jill R. Rice Paying and Receiving
Darlena F. Meadows Paying and Receiving
Mary E. Huff Paying and Receiving
Wesley O. Neal Bookkeeping
Ashley M. Johnson Bookkeeping
Jonathan S. Fisher, II Bookkeeping
Thomas P. Schmader, IV Loan Officer
Cameron T. Collins Credit Analyst
Kelley A. Lanning Loan Operations
Tiffani J. Stewart Loan Operations
James S. Coniff Loan Operations
Mark R. Billotti Credit Analyst
Lee O. Elliott Loan Assistant
Holly M. Rooper Paying & Receiving
Laci N. Thacker Paying & Receiving
Stacy L. McCallister Paying & Receiving
Janet F. Benjamin Paying & Receiving

Board of Directors



Standing, left to right

Gary D. Young	G & G Builders, Inc.
John R. Wilson, Jr.	Vice President and Chief Operations Officer
Tim Hayslett	Hayslett Construction Company
Stephen Hodges, Jr.	Stephen Hodges Home Builders, Inc.
Boyd Meadows	Half-Way Markets
Roger K. Randolph	Randolph Engineering Company, Inc.

Seated, left to right

J.R. Wilson	President and Chief Executive Officer
Robert F. Hatfield	Hatfield Enterprises, Inc.
Okey M. Landers, Jr.	A & C Corporation
Robert S. Duckworth	Executive Vice President



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