pcb
Putnam County Bank

2016 Annual Report

Annual Meeting

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

Thursday, June 8, 2017
10:30 a.m.
Putnam County Bank Boardroom
2762 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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Letter to Shareholders

The following is the financial results of Putnam Bancshares, Inc. and its wholly-owned subsidiary, Putnam County Bank, for 2016.

The Bank's earnings declined in 2016 with net earnings of $4.5 million compared with $7 million in 2015. Increased loan loss provisions totaling $4.6 million were recognized due to elevated nonperforming loans. Loan growth during the year was significant in supporting the increase of earnings.

Loans increased $6.8 million or 2% in 2016, in contrast to an increase of $29 million or 7% in 2015. This decline suggests a slowing in the local economy and growing competition for loans. We continue to provide local decisions for our customer base and efficient turnaround.

The Company's capital base grew to $89 million in 2016. Our capital base continues to show considerable strength.

Management will continue to focus on net interest margin closely in the future and grow lending in a safe and profitable manner. The Bank will continue to demonstrate responsible care in its operating expenses while serving its community.

During 2016, the economy has illustrated continued signs of recovery. While signs of recovery are evident, a consistent path is elusive. The banking industry has shown significant improvement. The bank failure rate in 2013 was 24; 18 in 2014 and eight in 2015. In 2016, five banks failed.

Our state continues to deal with unemployment and the effects of the coal industry. Rising energy prices has also had a negative effect on the natural gas industry. The state government has been challenged to balance a budget with declining revenue from coal, natural gas and related businesses. The local economy appears to be tightening as residential development appears to be slowing.

In 2016, Diana Handley retired from the Bank after 21 years of service. Diana served the Bank as a New Accounts Specialist and was known for her high level of customer service. We wish Diana and her family the best in the future.

In 2016, we lost a valued member of the Putnam County Bank family. Boyd Meadows served the Bank and Bancshares as a Director since 1987. Boyd was known and respected in our community and well beyond. He was known for his common-sense approach and by helping others. His advice and counsel made the Bank, Bancshares and the community a better place. We pass along our sincere condolences to the Meadows family.

Putnam County Bank will continue to serve its customers with the products and services they have come to expect. While the Bank may not provide every service imaginable, we feel the services we provide are cost-effective and secure.

We continue to be confident of the future of Putnam Bancshares, Inc. and Putnam County Bank. While the future holds many challenges, there continues to be a place for a local, community-minded institution which works hard every day to satisfy its customers. We expect to meet these challenges with a helpful and knowledgeable staff of professionals that provide services that are timely and meet customer expectations.

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

J. R. Wilson	Robert S. Duckworth	John R. Wilson, Jr.
Chairman of the Board	Chief Executive Officer	President

Selected Finanacial Summary

In Thousands of Dollars

	Four-Year Summary			
	2016	2015	2014	2013
YEAR-END BALANCE SHEET SUMMARY				
Loans, Net	435,870	433,200	404,120	343,875
Investment Securities	118,143	122,151	151,422	171,874
Total Assets	651,874	638,294	623,666	624,146
Deposits	557,788	547,616	538,435	544,589
Shareholders' Equity	88,930	86,114	80,520	76,928
AVERAGE BALANCE SHEET SUMMARY				
Loans, Net	439,966	421,063	370,148	330,883
Investment Securities	125,063	120,114	157,116	169,696
Total Assets	649,941	634,448	626,322	618,379
Deposits	556,263	544,681	543,821	538,720
Shareholders' Equity	88,193	84,328	80,221	77,196
SELECTED RATIOS				
Return On Average Assets	0.69%	1.11%	1.00%	0.81%
Return On Average Equity	5.09%	8.36%	7.79%	6.50%
Dividends Declared As a Percentage Of Net Income	37.42%	22.98%	24.91%	29.89%
SUMMARY OF OPERATIONS				
Interest Income	24,928	23,882	21,815	20,933
Interest Expense	4,848	4,428	4,882	5,466
Net Interest Income	20,080	19,454	16,933	15,468
Provision for Loan Losses	4,831	200	0	0
Noninterest Income	630	710	743	592
Noninterest Expense	8,971	8,546	8,183	8,341
Net Income	4,489	7,048	6,305	5,026
PER SHARE DATA				
Net Income	7.48	11.75	10.51	8.38
Cash Dividends	2.80	2.70	2.60	2.50
Book Value	148.22	143.52	134.20	128.21

Analysis of Earning Assets and Interest Bearing Liabilities
In Thousands of Dollars

	2016			2015		
ASSETS	**Avg. Balance**	**Interest**	**Yield/Rate**	**Avg. Balance**	**Interest**	**Yield/Rate**
Loans						
Commercial	54,160	2,843	5.25%	42,527	2,631	6.19%
Real Estate	383,805	19,708	5.13%	375,463	18,947	5.05%
Consumer(2)	7,671	646	8.42%	6,246	599	9.59%
Total Loans (1)	445,636	23,197	5.21%	424,236	22,177	5.23%
Securities (3)						
Taxable	118,479	1,273	1.07%	112,126	1,253	1.12%
Tax-Exempt (4)	4,788	243	5.08%	6,988	349	4.99%
Mutual Funds	1,000	24	2.40%	1,000	22	2.20%
Total Securities	124,267	1,540	1.24%	120,114	1,624	1.35%
Interest Bearing Deposit in Banks	9,509	35	0.37%	10,366	21	0.20%
Federal Funds Sold	58,199	156	0.27%	68,299	60	0.09%
Total Earning Assets	637,611	24,928	3.91%	623,015	23,882	3.83%
Cash and Due from Banks	6,707			5,104		
Premises and Equipment, Net	519			537		
Other Assets	10,774			8,965		
Allowance for Loan Losses	(5,670)			(3,173)		
Total Assets(5)	**649,941**			**634,448**		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest Bearing Deposits						
Super NOW and MMDA	117,004	234	0.20%	111,530	224	0.20%
Savings	28,683	43	0.15%	28,224	41	0.15%
Time	350,577	4,571	1.30%	344,917	4,163	1.21%
Total Interest Bearing Deposits	496,264	4,848	0.98%	484,671	4,428	0.91%
Long-Term Borrowings	0	0	0.00%	0	0	0.00%
Total Interest Bearing Liabilities	496,264	4,848	0.98%	484,671	4,428	0.91%
Noninterest Bearing Deposits	59,999			60,010		
Accrued Expenses and Other Liabilities	5,486			5,439		
Equity	88,193			84,328		
Total Liabilities and Equity	649,941			634,448		
Net Interest Margin	637,611	20,080	3.15%	623,015	19,454	3.12%

(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 of 34% and a state tax of 6.25%

(5) Net of SFAS 107 Market Value.

Rate Sensitivity Analysis As of December 31, 2016

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)	70,056	12,371	60,655	68,816	180,176	35,082
Investment Securities (2)	22,999	39,987	40,878	10,266	0	3,052
Federal Funds Sold	70,000	0	0	0	0	0
Total Selected Assets	163,055	52,358	101,533	79,082	180,176	38,134
LIABILITIES						
Interest Bearing Deposits (3)	150,691	122,291	69,998	7,805	0	0
Borrowed Funds	0	0	0	0	0	0
Total Selected Liabilities	150,691	122,291	69,998	7,805	0	0
Differences	12,363	(69,933)	31,535	71,278	180,176	38,134
Cumulative Differences	12,363	(57,570)	(26,035)	45,243	225,418	263,553

(1) Does not include loans on nonaccrual status.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

Summary

Putnam Bancshares, Inc., and its wholly-owned subsidiary Putnam County Bank, through the year of 2016 enjoyed a successful year in light of a continued challenging economic environment.

The year of 2016 witnessed a change in political administration in national and state governments.

Voters sought changes in national government as a response to discontent in the direction of the economy, for one. Many promises have been made by the new administration in areas of infrastructure, employment and trade. The new administration also desires to change income taxes and healthcare. These changes will require the cooperation of Senate and Congress, which has been hesitant. As a result, improvement in the national economy has been inconsistent up to the first quarter of 2017. While the national economy continues to show improvement since the financial crisis of 2008, confidence in the direction of the economy is not complete. This is illustrated in new home building and automobile sales. The Federal Reserve Board made one adjustment to its Discount Rate by .25% in December of this year, matching a similar increase in December of 2015. In March of 2017, the Board increased the Discount Rate by .25%. While it has been said additional adjustments may be made in 2017, Fed leadership looks for confirmation from economic indicators before further action is made. The new administration is also targeting relief from regulation in the banking industry. Close review of regulations will focus on necessity to protect financial markets and consumers in a reasonable manner.

Statewide, the economy has its own set of challenges. The continued impact of the coal industry on the state is undeniable. The loss of coal severance revenue affects the entire state leading to multi-million dollar deficits and forcing all areas of government to be viewed for potential cuts. State government has already ordered budget cuts directly affecting all Boards of Education in the state, as well as state universities. The picture in coal mining areas of the state continues to be challenging as county governments deal with job loss and declining revenue sources. The new administration touts building new infrastructure as a priority in the state, but financing major projects will be challenging.

The average annual unemployment rate for West Virginia was 6.0% in 2016 compared to 6.7% in 2015. The monthly state unemployment rate in 2016 ranged from a high of 6.3% in January and February to 5.8% in November and December. The state unemployment rate in December was the 14th highest in the nation in March of 2017. The unemployment rate for Putnam County was 4.9% for March of 2017. The surrounding counties of Kanawha (5.0%) and Cabell (4.5%) had relatively comparable unemployment rates in March of 2017 while Mason (6.8%) and Lincoln (7.4%) were relatively higher than Putnam.

The national monthly unemployment rate during 2016 fell from 4.9% in January and February to 4.7% in December.

The following description of the operating income and financial condition of Putnam Bancshares, Inc. (referred throughout as "the Company") should be read in conjunction with the Consolidated Balance Sheets, Statements of Income, Changes in Shareholders' Equity, Statements of Cash Flows, and Notes to Consolidated Financial Statements (beginning on page F-10 and ending on page F- 45). 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, 2016 there were 1,223 banks in this group. 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 in 2016. 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 increased slightly from 3.12% in 2015 to 3.15% in 2016. The peer's net interest margin was 3.74% in 2015 and 3.76% in 2016. The increase in margin was a result of an increase in mortgage loan yields compared with costs of large time deposits. Among other earning assets, investment yields continued to be lower than peer yields due to the investment portfolio's composition of U. S Government and Agency securities which are generally higher quality and lower risk. The Company's cost of funds was .98% in 2016 compared with .91% in 2015. The cost of funds is calculated by dividing the interest expense by the annual average of total deposits. The peer group's cost of funds increased slightly from .48% in 2015 to .49% in 2016. The yield on earning assets changed slightly from 3.83% in 2015 to 3.91% in 2016. Total loan yields declined slightly from 5.23% in 2015 to 5.21% in 2016. The yield on investment securities declined from 1.35% in 2015 to 1.24% in 2016.

Interest Income

Interest income increased nearly $1 million from year-end 2015 to year-end 2016. The Federal Reserve Open Market Committee (FOMC) held the federal funds target rate between .25% and .50% through December when the rate was increased by .25%. The Bank had 18% of its loan portfolio indexed to the Wall Street Journal prime rate as of year-end 2016. Average total loans increased $19 million during 2016. This compares with an increase of $50 million during the year of 2015. The lending group continues to focus on providing effective credit services to our market area. Total income from loans increased $1 million in 2016 compared with an increase of nearly $2.5 million in 2015. The decline is largely driven by volume of lending during the year. The Company's average earning assets increased $14.6 million in 2016 compared with an increase of $7.5 million in 2015. The income on average earning assets increased $1 million in 2016 contrasting an increase of $2 million in 2015.

Average total real estate loans increased $8 million in 2016 compared with an increase of $34 million in 2015. Interest income on real estate loans increased $761 thousand in 2016 compared with an increase of $1.7 million in 2015. The growth in volume in real estate lending has slowed some in 2016. Residential development has started to slow in in our local market. The Bank continues to promote 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 grew $212 thousand in 2016 compared with $656 thousand in 2015. Average total commercial loans increased nearly $12 million in 2016 compared with $15 million in 2015. The earnings on commercial lending reflected the decline in volume.

Income on consumer lending increased $47 thousand in 2016 compared with $142 thousand in 2015. The average total of consumer loans increased $1.4 million in 2016 compared with an increase of $697 thousand in 2015. Consumer lending continues to be highly competitive, especially with automotive finance units. The Bank continues to compete in this area through cross-selling existing customers and effective service.

Income on investments (on a tax effective basis) declined $84 thousand in 2016 compared to a decline of $460 thousand in 2015. In addition, average total investments increased $4 million in 2016 compared with a decline of $36 million in 2015. The change in income reflects a continued low interest rate environment. The Company's tax equivalent yield on investments declined from 1.35% in 2015 to 1.24% in 2016. The Bank's yield on investments continues to be lower than peer institutions. At year-end 2016, the investment portfolio was 96%

composed of U. S. Treasury and U. S. Federal Agency securities. The Bank has invested in three-month to one year 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. In periods of rising interest rates, these new Bills purchases will reflect prevailing market rates. The income on Federal Funds Sold at year-end 2016 increased $96 thousand compared with a decline of $2 thousand at the end of 2015 with average balances decreasing $10 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 2016, all municipal investments are West Virginia securities. Each municipal security is reviewed at least annually by an independent investment analysis company to assess their repayment ability and creditworthiness. The Bank held two municipal issues with a total carrying value of $3,135,000 at the end of 2016. These issues are revenue securities. In reports dated February 8, 2017, the investment company rated the issues as "investment grade". As of December 31, 2016, none of the municipal issues are known to be financially impaired.

Interest Expense

Interest expense on deposits increased $420 thousand from year-end 2015 to 2016 compared with a decline of $454 thousand from year-end 2014 to 2015. The cost on total deposits was .98% for 2016 representing an increase of seven basis points from 2015. For our peer group, the cost is .49% for 2016 representing a one basis point from 2015. 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 over $12 million in 2016 compared with no change between 2014 and 2015. The low market rate environment as a result of only limited action by the Federal Reserve on the discount rate has caused rates to remain low during 2016. Effective deposit pricing is important to ensure funding for lending and investment purposes, while also maintaining adequate margins. Management continues to monitor the effects of its strategies with net interest margins on a regular basis. The Bank has elected its deposit pricing strategy for its local market and 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. 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 F-3) 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 that will affect prepayments and withdrawals are discussed in the ALCO meetings.

There exist several sources of liquidity. The Bank's loan-to-deposit ratio was 78% in 2016 and 79% in 2015. The peer group ratio was 81% in 2016 and 80% in 2015. 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 2016, the ratio was 21% compared with 28% at year-end 2015. The ratio is above the peer group ratio of 14% in 2016 and 15%

in 2015. While the ratio tends to be high, the Bank maintains ample sources of liquidity.

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 2016 was $18.8 million or 4.27% of total loans compared with $4.3 million or .98% of total loans at year-end 2015. This compares with peer ratios of .79% and .87% respectively.

Loans in nonaccrual status increased to $15.5 million at the end of 2016 from $4.1 million at the end of 2015. At the end of 2016, 96% of the loans in nonaccrual states are comprised of four local borrowers. The borrowers consist of a real estate contractor/management company ($5.5 million); a residential real estate developer/contractor ($4.3 million); a local non-profit agency ($3 million); and a real estate management company ($2.1 million). The Bank maintains valid lien positions in marketable properties in these situations securing its loans and is working with these entities for repayment.

Loans which are past due ninety days or more increased from $155 thousand at year-end 2015 to $3.2 million at year-end 2016. At year-end 2016, approximately $2.3 million of the loans in this category had matured and were awaiting renewal. The Bank had changed management of its loan administration and credit analysis areas during 2016 and management of renewals has improved in 2017.

The Bank had a balance of $3.9 million in other real estate owned at year-end 2016 compared with $3.1 million in 2015. The most significant portion is a commercial real estate development in Winston-Salem, NC ($2.5 million) to the Bank. This property is being managed by a professional company and the Bank is confident in its future prospects.

Provision and Allowance for Loan Losses

The Bank made provisions to the allowance for loan losses of $4.8 million in 2016 and $200 thousand in 2015. A significantly higher provision was deemed necessary due to higher risk in the loan portfolio as evidenced by higher nonperforming loans in 2016. Loan loss recoveries in 2016 totaled $21 thousand compared with $53 thousand in 2015. Gross loan losses were $682 thousand in 2016 from $945 thousand in 2015. The highest single loss in 2016 was a local medical clinic for $207 thousand and the Bank is receiving recovery payments. Net loan losses were $661 thousand in 2016 and $892 thousand in 2015. The Bank's ratio of net loss to average total loans was .15% for 2016 compared to .11% for the peer group. As of year-end 2016, the allowance for loan loss was $7.2 million or 1.64% of total loans compared to $3.1 million or .71% of total loans at year-end 2015. The peer ratios of allowance to total loans were 1.30% in 2016 and 1.35% in 2015. The Bank's ratios are higher than peer due to elevated levels of nonperforming and past due loans. The allowance level is reflective of many factors including loss history, risk characteristics, underwriting practices and local economic conditions. 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 including all 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 auditor, external auditors, Federal Reserve Bank, and the West Virginia Division of Financial Institutions.

Noninterest Income

Total noninterest income (excluding gross securities gains) totaled $621 thousand in 2016 representing a decline of $19 thousand over 2015. Income from rental of other real estate decreased by $12 thousand by lower income received from the Winston-Salem, NC other real estate project. The Bank recognized a gain on the sale of other real estate of $90 thousand during 2016 compared with $9 thousand in 2015. Declines in nonsufficient check and overdraft charges were offset by increases in VISA debit card income. 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 2016, the percentage of noninterest income to average assets for the Bank is .10% compared to the peer ratio of .76%. In 2015, the Bank's ratio was .09% with the peer ratio being .76%.

Equity in earnings of the subsidiary was $44 thousand in 2016 and $64 thousand in 2015. 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 $425 thousand from year-end 2015 to year-end 2016 compared with a decrease of $363 thousand between years ending 2014 and 2015. Noninterest expenses are composed of expenses relating to personnel, occupancy, and other operating expenses. Total noninterest expense to average assets was 1.39% in 2016 compared with 1.35% in 2015. The peer group ratios showed 2.84% in 2016 and 2.86% in 2015. Earnings historically have benefitted from lower noninterest expenses, relative to the Bank's size.

Total personnel expenses increased by $408 thousand in 2016 compared with a increase of $395 thousand in 2015. The most significant personnel expense increase was found in salaries as a result of staff additions and increases to existing personnel. Reductions in retirement expense offset increases in health insurance expense. Retirement expense had previous had a history of increases. 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 responsible for maintenance requirements of the frozen retirement plan. The Bank's personnel costs as a percentage of average assets compare favorably. At the end of 2016, the Bank's ratio was .83% compared with the peer bank ratio of 1.61%.

Total occupancy expense includes the costs to maintain the Bank's premises and equipment. These expenses declined by $143 thousand in 2016 in contrast to an increase of $139 thousand in 2015 compared with 2014. Significant expenses in 2015 included the retrofitting of lighting from florescent to LED lighting in several buildings ($82 thousand), parking area repairs ($32 thousand) and replacement of drive-in window drawers at the Main Bank ($18 thousand). The Bank's occupancy expense as a percentage of average assets was .06% in 2016 compared with .34% for peer banks. The Bank continues to operate facilities 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 $245 thousand from 2015 to 2016. FDIC insurance expense increased by $318 thousand in 2016. The reason for the increase is due to a change in accounting for insurance premiums which was completed at year-end 2016 in addition to changes in size of the Bank and risk. Expenses related to our core data processing provider represents the second largest expense item in this category and expenses in this area increased $8 thousand from 2015 to 2016. 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 2016, the Bank's ratio of other operating expenses to average assets was .51% compared with the peer's ratio of .88%.

The Bank recognized a net gain of $8 thousand in 2016 from the sale of securities compared with a net gain of $70 thousand in 2015. 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 declined $1.9 million in 2016 due to higher level of deferred tax credits from increased provisions to the allowance for loan loss.

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

Equity and Capital Ratios

Putnam Bancshares' equity increased $2.8 million or 3% to $89 million. The change in equity during 2016 was reflective of $4.5 million in net income less $1.7 million in dividends. There was relatively no change in comprehensive income considering unrealized gains and losses on available for sale securities and unrealized gains and losses on pension plan. The book value per outstanding share increased from $143.52 in 2015 to $148.22 in 2016. The Company's net income as a percentage of average equity was 5.10% in 2016. Peer banks in 2016 posted net income as a percentage of average equity of 9.86%

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 2016, the Bank's Tier 1 risk-based capital-to-total risk-weighted assets ratio was 22.74% compared to 22.50% in 2015. The peer bank ratios were 14.24% and 14.31% in 2016 and 2015 respectively. As of year-end 2016, the Bank's total risk-based capital-to-total risk-weighted assets ratio was 23.99% compared to 23.28% in 2015. The peer bank ratios were 15.36% and 15.43% in 2016 and 2015 respectively. Both measures rank the Bank in the 93rd percentile in comparison with peers. Using the federal guidelines for capital adequacy, these ratios suggest the Bank is well-capitalized.

Dividends

The Company paid dividends of $1.7 million in 2016 and $1.6 million in 2015. This equates to a dividend payout (dividends to net income) ratio of 38% in 2016 and 22% in 2015. The peer Bank ratio for 2016 was 39% and 37% in 2015. Regular dividends were paid in June and December of 2016.

For a further discussion of dividends, please refer to "Note 13 – Regulatory Matters" and the Consolidated Statements of Changes in Shareholders' Equity in the Consolidated Financial Statements.

Statement of Management Responsibility

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

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

The Audit Committee of Putnam County Bank, composed solely of outside directors, meets on a quarterly basis to review various issues relating to audit, including coverage, findings, and responses. In 2016, the selection of Hess, Stewart and Campbell, PLLC as the Company's external auditors was recommended by the Board of Directors and ratified by the shareholders of Putnam Bancshares, Inc.

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying consolidated financial statements of Putnam Bancshares, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, 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 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free of 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 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, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Hess, Stewart & Campbell, PLLC

Huntington, West Virginia
March 16, 2017

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2016 AND 2015

ASSETS	2016	2015
Cash and due from banks	$ 17,099,705	$ 18,912,350
Federal funds sold	70,000,000	56,000,000
Cash and cash equivalents	87,099,705	74,912,350
Investment securities available-for-sale, at fair value	70,260,008	83,197,813
Investment securities held-to-maturity, at amortized cost	47,883,320	38,952,728
Federal Reserve Bank stock, at cost	39,000	39,000
Loans	443,121,190	436,281,619
Allowance for loan losses	(7,251,008)	(3,081,205)
Net loans	435,870,182	433,200,414
Bank premises and equipment, net	567,201	507,914
Other real estate owned	3,913,555	3,124,820
Accrued interest receivable	1,737,824	1,643,561
Other assets	4,502,902	2,715,634
TOTAL ASSETS	$ 651,873,697	$ 638,294,234
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest-bearing	$ 60,089,407	$ 58,168,505
Interest-bearing	497,698,940	489,447,793
Total deposits	557,788,347	547,616,298
Accrued interest payable	1,197,192	1,071,599
Other liabilities	3,957,682	3,491,964
TOTAL LIABILITIES	562,943,221	552,179,861
STOCKHOLDERS' EQUITY		
Common stock, $0.50 par value, 1,200,000 shares authorized, 600,000 shares issued and outstanding	300,000	300,000
Additional paid-in capital	1,000,000	1,000,000
Retained earnings	90,254,759	87,445,462
Accumulated other comprehensive income	(2,624,283)	(2,631,089)
TOTAL STOCKHOLDERS' EQUITY	88,930,476	86,114,373
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 651,873,697	$ 638,294,234

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
INTEREST INCOME		
Interest and fees on loans	$ 23,196,695	$ 22,177,258
Interest and dividends on investment securities:		
Available-for-sale	1,320,254	1,589,561
Held-to-maturity	217,829	32,614
Federal Reserve Bank	37,041	22,518
Interest on federal funds sold	156,294	59,859
Total interest income	24,928,113	23,881,810
INTEREST EXPENSE		
Interest on deposits	4,848,133	4,428,263
NET INTEREST INCOME	20,079,980	19,453,547
PROVISION FOR LOAN LOSSES	4,830,950	200,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	15,249,030	19,253,547
NONINTEREST INCOME		
Service fees	372,046	363,579
Securities gains	8,302	69,773
Rental income	196,957	208,508
Other income	52,435	68,030
Total noninterest income	629,740	709,890
NONINTEREST EXPENSES		
Salaries and employee benefits	5,363,626	4,955,836
Equipment and occupancy expenses	389,930	533,241
Data processing	1,005,691	944,362
Insurance	710,127	394,631
Professional fees	298,534	247,699
Other real estate operational losses	28,215	399,545
Other expenses	1,174,531	1,070,286
Total noninterest expenses	8,970,654	8,545,600
INCOME BEFORE INCOME TAX	6,908,116	11,417,837
INCOME TAX EXPENSE	2,418,819	4,369,544
NET INCOME	$ 4,489,297	$ 7,048,293

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Net income	$ 4,489,297	$ 7,048,293
Other comprehensive income:		
Unrealized (losses) gains on available-for-sale securities, net of income taxes of $28,884 in 2016 and $74,336 in 2015	(49,947)	(128,547)
Reclassification adjustment for gains realized, net of income taxes of $3,042 in 2016 and $25,564 in 2015	(5,260)	(44,208)
Change in underfunded pension liability, net of income taxes (benefit) of $35,861 in 2016 and $195,738 in 2015	62,013	338,481
Other comprehensive income, net of tax	6,806	165,726
Comprehensive income	$ 4,496,103	$ 7,214,019

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2016 AND 2015

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
BALANCE, December 31, 2014	$ 300,000	$ 1,000,000	$ 82,017,169	$ (2,796,815)	$ 80,520,354
Net income	-	-	7,048,293	-	7,048,293
Other comprehensive income	-	-	-	165,726	165,726
Dividends, $2.70 per share	-	-	(1,620,000)	-	(1,620,000)
BALANCE, December 31, 2015	300,000	1,000,000	87,445,462	(2,631,089)	86,114,373
Net income	-	-	4,489,297	-	4,489,297
Other comprehensive income	-	-	-	6,806	6,806
Dividends, $2.80 per share	-	-	(1,680,000)	-	(1,680,000)
BALANCE, December 31, 2016	$ 300,000	$ 1,000,000	$ 90,254,759	$ (2,624,283)	$ 88,930,476

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 4,489,297	$ 7,048,293
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	68,295	61,792
Deferred income taxes (benefits)	(1,670,319)	472,958
Provision for loan losses	4,830,950	200,000
Equity in earnings of unconsolidated subsidiary, net of distributions	777	(13,190)
Net premium amortization on investment securities	483,964	800,626
Gain on sale of securities	(8,302)	(69,773)
Loss on sale of OREO	7,626	58,011
Change in carrying value in OREO	-	332,680
(Increase) decrease in:		
Interest receivable	(94,263)	83,499
Other assets	(121,661)	116,654
Increase (decrease) in:		
Interest payable	125,593	127,329
Other liabilities	563,592	127,664
NET CASH PROVIDED BY OPERATING ACTIVITIES	8,675,549	9,346,543
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of available-for-sale securities	17,289,994	38,309,702
Purchases of available-for-sale securities	(5,132,813)	(5,116,699)
Proceeds from maturities of held-to-maturity securities	88,000,000	64,000,000
Purchases of held-to-maturity securities	(96,712,763)	(68,924,605)
Purchases of bank premises and equipment	(127,582)	(13,605)
Proceeds from sale of other real estate owned	2,317,542	199,786
Purchases of other real estate owned	-	(950,000)
Net increase in loans	(10,614,621)	(29,361,007)
NET CASH USED IN INVESTING ACTIVITIES	(4,980,243)	(1,856,428)

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	$ 8,404,738	$ 2,537,169
Net increase in time deposits	1,767,311	6,776,480
Cash dividends paid	(1,680,000)	(1,620,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	8,492,049	7,693,649
NET CHANGE IN CASH AND CASH EQUIVALENTS	12,187,355	15,183,764
CASH AND CASH EQUIVALENTS, BEGINNING	74,912,350	59,728,586
CASH AND CASH EQUIVALENTS, ENDING	$ 87,099,705	$ 74,912,350
SUPPLEMENTAL DISCLOSURES		
Cash paid for interest on deposits and borrowings	$ 4,722,540	$ 4,300,934
Cash paid for income taxes	$ 3,789,953	$ 3,980,071
SUPPLEMENTAL SCHEDULE OF NONCASH ACTIVITIES		
Loans transferred to foreclosed properties	$ 3,113,903	$ 80,357

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. NATURE OF OPERATIONS AND 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 commercial, real estate and consumer loans and deposit services principally to individuals and 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.

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

Use of estimates: The preparation of consolidated 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 as the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, the fair value of financial instruments and defined benefit plan obligations and expenses. 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, business assets and consumer 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 the consolidated statements of cash flows, cash and due from banks includes cash on hand, cash items in process of clearing, federal funds sold, and amounts due from correspondent banks.

Securities: Debt securities are classified as "held-to-maturity", "available-for-sale", or "trading" according to management's intent. The appropriate classification is determined at the time of purchase of each security and re-evaluated at each reporting date.

Securities held-to-maturity: Debt securities for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts using methods approximating the interest method.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Securities available-for-sale: Securities not classified as "held-to-maturity" or as "trading" 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 reported at fair value, net of unrealized gains or losses, which are adjusted for applicable income taxes and reported as other comprehensive income.

Trading securities: There are no securities classified as "trading" in the accompanying financial statements.

Any security that has experienced a decline in value, which management deems 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 sales of securities are recognized using the specific-identification method. Amortization of premiums and accretion discounts are computed using the effective interest rate method.

Investment in limited liability company: The Company entered into an agreement with other individuals 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 15 for additional information.

Loans: The Bank's primary market is Putnam County, West Virginia and surrounding areas. The Bank grants commercial, real estate and consumer loans to its customers, most of whom are located within the Bank's primary market. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the Bank's primary market economic conditions, particularly in the real estate sector. The concentration of credit in the regional economy is taken into consideration by management in determining the allowance for loan losses.

Loans are either secured or unsecured based on the type of loan and the financial condition of the borrower. The loans are generally expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrower; however, the Bank is exposed to risk of loss on any or all loans due to the borrower's difficulties, which can arise from any number of factors including problems within the respective industry or economic conditions within the Bank's primary market.

Loans are stated at the amount of unpaid principal, reduced by unearned discount and an allowance for loan losses. Interest is accrued daily on the unpaid principal balance.

Generally, loans are placed on nonaccrual status when principal or interest is greater than 90 days past due based upon the loan's contractual terms, unless such loans are well secured and in the process of collection. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt. Interest on nonaccrual loans is recognized primarily using the cost-recovery method.

Loans may be returned to accrual status when all principal and interest amounts contractually due are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

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

Off-balance sheet financial instruments: In the ordinary course of business, the Bank enters 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 consolidated financial statements when they are funded or related fees are incurred or received.

Bank premises and equipment: Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily on the straight-line method for Bank premises and equipment over the estimated useful lives of the respective assets as follows:

Buildings and improvements	10-40 years
Equipment, fixtures and vehicles	3-10 years

Repairs, maintenance and minor improvements are charged to occupancy and equipment expense as incurred. Major improvements and additions to premises and equipment are capitalized. Gains or losses on disposition, if any, are included in current operations.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Other real estate owned: Other real estate owned consists of real estate held for sale which was acquired through foreclosure on loans secured by such real estate. At the time of acquisition, these properties are recorded at the lower of cost or appraised market value with any write down being charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated selling costs. Revenues and expenses incurred in connection with operating these properties and any direct write downs are included in net cost of operations of other real estate in the Consolidated Statements of Income.

Bank-owned life insurance: The Bank purchased a life insurance policy on a key executive. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Advertising costs: Advertising costs are expensed as incurred and included in other operating expenses. Advertising expense was $161,981 and $142,663 for the years ended December 31, 2016 and 2015, respectively.

Compensated absences: Compensated absences have not been accrued since they cannot be reasonably estimated due to restrictions on usage. The Bank recognizes the cost of compensated absences when actually paid.

Employee benefit plans: The Bank accounts for its defined benefit plan in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 715, *Employer's Accounting for Pensions*. See Note 9 for additional information.

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.

Income taxes: Putnam Bancshares, Inc. and its subsidiary file a consolidated federal income tax return. 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 bases of the allowances for loan losses, unfunded pension liability and unrealized gains/losses on available-for-sale securities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the deferred tax assets or liabilities are expected to be settled or realized. Valuation allowances are established when deemed necessary to reduce deferred tax assets to the amount expected to be realized within a short term.

Other comprehensive income: Accounting principles generally require that recognized revenue, expenses, and gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and amortization of deferred gains and losses associated with the Company's pension plan, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of other comprehensive income. The components of other comprehensive income and related tax effects are presented within the Consolidated Statements of Comprehensive Income.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

Earnings per share: Earnings per share represent income available to common shareholders divided by the weighted average number of common shares outstanding during the period.

		2016		2015
Net income	$	4,489,297	$	7,048,293
Earnings per common share	$	7.48	$	11.75
Divdends paid per common share	$	2.80	$	2.70

Reclassifications: Certain reclassifications have been made to prior year's financial statements to place them on a basis comparable with the current year.

Date of management's review of subsequent events: Management has evaluated subsequent events through March 16, 2017, the date which the financial statements were available to be issued.

Recent accounting pronouncements: The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting and/or disclosure of financial information by the Company.

In January 2016, The FASB issued 2016-01, Financial Instruments – Overall. The amendments in this Update target improvements to generally accepted accounting principles (GAAP) and affect all entities that hold financial assets or owe financial liabilities. The improvements related to nonpublic entities are (1) require equity investments to be measured at fair value with changes in fair value recognized in net income, (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities, (4) require an entity to present separately in other comprehensive income the portion of the total charge in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (5) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements, and (6) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this Update are effective for fiscal years beginning after December 15, 2017, and are not expected to have a material impact on the Company's financial statements.

In February 2016, The FASB issued 2016-02, Leases. The FASB is issuing this Update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Leasing is utilized by many entities. It is a means of gaining access to assets, of obtaining financing, and/or of reducing an entity's exposure to the full risks of asset ownership. The prevalence of leasing, therefore, means that it is important that users of financial statements have a complete and understandable picture of an entity's leasing activities. Previous leases accounting was criticized for failing to meet the needs of users of financial statements because it did not always provide a faithful representation of leasing transactions. In particular, it did not require lessees to recognize assets and liabilities arising from operating leases on the balance sheet. As a result, there had been long-standing requests from many users of financial statements and others to change the accounting requirements so that lessees would be required to recognize the rights and obligations resulting from leases as assets and liabilities. The amendments in this Update are effective for fiscal years ending after December 15, 2019, and are being evaluated for any material impact on the Company's financial statements.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (continued)

In June 2016, the FASB issued 2016-13, Financial Instruments – Credit Losses. The amendments in this update affect entities holding financial assets and net investments in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this Update affect an entity in varying degrees depending on the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. There is diversity in practice in applying the incurred loss methodology, which means that before transition some entities may be more aligned, under current GAAP, than others to the new measure of expected credit losses. The amendments in this Update are effective for fiscal years beginning after December 15, 2020, and are being evaluated for any material impact on the Company's financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

NOTE 2. RESTRICTIONS ON CASH AND DUE FROM BANKS

Certain reserves are required to be maintained at the Federal Reserve Bank. The requirement as of December 31, 2016 and 2015 was $6,800,000 and $7,141,000, respectively. At December 31, 2016 and 2015, the Bank had accounts at correspondent banks, excluding the Federal Reserve Bank, which exceeded the FDIC insurable limit of $250,000 by $2,317,819 and $1,450,972, respectively.

NOTE 3. SECURITIES

The amortized gains, unrealized losses and estimated fair values of securities at December 31, 2016 and 2015, are as follows:

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government treasuries	$ 10,124,782	$ 44,148	$ (7,800)	$ 10,161,130
U.S. Government agencies	55,790,629	294,766	-	56,085,395
Municipal bonds	3,135,000	48,794	(131,500)	3,052,294
Mutual funds	1,000,000	-	(38,811)	961,189
Total available-for-sale	$ 70,050,411	$ 387,708	$ (178,111)	$ 70,260,008
Held-to-maturity:				
U.S. Government treasuries	$ 47,883,320	$ 3,365	$ (7,740)	$ 47,878,945

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. SECURITIES (continued)

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Government treasuries	$ 10,154,036	$ 36,185	$ (20,302)	$ 10,169,919
U.S. Government agencies	66,326,494	330,161	-	66,656,655
Municipal bonds	5,420,554	110,493	(136,500)	5,394,547
Mutual funds	1,000,000	-	(23,308)	976,692
Total available-for-sale	$ 82,901,084	$ 476,839	$ (180,110)	$ 83,197,813
Held-to-maturity:				
U.S. Government treasuries	$ 38,952,728	$ 5,950	$ (2,746)	$ 38,955,932

The following table shows the proceeds from maturities, sales, and calls of available for sale securities and the gross realized gains and losses on those sales. Gains and losses are computed using the specific-identification method.

	2016	2015
Proceeds from maturities, sales and calls	$ 2,278,041	$ 38,515,863
Gross realized gains	$ 8,302	$ 169,469
Gross realized losses	$ -	$ 99,696

The scheduled maturities of securities at December 31, 2016, by contractual maturity, 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 prepayment penalties.

	Available-for-sale securities		Held-to-maturity securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$ 15,090,291	$ 15,102,240	$ 47,883,320	$ 47,878,945
Due after one year through five years	50,825,120	51,144,285	-	-
Due after five years through ten years	-	-	-	-
Due after ten years	4,135,000	4,013,483	-	-
Totals	$ 70,050,411	$ 70,260,008	$ 47,883,320	$ 47,878,945

At December 31, 2016 and 2015, the carrying value of securities pledged to secure public funds totaled $75,910,000 and $75,840,000, respectively. At December 31, 2016 and 2015, the estimated fair values totaled $77,110,040 and $77,284,742, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. SECURITIES (continued)

Impairment is evaluated considering numerous factors, and their relative significance varies from case to case. Factors considered include the length of time and extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer; and the intent and ability to retain the security in order to allow for an anticipated recovery in market value. If, based on the analysis, it is determined that the impairment is other-than-temporary, the security is written down to fair value, and a loss is recognized through earnings. There were no other-than-temporary impairment losses for the years ended December 31, 2016 and 2015.

The Bank had 4 available-for-sale securities and 20 held-to-maturity securities with an unrealized loss position at December 31, 2016. These securities are predominately rated investment grade securities and the unrealized losses are due to overall market interest rate fluctuations and 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, 2016.

The following table summarizes the fair value and gross unrealized losses of securities, aggregated by major investment category and length of time that individual securities have been in a continuous unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
December 31, 2016						
Available-for-sale:						
U.S. Government treasuries	$ -	$ -	$ 5,122,070	$ (7,801)	$ 5,122,070	$ (7,801)
U.S. Government agencies	-	-	-	-	-	-
Municipal bonds	-	-	1,183,500	(131,500)	1,183,500	(131,500)
Mutual funds	-	-	961,189	(38,811)	961,189	(38,811)
Total available-for-sale	$ -	$ -	$ 7,266,759	$ (178,112)	$ 7,266,759	$ (178,112)
Held-to-maturity:						
U.S. Government treasuries	$ 23,925,923	$ (7,740)	$ -	$ -	$ 23,925,923	$ (7,740)

	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
December 31, 2015						
Available-for-sale:						
U.S. Government treasuries	$ 5,140,820	$ (20,302)	$ -	$ -	$ 5,140,820	$ (20,302)
U.S. Government agencies	-	-	-	-	-	-
Municipal bonds	-	-	1,228,500	(136,500)	1,228,500	(136,500)
Mutual funds	-	-	976,692	(23,308)	976,692	(23,308)
Total available-for-sale	$ 5,140,820	$ (20,302)	$ 2,205,192	$ (159,808)	$ 7,346,012	$ (180,110)
Held-to-maturity:						
U.S. Government treasuries	$ 16,981,963	$ (2,746)	$ -	$ -	$ 16,981,963	$ (2,746)

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. SECURITIES (continued)

Restricted investments, at cost

Federal Reserve Bank stock, which represents a required investment in the common stock of the Federal Reserve Bank (FRB), is carried at cost as a restricted long-term investment at December 31, 2016 and 2015. The balance for FRB stock at December 31, 2016 and 2015 totaled $39,000.

NOTE 4. LOANS

The following table summarizes the components of the Bank's loan portfolio as of December 31, 2016 and 2015:

	2016	2015
Loans		
Commercial	$ 141,151,557	$ 151,327,223
Real estate	229,666,242	223,034,866
Construction	49,490,186	41,642,018
Other	22,813,317	20,278,070
Gross loans	443,121,302	436,282,177
Less unearned interest on installment loans	(112)	(558)
Total loans	443,121,190	436,281,619
Less allowance for loan losses	(7,251,008)	(3,081,205)
Loans, net	$ 435,870,182	$ 433,200,414

A summary of risk characteristics by loan portfolio classification follows:

Commercial: This portfolio consists of nonresidential improved real estate, which includes shopping centers, office buildings, etc. New loans in this portfolio are typically balloon loans with initial fixed rate terms of five years and generally have an original loan-to-value ("LTV") of 85% or less. These properties are generally located in the Bank's normal lending area.

Real Estate: This portfolio primarily consists of owner-occupied, full documentation loans secured by properties in the Bank's normal lending area. New loans in this portfolio are typically balloon mortgages with an initial fixed rate terms of 10 years and generally have an original LTV of 90% or less.

Construction: This portfolio consists of residential and commercial construction loans. Loans in this portfolio are typically set for an interest only period of 12 months, during construction phase. Rates are typically prime plus 2% and usually have a set floor of 5%.

Other: This portfolio consists of loans that are unsecured, secured by automobiles, or secured by deposit accounts. This portfolio is generally granted to local customers only.

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 table below. Past due loans are examined to identify loans for non-accrual 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.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS (continued)

The following tables present the contractual aging of the recorded investment in past due loans as of December 31, 2016 and 2015:

December 31, 2016							
	Past due						Recorded investment >90 days and accruing
Dollars in thousands	30-59 Days	60-89 Days	> 90 Days	Total	Current	Total loans	
Commercial	$ 5,680	$ 4,082	$ 1,390	$ 11,152	$ 130,000	$ 141,152	$ 802
Real estate	6,259	1,972	2,417	10,648	219,018	229,666	2,007
Construction	3,340	430	4,503	8,273	41,217	49,490	547
Other	431	453	4	888	21,925	22,813	4
Totals	$ 15,710	$ 6,937	$ 8,314	$ 30,961	$ 412,160	$ 443,121	$ 3,360

December 31, 2015							
	Past due						Recorded investment >90 days and accruing
Dollars in thousands	30-59 Days	60-89 Days	> 90 Days	Total	Current	Total loans	
Commercial	$ 6,077	$ 345	$ 3,218	$ 9,640	$ 141,687	$ 151,327	$ 37
Real estate	2,871	149	591	3,611	219,424	223,035	118
Construction	765	-	-	765	40,877	41,642	-
Other	106	25	-	131	20,147	20,278	-
Totals	$ 9,819	$ 519	$ 3,809	$ 14,147	$ 422,135	$ 436,282	$ 155

The following table presents the non-accrual loans included in the net balance of loans at December 31, 2016 and 2015, respectively.

	2016	2015
Commercial	$ 6,379,000	$ 3,528,659
Real estate	4,378,982	577,221
Construction	4,751,312	-
Other	56,483	-
Totals	$ 15,565,777	$ 4,105,880

If interest on non-accrual loans had been accrued, such income would have approximated $584,422 and $197,736 for the years December 31, 2016 and 2015, respectively.

Loans are categorized 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. The Bank assigns credit quality indicators of pass, special mention, substandard, and doubtful to its loans. The following definitions are used for risk grades:

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS (continued)

Pass: Loans in this category are characterized by borrowers with an average to strong financial condition, sufficient cash flows to service the debt, and repayment history is satisfactory.

Special Mention: Special mention loans have potential weaknesses that deserve management's attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects.

Substandard: A substandard loan is inadequately protected by the sound worth and paying capacity of the borrower or the collateral pledged. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual assets. They require more intensive supervision by management.

Doubtful: Doubtful loans have all the weaknesses inherent in substandard loans, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. These are poor quality loans in which neither the collateral, if any, nor the financial condition of the borrower ensure collectability in full. Loans classified as doubtful are considered impaired.

The following tables present loans based upon the internal risk ratings by class:

	December 31, 2016				
	Commercial	Real estate	Construction	Other	Total
Pass	$ 116,349,424	$ 213,008,737	$ 40,851,511	$ 22,098,829	$ 392,308,501
Special mention	8,445,348	5,188,748	6,154,936	501,694	20,290,726
Substandard	16,356,785	11,468,757	2,483,739	212,682	30,521,963
Doubtful	-	-	-	-	-
Totals	$ 141,151,557	$ 229,666,242	$ 49,490,186	$ 22,813,205	$ 443,121,190

	December 31, 2015				
	Commercial	Real estate	Construction	Other	Total
Pass	$ 128,396,365	$ 206,913,194	$ 37,960,846	$ 19,769,257	$ 393,039,662
Special mention	3,959,761	6,111,875	2,368,957	312,146	12,752,739
Substandard	18,971,097	10,009,797	1,312,215	196,109	30,489,218
Doubtful	-	-	-	-	-
Totals	$ 151,327,223	$ 223,034,866	$ 41,642,018	$ 20,277,512	$ 436,281,619

In the normal course of business, the Bank makes loans to directors, executive officers, stockholders and their affiliates on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other customers and did not, in the opinion of management, involve more than the normal credit risk.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS (continued)

The following presents the activity with respect to loans to related parties for 2016 and 2015:

	2016	2015
Balances - January 1,	$ 12,458,445	$ 12,212,339
New loans	1,095,512	767,315
Repayments	(1,379,954)	(521,209)
Balances - December 31,	$ 12,174,003	$ 12,458,445

The following is a summary of impaired loans by class at December 31, 2016 and 2015:

	December 31, 2016		
	Unpaid principal balance	Related allowance	Interest income recognized
With a related allowance			
Commercial	$ 10,745,435	$ 4,369,073	$ 525,835
Real estate	5,618,410	1,038,382	174,412
Construction	304,547	65,399	12,324
Other	-	-	-
Totals	$ 16,668,392	$ 5,472,854	$ 712,571
With no related allowance			
Commercial	$ 9,827,522	$ -	$ 293,692
Real estate	14,650,677	-	635,057
Construction	1,472,077	-	50,612
Other	-	-	-
Totals	$ 25,950,276	$ -	$ 979,361
Total			
Commercial	$ 20,572,957	$ 4,369,073	$ 819,527
Real estate	20,269,087	1,038,382	809,469
Construction	1,776,624	65,399	62,936
Other	-	-	-
Totals	$ 42,618,668	$ 5,472,854	$ 1,691,932

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS (continued)

	December 31, 2015		
	Unpaid principal balance	Related allowance	Interest income recognized
With a related allowance			
Commercial	$ 2,094,012	$ 798,259	$ 111,469
Real estate	401,752	34,396	22,356
Construction	132,915	4,665	4,872
Other	-	-	-
Totals	$ 2,628,679	$ 837,320	$ 138,697
With no related allowance			
Commercial	$ 17,993,758	$ -	$ 842,750
Real estate	9,365,984	-	476,560
Construction	1,085,424	-	31,144
Other	-	-	-
Totals	$ 28,445,166	$ -	$ 1,350,454
Total			
Commercial	$ 20,087,770	$ 798,259	$ 954,219
Real estate	9,767,736	34,396	498,916
Construction	1,218,339	4,665	36,016
Other	-	-	-
Totals	$ 31,073,845	$ 837,320	$ 1,489,151

NOTE 5. ALLOWANCE FOR LOAN LOSSES

The allowance is comprised of three distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated, and (3) qualitative reserves related to loans collectively evaluated. A summary of the methodology the Bank employs on a quarterly basis with respect to each of these components in order to evaluate the overall adequacy of the allowance for loan losses is as follows:

Specific Reserve for Loans Individually Evaluated

To identify loans considered for impairment evaluation, management will begin with a review of the Loan Portfolio Watch List. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. "All amounts due, according to the contractual terms", means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. However, an insignificant delay or insignificant shortfall in amount of payments on the loan does not mean the loan is impaired.

Once determined to be impaired, impairment will be measured by the present value of expected cash flow at the loan's effective interest rate, less the fair value of the loans' collateral and costs to sell. Loans determined to be impaired will be identified and listed individually with the impairment measurement amount (even if the amount is zero). These loans will be deducted from the appropriate loan pool when calculating the estimated loss under ASC 450-10.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. ALLOWANCE FOR LOAN LOSSES (continued)

Quantitative Reserve for Loans Collectively Evaluated

Under ASC 450-10, loss estimates are calculated for groups of loans with similar risk characteristics. The Bank identifies the similar loan groups as Commercial, Real Estate, Construction, and Other. Charge-off amounts are compared to average loans outstanding to calculate a 2-Year Historic Average Loan Loss Percentage. This percentage is applied to the current loans outstanding for each loan pool, less the impaired loans for each loan pool. The result is the required general reserves amount.

Qualitative Reserve for Loans Collectively Evaluated

The Bank also considers the necessity to adjust the average historical net loan charge-off rates relative to each of the above loan pools for potential risk factors that could result in actual losses deviating from prior loss experience. Such qualitative risk factors considered are: (1) levels of and trends in delinquencies and impaired loans, (2) effects of any changes in the quality of the loan review system and findings, (3) trends in volume and term of loans, (4) effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practice, (5) experience, ability, and depth of lending management and other relevant staff, (6) national and local economic trends and conditions, (7) industry conditions such as competition and legal and regulatory requirements, (8) effects of changes in credit concentrations, and (9) effects of changes in the value of underlying collateral.

Activity in the allowance for loan losses by loan class for the years ended December 31, 2016 and 2015, is as follows:

2016	Commercial	Real estate	Construction	Other	Total
Allowance for loan loss					
Beginning balance	$ 1,960,863	$ 682,374	$ 352,812	$ 85,156	$ 3,081,205
Charge-offs	(651,670)	-	-	(30,685)	(682,355)
Recoveries	19,584	-	1,624	-	21,208
Provision	4,091,993	(49,944)	788,814	87	4,830,950
Ending balance	$ 5,420,770	$ 632,430	$ 1,143,250	$ 54,558	$ 7,251,008
Allowance related to:					
Loans individually evaluated for impairment	$ 4,369,073	$ 1,038,382	$ 65,399	$ -	$ 5,472,854
Loans collectively evaluated for impairment	1,051,697	(405,952)	1,077,851	54,558	1,778,154
Totals	$ 5,420,770	$ 632,430	$ 1,143,250	$ 54,558	$ 7,251,008
Loans					
Loans individually evaluated for impairment	$ 20,572,957	$ 20,269,087	$ 1,776,624	$ -	$ 42,618,668
Loans collectively evaluated for impairment	120,578,600	209,397,155	47,713,562	22,813,205	400,502,522
Totals	$ 141,151,557	$ 229,666,242	$ 49,490,186	$ 22,813,205	$ 443,121,190

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. ALLOWANCE FOR LOAN LOSSES (continued)

2015	Commercial	Real estate	Construction	Other	Total
Allowance for loan loss					
Beginning balance	$ 2,597,513	$ 386,946	$ 775,482	$ 13,298	$ 3,773,239
Charge-offs	(204,608)	(732,692)	-	(7,925)	(945,225)
Recoveries	14,750	26,747	-	11,694	53,191
Provision	(446,792)	1,001,373	(422,670)	68,089	200,000
Ending balance	$ 1,960,863	$ 682,374	$ 352,812	$ 85,156	$ 3,081,205
Allowance related to:					
Loans individually evaluated for impairment	$ 798,259	$ 34,396	$ 4,665	$ -	$ 837,320
Loans collectively evaluated for impairment	1,162,604	647,978	348,147	85,156	2,243,885
Totals	$ 1,960,863	$ 682,374	$ 352,812	$ 85,156	$ 3,081,205
Loans					
Loans individually evaluated for impairment	$ 20,087,771	$ 9,768,141	$ 1,218,339	$ -	$ 31,074,251
Loans collectively evaluated for impairment	131,239,452	213,266,725	40,423,679	20,277,512	405,207,368
Totals	$ 151,327,223	$ 223,034,866	$ 41,642,018	$ 20,277,512	$ 436,281,619

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. The modifications to the Company’s TDRs for the years ended December 31, 2016 and 2015 were concessions on the interest rate charged and paying real estate taxes. The effect of the modifications to the Company was a reduction in interest income. 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 is paid to date, the loan would continue to be evaluated for an asset-specific allowance for loan losses.

The following tables present TDRs, modified by class at December 31, 2016 and 2015:

2016	Number of contracts	Unpaid principal balance
Commercial	6	$ 6,515,950
Real estate	14	2,455,346
Construction	-	-
Other	-	-
Totals	20	$ 8,971,296

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. ALLOWANCE FOR LOAN LOSSES (continued)

2015	Number of contracts	Unpaid principal balance
Commercial	5	$ 7,397,609
Real estate	10	2,064,643
Construction	-	-
Other	-	-
Totals	15	$ 9,462,252

Default occurs when payments are not received in accordance with terms specified in the loan document, which may result in the loan being fully or partially charged-off. For the year ended December 31, 2016, there were no restructured loans that subsequently defaulted resulting in a principal charge-off. For the year ended December 31, 2015, there was one restructured commercial loan that subsequently defaulted resulting in a principal charge-off of $124,387.

NOTE 6. BANK PREMISES AND EQUIPMENT

Major classifications of bank premises and equipment and the total accumulated depreciation are as follows:

	2016	2015
Buildings and improvements	$ 1,856,589	$ 1,856,589
Furniture and fixtures	1,572,896	1,531,933
Vehicles	178,610	165,007
	3,608,095	3,553,529
Less: accumulated depreciation	(3,241,354)	(3,246,075)
	366,741	307,454
Land	200,460	200,460
Bank premises and equipment, net	$ 567,201	$ 507,914

Depreciation expense for the years ended December 31, 2016 and 2015, totaled $68,295 and $61,792, respectively, and is included in equipment and occupancy expense in the Consolidated Statements of Income.

The Bank has entered into a noncancelable lease agreement with a related party, consummated at arm's length, for its Teays Valley branch. Rent expense for the operating lease approximated $71,120 and $68,680 for the years ended December 31, 2016 and 2015, respectively. The minimum annual rental commitment under this lease, exclusive of taxes and other charges, payable by the lessee at December 31, 2016, is as follows:

Year	Amount
2017	$ 67,318
2018 and thereafter	-
Total	$ 67,318

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. DEPOSITS

The following is a summary of major categories of deposits at December 31, 2016 and 2015:

	2016	2015
Non-interest bearing	$ 60,089,407	$ 58,168,505
Interest bearing:		
Time deposits under $100,000	88,320,892	87,348,830
Time deposits over $100,000	262,468,006	261,672,757
Total time deposits	350,788,898	349,021,587
Money market	118,343,095	112,180,956
Savings	28,566,947	28,245,250
Total interest bearing deposits	497,698,940	489,447,793
Total deposits	$ 557,788,347	$ 547,616,298

Scheduled maturities of time and certificates of deposit at December 31, 2016, are as follows:

Year	Amount
2017	$ 272,985,972
2018	52,352,793
2019 and thereafter	25,450,133
Total	$ 350,788,898

The Bank has, and expects to have in the future, banking transactions in the ordinary course of business with 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. Aggregate deposit transactions with related parties approximated $44,583,972 and $42,790,886 at December 31, 2016 and 2015, respectively.

NOTE 8. INCOME TAXES

The components of applicable income tax expense (benefit) for the years ended December 31, 2016 and 2015, are summarized as follows:

	2016	2015
Current expense:		
Federal	$ 3,773,245	$ 3,580,215
State	315,893	316,371
Total current	4,089,138	3,896,586
Deferred expense:		
Federal	(1,527,453)	414,059
State	(142,866)	58,899
Total deferred	(1,670,319)	472,958
Income tax expense	$ 2,418,819	$ 4,369,544

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. INCOME TAXES (continued)

Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities at December 31, 2016 and 2015, are as follows:

	2016	2015
Deferred tax assets:		
Allowance for loan losses	$ 2,656,769	$ 1,128,954
Defined benefit plan	1,146,624	1,138,901
Nonaccrual interest	214,132	72,450
Total deferred tax assets	4,017,525	2,340,305
Deferred tax liabilities:		
Available-for-sale securities	(76,796)	(108,723)
Discount on investment securities	(2,202)	(2,202)
Depreciation and amortization	(14,472)	(14,472)
Total deferred tax liabilties	(93,470)	(125,397)
Net deferred tax assets	$ 3,924,055	$ 2,214,908

No valuation allowance for deferred tax assets was recorded at December 31, 2016 and 2015, as the Company believes it is more likely than not that all of the deferred tax assets will be realized because they were supported by recoverable taxes paid in prior years.

A reconciliation of the significant differences between the federal statutory income tax rate and the Company's effective income tax rate is as follows:

	2016	2015
Federal statutory rate	$ 2,355,668	$ 3,887,773
Increase(decrease) resulting from:		
State income tax	208,489	208,805
Tax exempt income	(76,734)	(112,481)
Nonaccrual interest	214,132	72,450
Nondeductible expense	6,810	7,389
Cumulative deferred tax expenses and other items	(289,546)	305,608
Income tax expense	$ 2,418,819	$ 4,369,544

NOTE 9. EMPLOYEE BENEFIT PLANS

The Company provides retirement benefits to its employees through the Putnam County Bank 401(k) Plan, which is intended to be compliant with Employee Retirement Income Security Act (ERISA) Section 404(c). The Company's total expense associated with the retirement benefit plan approximated $54,403 and $47,308 for the years ended December 31, 2016 and 2015, respectively.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9. EMPLOYEE BENEFIT PLANS (continued)

The Company also maintains a defined benefit pension plan ("the Defined Benefit Plan"). The Defined Benefit Plan was frozen as of October 31, 2012. The Defined Benefit Plan maintains a December 31 year-end for purposes of computing its benefit obligations.

The following table sets summarizes activity with the frozen Defined Benefit Plan in 2016 and 2015:

	2016	2015
Change in fair value of plan assets:		
Fair value at beginning of measurement period	$ 5,341,178	$ 5,666,619
Actual gain/(loss) on plan assets	279,477	(65,915)
Contributions	187,000	149,700
Benefits paid	(424,069)	(409,226)
Fair value at end of measurement periods	5,383,586	5,341,178
Change in benefit obligation:		
Benefit obligation at beginning of measurement period	(8,449,532)	(9,095,268)
Interest cost	(354,224)	(346,824)
Actuarial gain/(loss)	(133,331)	583,334
Benefits paid	424,069	409,226
Benefit obligation at end of measurement period	(8,513,018)	(8,449,532)
Funded status	$ (3,129,432)	$ (3,108,354)
Weighted-average assumptions for balance sheet liability at end of year:		
Discount rate	4.10%	4.30%
Expected long-term rate of return	7.00%	7.00%
Weighted-average assumptions for benefit cost at beginning of year:		
Discount rate	4.30%	3.90%
Expected long-term rate of return	7.00%	7.00%

The unfunded status of the plan as of December 31, 2016 is included within Other Liabilities on the Consolidated Balance Sheets. At December 31, 2016, Accumulated Other Comprehensive Income includes a balance of $2,757,084, net of tax, related to the underfunded pension liability.

The following table presents the components of the net periodic pension cost of the Defined Benefit Plan:

	2016	2015
Components of net periodic benefit:		
Interest cost	$ 354,224	$ 346,824
Expected return on plan assets	(388,308)	(390,408)
Net amortization and deferral	340,036	407,208
Net periodic pension cost	$ 305,952	$ 363,624

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9. EMPLOYEE BENEFIT PLANS (continued)

The Bank anticipates making contributions of $189,000 to the plan for the year ending December 31, 2017. The following table summarizes the expected benefits to be paid in each of the next five years and in the aggregate for the five years thereafter:

Plan year ending December 31,	Expected benefits to be paid
2017	$ 425,256
2018	425,436
2019	424,713
2020	420,861
2021	418,911
2022 through 2026	2,223,922
Total	$ 4,339,099

Asset allocation for the Defined Benefit Pension Plan as of the measurement date, by asset category, is as follows:

Plan Assets	Target Allocation 2016	Allowable allocation range	Percentage of plan assets at December 31, 2016	December 31, 2015
Equity Securities	50%	40-60%	46%	45%
Debt securities	50%	40-60%	53%	54%
Other		0-3%	1%	1%
Totals			100%	100%

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 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. The major categories of assets in the Company's Defined Benefit Plan as of year-end are presented in the following table. Assets are segregated by the level of the valuation inputs within the fair value hierarchy established by ASC Topic 820 utilized to measure fair value (See Note 14 for fair value hierarchy).

The following tables present the balances of the plan assets, by fair value, as of December 31, 2016 and 2015:

	Fair Value Measurement Using			
December 31, 2016	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 72,654	$ -	$ -	$ 72,654
Fixed income mutual funds	2,831,243	-	-	2,831,243
Equity common/collective trusts	-	277,807	-	277,807
Equity mutual funds	2,201,882	-	-	2,201,882
Totals	$ 5,105,779	$ 277,807	$ -	$ 5,383,586

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9. EMPLOYEE BENEFIT PLANS (continued)

December 31, 2015	Fair Value Measurement Using			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 72,521	$ -	$ -	$ 72,521
Fixed income mutual funds	2,872,902	-	-	2,872,902
Common stock	-	228,410	-	228,410
Equity mutual funds	2,167,345	-	-	2,167,345
Totals	$ 5,112,768	$ 228,410	$ -	$ 5,341,178

NOTE 10. 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 as discussed in Notes 4, 6 and 7. In the opinion of management, such transactions are consistent with prudent banking practices and are within applicable banking regulations. In 2016, the Company had an agreement with a related-party for their insurance. The Company paid $71,125 in 2016 and is under contract to pay $72,651, $72,651, and $41,537 for 2017, 2018, and 2019, respectively.

NOTE 11. COMMITMENTS AND CONTINGENCIES

The Bank is a party to certain 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, commercial letters of credit, 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.

A summary of the notional amounts of the financial instruments with off-balance sheet risk at December 31, 2016 and 2015, is as follows:

Contract Amount	2016	2015
Commitments to extend credit	$ 23,325,922	$ 26,315,122
Commercial and standby letters of credit	133,262	33,262
Totals	$ 23,459,184	$ 26,348,384

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.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. COMMITMENTS AND CONTINGENCIES (continued)

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.

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Based upon information currently available, management believes that such loss contingencies, in the aggregate, will not have a material adverse effect on the Bank's business, financial position, or results of operations.

NOTE 12. CONCENTRATION 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. Investments in state and municipal securities and loans to governmental entities are within the Bank's home state. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers.

NOTE 13. REGULATORY MATTERS

Putnam Bancshares, Inc.'s principal source of funds for future dividend payments to shareholders 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, 2016, that the Bank could declare without the approval of the West Virginia Division of Financial Institutions and the Federal Reserve Board amounted to approximately $8,237,590.

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 6% for Tier 1 capital, 8% for total risk-based capital, and 4% for Tier 1 leverage capital. To be well capitalized under the regulatory framework for prompt corrective actions, the ratios must be at least 8%, 10%, and 5%, respectively.

Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weighting of assets and certain off-balance sheet items, and other factors.

As of December 31, 2016 and 2015, 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. Management believes, as of December 31, 2016 and 2015, that the Company and the Bank met all capital adequacy requirements to which they were subject. As of December 31, 2016, the most recent notification from the Bank's primary regulatory agency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table below. There are no conditions or events since the notification that management believes have changed the Bank's category.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13. REGULATORY MATTERS (continued)

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

		Capital amounts		
	Ratios	Actual	Minimum	Well capitalized
December 31, 2016				
Total risk-based capital				
(to risk-weighted assets)	23.99%	$ 96,431,000	$ 32,155,000	$ 40,193,000
Tier 1 capital				
(to risk-weighted assets)	22.74%	91,380,000	24,116,000	32,155,000
Tier 1 leverage capital				
(to adjusted average assets)	13.94%	91,380,000	26,216,000	32,771,000
December 31, 2015				
Total risk-based capital				
(to risk-weighted assets)	23.28%	$ 91,704,000	$ 31,511,000	$ 39,389,000
Tier 1 capital				
(to risk-weighted assets)	22.50%	88,623,000	23,633,000	31,511,000
Tier 1 leverage capital				
(to adjusted average assets)	13.79%	88,623,000	25,699,000	32,124,000

NOTE 14. FAIR VALUES OF 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 risks and terms (Level 2).

Accrued Interest Receivable and Accrued Interest Payable: The carrying values of accrued interest receivable on the Bank's investment securities and loans is assumed to approximate fair value. Likewise, the carrying value of accrued interest payable on the Bank's interest-bearing deposits is assumed to approximate fair values (Level 1).

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14. FAIR VALUES OF FINANCIAL INSTRUMENTS (continued)

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).

The carrying values and estimated fair values of the Bank's financial instruments at December 31, 2016 and 2015, are summarized as follows:

	2016		2015	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets:				
Cash and due from banks	$ 17,099,705	$ 17,099,705	$ 18,912,350	$ 18,912,350
Federal funds sold	70,000,000	70,000,000	56,000,000	56,000,000
Securities available for sale	70,260,008	70,260,008	83,197,813	83,197,813
Securities held to maturity	47,883,320	47,878,945	38,952,728	38,955,932
Loans	435,870,182	435,870,182	433,200,414	433,200,414
Accrued interest receivable	1,737,824	1,737,824	1,643,561	1,643,561
Totals	$ 642,851,039	$ 642,846,664	$ 631,906,866	$ 631,910,070
Financial liabilities:				
Deposits	$ 557,788,347	$ 557,788,347	$ 547,616,298	$ 547,616,298
Accrued interest payable	1,197,192	1,197,192	1,071,599	1,071,599
Totals	$ 558,985,539	$ 558,985,539	$ 548,687,897	$ 548,687,897

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, securities available for sale 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.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14. FAIR VALUES OF FINANCIAL INSTRUMENTS (continued)

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 and municipal bonds.

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 ("OREO"): 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 OREO at December 31, 2016, are determined by sales agreements or appraisals, and costs to sell are based on estimation per the terms and conditions of the sales agreements 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

	Fair Value Measurement Using			
December 31, 2016	Level 1	Level 2	Level 3	Total
Available-for-sale securities				
U.S. Government treasuries	$ -	$ 10,161,130	$ -	$ 10,161,130
U.S. Government agencies	-	56,085,395	-	56,085,395
Municipal bonds	-	3,052,294	-	3,052,294
Mutual funds	961,189	-	-	961,189
Totals	$ 961,189	$ 69,298,819	$ -	$ 70,260,008

	Fair Value Measurement Using			
December 31, 2015	Level 1	Level 2	Level 3	Total
Available-for-sale securities				
U.S. Government treasuries	$ -	$ 10,169,919	$ -	$ 10,169,919
U.S. Government agencies	-	66,656,655	-	66,656,655
Municipal bonds	-	5,394,547	-	5,394,547
Mutual funds	976,692	-	-	976,692
Totals	$ 976,692	$ 82,221,121	$ -	$ 83,197,813

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14. FAIR VALUES OF FINANCIAL INSTRUMENTS (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. generally accepted accounting principles. 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, 2016 and 2015:

	Fair Value Measurement Using			
December 31, 2016	Level 1	Level 2	Level 3	Total
Impaired loans	$ -	$ 42,618,668	$ -	$ 42,618,668
OREO	$ -	$ 3,913,555	$ -	$ 3,913,555

	Fair Value Measurement Using			
December 31, 2015	Level 1	Level 2	Level 3	Total
Impaired loans	$ -	$ 32,722,047	$ -	$ 32,722,047
OREO	$ -	$ 3,124,820	$ -	$ 3,124,820

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 U.S. GAAP and, as such, has not included any gains or losses in earnings for the year ended December 31, 2016.

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information of Putnam Bancshares, Inc. (Parent Company) is presented below.

BALANCE SHEETS	December 31, 2016	December 31, 2015
ASSETS		
Cash	$ 168,644	$ 171,571
Investment in Putnam County Bank	87,900,234	85,162,452
Investment in Putnam County Title Insurance Agency	9,120	9,897
TOTAL ASSETS	$ 88,077,998	$ 85,343,920
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ -	$ 39,547
Income taxes payable	-	-
TOTAL LIABILITIES	-	39,547
STOCKHOLDERS' EQUITY	88,077,998	85,304,373
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 88,077,998	$ 85,343,920

STATEMENTS OF INCOME	Years Ended 2016	Years Ended 2015
INCOME	$ 1,724,835	$ 1,671,000
EXPENSES:		
Operating expenses	8,214	11,630
Income before income tax benefit and equity in undistributed earnings of subsidiaries	1,716,621	1,659,370
Applicable income taxes	-	18,879
Income before equity in undistributed earnings of subsidiaries	1,716,621	1,640,491
Equity in undistributed earnings of subsidiaries	2,772,676	5,407,802
Net income	$ 4,489,297	$ 7,048,293

PUTNAM BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. PARENT COMPANY FINANCIAL INFORMATION (continued)

STATEMENTS OF CASH FLOWS	Years Ended	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 4,489,297	$ 7,048,293
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed earnings of subsidiaries	(2,772,677)	(5,407,802)
Increase/(decrease) in accounts payable	(39,547)	30,900
Increase/(decrease) in income taxes payable	-	(12,021)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,677,073	1,659,370
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(1,680,000)	(1,620,000)
NET CASH USED IN FINANCING ACTIVITIES	(1,680,000)	(1,620,000)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(2,927)	39,370
CASH AND CASH EQUIVALENTS, BEGINNING	171,571	132,201
CASH AND CASH EQUIVALENTS, ENDING	$ 168,644	$ 171,571

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Jill R. Rice	Paying & Receiving
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Kelley A. Lanning	Loan Operations
James S. Coniff	Evaluations/Appraisal Review
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Elizabeth H. Handley	Paying & Receiving
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