U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

# FORM 10-KSB

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1996

Commission File Number 0-16587

South Branch Valley Bancorp, Inc.
(Exact name of registrant as specified in its charter)

| West Virginia | 55-0672148 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

310 N. Main Street
Moorefield, West Virginia 26836
(Address of principal executive offices) (Zip Code)

(304) 538-2353
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| None | None |

Securities registered pursuant to Section 12(g) of the Act:

Common
(Title of Class)

Indicate by check mark whether the registrant: (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No





Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K [229.405 of this chapter] is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendments to this Form 10-KSB. [ X ]

State issuer's revenues for its most recent fiscal year: $10,149,000

State the aggregate market value of the voting stock held by non-affiliates of the registrant. The aggregate market value shall be computed by reference to the price at which the stock was sold, or the average bid and asked prices of such stock, as of a specified date within 60 days prior to the date of filing.

| Aggregate Market Value of Voting Stock | Based Upon Reported Closing Price on |
|---|---|
| $11,611,200 | March 1, 1997 |

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

| Class | Outstanding as of March 1, 1996 |
|---|---|
| Common Stock ($2.50 par value) | 378,510 shares |

Documents Incorporated by Reference

The following lists the documents which are incorporated by reference in the Annual Report Form 10-KSB, and the Parts and Items of the Form 10-KSB into which the documents are incorporated.

| Document | Part of Form 10-KSB Into Which Document is Incorporated |
|---|---|
| South Branch Valley Bancorp, Inc. Annual Report to Shareholders for the year ended December 31, 1996 | Part II |
| Reports filed on Form 8-K | Part III |

This form 10-KSB is comprised of 64 pages. The exhibit index is located on page 17.

SOUTH BRANCH VALLEY BANCORP, INC
FORM 10-KSB
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PART I

ITEM 1. BUSINESS
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Organized in 1987 as a West Virginia Corporation, South Branch Valley Bancorp, Inc. ("SBVB"), is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. At the close of business on December 31, 1987, SBVB merged its wholly owned subsidiary, South Branch Valley National Bank Inc., with South Branch Valley National Bank of Moorefield, a commercial bank with its principal place of business located at 310 N. Main Street, Moorefield, West Virginia. SBVB's business activities are conducted through the Bank. The Bank presently accounts for substantially all of the consolidated assets, revenues and net income of SBVB.

South Branch Valley National Bank

The South Branch Valley National Bank of Moorefield was originally chartered by the Office of the Comptroller of the Currency on August 15, 1883. For purposes of effecting the 1987 merger, South Branch Valley National Bank Inc. was organized and chartered on October 2, 1987. The surviving Bank is currently operating as South Branch Valley National Bank of Moorefield. The Bank is a full service, FDIC insured, national banking association engaged in the commercial and retail banking business. At December 31, 1996 the Bank employed approximately 62 people.

The Bank offers a wide variety of banking services to its customers. The Bank accepts deposits and has a night depository and an automated teller machine for the convenience of its customers. The Bank offers its customers various deposit arrangements with various maturities and yields, including non-interest bearing and interest bearing demand deposits, savings deposits, time certificates of deposit, Christmas Club accounts, and individual retirement accounts.

The Bank offers a full spectrum of lending services to its customers, including commercial loans and lines of credit, residential real estate loans, consumer installment loans and other personal loans. Loan terms, including interest rates, loan to value ratios, and maturities are tailored as much as possible to meet the needs of the borrower. Commercial loans are generally secured by various collateral including commercial real estate, accounts receivable and business machinery and equipment. Residential real estate loans consist primarily of mortgages on the borrower's personal residence, and are typically secured by a first lien on the subject property. Consumer and personal loans are generally secured, often by first liens on automobiles, consumer goods or depository accounts. A special effort is made to keep loan products as flexible as possible within the guidelines of prudent banking practices in terms of interest rate risk and credit risk. Bank lending personnel adhere to established lending limits and authorities based on each individual's lending expertise and experience.

When considering loan requests, the primary factors taken into consideration by the Bank are the cash flow and financial condition of the borrower, the value of the underlying collateral, if any, and the character and integrity of the borrower. These factors are evaluated in a number of ways including an analysis of financial statements, credit reviews and visits to the borrower's place of business.

The Bank also serves as trustee where appointed by a court or under a private trust agreement. As trustee, the Bank invests the trust assets and makes disbursements according to the terms and conditions of the governing trust document and state and Federal law. For the year ended December 31, 1996, fees generated from the operation of the Bank's Trust Department comprised less than one percent of gross revenues earned during the year.

Supervision and Regulation

SBVB is a holding company subject to the provisions of the Bank Holding Company Act of 1956 and is registered with the Board of Governors of the Federal Reserve System. Under the Bank Holding Company Act, holding companies are prohibited, with certain exceptions, from engaging in or acquiring the voting stock of any company engaging in activities other than banking. However, the Bank Holding Company Act authorizes the Board of Governors to permit holding companies to engage in, and to acquire the stock of companies that engage in, activities which the Board of Governors has determined to be so closely related to banking as to be a proper incident thereto.

The Company's subsidiary bank is a national banking association chartered under the laws of the United States. As such, the operations of the Bank are subject to the regulations of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and West Virginia law. As a member of the Federal Deposit Insurance Corporation, the Bank's deposits are insured as provided by law.

The primary supervisory authority over the Bank is the Comptroller of the Currency who regularly examines such areas as reserves, loans, investments, management practices, and other aspects of the Bank's operations.

On September 29, 1994, the Bank Holding Company Act was amended by the Interstate Banking and Branch Efficiency Act of 1994 which authorizes interstate bank acquisition anywhere in the country, effective one year after the date of enactment and interstate branching by acquisition and consolidation, effective June 1, 1997 in those states that have not opted out by that date. The impact of this amendment on the Company cannot be measured at this time.

The United States Congress and numerous states, including West Virginia, have periodically considered and enacted legislation which has resulted in the deregulation of banks and other financial institutions. As additional legislation is enacted, certain geographical restrictions on banks and bank holding companies or certain prohibitions against banks engaging in certain non-banking activities may be modified or eliminated. Such legislation could have the effect of placing the Bank in more direct competition with other financial institutions.

The Bank's monetary policy is directly affected by the Federal Reserve Board whose actions directly affect the money supply, and affect banks' lending ability by increasing or decreasing the cost and availability of funds to banks. In addition, deregulation of interest rates paid by banks on deposits and the types of deposits that may be offered by banks have eliminated or altered minimum balance requirements and rate ceilings on various types of time deposit accounts. The effect of these actions and the deregulation of interest rates have increased banks' costs of funds and have made the profitability of banks more sensitive to fluctuations in market rate conditions.

Competition

The Bank competes primarily with seven commercial banks over a four county area: Hardy County, Hampshire County, Grant County, and Pendleton County. Additionally, Farmers' Home Administration and the Federal Land Bank are competitors for loans. According to the latest Sheshunoff Bank Quarterly, dated September 1996, the Bank had assets representing approximately 17% of total assets for the seven commercial banks serving its primary market area.

It can be expected that with the liberalization of the branch banking laws in West Virginia, additional financial institutions may compete with the Bank. The Bank has taken an aggressive posture with the establishment of the Mathias, Franklin and Petersburg branches, and intends to continue vigorously competing for its share of the market within its service area by offering competitive rates and terms on both loans and deposits.

Employees

At December 31, 1996, the Bank employed 52 full time employees and 10 part time employees.

ITEM 2. PROPERTIES
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In 1911 the Bank acquired the property now known as the "Old Bank" building located at 107 South Main Street, Moorefield, West Virginia. In 1963 the Bank acquired property adjacent to that same building which is now being used as a parking lot. In December

1994 the Bank acquired property on Winchester Avenue that adjoins the Old Bank building and the parking lot. The completion of the renovation and addition to the main office has allowed the Bank's bookkeeping and operations departments to move into the main office. Therefore, the Winchester Ave. parcel as well as the property located at 107 S. Main St. will be offered for sale.

In 1974 the Bank acquired 5.82 acres of land located on the west side of U.S. Route 220 of Main Street in Moorefield, West Virginia. On June 29, 1976 the Bank received the approval of the Office of the Comptroller of the Currency to change the location of its main office to this site. This is the present location of the Bank's principal banking offices. In April 1994 the Bank acquired approximately one acre of real estate on the west side of U.S. Route 220 adjoining the main office.

On April 5, 1983 the Bank acquired property located in the town of Mathias, West Virginia. Since December 28, 1984 the Bank has operated its Mathias branch bank from this site.

By deeds dated May 31, 1986 and July 14, 1986 the Bank acquired two parcels of land located on the east side of U.S. Route 220 in the town of Franklin, West Virginia. On October 3, 1986 the Bank received preliminary approval from the Office of the Comptroller of the Currency to establish a branch bank at this location. The Bank's Franklin branch was opened for banking operations on January 1, 1987.

During 1995, the Bank acquired a parcel of land and branch office located on the north side of U.S. Route 220 in the town of Petersburg, West Virginia. This property was purchased from Blue Ridge Bank and began operating as a branch of South Branch Valley National Bank on November 15, 1995.

At December 31, 1996, various parcels of real estate with an aggregate book value of $28,955 are maintained by the Bank as a result of foreclosure proceedings on loans collateralized by such real estate.

## ITEM 3. LEGAL PROCEEDINGS

The Bank is involved in various pending legal proceedings, all of which are regarded by management as normal litigation incident to the business of banking and are not expected to have a materially adverse effect on the business or financial condition of the Bank or the Holding Company.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS

No matters were submitted to a vote of stockholders during the fourth quarter of the fiscal year covered by this report.

PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company acts as its own registrar and transfer agent. Its shares are not publicly traded on any exchange or over the counter market. Shares of the Company's common stock are occasionally bought and sold by private individuals, firms or corporations. In many instances, the Company does not have knowledge of the purchase price or the terms of the purchase. No definitive records of bids and ask or sale prices are available. However, the average sales price for the shares that have voluntarily been reported to the Company in the last 60 days is $44.25 per share.

The approximate number of stockholders of record for SBVB's common stock as of March 1, 1997 was 640.

The following sets forth quarterly cash dividends declared per share for the prior two years.

Quarterly Common Stock Dividends

| Quarter | 1996 | 1995 |
|---|---|---|
| First | $ - | $ - |
| Second | .38 | .33 |
| Third | - | - |
| Fourth | .39 | .35 |

Dividends paid by SBVB to its stockholders are based on dividends it receives from its subsidiary bank. The ability of the Bank to pay dividends to SBVB is subject to certain limitations of the national banking laws. In general, these limitations provide that no bank can pay dividends if the total of all dividends, including any proposed dividend declared by a bank in any calendar year, exceeds net income for that year when combined with net income for the preceding two years, less dividends for all three years. This restriction may be waived if the approval of the Office of the Comptroller of the Currency is obtained for such distribution. The Comptroller of the Currency may also prohibit a bank's dividend payments if such payment is deemed to be an unsafe or unsound banking practice. The foregoing summary is not a complete statement of applicable limitations and is qualified by reference to Sections 56 and 60 of Title 12 of the United States Code.

Additional information related to dividend restrictions is included in Note 13 of the Notes to Consolidated Financial Statements included on pages 33 through 34 of the 1996 Annual Report which is incorporated herein by reference under Part II, Item 7 of this filing.

Cash dividends rose 13.2% to $.77 per share in 1996. It is the intention of management and the Board of Directors to continue to pay dividends on the same schedule during 1996. However, future cash dividends will depend on the earnings, financial condition and the business of the Bank as well as general economic conditions; however, management is not presently aware of any reason why dividend payments should not continue.

## ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS AND RELATED STATISTICAL DISCLOSURES

"Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 4 through 16 of the 1996 Annual Report is incorporated herein by reference.

## ITEM 7. FINANCIAL STATEMENTS

The report of the independent auditors and consolidated financial statements and notes thereto are included on pages 17 through 37 of the 1996 Annual Report and are incorporated herein by reference.

## ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There has been no Form 8-KSB filed within 24 months prior to the date of the most recent financial statements reporting a change of accountants and/or reporting disagreements on any matter of accounting principle or financial statement disclosure.

PART III

## ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

### CURRENT BOARD OF DIRECTORS.

The Board of Directors of the Company may consist of not less than nine (9) nor more than fifteen (15) persons in accordance with the Company's Articles of Incorporation. The number of directors may be fixed by the Board of Directors as deemed appropriate. Currently, the Board of Directors has fixed the number of directors at fourteen (14).

The current Board of Directors of the Company is comprised of the individuals listed below. Directors of the Company are divided into three classes and serve a staggered three (3) year term. All current directors of the Company are also directors of the Company's subsidiary, South Branch Valley National Bank ("Bank").
Directors of the Bank serve for a one (1) year term. The table below sets forth information concerning each director as of March 1, 1997.

| Name and Age | Date Current Term as Director of Company Expires | Positions & Principal Occupation or Employment Last Five Years |
|---|---|---|
| Oscar M. Bean (46) | 1998 | Chairman of the Board since February 1995; Director of Company since 1987; Director of Bank since 1978; Managing Partner of Bean & Bean Attorneys. |
| Donald W. Biller (65) | 1999 | Director and Vice Chairman of the Board since 1987; Director of Bank since 1975; President of D.W. Biller, Inc.; Director of WV Farm Credit ACA; Farmer. |
| James M. Cookman (42) | 1997 | Director of Bank since 1994; President of Cookman Insurance Center, Inc., President of Cookman Realty Group, Inc. and President of Transcover, Inc. |
| John W. Crites (56) | 1999 | Director of Company and Bank since 1989; President of Allegheny Wood Products, Inc.; Partner, JPC, Limited Liability Company; Partner, Allegheny Dimension; Principal Stockholder, KJV Aviation. |
| Thomas J. Hawse, III (51) | 1997 | Director of Company since 1988; President of Hawse Food Market, Inc. |
| Phoebe F. Heishman (55) | 1998 | Secretary of Company since 1995; Director of Company since 1987; Director of Bank since 1973; Editor and Publisher of Moorefield Examiner; President of R.E. Fisher Co., Inc. |

| | | |
|---|---|---|
| Gary L. Hinkle (47) | 1997 | Director the Company since 1993; President of Hinkle Trucking, Inc., Dettinburn Transport, Inc., and Mt. Storm Fuel Corporation. |
| Jeffrey E. Hott (46) | 1999 | Director of Company and Bank since 1990; Vice President of Hott's Ag Services, E.E. Hott, Inc., and Franklin Oil Co. |
| H. Charles Maddy, III,(33) | 1997 | Director of Company since 1993; Has served as the Bank's President and Chief Executive Officer since 1993. He served as Chief Financial Officer of the Company from 1988 to 1994 when he became President. |
| Harold K. Michael (53) | 1997 | Director of the Company since 1994 Owner/ agent of H.K. Michael & Son Insurance and a member of the West Virginia House of Delegates. |
| Mary Ann Ours (63) | 1998 | Director of Company and Bank since 1994; President of Ours Valley View Poultry Farm, Inc. |
| Russell F Ratliff, Jr.(46) | 1999 | Director of Company and Bank since 1994; Treasurer of the Company, 1987 to present; Vice President and Cashier of the Bank, 1993 to present; CEO and Cashier of the Bank, 1988 to 1993. |
| Harry C. Welton (67) | 1999 | Director of Company since 1987; Director of Bank since 1986; Retired farmer. |
| Renick C. Williams (62) | 1998 | Director of Company since 1987; President and Chairman of the Board of Company, 1987 to 1995; Director of Bank since 1967; President of South Branch Inn, Inc.; President of Fort Pleasant Farms, Inc.; President of Hampshire S&J Co., Inc. |

EXECUTIVE OFFICERS.

The following table identifies the executive officers of the Company, all of whom were appointed in April 1996 to serve until the next annual meeting. Mr. Pavan and Mr. Jennings are executive officers of the Company's only subsidiary, South Branch Valley National Bank. Mr. Bean and Mrs. Heishman, who are also directors of the Company, do not receive additional compensation for their service as executive officers of the Company and thus are not listed in the Executive Compensation Table.

| Name, Year Appointed, Age | Office, Experience covering the last five years |
|---|---|
| Oscar M. Bean, 1995 (46) | Chairman of the Board of the Company February 1995 to present; Chairman of the Board of the Bank, February 1995 to present; Secretary of the Company 1987 to February 1995. |
| Phoebe F. Heishman, 1995 (55) | Secretary of the Company, February 1995 to present. |
| H. Charles Maddy, III, 1988 (33) | President of the Company since 1994; Chief Financial Officer of the Company, 1988 to 1994; President and Chief Executive Officer of the Bank, April 1993 to present; Executive Vice President of the Bank, 1992 to 1993; Vice President and Controller, 1988 to 1992. |
| Russell F. Ratliff, Jr.,1986 (46) | Treasurer of the Company, 1987 to present; Vice President and Cashier of the Bank, April 1993 to present; CEO and Cashier of the Bank, 1988 to 1993. |

| | |
|---|---|
| Jeffery L. Pavan, 1992 (35) | Vice President of Loan administration, 1992 to present. Previously affiliated with United Companies Lending Corporation, Inc. in Fort Wayne, Indiana. |
| Scott C. Jennings, 1994 (35) | Vice President of Loan Review and Compliance, 1994 to present; Loan Review and Compliance Officer 1991 to 1994. |

## COMPLIANCE WITH REPORTING OF SECURITIES TRANSACTIONS

Pursuant to Section 16(a) of the Securities Exchange Act of 1934 and Securities and Exchange Commission (the "SEC") regulations, the Company's directors, executive officers and greater than ten percent shareholders are required to file reports of ownership and changes in ownership with the SEC and to furnish the Company with copies of all such reports they file. Based solely upon submissions of copies of reports to the Company, the Company is not aware of any late filings.

## ITEM 10. EXECUTIVE COMPENSATION

### Cash Compensation.

Executive officers of the Company are not compensated for services rendered to the Company. Executive officers of its subsidiary, South Branch Valley National Bank, are compensated for services rendered to the Bank. The table below sets forth the cash compensation of the Company's Chief Executive Officer and any executive officer of South Branch Valley Bancorp, Inc. or its subsidiary earning $100,000 or more for the years ended December 31, 1996, 1995 and 1994.

SUMMARY COMPENSATION TABLE

| Name and Principal Position | Annual Compensation | | | |
|---|---|---|---|---|
| | Year | Salary | Bonus | All Other Compensation |
| H. Charles Maddy, III | 1996 | $73,500 | $26,667 | $19,113 (1) |
| President & Chief Executive Officer | 1995 | $70,000 | $25,110 | $19,432 (1) |
| | 1994 | $60,000 | $23,886 | $17,427 (1) |

(1) Amount includes payments made on behalf of the executive to the ESOP ($3,675)and 401(k) Profit Sharing Plan ($4,043), amounts taxable to the executive for personal use of the Company vehicle ($6,141), excess life insurance ($54) and fees received by the executive as a member of the Company's subsidiary bank's board of directors, which

totaled $5,200. Mr. Maddy received no compensation for his position as Director of the Company.

SOUTH BRANCH VALLEY BANCORP, INC. PLANS.

The Company has a defined contribution profit-sharing and thrift plan with 401(k) provisions covering substantially all employees. Any employee who is at least 21 years of age and is employed in a position requiring at least 1,000 hours of service per year is eligible to participate. Under the provisions of the plan, the Company will make a matching contribution on behalf of each participant of 25% of the participant's salary reduction contributions of up to 4% of such participant's compensation. These matching contributions shall be fully vested at all times. The Company may also make additional contributions at the discretion of the Company's Board of Directors. Vesting in discretionary contributions occurs at the rate of 0% or the first two years of eligibility and 20% per year thereafter. Total Company contributions to the plan for the year ended December 31, 1996, totaled $54,240. The trustees of the plan are also members of the Company's Board of Directors.

The Company has an Employee Stock Ownership Plan (ESOP) covering substantially all employees. Any employee who is at least 21 years of age and is credited with at least 1,000 hours of service during the plan year is eligible to participate. Vesting occurs at the rate of 0% for the first year of credited service and 20% for each year thereafter. Under the provisions of the plan, employee participants in the ESOP are not permitted to contribute to the plan, rather the cost of the ESOP is borne by the Company through annual contributions in amounts determined by the Company's Board of Directors. Contributions to the plan for the year ended December 31, 1996, totaled $48,250. The trustees of the ESOP are also members of the Company's Board of Directors.

In 1990, the Company adopted an incentive compensation program for its key employees. Bonuses are awarded to key employees based on a prescribed formula using the Company's return on assets as a base. For the year ended December 31, 1996, $137,000 was paid under the provisions of the incentive compensation program. The amounts awarded to the Chief Executive Officer are shown in the bonus column of the Compensation Table.

Neither the Company nor the Bank maintain any form of stock option, stock appreciation rights, or other long term compensation plans. The Chief Executive Officer has an employment contract with the Bank. The significant provisions of this agreement and potential amounts involved are included in Note 12 of the Consolidated Financial Statements included in Item 7 of this filing.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth the amount of common stock beneficially owned by each director and by all executive officers and directors of the Company and its subsidiary, South Branch Valley National Bank, as a group of sixteen (16) persons as of March 4, 1997.

| Name of Beneficial Owner | Qualifying Shares Owned | Other Shares Beneficially Owned Direct | Indirect | Percent of Class** |
|---|---|---|---|---|
| Oscar M. Bean | 1,000 | 5,961 | 1,738 (4) | 2.0% |
| Donald W. Biller | 1,000 | --- | 5,120 (9) | 1.4% |
| James M. Cookman | 1,000 | --- | 1,161 (7) | .3% |
| John W. Crites | 1,000 | 1,000 | 23,905 (2) | 6.6% |
| Thomas J. Hawse, III | 1,000 | 1,800 | --- | .5% |
| Phoebe F. Heishman | 1,000 | 9,150 | 1,540 (5) | 2.8% |
| Gary L. Hinkle | 1,000 | 6,517 | 2,400 (8) | 2.4% |
| Jeffrey E. Hott | 1,000 | 1,000 | 16,975 (3) | 4.8% |
| H. Charles Maddy, III | * | 202 | 783 (6) | .3% |
| Harold K. Michael | 1,000 | 38 | --- | .0% |
| Mary Ann Ours | 1,000 | 3,615 | --- | 1.0% |
| Russell F. Ratliff, Jr. | * | 950 | 838 (6) | .5% |
| Harry C. Welton, Jr. | 1,000 | 1,840 | 9,465 (1) | 3.0% |
| Renick C. Williams | 1,000 | 130 | --- | .0% |
| | | 32,203 | 63,925 | 25.6% |
| All directors and executive officers as a group (16 persons), ESOP and Trust Department*** | | 32,231 | 71,879 | 27.5% |

* Director/employee exempt from qualifying requirement

** Does not include qualifying shares.

*** Includes 510 shares held in the Trust Department and voted by the Trust Officer and 6,864 shares owned by the Bank's ESOP and voted by three Trustees, who are Directors of the Bank. This total excludes Mr. Maddy's and Mr. Ratliff's shares held in the ESOP.

(1) All shares indirectly held are owned by the spouse.

(2) All shares indirectly held by Mr. Crites are owned by Allegheny Wood Products, Inc. of which Mr. Crites is the president and majority shareholder.

(3) 150 shares are owned by Mr. Hott's minor children; 9,725 shares are owned by E.E. Hott, Inc. and 7,100 shares are owned by Franklin Oil Co. (Mr. Hott is vice president of both companies).

(4) 55 shares are owned by Mr. Bean's spouse; 493 shares are owned by Mr. Bean's minor children; 1,190 shares are owned by Mr. Bean's mother for whom he has power of attorney.

(5) 220 shares are owned by Ms. Heishman's spouse; 1320 shares are owned by minor children.

(6) Fully vested shares held on behalf of named individual in the Company's ESOP.

(7) 710 shares are owned by Mr. Cookman's minor children; 500 shares are owned by Cookman Insurance Center, Inc. in which Mr. Cookman has a majority interest, and 368 shares are owned by the Cookman Insurance Center, Inc. Profit Sharing Plan.

(8) 2,400 shares are owned by Hinkle Trucking, Inc. of which Mr. Hinkle is the president.

(9) All shares indirectly held by Mr. Biller are owned by D.W. Biller, Inc. of which Mr. Biller is the president.

## ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Directors and executive officers of South Branch Valley Bancorp, Inc. and subsidiary, members of their immediate families, and business organizations and individuals associated with them have been customers of, and have had normal banking transactions with, South Branch Valley National Bank. All such transactions were made in the ordinary course of business, were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and did not involve more than the normal risk of collectibility or present other unfavorable features. It is anticipated that similar transactions will continue in the future. The extent of significant transactions with related parties is disclosed the Notes to the Consolidated Financial Statements included on pages 22 though 37 of the 1996 Annual Report and is incorporated herein by reference.

Director Oscar M. Bean is a partner in the law firm of Bean & Bean which has served as counsel for South Branch Valley National Bank in a number of matters during the year. It is anticipated that this relationship will continue in 1997. Fees paid by the Bank to the law firm of Bean & Bean were less than 5% of the law firm's gross revenues in 1996.

ITEM 13. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

All financial statements and financial statement schedules required to be filed by this Form or by Regulation S-X, which are applicable to the registrant, have been presented in the financial statements and notes thereto in Item 7 in management's discussion and analysis of financial condition and results of operation in Item 6 or elsewhere in this filing where appropriate. The listing of exhibits follows:

INDEX TO EXHIBITS

A) Exhibits

| Exhibit Number | Description | Page(s) in Form 10-KSB or Prior Filing Reference |
|---|---|---|
| (3) | Articles of Incorporation and By-laws | |
| | (i) Articles of Association of South Branch Valley National Bank | (a) |
| | (ii) Articles of Incorporation of South Valley Bancorp, Inc., dated March 3, 1987 | (a) |
| | (iii) By-laws of South Branch Valley Bancorp, Inc. | (a) |
| (10) | Material Contracts | |
| | (i) Change of Control Agreement | (b) |
| (12) | Annual Report to Shareholders | 21-61 |
| (21) | Subsidiaries of the Registrant | 62 |
| (23) | Consent of Independent Certified Public Accountants | 63 |
| (27) | Financial Data Schedule | 64 |

(a)Incorporated herein by reference to exhibits to South Branch Valley Bancorp, Inc.'s registration statement on Form S-4 dated September 1, 1987, Registration No. 33-16947 filed on or about September 1, 1987.

(b)Incorporated herein by reference to exhibits to South Branch Valley Bancorp, Inc.'s Form 10-KSB for the fiscal year ended December 31, 1995 filed on or about March 22, 1996.

B) Reports on Form 8-K

No reports of Form 8-K were filed by the registrant during the fourth quarter of the year ended December 31, 1996. However, prior to this filing on or about January 15, 1997 and February 7, 1997, the Registrant filed Form 8-K and related Form F-11 related to the execution of a stock purchase agreement to acquire approximately 35.4% of the Capital State Bank, Inc. a state non-member financial institution located in Charleston, West Virginia. On March 27, 1997, the Registrant filed Form 8-K and related Form F-11 related to the execution of a stock purchase agreement to acquire approxmiately 50,000 shares of the Capital State Bank, Inc. This will give the Registrant an ownership interest of approximately 40% in Capital State Bank, Inc. These documents are incorporated herein by reference in their entirety.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

South Branch Valley Bancorp, Inc.
a West Virginia Corporation
(registrant)

| | |
|---|---|
| By:/s/Oscar M. Bean 3/28/97 | By:/s/H. Charles Maddy, III 3/28/97 |
| Oscar M. Bean, Date<br>Chairman of the Board | H. Charles Maddy, III Date<br>President |

By:/s/Russell F. Ratliff, Jr. 3/28/97

Russell F. Ratliff, Jr. Date
Treasurer
Principal Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| | Title | Date |
|---|---|---|
| /s/ Oscar M. Bean<br>Oscar M. Bean | Director | March 28, 1997 |
| /s/ Donald W. Biller<br>Donald W. Biller | Director | March 28, 1997 |
| /s/ James M. Cookman<br>James M. Cookman | Director | March 28, 1997 |
| /s/ John W. Crites<br>John W. Crites | Director | March 28, 1997 |
| /s/ Thomas J. Hawse, III<br>Thomas J. Hawse, III | Director | March 28, 1997 |
| /s/ Phoebe F. Heishman<br>Phoebe F. Heishman | Director | March 28, 1997 |

SIGNATURES (cont'd)

| | | |
|---|---|---|
| /s/ Gary L. Hinkle<br>- ------------------------<br>Gary L. Hinkle | Director | March 28, 1997 |
| /s/ Jeffrey E. Hott<br>- ------------------------<br>Jeffrey E. Hott | Director | March 28, 1997 |
| /s/ H. Charles Maddy, III<br>- ---------------------------<br>H. Charles Maddy, III | Director | March 28, 1997 |
| /s/ Harold K. Michael<br>- ---------------------------<br>Harold K. Michael | Director | March 28, 1997 |
| /s/ Mary Ann Ours<br>- ---------------------------<br>Mary Ann Ours | Director | March 28, 1997 |
| /s/ Russell F. Ratliff, Jr.<br>- ---------------------------<br>Russell F. Ratliff, Jr. | Director | March 28, 1997 |
| /s/ Harry C. Welton, Jr.<br>- ---------------------------<br>Harry C. Welton, Jr. | Director | March 28, 1997 |
| /s/ Renick C. Williams<br>- ---------------------------<br>Renick C. Williams | Director | March 28, 1997 |

E X H I B I T (13)

SOUTH BRANCH VALLEY BANCORP,INC ANNUAL
REPORT TO SHAREHOLDERS FOR THE YEAR
ENDED DECEMBER 31, 1996



1996
ANNUAL REPORT

SOUTH BRANCH VALLEY
BANCORP, INC.

CONTENTS



MAILING ADDRESS

South Branch Valley Bancorp, Inc.
P.O. Box 680
Moorefield, West Virginia 26836

[South Branch Valley Bancorp, Inc. logo]

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To Our Stockholders and Friends:

We are proud to present to you the 1996 Consolidated Annual Report of South Branch Valley Bancorp, Inc. The past year was our ninth consecutive year of realizing record earnings which totaled $1,490,000. This earnings strength has enabled us to increase our dividends over 1995 by 13.2% to $.77 per share. Meeting the challenge of a highly competitive market, South Branch Valley achieved record levels of total assets and total capital. Once again, our entire staff is to be commended for their excellent performance in responding to the increasing demands of a competitive industry.

During 1996, we successfully upgraded our computer system and put the finishing touches on our main office. In addition, our strong management team and support staff should be commended for successfully guiding us through the aftermath of a flood. Although the flood disrupted our daily routines, "it was business as usual" at South Branch Valley National Bank.

Additionally, as most of you are aware, we have entered into an agreement to purchase approximately a 35% interest in the Capital State Bank located in Charleston, WV. We are confident that this transaction will help further our goals in creating shareholder value for many years to come.

Our Board of Directors and management team wish to convey our deepest appreciation for your continued support. We are proud of the performance of our Company and hope you are as well. Your comments and suggestions are always welcome and your friendship is appreciated.

| | |
|---|---|
| /s/ OSCAR M. BEAN | /s/ H. CHARLES MADDY, III |
| Oscar M. Bean | H. Charles Maddy, III |
| Chairman of the Board | President |

P. O. Box 680-Moorefield, West Virginia 26836-Phone(304) 538-2353-Fax(304) 538-7053

FINANCIAL HIGHLIGHTS
SOUTH BRANCH VALLEY BANCORP, INC. AND SUBSIDIARY

DIVIDENDS PER SHARE
[CHART GOES HERE]

| | |
|---|---|
| 1992 | $0.42 |
| 1993 | $0.48 |
| 1994 | $0.61 |
| 1995 | $0.68 |
| 1996 | $0.77 |

EARNINGS PER SHARE
[CHART GOES HERE]

| | |
|---|---|
| 1992 | $2.97 |
| 1993 | $3.06 |
| 1994 | $3.26 |
| 1995 | $3.49 |
| 1996 | $3.94 |

| | 1996 | 1995 | % CHANGE |
|---|---|---|---|
| FOR THE YEAR (IN THOUSANDS) | | | |
| Net Income | $ 1,490 | $ 1,320 | 12.88% |
| Net Interest Income | 4,928 | 4,542 | 8.50% |
| YEAR END BALANCES (IN THOUSANDS) | | | |
| Total Assets | $122,114 | $113,118 | 7.95% |
| Total Loans | 83,273 | 71,458 | 16.53% |
| Total Deposits | 100,941 | 100,046 | 0.89% |
| Total Equity | 12,304 | 11,329 | 8.61% |
| PER SHARE DATA | | | |
| Earnings | $ 3.94 | $ 3.49 | 12.89% |
| Book Value | $ 32.51 | $ 29.93 | 8.62% |
| Cash Dividends | $ 0.77 | $ 0.68 | 13.24% |
| RATIOS | | | |
| Return on Average Assets | 1.27% | 1.29% | -1.55% |
| Return on Average Equity | 12.97% | 12.83% | 1.09% |
| Dividend Pay-out | 19.56% | 19.50% | 0.31% |
| Shareholders' Equity to Total Assets | 10.08% | 10.01% | 0.70% |

RETURN ON AVERAGE ASSETS
(before cumulative effect of accounting change)
[GRAPH GOES HERE]

| | |
|---|---|
| 1992 | 1.22% |
| 1993 | 1.27% |
| 1994 | 1.29% |
| 1995 | 1.29% |
| 1996 | 1.27% |

TOTAL ASSETS
[GRAPH GOES HERE]

| | |
|---|---|
| 1992 | $ 90.1 |
| 1993 | $ 94.6 |
| 1994 | $ 96.6 |
| 1995 | $113.1 |
| 1996 | $122.1 |

SOUTH BRANCH VALLEY BANCORP, INC. AND SUBSIDIARY
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is management's discussion and analysis of the financial condition and changes in financial condition and results of operations of South Branch Valley Bancorp, Inc., and its wholly owned subsidiary, South Branch Valley National Bank, (hereafter referred to as the Company) for the two years ended December 31, 1996. Also presented is an analysis of the rate sensitivity of the components of the Company's statement of condition.

RESULTS OF OPERATIONS

Net income for the three years ended December 31, 1996, 1995, and 1994, was $1,490,000, $1,320,000, and $1,245,000 respectively. Return on average total assets for the year ended December 31, 1996 was 1.27% compared to 1.29% in 1995 and 1.29% in 1994. On a per share basis, net income was $3.94 in 1996 compared to $3.49 in 1995 and $3.26 in 1994. Dividends per share totaled $.77 in 1996 compared to $.68 in 1995 and $.61 per share in 1994.

NET INTEREST INCOME

The major component of the Company's net earnings is net interest income, which is the excess of interest earned on earning assets over the interest expense for sources of funds. Net interest income is affected by changes in volume, resulting from growth and alterations of the balance sheet's composition, as well as fluctuations in interest rates and maturities of sources and uses of funds. Bank management seeks to maximize net interest income through management of the balance sheet. This is accomplished by determining the optimal product mix with respect to yields on assets and costs of funds in light of projected economic conditions, while maintaining portfolio risk at an acceptable level. Management uses GAP analysis to determine the optimal product mix.

Included in interest and fees on loans are loan fees earned of $181,000, $180,000, and $175,000 for the years ended December 31, 1996, 1995, and 1994, respectively.

Interest income on securities which are exempt from Federal tax typically provide a favorable impact on earnings through reduction of the Company's tax liability. Consequently, for purposes of this discussion, interest income on tax exempt securities has been adjusted to reflect the tax benefit derived, after consideration of nondeductible interest expense related to these obligations, assuming an effective tax rate of 34.0 percent for all the years presented. The tax equivalent adjustment results in an increase of $52,000 in interest income for 1996, $41,000 for 1995 and $45,000 for 1994.

Table I presents, for the periods indicated, the changes in interest income and expense attributable to (a) changes in volume (changes in volume multiplied by prior period rate) and (b) changes in rate (change in rate multiplied by prior period volume). Changes in interest income and expense attributable to both rate and volume have been allocated between the factors in proportion to the relationship of the absolute dollar amounts of the change in each. Net interest income on a fully tax equivalent basis, average balance sheet amounts, and corresponding average rates for the years 1994, 1995 and 1996 are presented in Table II.

Net interest income, as adjusted, totaled $4,980,000, $4,583,000 and $4,531,000 for the years ended December 31, 1996, 1995 and 1994, respectively. The net interest margin, which recognizes earning asset growth by expressing net interest income as a percentage of total average earning assets, decreased from 4.9% in 1994 to 4.7% in 1995 and to 4.5% in 1996. Lower loan yields and an increase in the cost of funds, primarily time deposits and borrowed funds, which have been used to primarily fund loan growth, continued to negatively impact the Company's net interest margin. In 1996, the yield on interest earning assets remained the same as 1995, while the cost of interest bearing liabilities rose 10 basis points. See Table II for a detailed analysis of the Company's net interest yield on earning assets.

The spread between interest earning assets and interest bearing liabilities could continue to contract, thus negatively impacting the Company's net interest income in 1997. Management continues to monitor the net interest margin through GAP analysis to minimize the potential for any significant negative impact. See the "Liquidity and Interest Rate Sensitivity" section for further discussion of the impact of changes in market interest rates on the Company.

Table I: Changes in Interest Margin Attributable to Rate and Volume
(In Thousands of Dollars)

| | 1996 VERSUS 1995 | | | 1995 VERSUS 1994 | | |
|---|---|---|---|---|---|---|
| | Increase (Decrease) Due to Change in: | | | Increase (Decrease) Due to Change in: | | |
| | Volume | Rate | Net | Volume | Rate | Net |
| Loans | $ 1,091 | $ (129) | $ 962 | $ 486 | $ 309 | $ 795 |
| Securities | | | | | | |
| Taxable | 33 | 27 | 60 | 23 | (1) | 22 |
| Tax-exempt | 121 | (19) | 102 | 39 | (33) | 6 |
| Interest bearing deposits with other banks | (8) | (4) | (12) | 9 | (1) | 8 |
| Federal funds sold | 8 | (8) | -- | (14) | 20 | 6 |
| Total interest earned on interest-earning assets | 1,245 | (133) | 1,112 | 543 | 294 | 837 |
| Interest paid on: | | | | | | |
| Interest bearing demand deposits | 64 | (36) | 28 | 72 | 113 | 185 |
| Regular savings | 64 | 13 | 77 | (22) | 34 | 12 |
| Time savings | 343 | 154 | 497 | 152 | 397 | 549 |
| Federal funds purchased and securities sold with agreement to repurchase | 60 | -- | 60 | -- | -- | -- |
| Borrowed funds | 56 | (3) | 53 | 38 | 1 | 39 |
| Total interest paid on liabilities | 586 | 129 | 715 | 240 | 545 | 785 |
| Net interest income | $ 659 | $ (262) | $ 397 | $ 303 | $ (251) | $ 52 |

Table II: Average Distribution of Assets, Liabilities and Shareholders' Equity, Interest Earnings & Expenses, and Average Rates

| (In thousands of dollars) | 1996 Average Balances | 1996 Earnings/ Expense | 1996 Yield/ Rate | 1995 Average Balances | 1995 Earnings/ Expense | 1995 Yield/ Rate | 1994 Average Balances | 1994 Earnings/ Expense | 1994 Yield/ Rate |
|---|---|---|---|---|---|---|---|---|---|
| ASSETS | | | | | | | | | |
| Interest earning assets: | | | | | | | | | |
| Loans, net of unearned interest | $ 76,797 | $ 7,552 | 9.8% | $ 66,148 | $ 6,590 | 10.0% | $ 61,175 | $ 5,795 | 9.5% |
| Securities | | | | | | | | | |
| Taxable | 26,557 | 1,711 | 6.4% | 26,059 | 1,651 | 6.3% | 25,703 | 1,629 | 6.3% |
| Tax-exempt | 4,757 | 307 | 6.5% | 2,898 | 205 | 7.1% | 2,390 | 199 | 8.3% |
| Interest bearing deposits with other banks | 1,869 | 125 | 6.7% | 1,997 | 137 | 6.9% | 1,859 | 129 | 6.9% |
| Federal Funds sold | 892 | 49 | 5.5% | 756 | 49 | 6.5% | 1,051 | 43 | 4.1% |
| Total interest earning assets | 110,872 | 9,744 | 8.8% | 97,858 | 8,632 | 8.8% | 92,178 | 7,795 | 8.5% |
| Noninterest earning assets: | | | | | | | | | |
| Cash & due from banks | 2,419 | | | 2,157 | | | 2,694 | | |
| Bank premises & equipment | 3,155 | | | 2,084 | | | 1,298 | | |
| Other assets | 1,298 | | | 1,052 | | | 1,032 | | |
| Allowance for loan losses | (861) | | | (930) | | | (990) | | |
| Total assets | $ 116,883 | | | $ 102,221 | | | $ 96,212 | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | | | | |
| Liabilities | | | | | | | | | |
| Interest bearing liabilities: | | | | | | | | | |
| Interest bearing demand deposits | $ 19,761 | $ 669 | 3.4% | $ 17,825 | $ 641 | 3.6% | $ 15,579 | $ 456 | 2.9% |
| Regular savings | 15,048 | 523 | 3.5% | 13,084 | 446 | 3.4% | 13,757 | 434 | 3.2% |
| Time savings | 57,756 | 3,398 | 5.9% | 51,492 | 2,901 | 5.6% | 48,486 | 2,352 | 4.9% |
| Federal funds purchased and securities sold with agreement to repurchase | 1,422 | 60 | 4.2% | -- | -- | -- | -- | -- | -- |
| Borrowed funds | 1,960 | 114 | 5.8% | 995 | 61 | 6.1% | 377 | 22 | 5.8% |
| | 95,947 | 4,764 | 5.0% | 83,396 | 4,049 | 4.9% | 78,199 | 3,264 | 4.2% |
| Noninterest bearing liabilities | | | | | | | | | |
| Demand deposits | 8,532 | | | 7,819 | | | 8,009 | | |
| Other liabilities | 914 | | | 716 | | | 606 | | |
| Total liabilities | 105,393 | | | 91,931 | | | 86,814 | | |
| Shareholders' equity | 11,490 | | | 10,290 | | | 9,398 | | |
| Total liabilities and shareholders' equity | $ 116,883 | | | $ 102,221 | | | $ 96,212 | | |
| NET INTEREST EARNINGS | | $ 4,980 | | | $ 4,583 | | | $ 4,531 | |
| NET INTEREST YIELD ON EARNING ASSETS | | | 4.5% | | | 4.7% | | | 4.9% |

PROVISION FOR LOAN LOSSES

The provision for loan losses represents management's determination of the amount necessary to be charged against the current period's earnings in order to maintain the allowance for loan losses at a level which is considered adequate in relation to the estimated risk inherent in the loan portfolio. The provision for loan losses was $95,000, $55,000, and $120,000 for the years ended December 31, 1996, 1995, and 1994, respectively. Charge-offs, net of recoveries, for 1996 were $96,000 compared to $188,000 and $32,000 in 1995 and 1994, respectively. See the "Risk Elements" section for further discussion of the allowance for loan losses.

OTHER INCOME

Other income totaled $457,000, $379,000 and $342,000 or 4.5%, 4.2%, and 4.2% of total income for each of the years ended December 31, 1996, 1995, and 1994, respectively. The following table details the components of non-interest income earned by the Company for the years ended December 31, 1996, 1995 and 1994 in thousands of dollars, as well as the percentage increase (decrease) in each of the components over the prior year.

| | (In thousands of dollars) | | | | |
|---|---|---|---|---|---|
| | 1996 | | 1995 | | 1994 |
| | Amount | Percent Change | Amount | Percent Change | Amount |
| Insurance commissions | $ 111 | 0.1% | $ 110 | (0.1%) | $ 111 |
| Trust department income | 6 | 20.0% | 5 | (68.8%) | 16 |
| Service fees | 233 | 10.4% | 211 | 1.0% | 209 |
| Securities gains (losses) | 30 | 3100.0% | (1) | 50.0% | (2) |
| Gain (loss) on sales of other assets | 7 | 100.0% | -- | 100.0% | (21) |
| Other | 70 | 29.6% | 54 | 86.2% | 29 |
| | $ 457 | 20.6% | $ 379 | 10.8% | $ 342 |

Non-interest income earned in 1996 increased $78,000 or 20.6%.This increase is attributable to three items. Service fee income increased 10.4% from $211,000 in 1995 to $233,000 in 1996. Securities gains (losses) increased from a loss of $1,000 in 1995 to a gain of $30,000 in 1996. Gain on sales of other assets increased from $0 in 1995 to $7,000 in 1996. There were no significant fluctuations or unusual items during 1996.

OTHER EXPENSES

Other expense totaled $3,156,000, $2,866,000, and $2,799,000 or 39.4%, 41.1%, and 45.3% of total expense for each of the years ended December 31, 1996, 1995, and 1994, respectively. The following table itemizes the primary components of non-interest expense in thousands of dollars for the three years ended December 31, 1996 by dollar amount and percentage variance from the preceding year.

| | (In thousands of dollars) | | | | |
|---|---|---|---|---|---|
| | 1996 | | 1995 | | 1994 |
| | Amount | Percent Change | Amount | Percent Change | Amount |
| Salaries and employee benefits | $ 1,728 | 11.0% | $ 1,557 | 7.5% | $ 1,448 |
| Net occupancy expense of premises | 189 | 48.8% | 127 | 7.6% | 118 |
| Equipment rentals, depreciation and maintenance | 181 | 11.7% | 162 | 3.2% | 157 |
| Federal deposit insurance premiums | 2 | (98.0%) | 100 | (51.2%) | 205 |
| Other expense | 1,056 | 14.8% | 920 | 5.6% | 871 |
| | $ 3,156 | 10.1% | $ 2,866 | 2.4% | $ 2,799 |

Non-interest expense increased $290,000 or 10.1% from 1995 to 1996. The most significant component of non-interest expense, salaries and employee benefits, increased 11.0% from $1,557,000 in 1995 to $1,728,000 in 1996. This is a result of general merit raises and an increase in our employee health insurance premiums. Net occupancy expense of premises totaled $189,000 for 1996 as compared to $127,000 for 1995 for a 48.8% increase. A major portion of this increase is the annual depreciation expense resulting from the purchase of the Petersburg, West Virginia branch building and the new addition to the main office in Moorefield, West Virginia. Equipment rentals, depreciation and maintenance increased 11.7% from $162,000 in 1995 to $181,000 in 1996. A major portion of this increase is the annual depreciation expense resulting from the purchase of the equipment for the Petersburg branch and the new addition to the main office. FDIC Insurance premiums decreased approximately $98,000 or (98.0%) from 1995 to 1996. This decrease was a result of the FDIC's reduction of the premiums for adequately capitalized banks from 4 cents per $100 of deposits to $500 per quarter. These increases were expected and planned for by management.

INCOME TAX EXPENSE

Income tax expense (benefit) for the three years ended December 31, 1996, 1995, and 1994 totaled $643,000, $680,000, and $665,000, respectively. See Note 10 of the accompanying consolidated financial statements for further information relating to the Company's income taxes.

CHANGES IN FINANCIAL POSITION

Table III illustrates the average composition of major balance sheet classifications of the Company expressed in terms of dollar amounts and as a percentage of total assets for each of the three years ended December 31, 1996, 1995 and 1994.

Total average assets for the year ended December 31, 1996 were $116,883,000, an increase of 14.3% over 1995's average of $102,221,000. Total average assets increased $6,009,000 or 6.2% from 1994 to 1995.

Total average interest earning assets, expressed as a percentage of total assets, decreased slightly to 94.8% for 1996 as compared to 95.7% for 1995 and 95.8% for 1994.

Management has been making an effort to effectively leverage the Bank's capital and has used the Federal Home Loan Bank of Pittsburgh to achieve that goal. The Bank uses these funds to fund fixed rate, long term mortgage loans as well as specific commercial loan projects. The Bank's total line of credit limit with the Federal Home Loan Bank is approximately $35,000,000. During 1996 the Bank borrowed a total of $2,840,000 from the Federal Home Loan Bank. See Note 9 of the accompanying consolidated financial statements for further information concerning the Bank's long term borrowings.

Total deposits at December 31, 1996 increased approximately 1.0% compared to December 31, 1995. Average deposits increased approximately $11,000,000 or 12.3% during 1996. Approximately 45.5% or $5,000,000 of the Company's average balance growth in deposits in 1996 was the result of the deposits acquired at the time of purchase of the Company's Petersburg branch, which was acquired in November 1995. This growth was within management's goals of consistent, controlled deposit growth. See Table II for average deposit balances by type and their related interest expense. Also see Note 8 of the accompanying consolidated financial statements for a maturity distribution of certificates of deposit and Individual Retirement Accounts in denominations of $100,000 or more as of December 31, 1996.

LOAN PORTFOLIO

Total net loans averaged $76,797,000 in 1996 and comprised 65.7% of total average assets compared to $66,148,000 or 64.7% of total average assets during 1995. This increase in the dollar volume of loans is primarily attributable to increased loan demand experienced in 1996 as well as a more aggressive strategy taken by management to increase quality loan volume by expanding the Bank's commercial and real estate portfolios.

The following table depicts loan balances at December 31, 1996 and 1995 by types along with their respective percentage of total loans outstanding.

(In thousands of dollars)

| | 1996 Amount | 1996 Percent of Total | 1995 Amount | 1995 Percent of Total |
|---|---|---|---|---|
| Commercial, financial, and agricultural | $ 20,451 | 24.6% | $ 18,875 | 26.4% |
| Real estate--mortgage | 43,468 | 52.2% | 36,980 | 51.7% |
| Real estate--construction | 154 | .2% | 103 | .2% |
| Installment loans to individuals (net of unearned interest) | 18,584 | 22.3% | 14,957 | 20.9% |
| Other | 615 | .7% | 543 | .8% |
| Total loans (net of unearned interest) | $ 83,272 | 100.0% | $ 71,548 | 100.0% |
| Less allowance for loan losses | 858 | | 860 | |
| Loans, net | $ 82,414 | | $ 70,598 | |

No significant changes in the Company's loan portfolio composition occurred during 1996. Refer to Note 5 of the accompanying consolidated financial statements for the Company's loan maturities and a discussion of the Company's adjustable rate loans as of December 31, 1996.

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities which are disclosed but not reflected in the accompanying financial statements. These commitments and contingent liabilities include various guarantees and commitments to extend credit and standby letters of credit. At December 31, 1996, 1995, and 1994, such commitments approximated $5,639,000, $4,463,000, and $3,445,000, respectively. The Bank does not anticipate any material losses as a result of these commitments.

Interest on installment loans is recognized using methods which approximate the simple interest method depending on the term of the loan and provisions of State law on the date the loan was originated. For commercial and real estate mortgage loans, interest income is computed using the simple interest method.

Certain loan fees and direct loan costs are recognized as income or expense when incurred, whereas, generally accepted accounting principles require that such fees and costs be deferred and amortized as adjustments of the related loan's yield over the contractual life of the loan. The effects of this departure from generally accepted accounting principles are not significant to the Company's consolidated financial statements.

RISK ELEMENTS

A loan is impaired when, based on current information and events, it is probable that all amounts due will not be collected in accordance with the contractual terms of the specific loan agreement. Impaired loans, other than certain large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, are reported at the present value of expected future cash flows discounted using the loan's original effective interest rate or, alternatively, at the loan's observable market price, or at the fair value of the loan's collateral if the loan is collateral dependent.

South Branch Valley Bancorp, Inc. and Subsidiary
Table III: Average Balances (In thousands of dollars)

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | Average Balances | Percent | Average Balances | Percent | Average Balances | Percent |
| **ASSETS** | | | | | | |
| Interest earning assets: | | | | | | |
| Loans, net of unearned interest | $ 76,797 | 65.7% | $ 66,148 | 64.7% | $ 61,175 | 63.6% |
| Securities | | | | | | |
| Taxable | 26,557 | 22.7% | 26,059 | 25.5% | 25,703 | 26.7% |
| Tax-exempt | 4,757 | 4.1% | 2,898 | 2.8% | 2,390 | 2.5% |
| Total | 31,314 | 26.8% | 28,957 | 28.3% | 28,093 | 29.2% |
| Interest bearing deposits with other banks | 1,869 | 1.6% | 1,997 | 2.0% | 1,859 | 1.9% |
| Federal Funds sold | 892 | 0.7% | 756 | 0.7% | 1,051 | 1.1% |
| Total interest earning assets | 110,872 | 94.8% | 97,858 | 95.7% | 92,178 | 95.8% |
| Noninterest earning assets: | | | | | | |
| Cash & due from banks | 2,419 | 2.1% | 2,157 | 2.1% | 2,694 | 2.8% |
| Bank premises & equipment | 3,155 | 2.7% | 2,084 | 2.1% | 1,298 | 1.3% |
| Other assets | 1,298 | 1.1% | 1,052 | 1.0% | 1,032 | 1.1% |
| Allowance for loan losses | (861) | (0.7%) | (930) | (0.9%) | (990) | (1.0%) |
| Total assets | $ 116,883 | 100.0% | $ 102,221 | 100.0% | $ 96,212 | 100.0% |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | | | |
| Interest bearing liabilities: | | | | | | |
| Interest bearing demand deposits | $ 19,761 | 16.9% | $ 17,825 | 17.4% | $ 15,579 | 16.2% |
| Regular savings | 15,048 | 12.9% | 13,084 | 12.8% | 13,757 | 14.3% |
| Time savings | 57,756 | 49.4% | 51,492 | 50.4% | 48,486 | 50.4% |
| Federal funds purchased and securities sold with agreement to repurchase | 1,422 | 1.2% | -- | -- | -- | -- |
| Borrowed funds | 1,960 | 1.7% | 995 | 1.0% | 377 | 0.4% |
| | 95,947 | 82.1% | 83,396 | 81.6% | 78,199 | 81.3% |
| Noninterest bearing liabilities: | | | | | | |
| Demand deposits | 8,532 | 7.3% | 7,819 | 7.6% | 8,009 | 8.3% |
| Other liabilities | 914 | 0.8% | 716 | 0.7% | 606 | 0.6% |
| Total liabilities | 105,393 | 90.2% | 91,931 | 89.9% | 86,814 | 90.2% |
| Shareholders' equity | 11,490 | 9.8% | 10,290 | 10.1% | 9,398 | 9.8% |
| Total liabilities and shareholders' equity | $ 116,883 | 100.0% | $ 102,221 | 100.0% | $ 96,212 | 100.0% |

The following table presents a summary of restructured or nonperforming loans for each of the three years ended December 31, 1996, 1995 and 1994.

| | December 31, 1996 | 1995 | 1994 |
|---|---|---|---|
| | (In thousands of dollars) | | |
| Nonaccrual loans | $ 343 | $ 538 | $ 675 |
| Accruing loans past due 90 days or more | 324 | 260 | 585 |
| Restructured loans | 55 | 230 | 366 |
| Total | $ 722 | $ 1,028 | $ 1,626 |
| Percentage of total loans net of unearned interest | .9% | 1.4% | 2.5% |

If interest on non-accrual loans had been accrued, such income would have approximated $31,000, $37,000 and $6,000 for the years ended December 31, 1996, 1995 and 1994, respectively. Interest income previously accrued on non-accrual loans and included as a part of the Company's interest income is not material.

The Company's subsidiary bank, on a quarterly basis, performs a comprehensive loan evaluation which encompasses the identification of all potential problem credits which are included on an internally generated watch list. The identification of loans for inclusion on the watch list is facilitated through the use of various sources, including past due loan reports, previous internal and external loan evaluations, classified loans identified as part of regulatory agency loan reviews and reviews of new loans representative of current lending practices within the Bank. Once this list is reviewed to ensure it is complete, the credit review department reviews the specific loans for collectibility, performance and collateral protection. In addition, a grade is assigned to the individual loans utilizing internal grading criteria, which is somewhat similar to the criteria utilized by the Bank's primary regulatory agency. Based on the results of these reviews, specific reserves for potential losses are identified and the allowance for loan losses is adjusted appropriately. While there may be some loans or portions of loans identified as potential problem credits which are not specifically identified as either non-accrual or accruing loans past due 90 or more days, they are considered by management to be insignificant to the overall disclosure and are, therefore, not specifically quantified within the Management's Discussion and Analysis.

In addition, management feels these additional loans do not represent or result from trends or uncertainties which management reasonably expects will materially impact future operating results, liquidity or capital resources. Also, these loans do not represent material credits about which management is aware of any information which would cause the borrowers to not comply with the loan repayment terms.

Specific reserves are allocated to the non-performing loans based on the quarterly evaluation of expected loan loss reserve requirements as determined by Bank management. In addition, a portion of the reserve is determined through the use of loan loss experience factors which do not provide for identification of specific potential problem loans. As noted above, some of the loans, which are not deemed significant, are included in the watch list of potential problem loans and have specific reserves allocated to them.

At December 31, 1996, the Company's allowance for loan loss was $858,000 or 1.0% of total loans compared to $860,000 or 1.2% at December 31, 1995.

Table IV below presents an allocation of the expected allowance for loan losses by major loan type.

Table IV: Allocation of the Allowance for Loan Losses (In thousands of dollars)

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans | Amount | Percent of Loans in Each Category to Total Loans |
| Commercial, financial, and agricultural | $ 204 | 24.3% | $ 232 | 26.4% | $ 364 | 27.7% |
| Real estate | 333 | 51.8% | 378 | 51.9% | 488 | 52.3% |
| Installment | 309 | 23.2% | 241 | 20.9% | 138 | 19.3% |
| Other | 12 | .7% | 9 | 0.8% | 3 | 0.7% |
| | $ 858 | 100.0% | $ 860 | 100.0% | $ 993 | 100.0% |

At December 31, 1996, the Company had approximately $29,000 in other real estate owned which was obtained as the result of foreclosure proceedings and $39,500 in other repossessed assets which was obtained as the result of auto repossessions. Management does not anticipate any material losses on any of the items currently held in other real estate owned or other repossessed assets.

LOAN CONCENTRATIONS

The Company's subsidiary bank grants commercial, residential and consumer loans to customers primarily located in Hardy, Grant, Hampshire and Pendleton Counties of West Virginia. Although the Bank strives to maintain a diverse loan portfolio, a substantial portion of its debtors' ability to honor their contracts is indirectly dependent upon the poultry industry.

As of December 31, 1996 and 1995, the Bank had direct extensions of credit used to build and operate poultry houses totaling approximately $4,564,000 and $5,873,000, respectively. These loans are generally structured to be repaid over periods ranging from 15 to 20 years, however, most also contain balloon provisions which serve to require each loan's renewal every 1 to 5 years. Further, interest rate risk is minimized by underwriting loans not subject to a balloon provision with an adjustable interest rate feature. The security for these loans generally consists of liens on the land, buildings and equipment associated with each poultry house.

The Bank evaluates the credit worthiness of each of its customers on a case-by-case basis and the amount of collateral it obtains is based upon management's credit evaluation. Although, by definition, loan concentrations are more susceptible to deteriorating economic conditions affecting the specific areas and industries to which the concentrations are tied, the Company does not, as of this writing, anticipate losses in this identified area that would be materially different from the losses experienced in the loan portfolio taken as a whole.

SECURITIES

All securities have been classified as available for sale as of December 31, 1996. The fair value of the Bank's available for sale portfolio totaled $29,351,998, at December 31, 1996, which was 100.7% of the amortized cost. See Note 4 of the accompanying consolidated financial statements for details of amortized cost, the fair values, unrealized gains and losses as well as the security classifications by type. Available for sale securities comprised approximately 24.0% of total assets at December 31, 1996.

At December 31, 1996, the Bank did not own securities of any one issuer that exceeded ten percent of shareholders' equity. The maturity distribution of the securities portfolio at December 31, 1996, excluding equity securities of $394,425, together with the weighted average yields for each range of maturity are summarized in Table V. The maturity distribution is based on contractual maturities except for amortizing securities which are based on anticipated average life to maturity, as discussed in Note 4 to the accompanying consolidated financial statements. The stated average yields are actual yields and are not stated on a tax equivalent basis.

Table V: Investment Security Maturity Analysis (In thousands of dollars)

| Securities Available for Sale | Within One Year | | After One but within Five Years | | After Five but within Ten Years | | After Ten Years | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| U.S. Treasury securities | $ 1,259 | 5.54% | $ 2,988 | 6.63% | $ - - | - - | $ - - | - - |
| U.S. Government agencies and corporations | 850 | 5.30% | 8,734 | 6.61% | 3,909 | 6.93% | 200 | 6.45% |
| Mortgage backed securities: U.S. Government agencies and corporations | 1,602 | 7.15% | 2,835 | 6.22% | 173 | 6.59% | - - | - - |
| State and political subdivisions | 285 | 5.52% | 1,383 | 5.26% | 2,181 | 5.05% | 1,870 | 5.29% |
| Other | 250 | 5.47% | 248 | 7.00% | - - | - - | - - | - - |
| Total | $ 4,246 | 6.34% | $ 16,188 | 6.46% | $ 6,263 | 6.37% | $ 2,070 | 5.26% |

SHORT TERM BORROWINGS

The Bank has a line of credit from the Federal Home Loan Bank of Pittsburgh. Management uses this line to make additional funds available to customers in the form of loans at competitive rates. Funds acquired through this program are reflected on the consolidated balance sheet as short-term borrowings due to the repayment terms of the debt agreement.

The Federal Home Loan Bank borrowings is a product known as Flexline. It is a line of credit limited to 10% of the Bank's assets and is subject to annual renewals that are effective the first business day of the new year. The line bears interest at the Bank's overnight cost of funds rate, and may be paid off at any time without prepayment penalty. The Bank's borrowing rate is subject to change daily. The line of credit is secured by a blanket lien on all unpledged and unencumbered assets of the Bank.

The Bank's management has recognized that the Bank has excess capital. Management has been using the Federal Home Loan Bank's long term and short term loan programs to effectively leverage this unused capital.

See note 9 to the accompanying consolidated financial statements for a summary of the Company's short term borrowings, consisting of Federal funds purchased, repurchase agreements and borrowings from the Federal Home Loan Bank, for the years ended December 31, 1996 and December 31, 1995.

LONG TERM BORROWINGS

The Bank's long term borrowings of $3,514,652 at December 31, 1996 consist of advances from the Federal Home Loan Bank of Pittsburgh. During 1996, borrowings through the Community Investment Program totaled $2,090,000 with an average weighted interest rate of 5.95% while borrowings through the regular long term fixed rate program totaled $1,443,913 with an average weighted interest rate of 5.48%. The Bank used these funds to fund fixed rate, long term mortgage loans as well as specific commercial loan projects.

See note 9 to the accompanying consolidated financial statements for a summary of the Company's long term borrowings maturities for the year ended December 31, 1996.

## LIQUIDITY

Liquidity in commercial banking can be defined as the ability to satisfy customer loan demand and meet deposit withdrawals while maximizing net interest income. The Bank uses ratio analysis to monitor the changes in its sources and uses of funds so that an adequate liquidity position is maintained. At December 31, 1996, liquidity was available through cash, due from banks, Federal funds sold, securities and interest bearing deposits with other banks maturing within one year and totaled approximately $6,851,000 or 5.6% of total assets. Secondary sources of liquidity are provided by all remaining available for sale securities, Federal funds purchased, Federal Home Loan Bank lines of credit, and correspondent banks lines of credit. Management believes that the liquidity of the Company is adequate and foresees no demand or conditions that would adversely affect it.

## ASSET/LIABILITY MANAGEMENT

The principal objective of asset/liability management is to minimize interest rate risk, which is the vulnerability of the Company's net interest income to changes in interest rates and manage the ratio of interest rate sensitive assets to interest rate sensitive liabilities within specified maturities or repricing dates. The Company's actions in this regard are taken under the guidance of the Subsidiary Bank's Asset/Liability Management Committee, which is comprised of members of the Bank's senior management and members of the Board of Directors. The Bank's Asset/Liability Management Committee is actively involved in formulating the economic assumptions that the Bank uses in its financial planning and budgeting process and establishes policies which control and monitor the Bank's sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Several techniques are available to monitor and control the level of interest rate risk. The Bank regularly performs modeling to project the potential impact of future interest rate scenarios on net interest income. Through such simulation analysis, interest rate risk is maintained within established policy limits. Based upon the present mix of assets and liabilities and management's assumptions with respect to growth and repricing, no significant impact on the Company's 1997 net interest margin is expected given a 200 basis point change in interest rates during 1997.

Another means of analyzing an institution's interest rate risk is by monitoring its interest rate sensitivity "gaps." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity "gap" is defined as the difference between interest earning assets and interest bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds interest rate sensitive assets. During a period of falling interest rates, a positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net interest income. During a period of rising interest rates, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to affect net interest income adversely.

Table VI sets forth at December 31, 1996 the Company's interest rate sensitivity gaps within the one year time horizon computed based upon contractual repricings and maturities. As presented in the table, the Company has a one year cumulative negative interest sensitivity gap of $35.0 million (or 30.6% of total earning assets). However, included within the one year time period are $33.1 million of interest bearing demand and savings deposits which on a contractual basis are immediately repriceable. However, the actual repricing of these deposits tends to lag well behind movements in market interest rates. Accordingly, the sensitivity of such core deposits to changes in market interest rate may differ significantly from their contractual terms. If interest bearing demand and savings deposits are assumed to reprice beyond the one year time horizon, the

Company's one year cumulative interest rate sensitivity gap at December 31, 1996 would be a negative $1.9 million or just 1.6% of interest earning assets.

Table VI: Asset & Liability Rate Sensitivity Analysis, December 31, 1996 (In thousands of dollars)

| | Maturing or Repricing Within | | | |
|---|---|---|---|---|
| | 0-90 Days | 91-180 Days | 181-365 Days | Total 1 Year |
| Interest Earning Assets: | | | | |
| Loans | $ 11,695 | $ 10,815 | $ 10,522 | $ 33,032 |
| Taxable Securities | 284 | 805 | 1,294 | 2,383 |
| Tax Exempt Securities | - - | 250 | 35 | 285 |
| Other | - - | - - | 297 | 297 |
| Total Earning Assets | $ 11,979 | $ 11,870 | $ 12,148 | $ 35,997 |
| Interest Bearing Liabilities: | | | | |
| Certificates of Deposit | $ 9,218 | $ 10,611 | $ 18,041 | $ 37,870 |
| Savings Deposits | 12,939 | - - | - - | 12,939 |
| Interest Bearing Demand Deposits | 20,140 | - - | - - | 20,140 |
| | $ 42,297 | $ 10,611 | $ 18,041 | $ 70,949 |
| Static Interest Sensitivity Gap | $(30,318) | $ 1,259 | $ (5,893) | $ (34,952) |
| Cumulative Gap | $(30,318) | $ (29,059) | $ (34,952) | |
| Gap/Total Earning Assets | | | | (30.6%) |
| Gap/Total Earning Assets (excluding savings & demand deposits) | | | | (1.6%) |

CAPITAL RESOURCES

The capital position of South Branch Valley Bancorp, Inc. has shown consistent growth during the past three years. Stated as a percentage of total assets, the Company's equity ratio was 10.1%, 10.0%, and 9.7% at December 31, 1996, 1995 and 1994, respectively. These increases can be attributed to a strong earnings base during the past three years combined with controlled asset growth. The Company's subsidiary bank's risk weighted tier I capital, total capital and leverage capital ratios were approximately 14.8%, 15.9% and 9.9%, respectively, at December 31, 1996, which is considered well capitalized under regulatory guidelines for prompt corrective actions. The Bank is subject to minimum capital ratios as further discussed in Note 13 of the accompanying consolidated financial statements.

Management has established an objective to maintain a minimum 8.0% rate of internal capital growth as a primary means of ensuring capital adequacy within regulatory guidelines. The percent of return on average equity multiplied by the percent of earnings retained equals the internal capital growth rate percentage. The following table illustrates this relationship.

Relationship Between Significant Financial Ratios

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Return on average equity<br>times | 13.3% | 12.8% | 13.3% |
| Earnings retained<br>equals | 80.4% | 80.5% | 81.4% |
| Internal capital growth rate | 10.7% | 10.3% | 10.8% |

Cash dividends rose 13.2% to $.77 in 1996. It is the intention of management and the Board of Directors to continue to pay dividends on a similar schedule during 1997. However, future cash dividends will depend on the earnings, financial condition and the business of the Bank as well as general economic conditions. Management is not presently aware of any reason dividend payments should not continue.

Dividends paid by the Bank are subject to restrictions by banking regulations. The most restrictive provision requires approval by the regulatory agency if dividends declared in any year exceed the year's net income, as defined, plus the retained net profits of the two preceding years. During 1997, the net retained profits available for distribution to South Branch Valley Bancorp, Inc. as dividends without regulatory approval are approximately $1,970,000, plus net income of the interim periods through the date of declaration.

EFFECTS OF CHANGING PRICES

The results of operations and the financial position of the Company have been presented based on historical cost, unadjusted for the effects of inflation, except for the recording of unrealized gains/losses on available for sale securities. Inflation could significantly impact the value of the Company's interest rate sensitive assets and liabilities and the cost of noninterest expenses, such as salaries and occupancy expenses.

As a financial intermediary, the Company holds a high percentage of interest rate sensitive assets and liabilities. Consequently, the estimated fair value of a significant portion of the Company's assets and liabilities reprice more frequently than those of non-banking entities. The Company's policies attempt to structure its mix of financial instruments and manage its interest rate sensitivity gap in order to minimize the potential adverse effects of inflation or other market forces on its net interest income, earnings and capital. A comparison of the carrying value of the Company's financial instruments to their estimated fair value as of December 31, 1996 is disclosed in Note 14 to the accompanying consolidated financial statements.

Indirectly, management of the money supply by the Federal Reserve to control the rate of inflation has an impact on the earnings of the Company. Further, changes in interest rates to control inflation may have a corresponding impact on the ability of certain borrowers to repay loans granted by the Company.

OTHER

As disclosed in Note 15 to the accompanying consolidated financial statement, on January 15, 1997, the Company executed a binding letter of intent to purchase approximately 23% of the outstanding stock of a state chartered financial institution located in Charleston, Kanawha County, West Virginia, subject to the occurrence of certain events and regulatory approval. On February 7, 1997, the Company amended its notification to regulatory authorities to acknowledge the Company's execution of additional letters of intent with other parties which will result in the total acquisition of 424,680 shares or 35.4% of this state bank's outstanding common stock for approximately $4,671,480. The purpose of this transaction is to permit the Company to obtain control of the state bank.

The source and amount of funds to be used in this acquisition are expected to be (i) $178,000 in funds currently available to the Company: (ii) $3,000,000 from a long-term borrowing to be obtained from another financial institution: and (iii) $1,492,790 from the proceeds of the expected issuance of 34,317 shares of Company common stock to certain directors at a price of $43.50 per share.

This proposed transaction remains subject to approval by state and federal regulatory authorities.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
South Branch Valley Bancorp,Inc.
Moorefield, West Virginia

We have audited the accompanying consolidated balance sheets of South Branch Valley Bancorp, Inc., and subsidiary as of December 31, 1996 and 1995, and the related consolidated statements of income, shareholders' equity and cash flows for the years ended December 31, 1996, 1995 and 1994. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of South Branch Valley Bancorp, Inc. and subsidiary as of December 31, 1996 and 1995, and the results of their operations and cash flows for the years ended December 31, 1996, 1995 and 1994, in conformity with generally accepted accounting principles.

ARNETT & FOSTER, P.L.L.C.

Charleston, West Virginia
January 31, 1997

1000 Laidley Tower, 500 Lee Street, East, P.O. Box 2629
Charleston, West Virginia 25329
304/346-0441 o 800/642-3601
Certified Public Accountants
Member of the McGladrey Network

South Branch Valley Bancorp, Inc., and Subsidiary
Consolidated Balance Sheets
December 31, 1996 and 1995

| | 1996 | 1995 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 3,162,552 | $ 2,191,647 |
| Interest bearing deposits with other banks | 1,553,000 | 2,134,919 |
| Federal funds sold | 723,734 | 2,161,745 |
| Securities available for sale | 29,351,998 | 31,480,580 |
| Loans, less allowance for loan losses of $858,423 and $859,681, respectively | 82,414,205 | 70,598,398 |
| Bank premises and equipment, net | 3,121,892 | 3,180,351 |
| Accrued interest receivable | 928,642 | 983,841 |
| Other assets | 857,582 | 386,377 |
| Total assets | $ 122,113,605 | $ 113,117,858 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits | | |
| Non interest bearing | $ 9,075,059 | $ 7,832,774 |
| Interest bearing | 91,866,353 | 92,213,562 |
| Total deposits | 100,941,412 | 100,046,336 |
| Short-term borrowings | 4,377,397 | - - |
| Long-term borrowings | 3,514,652 | 750,000 |
| Other liabilities | 976,351 | 992,862 |
| Total liabilities | 109,809,812 | 101,789,198 |
| Commitments and Contingencies | | |
| SHAREHOLDERS' EQUITY | | |
| Common stock, $2.50 par value, authorized 600,000 shares, issued 382,625 | 956,562 | 956,562 |
| Capital surplus | 685,534 | 685,534 |
| Retained earnings | 10,711,468 | 9,512,884 |
| Less cost of shares acquired for the treasury 1996 and 1995, 4,115 shares | (166,970) | (166,970) |
| Net unrealized gain (loss) on securities | 117,199 | 340,650 |
| Total shareholders' equity | 12,303,793 | 11,328,660 |
| Total liabilities and shareholders' equity | $ 122,113,605 | $ 113,117,858 |

See Notes to Consolidated Financial Statements

South Branch Valley Bancorp, Inc., and Subsidiary

Consolidated Statements of Income
For The Years Ended December 31, 1996, 1995 and 1994

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| **Interest income** | | | |
| Interest and fees on loans | $ 7,551,735 | $ 6,589,530 | $ 5,795,517 |
| Interest and dividends on securities: | | | |
| Taxable | 1,711,158 | 1,650,905 | 1,629,643 |
| Tax-exempt | 254,988 | 164,410 | 153,951 |
| Interest on interest bearing deposits with other banks | 125,604 | 136,696 | 128,561 |
| Interest on Federal funds sold | 48,811 | 49,297 | 43,322 |
| Total interest income | 9,692,296 | 8,590,838 | 7,750,994 |
| **Interest expense** | | | |
| Interest on deposits | 4,590,018 | 3,987,850 | 3,242,307 |
| Interest on short-term borrowings | 68,676 | 55,994 | 21,772 |
| Interest on long-term borrowings | 105,668 | 5,095 | - - |
| Total interest expense | 4,764,362 | 4,048,939 | 3,264,079 |
| Net interest income | 4,927,934 | 4,541,899 | 4,486,915 |
| Provision for loan losses | 95,000 | 55,000 | 120,000 |
| Net interest income after provision for loan losses | 4,832,934 | 4,486,899 | 4,366,915 |
| **Other income (expense)** | | | |
| Insurance commissions | 110,982 | 110,352 | 111,140 |
| Trust department income | 5,853 | 5,052 | 16,218 |
| Service fees | 232,845 | 211,379 | 208,439 |
| Securities gains (losses) | 29,999 | (1,546) | (1,607) |
| Gain (loss) on sales of other assets | 7,202 | -- | (21,391) |
| Other | 69,705 | 53,758 | 29,114 |
| Total other income | 456,586 | 378,995 | 341,913 |
| **Other expenses** | | | |
| Salaries and employee benefits | 1,727,839 | 1,557,108 | 1,447,838 |
| Net occupancy expense | 189,285 | 126,315 | 118,479 |
| Equipment rentals, depreciation and maintenance | 181,119 | 162,277 | 157,315 |
| Federal deposit insurance premiums | 2,000 | 100,174 | 204,642 |
| Other | 1,056,027 | 920,188 | 871,162 |
| Total other expenses | 3,156,270 | 2,866,062 | 2,799,436 |
| Income before income tax expense | 2,133,250 | 1,999,832 | 1,909,392 |
| Income tax expense | 643,213 | 679,676 | 664,802 |
| Net income | $ 1,490,037 | $ 1,320,156 | $ 1,244,590 |
| Earnings per common share | $ 3.94 | $ 3.49 | $ 3.26 |
| Average common shares outstanding | 378,510 | 378,510 | 381,218 |

See Notes to Consolidated Financial Statements

South Branch Valley Bancorp, Inc., and Subsidiary

Consolidated Statements of Shareholders' Equity
For The Years Ended December 31, 1996, 1995 and 1994

| | Common Stock | Capital Surplus | Retained Earnings | Treasury Stock | Net Unrealized Gain (Loss) on Securities |
|---|---|---|---|---|---|
| Balance, December 31, 1993 | $ 956,562 | $ 685,534 | $ 7,437,650 | $ - - | $ - - |
| Net income | - - | - - | 1,244,590 | - - | - - |
| Cost of 4,115 shares acquired for the treasury | - - | - - | - - | (166,970) | - - |
| Cash dividends declared on common stock ($.61 per share) | - - | - - | (232,126) | - - | - - |
| Net unrealized gain (loss) on securities upon adoption of SFAS No. 115 | - - | - - | - - | - - | 431,220 |
| Change in net unrealized gain (loss) on securities | - - | - - | - - | - - | (978,320) |
| Balance, December 31, 1994 | 956,562 | 685,534 | 8,450,114 | (166,970) | (547,100) |
| Net income | - - | - - | 1,320,156 | - - | - - |
| Cash dividends declared on common stock ($.68 per share) | - - | - - | (257,386) | - - | - - |
| Change in net unrealized gain (loss) on securities | - - | - - | - - | - - | 887,750 |
| Balance, December 31, 1995 | 956,562 | 685,534 | 9,512,884 | (166,970) | 340,650 |
| Net income | - - | - - | 1,490,037 | - - | - - |
| Cash dividends declared on common stock ($.77 per share) | - - | - - | (291,453) | - - | - - |
| Change in net unrealized gain (loss) on securities | - - | - - | - - | - - | (223,451) |
| Balance, December 31, 1996 | $ 956,562 | $ 685,534 | $ 10,711,468 | $ (166,970) | $ 117,199 |

See Notes to Consolidated Financial Statements

South Branch Valley Bancorp, Inc., and Subsidiary

Consolidated Statements of Cash Flows
For The Years Ended December 31, 1996, 1995 and 1994

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| **Cash Flows from Operating Activities** | | | |
| Net Income | $ 1,490,037 | $ 1,320,156 | $ 1,244,590 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation | 212,383 | 154,338 | 133,833 |
| Provision for loan losses | 95,000 | 55,000 | 120,000 |
| Security (gains) losses | (29,999) | 1,546 | 1,607 |
| (Gain) loss on sale of other assets | (7,202) | - - | 21,391 |
| (Gain) on disposal of Bank premises and equipment | (23,176) | - - | - - |
| Deferred income tax expense (benefit) | (35,110) | 22,802 | (8,259) |
| (Increase) decrease in accrued interest receivable | 55,199 | (96,329) | (61,855) |
| Amortization of security premiums and (accretion of discounts) net | 50,141 | 88,705 | 124,215 |
| (Increase) decrease in other assets | (455,720) | (82,702) | 52,515 |
| Increase in other liabilities | 167,700 | 146,024 | 59,920 |
| Net cash provided by operating activities | 1,519,253 | 1,609,540 | 1,687,957 |
| **Cash Flows from Investing Activities** | | | |
| (Purchase of) proceeds from interest bearing deposits with other banks, net | 581,919 | (401,219) | 575,800 |
| Proceeds from maturities and calls of securities held to maturity | - - | 100,000 | 590,000 |
| Proceeds from maturities and calls of securities available for sale | 3,950,000 | 5,345,000 | 3,075,000 |
| Proceeds from sales of securities available for sale | 6,735,258 | 2,030,688 | 3,008,437 |
| Principal payments received on securities held to maturity | - - | 313,701 | 1,038,080 |
| Principal payments received on securities available for sale | 768,591 | 170,994 | 132,666 |
| Purchases of securities held to maturity | - - | (615,569) | (248,703) |
| Purchases of securities available for sale | (9,708,744) | (10,917,720) | (6,839,992) |
| (Increase) decrease in Federal funds sold | 1,438,011 | (2,161,745) | 525,000 |
| Loans made to customers, net | (11,950,307) | (6,147,361) | (4,810,871) |
| Purchases of Bank premises and equipment | (223,759) | (1,427,803) | (616,751) |
| Net cash acquired in purchase of Petersburg Branch | - - | 3,400,973 | - - |
| Proceeds from sales of other assets | 22,000 | - - | 139,500 |
| Proceeds from disposal of Bank premises and equipment | 93,011 | - - | - - |
| Net cash (used in) investing activities | (8,294,020) | (10,310,061) | (3,431,834) |
| **Cash Flows from Financing Activities** | | | |
| Net increase (decrease) in demand deposit, NOW and savings accounts | (1,437,576) | 4,987,833 | 1,010,167 |
| Proceeds from sales of (payments for matured) time deposits, net | 2,332,652 | 4,958,802 | (1,023,399) |
| Net increase (decrease) in short-term borrowings | 4,377,397 | (1,700,000) | 1,700,000 |
| Proceeds from long-term borrowings | 2,840,000 | 750,000 | - - |
| Repayment of long-term debt | (75,348) | - - | - - |
| Purchase of treasury stock | - - | - - | (166,970) |
| Dividends paid | (291,453) | (257,386) | (232,126) |
| Net cash provided by financing activities | 7,745,672 | 8,739,249 | 1,287,672 |
| Increase (decrease) in cash and due from banks | 970,905 | 38,728 | (456,205) |
| Cash and due from banks: | | | |
| Beginning | 2,191,647 | 2,152,919 | 2,609,124 |
| Ending | $ 3,162,552 | $ 2,191,647 | $ 2,152,919 |
| **Supplemental Disclosures of Cash Flow Information** | | | |
| Cash payments for: | | | |
| Interest, net of interest capitalized during construction | $ 4,742,367 | $ 3,943,067 | $ 3,219,912 |
| Income taxes | $ 627,563 | $ 759,002 | $ 605,411 |
| **Supplemental Schedule of Noncash Investing and Financing Activities** | | | |
| Other assets acquired in settlement of loans | $ 39,500 | $ 17,905 | $ 38,800 |
| Acquisition of Petersburg Branch: | | | |
| Net cash acquired in purchase | $ - - | $ 3,400,973 | $ - - |
| Fair value of assets acquired, net of cash and cash equivalents (principally loans) | $ - - | $ 1,738,987 | $ - - |
| Deposits and other liabilities assumed | - - | (5,139,960) | - - |
| | $ - - | $ (3,400,973) | $ - - |

See Notes to Consolidated Financial Statements

South Branch Valley Bancorp, Inc., And Subsidiary

Notes to Consolidated Financial Statments

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of South Branch Valley Bancorp, Inc., and its subsidiary conform to generally accepted accounting principles and to general practices within the banking industry. The following is a summary of the Company's more significant accounting policies.

Principles of consolidation:

The accompanying consolidated financial statements include the accounts of South Branch Valley Bancorp, Inc., and its subsidiary, South Branch Valley National Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of estimates:

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

Presentation of cash flows:

For purposes of reporting cash flows, cash and due from banks includes cash on hand and amounts due from banks (including cash items in process of clearing). Cash flows from demand deposits, NOW accounts, savings accounts and Federal funds purchased and sold are reported net since their original maturities are less than three months. Cash flows from loans and certificates of deposit and other time deposits are reported net.

Securities:

Debt and equity 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--

There are no securities classified as "held to maturity" in the accompanying consolidated financial statements.

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 estimated fair value net of unrealized gains or losses, which are adjusted for applicable income taxes, and reported as a separate component of shareholders' equity.

Trading securities--

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

Realized gains and losses on sales of securities are recognized on the specific identification method.Amortization of premiums and accretion of discounts are computed using the interest method.

Loans and allowance for loan losses:

Loans are stated at the amount of unpaid principal, reduced by unearned discount and an allowance for loan losses. The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. The subsidiary bank makes continuous credit reviews of the loan portfolio and considers current economic conditions, historical loan loss experience, review of specific problem loans and other factors in determining the adequacy of the allowance for loan losses. Loans are charged against the allowance for loan losses when management believes that collectibility is unlikely.

Unearned interest on discounted loans is amortized to income over the life of the loans, using methods which approximate the interest method. For all other loans, interest is accrued daily on the outstanding balances.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the specific loan agreement. Impaired loans, other than certain large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, are required to be reported at the present value of expected future cash flows discounted using the loan's original effective interest rate or, alternatively, at the loan's observable market price, or at the fair value of the loan's collateral if the loan is collateral dependent. The method selected to measure impairment is made on a loan-by-loan basis, unless foreclosure is deemed to be probable, in which case the fair value of the collateral method is used.

Generally, after management's evaluation, loans are placed on nonaccrual status when principal or interest is greater than 90 days past due based upon the loan's contractual terms. Interest is accrued daily on impaired loans unless the loan is placed on non-accrual status. Impaired loans are placed on non-accrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well-secured and in the process of collection. Interest on non-accrual loans is recognized primarily using the cost-recovery method.

Certain loan fees and direct loan costs are recognized as income or expense when incurred, whereas, generally accepted accounting principles require that such fees and costs be deferred and amortized as adjustments of the related loan's yield over the contractual life of the loan. The subsidiary bank's method of recognition of loan fees and direct loan costs produces results which are not materially different from those that would be recognized had Statement Number 91 of the Financial Accounting Standards Board been adopted.

Bank premises and equipment:
- ----------------------------

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily by the straight-line method for bank premises and equipment over the estimated useful lives of the assets. Repairs and maintenance expenditures are charged to operating expenses as incurred. Major improvements and additions to premises and equipment, including construction period interest costs, are capitalized. No interest was capitalized during 1996 and 1994. Interest capitalized during 1995 totaled $26,921.

Other real estate:
- ------------------

Other real estate consists primarily of real estate held for resale which was acquired through foreclosure on loans secured by such real estate. At the time of acquisition, these properties are recorded at fair value with any writedown being charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Expenses incurred in connection with operating these properties are insignificant and are charged to operating expenses. Gains and losses on the sales of these properties are credited or charged to operating income in the year of the transactions.

Other real estate acquired through foreclosure with carrying values of $28,955 and $40,355, at December 31, 1996 and 1995, respectively, is included in other assets in the accompanying consolidated balance sheets.

Income taxes:
- --------------

The consolidated provision for income taxes includes Federal and state income taxes and is based on pretax net income reported in the consolidated financial statements, adjusted for transactions that may never enter into the computation of income taxes payable. Deferred tax assets and liabilities are determined based on the differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Valuation allowances are established when deemed necessary to reduce deferred tax assets to the amount expected to be realized.

Earnings per share:
- -------------------

Earnings per common share are computed based upon the weighted average shares outstanding. The weighted average number of shares outstanding was 378,510, 378,510, and 381,218 for the years ended December 31, 1996, 1995 and 1994, respectively.

Employee benefits:
- -------------------

The Company has a profit-sharing and thrift plan and an employee stock ownership plan (ESOP) which cover substantially all employees. The amount of the contributions to the plans are at the discretion of the Company's Board of Directors.

Trust department:
- ------------------

Assets held in an agency or fiduciary capacity by the subsidiary bank'sTrust Department are not assets of the subsidiary bank and are not included in the accompanying consolidated balance sheets. Trust Department income is recognized on the cash basis in accordance with customary banking practice. Reporting such income on a cash basis rather than the accrual basis does not have a material affect on net income.

Reclassifications:
- ------------------

Certain accounts in the consolidated financial statements for 1995 and 1994, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. ACQUISITION OF PETERSBURG BRANCH

On November 15, 1995, the Bank acquired a branch bank located in Petersburg, West Virginia from an unaffiliated institution. In connection with this acquisition, the Bank acquired the branch's assets including its land, banking facility, equipment and loans and assumed its deposit liabilities. The acquisition was accounted for as a purchase and the results of operations of the Petersburg Branch since the date of its acquisition are included in the accompanying consolidated financial statements. The Branch's purchase price and the related excess of the purchase price over the fair value of the net assets acquired was not significant.

NOTE 3. CASH CONCENTRATION

At December 31, 1996 and 1995, the subsidiary bank had a concentration totaling $2,451,256 and $3,133,942, respectively, with Nationsbank, consisting of a due from bank account balance and Federal funds sold.

NOTE 4. SECURITIES

During 1995, concurrent with the adoption of the Special Report "A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities" issued by the Financial Accounting Standards Board, the subsidiary bank reassessed the classifications of its securities and transferred securities with amortized cost of $3,358,274 and estimated fair value of $3,410,711 from the held to maturity category to the available for sale category. Accordingly, shareholders' equity was increased $32,410, net of deferred income taxes of $20,027, to reflect the net unrealized holding gain on such securities. This reclassification did not have an impact on the accompanying statements of income.

The amortized cost, unrealized gains and losses, and estimated fair values of securities at December 31, 1996 and 1995, are summarized as follows:

| Amortized | 1996<br>Cost | Unrealized<br>Gains | (Estimated<br>Losses | Carrying<br>Value<br>Fair Value) |
|---|---|---|---|---|
| Available for sale: | | | | |
| Taxable: | | | | |
| U.S. Treasury Securities | $ 4,246,582 | $ 46,198 | $ 12,270 | $ 4,280,510 |
| U.S. Government agencies and corporations | 12,013,602 | 75,012 | 46,518 | 12,042,096 |
| Small Business Administration guaranteed loan participation certificates | 1,646,390 | 36,719 | - - | 1,683,109 |
| Mortgage-backed securities - U.S. Government agencies and corporations | 4,642,785 | 22,891 | 49,602 | 4,616,074 |
| Corporate debt securities | 498,476 | 3,688 | 672 | 501,492 |
| Federal Reserve Bank stock | 44,300 | - - | - - | 44,300 |
| Federal Home Loan Bank stock | 339,400 | - - | - - | 339,400 |
| Other equity securities | 6,625 | - - | - - | 6,625 |
| Total taxable | 23,438,160 | 184,508 | 109,062 | 23,513,606 |
| Tax-Exempt: | | | | |
| State and political subdivisions | 5,719,170 | 129,004 | 13,882 | 5,834,292 |
| Federal Reserve Bank stock | 4,100 | - - | - - | 4,100 |
| Total tax-exempt | 5,723,270 | 129,004 | 13,882 | 5,838,392 |
| Total | $ 29,161,430 | $ 313,512 | $ 122,944 | $ 29,351,998 |

| | 1995<br>Amortized<br>Cost | Unrealized<br>Gains | <br>Losses | Carrying<br>Value<br>(Estimated<br>Fair Value) |
|---|---|---|---|---|
| Available for sale: | | | | |
| Taxable: | | | | |
| U.S. Treasury Securities | $ 7,830,447 | $ 115,362 | $ 11,594 | $ 7,934,215 |
| U.S. Government agencies and corporations | 14,866,575 | 296,026 | 19,554 | 15,143,047 |
| Small Business Administration guaranteed loan participation certificates | 1,680,257 | 33,838 | - - | 1,714,095 |
| Mortgage-backed securities - U.S. Government agencies and corporations | 2,381,926 | 24,146 | 5,637 | 2,400,435 |
| Corporate debt securities | 497,930 | 9,951 | 227 | 507,654 |
| Federal Reserve Bank stock | 44,300 | - - | - - | 44,300 |
| Federal Home Loan Bank stock | 289,900 | - - | - - | 289,900 |
| Other equity securities | 6,625 | - - | - - | 6,625 |
| Total taxable | 27,597,960 | 479,323 | 37,012 | 28,040,271 |
| Tax-Exempt: | | | | |
| State and political subdivisions | 3,324,621 | 116,183 | 4,595 | 3,436,209 |
| Federal Reserve Bank stock | 4,100 | - - | - - | 4,100 |
| Total tax-exempt | 3,328,721 | 116,183 | 4,595 | 3,440,309 |
| Total | $ 30,926,681 | $ 595,506 | $ 41,607 | $ 31,480,580 |

Federal Reserve Bank stock and Federal Home Loan Bank stock are equity securities which are included in securities available for sale in the accompanying consolidated financial statements. Such securities are carried at cost, since they may only be sold back to the respective Federal Reserve Bank or Federal Home Loan Bank or another member at par value.

Mortgage-backed obligations of U.S. Government agencies and corporations and Small Business Administration guaranteed loan participation certificates are included in securities at December 31, 1996 and 1995. These obligations, having contractual maturities ranging from 1 to 22 years, are reflected in the following maturity distribution schedules based on their anticipated average life to maturity, which ranges from 1 to 7 years. Accordingly, discounts are accreted and premiums are amortized over the anticipated average life to maturity of the specific obligation.

The maturities, amortized cost and estimated fair values of securities at December 31, 1996, are summarized as follows:

| | Available for Sale | |
|---|---|---|
| | Amortized Cost | Carrying Value (Estimated Fair Value) |
| Due in one year or less | $ 4,245,875 | $ 4,244,351 |
| Due from one to five years | 16,188,141 | 16,303,589 |
| Due from five to ten years | 6,263,038 | 6,311,374 |
| Due after ten years | 2,069,951 | 2,098,259 |
| Equity securities | 394,425 | 394,425 |
| Total | $ 29,161,430 | $ 29,351,998 |

The proceeds from sales, calls, maturities of securities, including principal payments received on mortgage-backed obligations and the related gross gains and losses realized are as follows:

| | Proceeds From | | | Gross Realized | |
|---|---|---|---|---|---|
| Years Ended December 31, | Sales | Calls and Maturities | Principal Payments | Gains | Losses |
| 1996 | | | | | |
| Securities available for sale | $ 6,735,258 | $ 3,950,000 | $ 768,591 | $ 45,824 | $ 15,825 |
| 1995 | | | | | |
| Securities held to maturity | $ - - | $ 100,000 | $ 313,701 | $ - - | $ - - |
| Securities available for sale | 2,030,688 | 5,345,000 | 170,994 | 19,618 | 21,164 |
| | $ 2,030,688 | $ 5,445,000 | $ 484,695 | $ 19,618 | $ 21,164 |
| 1994 | | | | | |
| Securities held to maturity | $ - - | $ 590,000 | $ 1,038,080 | $ - - | $ - - |
| Securities available for sale | 3,008,437 | 3,075,000 | 132,666 | 7,172 | 8,779 |
| | $ 3,008,437 | $ 3,665,000 | $ 1,170,746 | $ 7,172 | $ 8,779 |

At December 31, 1996 and 1995, securities carried at $16,120,939 and $11,329,098, respectively, with estimated fair values of $16,240,924 and $11,578,096, respectively, were pledged to secure public deposits, and for other purposes required or permitted by law.

NOTE 5. LOANS

Loans are summarized as follows:

| | 1996 | 1995 |
|---|---|---|
| Commercial, financial and agricultural | $ 20,450,598 | $ 18,875,277 |
| Real estate - construction | 154,388 | 102,690 |
| Real estate - mortgage | 43,468,235 | 36,980,052 |
| Installment | 19,486,254 | 15,981,416 |
| Other | 614,818 | 542,519 |
| Total loans | 84,174,293 | 72,481,954 |
| Less unearned discount | 901,665 | 1,023,875 |
| Total loans net of unearned income | 83,272,628 | 71,458,079 |
| Less allowance for loan losses | 858,423 | 859,681 |
| Loans, net | $ 82,414,205 | $ 70,598,398 |

Included in the net balance of loans are non-accrual loans amounting to $342,842 and $538,239 at December 31, 1996 and 1995, respectively. If interest on non-accrual loans had been accrued, such income would have approximated $30,978, $36,708 and $5,500 for the years ended December 31, 1996, 1995 and 1994, respectively.

The following presents loan maturities at December 31, 1996:

| | Within 1 Year | After 1 But Within 5 Years | After 5 Years |
|---|---|---|---|
| Commercial, financial and agricultural | $ 6,828,525 | $ 4,679,935 | $ 8,942,138 |
| Real estate - construction | 154,388 | - - | - - |
| Real estate - mortgage | 1,566,343 | 4,062,245 | 37,839,647 |
| Installment loans | 2,388,304 | 13,110,306 | 3,987,644 |
| Other | 357,875 | - - | 256,943 |
| Total | $ 11,295,435 | $ 21,852,486 | $ 51,026,372 |
| Loans due after one year with: | | | |
| Variable rates | | $ 31,818,449 | |
| Fixed rates | | 41,060,409 | |
| | | $ 72,878,858 | |

The Bank has made, and may be expected to make in the future, commercial and mortgage loans that have adjustable rates. Such loan rates are generally indexed to the Wall Street prime interest rate or to other common indices. At December 31, 1996, the Bank's commercial loan portfolio contained adjustable rate loans of approximately $9,996,983. The interest rates on such loans ranged from 7.34% to 12.00%, and provided for future interest rate changes at set intervals, ranging from one to sixty months.

Likewise, the Bank's mortgage portfolio contained adjustable rate loans of approximately $24,338,213 at December 31, 1996. The interest rates on such loans ranged from 6.75% to 13.56%, and provided for future interest rate changes at set intervals, ranging from monthly to fifteen years.

Concentration of credit risk:

The subsidiary bank grants commercial, residential and consumer loans to customers primarily located in Hardy, Grant, Hampshire and Pendleton Counties of West Virginia. Although the Bank strives to maintain a diverse loan portfolio, a substantial portion of its debtors' ability to honor their contracts is indirectly dependent upon the poultry industry.

As of December 31, 1996 and 1995, the Bank had direct extensions of credit used to build and operate poultry houses totaling approximately $4,563,919 and $5,872,805, respectively. These loans are generally structured to be repaid over periods ranging from 15 to 20 years, however, most also contain balloon provisions which serve to require each loan's renewal every 1 to 5 years or are written with an adjustable interest rate feature. The security for these loans generally consists of liens on the land, buildings and equipment associated with each poultry house.

The Bank evaluates the credit worthiness of each of its customers on a case-by-case basis and the amount of collateral it obtains is based upon management's credit evaluation.

The subsidiary bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal stockholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

The following presents the activity with respect to related party loans aggregating $60,000 or more to any one related party (other changes represent additions to and changes in director and executive officer status):

| | 1996 | 1995 |
|---|---|---|
| Balance, beginning | $ 5,176,398 | $ 3,679,777 |
| Additions | 1,574,443 | 3,998,154 |
| Amounts collected | (1,658,303) | (2,450,899) |
| Other changes, net | (774,441) | (50,634) |
| Balance, ending | $ 4,318,097 | $ 5,176,398 |

NOTE 6: ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses for the years ended December 31, 1996, 1995 and 1994, is as follows:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Balance, beginning of year | $ 859,681 | $ 993,023 | $ 905,448 |
| Losses: | | | |
| Commercial, financial and agricultural | 10,194 | 46,373 | 10,589 |
| Real estate - mortgage | 12,778 | 137,334 | 14,779 |
| Installment loans | 93,826 | 39,004 | 45,380 |
| Other | 9,951 | 10,909 | 11,609 |
| Total | 126,749 | 233,620 | 82,357 |
| Recoveries: | | | |
| Commercial, financial and agricultural | 5,658 | 7,864 | 24,627 |
| Real estate - mortgage | 1,885 | 3,135 | 1,107 |
| Installment loans | 20,525 | 28,862 | 23,422 |
| Other | 2,423 | 5,417 | 776 |
| Total | 30,491 | 45,278 | 49,932 |
| Net losses | 96,258 | 188,342 | 32,425 |
| Provision for loan losses | 95,000 | 55,000 | 120,000 |
| Balance, end of year | $ 858,423 | $ 859,681 | $ 993,023 |

The Bank's total recorded investment in impaired loans at December 31, 1996 and 1995, approximated $383,615 and $747,950, respectively, for which the related allowance for loan losses determined in accordance with generally accepted accounting principles approximated $91,518 and $153,560, respectively. The Bank's average investment in such loans approximated $381,938 and $696,425 for the years ended December 31, 1996 and 1995, respectively. All impaired loans at December 31, 1996 and 1995, were collateral dependent, and accordingly, the fair value of the loan's collateral was used to measure the impairment of each loan.

For purposes of evaluating impairment, the Bank considers groups of smaller-balance, homogeneous loans to include: mortgage loans secured by residential property, other than those which significantly exceed the Bank's typical residential mortgage loan amount (currently those in excess of $100,000): small balance commercial loans (currently those less than $50,000); and installment loans to individuals, exclusive of those loans in excess of $50,000.

For the years ended December 31, 1996 and 1995, the Bank recognized approximately $46,779 and $85,398, respectively, in interest income on impaired loans. Using a cash-basis method of accounting, the Bank would have recognized approximately the same amount of interest income on such loans.

NOTE 7. BANK PREMISES AND EQUIPMENT

The major categories of Bank premises and equipment and accumulated depreciation at December 31, 1996 and 1995, are summarized as follows:

| | 1996 | 1995 |
|---|---|---|
| Land | $ 435,473 | $ 443,566 |
| Building and improvements | 2,805,616 | 2,793,282 |
| Furniture and equipment | 1,674,269 | 1,940,716 |
| | 4,915,358 | 5,177,564 |
| Less accumulated depreciation | 1,793,466 | 1,997,213 |
| Bank, premises and equipment, net | $ 3,121,892 | $ 3,180,351 |

Depreciation expense for the years ended December 31, 1996, 1995 and 1994 totaled $212,383, $154,338 and $133,833, respectively.

NOTE 8. DEPOSITS

The following is a summary of interest bearing deposits by type as of December 31, 1996 and 1995:

| | 1996 | 1995 |
|---|---|---|
| Demand deposits, interest bearing | $ 20,139,983 | $ 20,027,502 |
| Savings deposits | 12,938,812 | 15,731,154 |
| Certificates of deposit | 50,997,400 | 48,947,117 |
| Individual Retirement Accounts | 7,790,158 | 7,507,789 |
| Total | $ 91,866,353 | $ 92,213,562 |

Time certificates of deposit and IRA's in denominations of $100,000 or more totaled $9,260,399 and $7,758,560 at December 31, 1996 and 1995, respectively. Interest paid on time certificates of deposit and Individual Retirement Accounts in denominations of $100,000 or more was $501,754, $392,641 and $290,030 for the years ended December 31, 1996, 1995 and 1994, respectively.

The following is a summary of the maturity distribution of certificates of deposit and IRA's in denominations of $100,000 or more as of December 31, 1996:

| | Amount | Percent |
|---|---|---|
| Three months or less | $ 844,555 | 9.12% |
| Three through six months | 3,117,854 | 33.67% |
| Six through twelve months | 2,908,004 | 31.40% |
| Over twelve months | 2,389,986 | 25.81% |
| Total | $ 9,260,399 | 100.00% |

A summary of the scheduled maturities for all time deposits as of December 31, 1996, follows:

| | |
|---|---|
| 1997 | $ 36,483,558 |
| 1998 | 12,327,751 |
| 1999 | 5,055,730 |
| 2000 | 1,193,387 |
| 2001 | 2,974,651 |
| Thereafter | 752,481 |
| | $ 58,787,558 |

NOTE 9. OTHER BORROWINGS

Short-term borrowings:

Federal funds purchased and securities sold under agreements to repurchase mature the next business day. The securities underlying the repurchase agreements are under the subsidiary bank's control and secure the total outstanding daily balances. Other borrowings consist of lines of credit from the Federal Home Loan Bank (FHLB) under its Flexline and RepoPlus Programs. The Flexline is limited to 10% of the Bank's calculated maximum borrowing capacity of approximately $2,900,000 at December 31, 1996, and is subject to annual renewal. Borrowings under this arrangement bear interest at the rate posted by the FHLB on the day of the borrowing and is subject to change daily. The RepoPlus is limited to the Bank's outstanding maximum borrowing capacity of approximately $35,000,000 at December 31, 1996, less the current outstanding Flexline balance, and is subject to annual renewal. Borrowings under this arrangement will be granted for terms of 1 to 120 days and will bear interest at a fixed rate set at the time of the funding request. The lines of credit are secured by a blanket lien on all unpledged and unencumbered assets of the Bank.

Additional details regarding short-term borrowings during the years ended December 31, 1996 and 1995, are presented below:

| | 1996 | | |
|---|---|---|---|
| | Federal Funds Purchased | Repurchase Agreements | Other Borrowings |
| Outstanding at year end | $ - - | $ 4,377,397 | $ - - |
| Average amount outstanding | 86,175 | 1,335,635 | 156,733 |
| Maximum amount outstanding at any month end | 1,050,000 | 4,377,397 | 2,916,000 |
| Weighted average interest rate | 5.76% | 4.13% | 5.49% |

| | 1995 | | |
|---|---|---|---|
| Federal | Funds Purchased | Repurchase Agreements | Other Borrowings |
| Outstanding at year end | $ - - | $ - - | $ - - |
| Average amount outstanding | 53,671 | - - | 1,075,000 |
| Maximum amount outstanding at any month end | 750,000 | - - | 3,000,000 |
| Weighted average interest rate | 6.34% | - - | 6.06% |

Long-term borrowings:

The subsidiary bank's long term borrowings of $3,514,652 and $750,000 at December 31, 1996 and 1995, respectively, consisted of advances from the FHLB under its Community Investment Program and other fixed rate loans. These borrowings bear an average fixed interest rate of 5.81% and mature in varying amounts through the year 2006. A summary of the maturities of these borrowings for the next five years is as follows:

| | |
|---|---|
| 1997 | $ - - |
| 1998 | - - |
| 1999 | 340,000 |
| 2000 | - - |
| 2001 | 500,000 |
| Thereafter | 2,674,652 |
| | $ 3,514,652 |

NOTE 10: INCOME TAXES

The components of applicable income tax expense(benefit) for the years ended December 31, 1996, 1995 and 1994, are as follows:

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Current: | | | |
| Federal | $ 602,391 | $ 587,472 | $ 611,581 |
| State | 75,932 | 69,402 | 61,480 |
| | 678,323 | 656,874 | 673,061 |
| Deferred: | | | |
| Federal | (31,208) | 20,268 | (7,342) |
| State | (3,902) | 2,534 | (917) |
| | (35,110) | 22,802 | (8,259) |
| Total | $ 643,213 | $ 679,676 | $ 664,802 |

A reconciliation between the amount of reported income tax expense and the amount computed by multiplying the statutory income tax rates by book pretax income for the years ended December 31, 1996, 1995 and 1994, is as follows:

| | 1996 | | 1995 | | 1994 | |
|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent |
| Computed tax at applicable statutory rate | $ 725,305 | 34 | $ 679,943 | 34 | $ 649,193 | 34 |
| Increase (decrease) in taxes resulting from: | | | | | | |
| Tax-exempt interest, net | (80,961) | (4) | (55,982) | (3) | (51,525) | (3) |
| State income taxes, net of Federal tax benefit | 47,540 | 2 | 45,802 | 2 | 40,577 | 2 |
| Noncash charitable contribution | (59,704) | (3) | - - | - - | - - | - - |
| Other, net | 11,033 | 1 | 9,913 | 1 | 26,557 | 1 |
| Applicable income taxes | $ 643,213 | 30 | $ 679,676 | 34 | $ 664,802 | 34 |

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Deferred income taxes reflect the impact of "temporary differences" between amounts of assets and liabilities for financial reporting purposes and such amounts as measured for tax purposes. Deferred tax assets and liabilities represent the future tax return consequences of temporary differences, which will either be taxable or deductible when the related assets and liabilities are recovered or settled. Valuation allowances are established when deemed necessary to reduce deferred tax assets to the amount expected to be realized. The tax effects of temporary differences which give rise to the Company's deferred tax assets and liabilities as of December 31, 1996 and 1995, are as follows:

| | 1996 | 1995 |
|---|---|---|
| Deferred tax assets: | | |
| Allowance for loan losses | $ 217,199 | $ 216,678 |
| Deferred compensation | 43,280 | 24,930 |
| Charitable contribution carryover | 44,327 | - - |
| Goodwill | 9,482 | 790 |
| | 314,288 | 242,398 |
| Less valuation allowance | (194,010) | (188,773) |
| | 120,278 | 53,625 |
| Deferred tax liabilities: | | |
| Depreciation | 33,104 | 20,959 |
| Net unrealized gain on securities | 73,369 | 213,253 |
| Accretion on tax-exempt securities | 480 | - - |
| Bank premises and equipment disposal | 18,919 | - - |
| | 125,872 | 234,212 |
| Net deferred tax assets (liabilities) | $ (5,594) | $ (180,587) |

The income tax expense (benefit) on realized securities gains (losses) was $11,550, $(595) and $(619), for the years ended December 31, 1996, 1995 and 1994, respectively.

NOTE 11. EMPLOYEE BENEFITS

Profit-Sharing and Thrift Plan:

The Company has a defined contribution profit-sharing and thrift plan with 401(k) provisions covering substantially all employees. Contributions to the Plan are at the discretion of the Board of Directors. Contributions made to the plan and charged to expense were $54,240, $50,475 and $45,106 for the years ended December 31, 1996, 1995 and 1994, respectively.

Employee Stock Ownership Plan:

The Company has an Employee Stock Ownership Plan (ESOP) which enables eligible employees to acquire shares of the Company's common stock. The cost of the ESOP is borne by the Company through annual contributions to an Employee Stock Ownership Trust in amounts determined by the Board of Directors.

The expense recognized by the Company is based on cash contributed or committed to be contributed by the Company to the ESOP during the year. Contributions to the ESOP for the years ended December 31, 1996, 1995 and 1994 were $48,250, $45,582 and $40,166, respectively. Dividends made by the Company to the ESOP are reported as a reduction to retained earnings. The ESOP owns 9,065 shares of the Company's common stock, all of which, are considered outstanding for earnings per share computations.

The trustees of both the Profit-Sharing and Thrift Plan and ESOP are also members of the Company's and subsidiary bank's Board of Directors.

Incentive Compensation Program:
- ------------------------------

The subsidiary bank has an incentive compensation program for its key employees. Bonuses are awarded to key employees based on a prescribed formula using the Bank's return on assets as a base. Under the terms of the incentive compensation program, bonuses charged to operations were $137,000, $120,000 and $112,000 for 1996, 1995 and 1994, respectively.

Directors Deferred Compensation Plan:
- ------------------------------------

The Bank has established a non-qualified deferred compensation plan for directors who voluntarily elect to participate. Under that plan, a director, on or before December 31, of any year, may elect to defer payment of all retainer, meeting and committee fees earned during the calendar year following such election and, unless such election is subsequently terminated, all succeeding calendar years. Amounts deferred are periodically converted to units representing shares of the Company's stock which are to be periodically purchased by the plan at current market values when available on the open market. The liability for deferred directors compensation at December 31, 1996 and 1995, was $113,150 and $66,850, respectively, which is included in other liabilities in the accompanying consolidated balance sheets.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Financial instruments with off-balance sheet risk:
- -------------------------------------------------------

The subsidiary bank is a party of certain financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. Such financial instruments consist solely of commitments to extend credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. The contract amounts of these instruments reflect the extent of involvement the Bank has in this class of financial instruments. The Bank's total contract amount of commitments to extend credit at December 31, 1996 and 1995, approximated $5,639,457 and $4,462,545, respectively.

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 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. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, equipment or real estate.

Litigation:
- -----------

The Bank is involved in various legal actions arising in the ordinary course of business. In the opinion of counsel, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

Employment Agreement:
- ---------------------

The Company has an employment agreement with its chief executive officer. This agreement contains change in control provisions that would entitle the officer to receive compensation in the event there is a change in control in the Company (as defined) and a termination of his employment without cause (as defined).

NOTE 13. RESTRICTIONS ON CAPITAL AND DIVIDENDS

The primary source of funds for the dividends paid by South Branch Valley Bancorp, Inc. is dividends received from its subsidiary bank. Dividends paid by the subsidiary bank are subject to restrictions by banking regulations. The most restrictive provision requires approval by the regulatory agency if dividends declared in any year exceed the year's net income, as defined, plus the net retained profits of the two preceding years. During 1997, the net retained profits available for distribution to South Branch Valley Bancorp, Inc. as dividends without regulatory approval are approximately $1,970,000 plus net retained income of the subsidiary bank for the interim periods through the date of declaration.

The Bank is subject to various regulatory capital requirements administered by the Federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 1996, that the Bank meets all capital adequacy requirements to which it is subject.

The most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table.

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 1996: | | | | | | |
| Total Capital (to Risk Weighted Assets) | $ 12,522 | 15.86% | $ 6,315 | 8.0% | $ 7,893 | 10.0% |
| Tier I Capital (to Risk Weighted Assets) | 11,664 | 14.78% | 3,157 | 4.0% | 4,736 | 6.0% |
| Tier I Capital (to Average Assets) | 11,664 | 9.88% | 3,540 | 3.0% | 7,081 | 6.0% |

NOTE 14. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following summarizes the methods and significant assumptions used by the Company 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.

INTEREST BEARING DEPOSITS WITH OTHER BANKS: The fair values of interest bearing deposits with other banks are estimated by discounting scheduled future receipts of principal and interest at the current rates offered on similar instruments with similar remaining maturities.

FEDERAL FUNDS SOLD: The carrying values of Federal funds sold approximate their estimated fair values.

SECURITIES: Estimated fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

LOANS: The estimated fair values for loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality. No prepayments of principal are assumed.

ACCRUED INTEREST RECEIVABLE AND PAYABLE: The carrying values of accrued interest receivable and payable approximate their estimated fair values.

DEPOSITS: The estimated fair values of demand deposits (i.e. noninterest bearing checking, NOW, Super NOW, money market and savings accounts) and other variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated using a discounted cash flow methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of long-term relationships with depositors is not considered in estimating the fair values disclosed.

SHORT-TERM BORROWINGS: The carrying values of short-term borrowings approximate their estimated fair values.

LONG-TERM BORROWINGS: The fair values of long-term borrowings are estimated by discounting scheduled future payments of principal and interest at current rates available on borrowings with similar terms.

OFF-BALANCE SHEET INSTRUMENTS: The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit standing of the counterparties. The amounts of fees currently charged on commitments and standby letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values are not shown below.

The carrying values and estimated fair values of the Company's financial instruments are summarized below:

| | December 31, 1996 | | December 31, 1995 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Financial assets: | | | | |
| Cash and due from banks | $ 3,162,552 | $ 3,162,552 | $ 2,191,647 | $ 2,191,647 |
| Interest bearing deposits, other banks | 1,553,000 | 1,596,273 | 2,134,919 | 2,199,418 |
| Federal funds sold | 723,734 | 723,734 | 2,161,745 | 2,161,745 |
| Securities available for sale | 29,351,998 | 29,351,998 | 31,480,580 | 31,480,580 |
| Loans | 82,414,205 | 82,296,508 | 70,598,398 | 70,757,154 |
| Accrued interest receivable | 928,642 | 928,642 | 983,841 | 983,841 |
| | $ 118,134,131 | $ 118,059,707 | $ 109,551,130 | $ 109,774,385 |
| Financial liabilities: | | | | |
| Deposits | $ 100,941,412 | $ 101,317,554 | $ 100,046,336 | $ 100,603,254 |
| Short-term borrowings | 4,377,397 | 4,377,397 | - - | - - |
| Long-term borrowings | 3,514,652 | 3,514,652 | 750,000 | 750,000 |
| Accrued interest payable | 428,334 | 428,334 | 406,339 | 406,339 |
| | $ 109,261,795 | $ 109,637,937 | $ 101,202,675 | $ 101,759,593 |

NOTE 15. SUBSEQUENT EVENT

Subsequent to December 31, 1996, the Corporation executed a binding Letter of Intent to purchase 275,000 shares, or approximately 23%, of a state bank from an individual for a purchase price of $11.00 per share. The Letter of Intent is contingent on the happening of various events including the Corporation's purchase of an additional 149,680 shares of the same state bank at a purchase price of $11.00 per share from six individuals who are related to the aforementioned shareholder of the state bank and obtaining all regulatory approvals.

NOTE 16. CONDENSED FINANCIAL STATEMENTS OF PARENT COMPANY

The investment of the Corporation in its wholly-owned subsidiary is presented on the equity method of accounting. Information relative to the Corporation's balance sheets at December 31, 1996 and 1995, and the related statements of income and cash flows for the years ended December 31, 1996, 1995 and 1994 are presented as follows:

| | December 31, | |
|---|---|---|
| | 1996 | 1995 |
| Assets | | |
| Cash | $ 157,133 | $ 68,466 |
| Investment in bank subsidiary, eliminated in consolidation | 11,926,831 | 11,246,742 |
| Securities available for sale | 206,625 | 6,625 |
| Other assets | 13,204 | 6,827 |
| Total assets | $ 12,303,793 | $ 11,328,660 |
| Liabilities and shareholders' equity | | |
| Common stock, $2.50 par value, authorized 600,000 shares, issued 382,625 | $ 956,562 | $ 956,562 |
| Capital surplus | 685,534 | 685,534 |
| Retained earnings (consisting of undivided profits of bank subsidiary not yet distributed) | 10,711,468 | 9,512,884 |
| Less cost of shares acquired for the treasury 1996 and 1995, 4,115 shares | (166,970) | (166,970) |
| Net unrealized gain (loss) on securities | 117,199 | 340,650 |
| Total shareholders' equity | 12,303,793 | 11,328,660 |
| Total liabilities and shareholders' equity | $ 12,303,793 | $ 11,328,660 |

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| Statements of Income | | | |
| Income - dividends from bank subsidiary | $ 600,000 | $ 264,000 | $ 460,000 |
| Other dividends | 197 | 191 | 186 |
| Tax-exempt interest | 2,600 | - - | - - |
| Expenses--operating | (26,504) | (17,727) | (17,729) |
| Income before income taxes and undistributed income | 576,293 | 246,464 | 442,457 |
| Applicable income tax expense (benefit) | (10,204) | (6,826) | (6,826) |
| Income before undistributed income | 586,497 | 253,290 | 449,283 |
| Equity in undistributed income of bank subsidiary | 903,540 | 1,066,866 | 795,307 |
| Net income | $ 1,490,037 | $ 1,320,156 | $ 1,244,590 |

Statements of Cash Flows

| | 1996 | 1995 | 1994 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | $ 1,490,037 | $ 1,320,156 | $ 1,244,590 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed net income of subsidiary | (903,540) | (1,066,866) | (795,307) |
| (Increase) decrease in other assets | (6,377) | - - | (1,247) |
| Net cash provided by operating activities | 580,120 | 253,290 | 448,036 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Purchase of securities available for sale | (200,000) | - - | (6,625) |
| Net cash (used in) investing activities | (200,000) | - - | (6,625) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Purchase of treasury stock | - - | - - | (166,970) |
| Dividends paid to shareholders | (291,453) | (257,386) | (232,126) |
| Net cash (used in) financing activities | (291,453) | (257,386) | (399,096) |
| Increase (decrease) in cash | 88,667 | (4,096) | 42,315 |
| Cash: | | | |
| Beginning | 68,466 | 72,562 | 30,247 |
| Ending | $ 157,133 | $ 68,466 | $ 72,562 |

South Branch Valley Bancorp, Inc., accounts for its investment in its bank subsidiary by the equity method. During the years ended December 31, 1996, 1995 and 1994, changes were as follows:

| | |
|---|---|
| Number of shares owned at December 31, 1996 - | 60,000 |
| Percent to total shares at December 31, 1996 - | 100% |

| | |
|---|---|
| Balance at December 31, 1993 | $ 9,043,919 |
| Add (deduct): | |
| Equity in net income | 1,255,307 |
| Dividends declared | (460,000) |
| Net unrealized gain (loss) on securities | (547,100) |
| Balance at December 31, 1994 | $ 9,292,126 |
| Add (deduct): | |
| Equity in net income | 1,330,866 |
| Dividends declared | (264,000) |
| Change in net unrealized gain (loss) on securities | 887,750 |
| Balance at December 31, 1995 | $ 11,246,742 |
| Add (deduct): | |
| Equity in net income | 1,503,540 |
| Dividends declared | (600,000) |
| Change in net unrealized gain (loss) on securities | (223,451) |
| Balance at December 31, 1996 | $ 11,926,831 |

## SHAREHOLDERS' INFORMATION

South Branch Valley Bancorp, Inc. files an annual report to the Securities and Exchange Commission on Form 10-KSB. Copies of this report may be obtained without charge upon written request to:

Carol A. Riggleman
South Branch Valley Bancorp, Inc.
Post Office Box 680
Moorefield, West Virginia 26836

## COMMON STOCK DIVIDEND

Dividends on South Branch Valley Bancorp, Inc. stock are normally paid on the 15th day of June and December. The record date is normally the 1st day of the same months.

The Company acts as its own registrar and transfer agent. Its shares are not publicly traded on any exchange or over the counter market. Shares of the Company's common stock are occasionally bought and sold by private individuals, firms or corporations. In many instances, the Company does not have knowledge of the purchase price or the terms of the purchase. No definitive records of bids and ask or sale prices are available.

## OFFICES OF SOUTH BRANCH VALLEY NATIONAL BANK

| | |
|---|---|
| Main Bank<br>310 North Main Street<br>Moorefield, WV 26836<br>(304) 538-2353 | Petersburg Branch<br>102 Virginia Avenue<br>Petersburg, WV 26847<br>(304) 257-2122 |
| Mathias Branch<br>P.O. Box 40<br>Mathias, WV 26812<br>(304) 897-5997 | Franklin Branch<br>P.O. Box 863<br>Franklin, WV 26807<br>(304) 358-2388 |

## OFFICERS OF THE HOLDING COMPANY

SOUTH BRANCH VALLEY BANCORP, INC.

| | |
|---|---|
| OSCAR M. BEAN<br>Chairman of the Board | H. CHARLES MADDY, III<br>President |
| DONALD W. BILLER<br>Vice Chairman | PHOEBE F. HEISHMAN<br>Secretary |
| RUSSELL F. RATLIFF, JR.<br>Treasurer | CAROL A. RIGGLEMAN<br>Assistant Secretary |

DIRECTORS

SOUTH BRANCH VALLEY BANCORP, INC.
AND
SOUTH BRANCH VALLEY NATIONAL BANK

OSCAR M. BEAN
Chairman of the Board
Managing Partner -- Bean & Bean Attorneys

H. CHARLES MADDY, III
President and Chief Executive Officer,
South Branch Valley National Bank

DONALD W. BILLER
Vice-Chairman
President -- D. W. Biller, Inc.
Director -- WV Farm Credit ACA

PHOEBE F. HEISHMAN
Secretary
Editor and Publisher -- Moorefield Examiner
President -- R.E. Fisher Co., Inc.

JAMES M. COOKMAN
President -- Cookman Insurance Group
President -- Cookman Realty Group, Inc.
President -- Transcover, Inc.

JOHN W. CRITES
President -- Allegheny Wood Products, Inc.
Partner -- JPC, Limited Liability Co.
Partner -- Allegheny Dimension, Limited Liability Co.
Principal Stockholder - KJV Aviation, Inc.

THOMAS J. HAWSE, III
President -- Hawse Food Market, Inc.

GARY L. HINKLE
President -- Hinkle Trucking, Inc.
President -- Dettinburn Transport, Inc.
President -- Mt. Storm Fuel Corp.

JEFFREY E. HOTT
Vice-President -- Hott's Ag Services, Inc.
Vice-President -- Franklin Oil Co.
Vice-President -- E. E. Hott, Inc.

HAROLD K. MICHAEL
Owner/Agent -- Nationwide Insurance
Member -- WV House of Delegates

MARY ANN OURS
President -- Ours Valley View Poultry Farms, Inc.

RUSSELL F. RATLIFF, JR.
Vice President & Cashier
South Branch Valley National Bank

HARRY C. WELTON, JR.
Retired Farmer

RENICK C. WILLIAMS
President -- South Branch Inn, Inc.
President -- Fort Pleasant Farms, Inc.
President -- Hampshire S & J Co., Inc.

J. ALECK WELTON
Director Emeritus

OPERATING OFFICERS OF THE BANK

South Branch Valley National Bank

H. CHARLES MADDY, III
President and Chief Executive Officer

RUSSELL F. RATLIFF, JR.
Vice President Operations, Cashier & Trust Officer

JEFFERY L. PAVAN
Vice President Loan Administration

SCOTT C. JENNINGS
Vice President, Loan Review & Compliance

CAROL A. RIGGLEMAN
Community Reinvestment Officer

JULIE R. COOK
Assistant Controller & IRA Officer

DANYL FREEMAN
Assistant Vice President Operations

BARBARA GORENFLO
Assistant Vice President Teller Operations

KATHLEEN SIMERLY
Accounting Officer

DEBRA S. DAVIS
Asst. VP Loan Administration & Senior Loan Officer

MARK H. WRIGHT
Commercial Loan Officer

KENT SHIPE
Mathias Branch Manager

THOMAS G. KIMBLE
Franklin Branch Manager

MARLIN C. CASTO
Petersburg Branch Manager

LARRY G. SMITH
Assistant Branch Manager, Franklin

BELINDA L. TURNER
Assistant Branch Manager, Petersburg

DEBORAH HAMILTON
Assistant Branch Manager, Mathias

J. VANCE WILSON
Loan Officer

WILLIAM F. COOK
Loan Officer

EMPLOYEES OF THE BANK

SOUTH BRANCH VALLEY NATIONAL BANK

STAFF

Main Bank

| | | | |
|---|---|---|---|
| Teresa Barr | Rebecca Bishoff | Jonathan Bland | Curt Boswell |
| Stacey Bowman | Shirley Corsetti | Gloria George | Tracey Gochenour |
| Jean Griffith | Jolene Johnson | Amy Ketterman | Fern Ludwick |
| Gail Malcolm | Tina Martin | Lindsay Metheny | Tabitha Mongold |
| Bernadette Nesslerodt | Sandra Ours | Shelly Reel | Angie Smith |
| Elizabeth Snyder | Elaine Stickley | Ramona Thorne | Pamela Wilson |

Mathias

Christine Delawder
Connie Landacre
Donna Shipe
Teresa Halterman
Helen May

Franklin

Tammy Clutter
Kathy Hartman
Lisa Roberson
Amber-Jon Hanna
Renee Hedrick

Petersburg

Regina Burton
Lisa Casto
Stacy Vance

Exhibit 21

SOUTH BRANCH VALLEY BANCORP, INC.

SUBSIDIARIES OF REGISTRANT

The following lists the subsidiary of the registrant, a West Virginia Corporation.

South Branch Valley National Bank, a national banking association organized under the laws of the United States of America

Exhibit 23

CONSENT OF INDEPENDENT AUDITORS

Securities and Exchange Commission
Washington, D.C.

We hereby consent to the incorporation by reference in this Annual Report on Form 10-KSB of our report dated January 31, 1997, on our audit of the consolidated financial statements of South Branch Valley Bancorp, Inc. as of December 31, 1996 and 1995, and for the three years in the period ended December 31, 1996, appearing in the 1996 Annual Report to Shareholders of South Branch Valley Bancorp, Inc.

Arnett & Foster, P.L.L.C.

Charleston, West Virginia
March 28, 1997

0000811808
SOUTH BRANCH VALLEY NATIONAL BANK

YEAR
DEC-31-1996
JAN-01-1996
DEC-31-1996
3,162,552
1,553,000
723,734
0
29,351,998
0
0
83,272,628
(858,423)
122,113,605
100,941,412
4,377,397
976,351
3,514,652
0
0
956,562
11,347,231
122,113,605
7,551,735
1,966,146
174,415
9,692,296
4,590,018
4,764,362
4,927,934
95,000
29,999
3,156,270
2,133,250
2,133,250
0
0
1,490,037
3.94
3.94
4.50
342,842
324,203
54,647
722,326
859,681
126,749
30,491
858,423
858,423
0
0