

NATIONAL BANKSHARES INC

Form 10-Q

May 06, 2009

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D. C. 20549**

**FORM 10-Q**

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

For the quarterly period ended March 31, 2009

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-15204

## **NATIONAL BANKSHARES, INC.**

(Exact name of registrant as specified in its charter)

Virginia

(State or other jurisdiction of incorporation or organization)

54-1375874

(I.R.S. Employer Identification No.)

101 Hubbard Street

24062-9002

P. O. Box 90002

Blacksburg, VA

(Address of principal executive offices)

(Zip Code)

(540) 951-6300

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed 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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

<u>Class</u>	<u>Outstanding at April 30, 2009</u>
Common Stock, \$1.25 Par Value	6,929,474

(This report contains 29 pages)

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**NATIONAL BANKSHARES, INC. AND SUBSIDIARIES**

Form 10-Q

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**Part I****Financial Information****Item 1. Financial Statements**

National Bankshares, Inc. and Subsidiaries

Consolidated Balance Sheets

<b>\$ in thousands, except share data</b>	<b>(Unaudited)</b>		<b>December 31,</b>
	<b>March 31,</b>		<b>2008</b>
	<b>2009</b>		
<b>Assets</b>			
Cash and due from banks	\$ 13,603		\$ 16,316
Interest-bearing deposits	41,929		29,656
Securities available for sale, at fair value	166,007		147,227
Securities held to maturity (fair value approximates \$133,177 at March 31, 2009 and \$117,277 at December 31, 2008)	134,484		117,772
Mortgage loans held for sale	998		348
Loans:			
Real estate construction loans	58,645		60,798
Real estate mortgage loans	164,684		162,757
Commercial and industrial loans	249,925		246,218
Loans to individuals	102,533		106,907
Total loans	575,787		576,680
Less unearned income and deferred fees	(1,069)	)	(1,123)
Loans, net of unearned income and deferred fees	574,718		575,557
Less: allowance for loan losses	(6,118)	)	(5,858)
Loans, net	568,600		569,699
Bank premises and equipment, net	11,070		11,204
Accrued interest receivable	6,209		5,760
Other real estate owned, net	1,918		1,984
Intangible assets and goodwill, net	13,441		13,719
Other assets	21,528		21,689
<b>Total assets</b>	<b>\$ 979,787</b>		<b>\$ 935,374</b>
<b>Liabilities and Stockholders' Equity</b>			
Noninterest-bearing demand deposits	\$ 112,473		\$ 109,630
Interest-bearing demand deposits	285,218		256,416
Savings deposits	49,178		45,329
Time deposits	410,960		406,473

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Total deposits	<b>857,829</b>	817,848
Other borrowed funds	<b>51</b>	54
Accrued interest payable	<b>650</b>	655
Other liabilities	<b>7,701</b>	6,709
<b>Total liabilities</b>	<b>866,231</b>	825,266

*continued*

**Stockholders' Equity**

Preferred stock of no par value.

Authorized 5,000,000 shares; none issued and outstanding

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Common stock of \$1.25 par value.

Authorized 10,000,000 shares; issued and outstanding 6,929,474 shares in 2009 and in 2008

**8,662**

8,662

Retained earnings

**108,743**

105,356

Accumulated other comprehensive (loss), net

**(3,849**

)

(3,910

)

**Total stockholders' equity**

**113,556**

110,108

**Total liabilities and stockholders' equity**

**\$ 979,787**

**\$ 935,374**

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended March 31, 2009 and 2008

(Unaudited)

<b>\$ in thousands, except share and per share data</b>	<b>March 31, 2009</b>	<b>March 31, 2008</b>
<b>Interest income</b>		
Interest and fees on loans	\$ 9,462	\$ 9,353
Interest on interest-bearing deposits	24	261
Interest on securities – taxable	1,561	1,710
Interest on securities – nontaxable	1,531	1,387
Total interest income	12,578	12,711
<b>Interest expense</b>		
Interest on time deposits \$100,000 or more	1,491	1,664
Interest on other deposits	2,920	3,742
Interest on borrowed funds	1	1
Total interest expense	4,412	5,407
Net interest income	8,166	7,304
Provision for loan losses	370	100
Net interest income after provision for loan losses	7,796	7,204
<b>Noninterest income</b>		
Service charges on deposit accounts	804	768
Other service charges and fees	73	84
Credit card fees	625	637
Trust income	276	303
Other income	249	221
Realized securities gains, net	80	283
Total noninterest income	2,107	2,296
<b>Noninterest expense</b>		
Salaries and employee benefits	2,831	2,857
Occupancy, furniture and fixtures	469	456
Data processing and ATM	322	349
Credit card processing	463	460
Intangibles amortization	278	284
Net costs of other real estate owned	60	14
Other operating expenses	1,207	1,037

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Total noninterest expense	5,630	5,457
Income before income tax expense	4,273	4,043
Income tax expense	886	862
<b>Net income</b>	<b>\$ 3,387</b>	<b>\$ 3,181</b>

*continued*

Net income per share - basic	\$ 0.49	\$ 0.46
- diluted	\$ 0.49	\$ 0.46
Weighted average number of common		
shares outstanding - basic	6,929,474	6,937,933
- diluted	6,934,846	6,947,278
Dividends declared per share	\$ ---	\$ ---

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

Three Months Ended March 31, 2009 and 2008

(Unaudited)

<b>\$ in thousands, except per share data</b>	<b>Common Stock</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive (Loss)</b>	<b>Comprehensive Income</b>	<b>Total</b>
Balances at December 31, 2007	\$ 8,690	\$ 97,810	\$ (1,700 )		\$ 104,800
Net income	---	3,181	---	\$ 3,181	3,181
Other comprehensive income, net of tax:					
Unrealized gain on securities available for sale, net of income tax \$886	---	---	---	1,645	---
Reclass adjustment, net of tax \$(92)	---	---	---	(170 )	---
Other comprehensive income, net of tax \$794	---	---	1,475	1,475	1,475
Comprehensive income	---	---	---	\$ 4,656	---
Effect of changing pension plan measurement date pursuant to SFAS No. 158	---	(45 )	3	---	(42 )
Stock repurchase	(29 )	(428 )	---	---	(457 )
Balances at March 31, 2008	\$ 8,661	\$ 100,518	\$ (222 )		\$ 108,957
Balances at December 31, 2008	\$ 8,662	\$ 105,356	\$ (3,910 )		\$ 110,108
Net income	---	3,387	---	\$ 3,387	3,387
Other comprehensive income, net of tax:					
Unrealized gains on securities available for sale, net of income tax \$61	---	---	---	113	---
Reclass adjustment, net of tax \$(28)	---	---	---	(52 )	---
Other comprehensive income, net of tax \$33	---	---	61	61	61
Comprehensive income	---	---	---	\$ 3,448	---
<b>Balances at March 31, 2009</b>	<b>\$ 8,662</b>	<b>\$ 108,743</b>	<b>\$ (3,849 )</b>		<b>\$ 113,556</b>

See accompanying notes to consolidated financial statements.



National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Three Months Ended March 31, 2009 and 2008

(Unaudited)

<b>\$ in thousands</b>	<b>March 31, 2009</b>		<b>March 31, 2008</b>	
<b>Cash Flows from Operating Activities</b>				
Net income	\$ 3,387		\$ 3,181	
Adjustments to reconcile net income to net cash provided by operating activities:				
Provision for loan losses	370		100	
Depreciation of bank premises and equipment	235		249	
Amortization of intangibles	278		284	
Amortization of premiums and accretion of discounts, net	85		63	
(Gains) on sales and calls of securities available for sale, net	(75)	)	(262)	)
(Gains) on calls of securities held to maturity, net	(5)	)	(21)	)
Losses on other real estate owned	49		---	
Net change in:				
Mortgage loans held for sale	(650)	)	(249)	)
Accrued interest receivable	(449)	)	8	
Other assets	131		(394)	)
Accrued interest payable	(5)	)	8	
Other liabilities	992		1,103	
Net cash provided by operating activities	4,343		4,070	
<b>Cash Flows from Investing Activities</b>				
Net change interest-bearing deposits	(12,273)	)	(14,189)	)
Proceeds from calls, principal payments, sales and maturities of securities available for sale	7,978		10,150	
Proceeds from calls, principal payments and maturities of securities held to maturity	14,541		17,031	
Purchases of securities available for sale	(26,648)	)	(10,370)	)
Purchases of securities held to maturity	(31,277)	)	(18,471)	)
Purchases of loan participations	---		(117)	)
Collections of loan participations	68		61	
Loan originations and principal collections, net	648		(4,028)	)
Proceeds from disposal of other real estate owned	17		8	
Recoveries on loans charged off	13		61	
Purchase of bank premises and equipment	(101)	)	(74)	)
Net cash used in investing activities	(47,034)	)	(19,938)	)
<b>Cash Flows from Financing Activities</b>				
Net change in other deposits	35,494		15,493	
Net change in time deposits	4,487		3,253	

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Net change in other borrowed funds	(3	)	(3	)
Common stock repurchased	---		(457	)
Net cash provided by financing activities	<b>39,978</b>		18,286	
Net change in cash and due from banks	<b>(2,713</b>	)	2,418	
Cash and due from banks at beginning of period	<b>16,316</b>		16,324	
Cash and due from banks at end of period	<b>\$ 13,603</b>		<b>\$ 18,742</b>	

*continued*

**Supplemental Disclosures of Cash Flow Information**

Interest paid on deposits and borrowed funds	\$ 4,417	\$ 5,399
Income taxes paid	\$ ---	\$ 105

**Supplemental Disclosure of Noncash Activities**

Loans charged against the allowance for loan losses	\$ 123	\$ 152
Loans transferred to other real estate owned	\$ ---	\$ 15
Unrealized gains on securities available for sale	\$ 94	\$ 2,269
Capital reduction due to change in pension measurement date	\$ ---	\$ 63

See accompanying notes to consolidated financial statements.

**National Bankshares, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**March 31, 2009**

**(Unaudited)**

(\$ in thousands, except share and per share data)

**Note (1) General**

The consolidated financial statements of National Bankshares, Inc. (NBI) and its wholly-owned subsidiaries, The National Bank of Blacksburg (NBB) and National Bankshares Financial Services, Inc. (NBFS) (collectively, the Company), conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of results of operations for the full year or any other interim period. The interim period consolidated financial statements and financial information included in this Form 10-Q should be read in conjunction with the notes to consolidated financial statements included in the Company's 2008 Form 10-K. The Company posts all reports required to be filed under the Securities and Exchange Act of 1934 on its web site at [www.nationalbankshares.com](http://www.nationalbankshares.com).

**Note (2) Stock-Based Compensation**

The Company adopted the National Bankshares, Inc. 1999 Stock Option Plan to give key employees of NBI and its subsidiaries an opportunity to acquire shares of NBI common stock. The Plan terminated on March 9, 2009. The purpose of the 1999 Stock Option Plan was to promote the success of NBI and its subsidiaries by providing an incentive to key employees that enhanced the identification of their personal interest with the long term financial success of the Company and with growth in stockholder value. Under the 1999 Stock Option Plan, up to 500,000 shares of NBI common stock could be granted. The 1999 Stock Option Plan limited the maximum term of any option granted to ten years, stated that options could be granted at not less than fair market value on the date of the grant and contained certain other limitations on the exercisability of incentive stock options. The options generally vested 25% after one year, 50% after two years, 75% after three years and 100% after four years. There were no nonvested options outstanding at March 31, 2009.

Compensation expense is calculated using the Black-Scholes model and is amortized over the requisite service period using the straight-line method. There have been no grants of stock options in 2009.

<b>Options</b>	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value (\$000)</b>

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Outstanding at January 1, 2009	113,500	\$ 21.84		
Granted	---	---		
Exercised	---	---		
Forfeited or expired	---	---		
Outstanding at March 31, 2009	113,500	\$ 21.84	5.86	\$ ---
Exercisable at March 31, 2009	113,500	\$ 21.84	5.86	\$ ---

Because no options have been granted in 2009 and all options were fully vested at December 31, 2008, there is no expense included in net income.

During the three months ended March 31, 2009 and 2008, there were no stock options granted and no options were exercised.

**Note (3) Allowance for Loan Losses, Nonperforming Assets and Impaired Loans**

	<b>Three Months ended</b>		<b>Year ended</b>	
	<b>March 31,</b>		<b>December 31,</b>	
<b>\$ in thousands, except % data</b>	<b>2009</b>	<b>2008</b>	<b>2008</b>	
Balance at beginning of period	\$ 5,858	\$ 5,219	\$ 5,219	
Provision for loan losses	370	100	1,119	
Loans charged off	(123 )	(152 )	(611 )	
Recoveries	13	61	131	
Balance at the end of period	\$ 6,118	\$ 5,228	\$ 5,858	
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	1.06 %	0.99 %	1.02 %	
Ratio of net charge-offs to average loans, net of unearned income and deferred fees <sup>1</sup>	0.08 %	0.07 %	0.09 %	
Ratio of allowance for loan losses to nonperforming loans <sup>2</sup>	457.59 %	396.36 %	439.46 %	

1. Net charge-offs are on an annualized basis.
2. The Company defines nonperforming loans as total nonaccrual and restructured loans. Loans 90 days past due and still accruing are excluded.

	<b>March 31,</b>		<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>	<b>2008</b>	
<b>\$ in thousands, except % data</b>				
Nonperforming assets:				
Nonaccrual loans	\$ 1,337	\$ 1,319	\$ 1,333	
Restructured loans	---	---	---	
Total nonperforming loans	1,337	1,319	1,333	
Foreclosed property	1,918	270	1,984	
Total nonperforming assets	\$ 3,255	\$ 1,589	\$ 3,317	
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	0.56 %	0.30 %	0.57 %	

	<b>March 31,</b>		<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>	<b>2008</b>	
<b>\$ in thousands, except % data</b>				
Loans past due 90 days or more and still accruing	\$ 1,607	\$ 1,392	\$ 1,127	
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	0.28 %	0.26 %	0.20 %	
Impaired loans				
Total impaired loans	\$ 3,208	\$ 1,319	\$ 3,576	
Impaired loans with a valuation allowance	\$ 2,176	\$ ---	\$ 2,548	
Valuation allowance	(893 )	---	(679 )	
Impaired loans, net of allowance	\$ 1,283	\$ ---	\$ 1,869	
Impaired loans with no valuation allowance	\$ 1,032	\$ 1,319	\$ 1,028	
Average recorded investment in impaired loans	\$ 3,223	\$ 1,235	\$ 3,790	
Income recognized on impaired loans	\$ 44	\$ ---	\$ 140	

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Amount of income recognized on a cash basis	\$ ---	\$---	\$ ---
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There were no nonaccrual loans excluded from impaired loan disclosure under SFAS 114 at March 31, 2009.

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**Note (4) Securities**

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities available for sale by major security type as of March 31, 2009 are as follows:

	March 31, 2009			
	Amortized	Gross	Gross	Fair
\$ in thousands	Costs	Unrealized	Unrealized	Values
		Gains	Losses	
Available for sale:				
U.S. Treasury	\$ 2,023	\$ 218	\$ ---	\$ 2,241
U.S. Government agencies and corporations	33,226	524	338	33,412
State and political subdivisions	82,981	1,875	865	83,991
Mortgage-backed securities	21,538	680	---	22,218
Corporate debt securities	23,984	92	4,293	19,783
Federal Reserve Bank stock-restricted	92	---	---	92
Federal Home Loan Bank stock-restricted	1,677	---	---	1,677
Other securities	2,768	---	175	2,593
Total securities available for sale	\$ 168,289	\$ 3,389	\$ 5,671	\$ 166,007

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities held to maturity by major security type as of March 31, 2009 are as follows:

	March 31, 2009			
	Amortized	Gross	Gross	Fair
\$ in thousands	Costs	Unrealized	Unrealized	Values
		Gains	Losses	
Held to maturity:				
U.S. Government agencies and corporations	\$ 38,816	\$ 493	\$ 210	\$ 39,099
State and political subdivisions	85,276	1,388	1,968	84,696
Mortgage-backed securities	1,720	66	---	1,786
Corporate debt securities	8,672	22	1,098	7,596
Total securities held to maturity	\$ 134,484	\$ 1,969	\$ 3,276	\$ 133,177

Information pertaining to securities with gross unrealized losses at March 31, 2009 and December 31, 2008, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

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	<b>March 31, 2009</b>			
	<b>Less Than 12 Months</b>		<b>12 Months or More</b>	
	<b>Fair Value</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>	<b>Unrealized Loss</b>
<b>\$ in thousands</b>				
U.S. Government agencies and corporations	\$ 31,483	\$ 548	\$ ---	\$ ---
State and political subdivisions	44,671	2,393	5,631	440
Mortgage-backed securities	51			