NATIONAL BANKSHARES INC
Form 10-Q
November 09, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

[x]QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 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	54-1375874
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Hubbard Street P. O. Box 90002 Blacksburg, VA	24062-9002
(Address of principal executive offices)	(Zip Code)

(540) 951-6300
(Registrant’s telephone number, including area code)

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. [x] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). [x] 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 [x] 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 [x] No

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

Class	Outstanding at October 31, 2009
Common Stock, $1.25 Par Value	6,933,474

(This report contains 30 pages)

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES

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Part I
Financial Information

Item 1. Financial Statements

National Bankshares, Inc. and Subsidiaries
Consolidated Balance Sheets

$ in thousands, except share data	(Unaudited) September 30, 2009	December 31, 2008
Assets		
Cash and due from banks	$ 11,891	$ 16,316
Interest-bearing deposits	22,935	29,656
Securities available for sale, at fair value	169,457	147,227
Securities held to maturity (fair value approximates $134,285 at September 30, 2009 and $117,277 at December 31, 2008)	132,786	117,772
Mortgage loans held for sale	628	348
Loans:		
Real estate construction loans	47,671	60,798
Real estate mortgage loans	167,589	162,757
Commercial and industrial loans	268,868	246,218
Loans to individuals	98,632	106,907
Total loans	582,760	576,680
Less unearned income and deferred fees	(1,119)	(1,123)
Loans, net of unearned income and deferred fees	581,641	575,557
Less: allowance for loan losses	(6,453)	(5,858)
Loans, net	575,188	569,699
Bank premises and equipment, net	10,734	11,204
Accrued interest receivable	6,322	5,760
Other real estate owned, net	1,944	1,984
Intangible assets and goodwill, net	12,897	13,719
Other assets	21,106	21,689
Total assets	$ 965,888	$ 935,374
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	$ 122,519	$ 109,630
Interest-bearing demand deposits	277,884	256,416
Savings deposits	50,241	45,329
Time deposits	385,229	406,473
Total deposits	835,873	817,848
Other borrowed funds	46	54
Accrued interest payable	473	655
Other liabilities	8,025	6,709
Total liabilities	844,417	825,266
Stockholders' Equity		
Preferred stock of no par value.		
Authorized 5,000,000 shares; none issued and outstanding	---	---

Common stock of $1.25 par value.		
Authorized 10,000,000 shares; issued and outstanding		
6,933,474 shares in 2009 and 6,929,474 in 2008	8,667	8,662
Retained earnings	113,087	105,356
Accumulated other comprehensive (loss), net	(283)	(3,910)
Total stockholders' equity	121,471	110,108
Total liabilities and stockholders' equity	$ 965,888	$ 935,374

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income
Three Months Ended September 30, 2009 and 2008
(Unaudited)

$ in thousands, except share and per share data	September 30, 2009	September 30, 2008
Interest Income		
Interest and fees on loans	$ 9,316	$ 9,196
Interest on interest-bearing deposits	23	36
Interest on securities – taxable	1,600	1,726
Interest on securities – nontaxable	1,677	1,451
Total interest income	12,616	12,409
Interest Expense		
Interest on time deposits $100,000 or more	1,379	1,323
Interest on other deposits	2,496	2,865
Interest on borrowed funds	1	7
Total interest expense	3,876	4,195
Net interest income	8,740	8,214
Provision for loan losses	305	280
Net interest income after provision for loan losses	8,435	7,934
Noninterest Income		
Service charges on deposit accounts	865	930
Other service charges and fees	107	88
Credit card fees	723	728
Trust income	255	307
Bank owned life insurance income	201	144
Other income	76	87
Realized securities (losses), net	(15)	(76)
Total noninterest income	2,212	2,208
Noninterest Expense		
Salaries and employee benefits	2,784	2,792
Occupancy, furniture and fixtures	450	437
Data processing and ATM	380	355
FDIC insurance	423	47
Credit card processing	550	546
Intangibles amortization	271	279
Net costs of other real estate owned	29	52
Franchise taxes	221	208
Other operating expenses	783	815
Total noninterest expense	5,891	5,531
Income before income tax expense	4,756	4,611
Income tax expense	976	996
Net Income	$ 3,780	$ 3,615

Net income per share - basic	$	0.55	$	0.52
Net income per share - diluted	$	0.54	$	0.52
Weighted average number of common shares outstanding - basic		6,933,474		6,926,974
Weighted average number of common shares outstanding - diluted		6,948,083		6,932,438
Dividends declared per share	$	---	$	---

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income
Nine Months Ended September 30, 2009 and 2008
(Unaudited)

$ in thousands, except share and per share data	September 30, 2009	September 30, 2008
Interest Income		
Interest and fees on loans	$ 28,170	$ 27,682
Interest on interest-bearing deposits	73	426
Interest on securities – taxable	4,766	5,175
Interest on securities – nontaxable	4,896	4,309
Total interest income	37,905	37,592
Interest Expense		
Interest on time deposits $100,000 or more	4,363	4,502
Interest on other deposits	8,197	9,904
Interest on borrowed funds	2	11
Total interest expense	12,562	14,417
Net interest income	25,343	23,175
Provision for loan losses	953	515
Net interest income after provision for loan losses	24,390	22,660
Noninterest Income		
Service charges on deposit accounts	2,506	2,502
Other service charges and fees	263	250
Credit card fees	2,060	2,101
Trust income	792	929
Bank owned life insurance income	554	446
Other income	261	314
Realized securities gains, net	55	189
Total noninterest income	6,491	6,731
Noninterest Expense		
Salaries and employee benefits	8,409	8,395
Occupancy, furniture and fixtures	1,344	1,328
Data processing and ATM	1,016	1,033
FDIC insurance	1,429	90
Credit card processing	1,551	1,570
Intangibles amortization	822	841
Net costs of other real estate owned	100	64
Franchise taxes	666	619
Other operating expenses	2,364	2,354
Total noninterest expense	17,701	16,294
Income before income tax expense	13,180	13,097
Income tax expense	2,656	2,832
Net Income	$ 10,524	$ 10,265

Net income per share - basic	$	1.52	$	1.48
Net income per share - diluted	$	1.52	$	1.48
Weighted average number of common shares outstanding - basic		6,931,672		6,930,133
Weighted average number of common shares outstanding - diluted		6,942,712		6,937,018
Dividends declared per share	$	0.41	$	0.39

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
Nine Months Ended September 30, 2009 and 2008
(Unaudited)

$ in thousands, except per share data	Common Stock	Retained Earnings	Accumulated Other Compre- hensive Income(Loss)	Compre-hensive Income	Total
Balances at December 31, 2007	$ 8,690	$ 97,810	$ (1,700)		$ 104,800
Net income	---	10,265	---	$ 10,265	10,265
Dividends $0.39 per share	---	(2,702)	---	---	(2,702)
Exercise of stock options	5	41	---	---	46
Other comprehensive loss, net of tax:					
Unrealized loss on securities available for sale, net of income tax $(1,198)	---	---	---	(2,224)	---
Reclass adjustment, net of tax $(58)	---	---	---	(108)	---
Other comprehensive loss, net of tax $(1,256)	---	---	(2,332)	(2,332)	(2,332)
Comprehensive income	---	---	---	$ 7,933	---
Effect of changing pension plan measurement date pursuant to SFAS No. 158	---	(45)	3		(42)
Stock repurchase	(36)	(526)	---		(562)
Balances at September 30, 2008	$ 8,659	$ 104,843	$ (4,029)		$ 109,473
Balances at December 31, 2008	$ 8,662	$ 105,356	$ (3,910)		$ 110,108
Net income	---	10,524	---	$ 10,524	10,524
Dividends $0.41per share	---	(2,843)	---	---	(2,843)
Exercise of stock options	5	50	---	---	55
Other comprehensive income, net of tax:					
Unrealized gains on securities available for sale, net of income tax $1,938	---	---	---	3,600	---
Reclass adjustment, net of tax $15	---	---	---	27	---
Other comprehensive income, net of tax $1,953	---	---	3,627	3,627	3,627
Comprehensive income	---	---	---	$ 14,151	---
Balances at September 30, 2009	$ 8,667	$ 113,087	$ (283)		$ 121,471

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2009 and 2008
(Unaudited)

$ in thousands	September 30, 2009	September 30, 2008
Cash Flows from Operating Activities		
Net income	$ 10,524	$ 10,265
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	953	515
Depreciation of bank premises and equipment	687	730
Amortization of intangibles	822	841
Amortization of premiums and accretion of discounts, net	268	189
Losses on sale of disposal of fixed assets	---	2
(Gains) on sales and calls of securities available for sale, net	(42)	(166)
(Gains) on calls of securities held to maturity, net	(13)	(23)
(Gains) losses on other real estate owned	54	(5)
Net change in:		
Mortgage loans held for sale	(280)	125
Accrued interest receivable	(562)	(290)
Other assets	(1,309)	(2,722)
Accrued interest payable	(182)	(156)
Other liabilities	1,316	415
Net cash provided by operating activities	12,236	9,720
Cash Flows from Investing Activities		
Net change interest-bearing deposits	6,721	17,430
Proceeds from calls, principal payments, sales and maturities of securities available for sale	19,699	20,409
Proceeds from calls, principal payments and maturities of securities held to maturity	31,929	19,953
Purchases of securities available for sale	(36,542)	(16,957)
Purchases of securities held to maturity	(47,024)	(32,350)
Purchases of loan participations	(13)	(369)
Collections of loan participations	704	102
Loan originations and principal collections, net	(7,480)	(24,161)
Proceeds from disposal of other real estate owned	269	65
Recoveries on loans charged off	64	110
Purchase of bank premises and equipment	(217)	(194)
Proceeds from disposal of bank premises and equipment	---	8
Net cash used in investing activities	(31,890)	(15,954)
Cash Flows from Financing Activities		
Net change in other deposits	39,269	716
Net change in time deposits	(21,244)	8,931
Net change in other borrowed funds	(8)	(8)
Stocks options exercised	55	46

Cash dividends	(2,843)	(2,702)
Common stock repurchased	---	(562)
Net cash provided by financing activities	15,229	6,421
Net change in cash and due from banks	(4,425)	187
Cash and due from banks at beginning of period	16,316	16,324
Cash and due from banks at end of period	$ 11,891	$ 16,511
Supplemental Disclosures of Cash Flow Information		
Interest paid on deposits and borrowed funds	$ 12,744	$ 14,573
Income taxes paid	$ 3,200	$ 3,034

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Supplemental Disclosure of Noncash Activities				
Loans charged against the allowance for loan losses	$	422	$	409
Loans transferred to other real estate owned	$	283	$	834
Unrealized gains (losses) on securities available for sale	$	5,580	$	(3,588)
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
September 30, 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 and nine months ended September 30, 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.
Subsequent events have been considered through November 9, 2009, the same date on which these financial statements were issued.

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. There were no nonvested options outstanding at September 30, 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.

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2009	113,500	$ 21.84		
Granted	---	---		
Exercised	4,000	13.58		$ 47
Forfeited or expired	---	---		
Outstanding at September 30, 2009	109,500	$ 22.14	5.74	$ 362
Exercisable at September 30, 2009	109,500	$ 22.14	5.74	$ 362

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 nine months ended September 30, 2009 and 2008, there were no stock options granted. During the nine months ended September 30, 2009, options for 4,000 shares of stock with an intrinsic value of $47 were exercised. During the nine months ended September 30, 2008, options for 4,000 shares with an intrinsic value of $20 were exercised.

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

$ in thousands, except % data	Nine Months ended September 30, 2009	Nine Months ended September 30, 2008	Year ended December 31, 2008
Balance at beginning of period	$ 5,858	$ 5,219	$ 5,219
Provision for loan losses	953	515	1,119
Loans charged off	(422)	(409)	(611)
Recoveries	64	110	131
Balance at the end of period	$ 6,453	$ 5,435	$ 5,858
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	1.11%	0.99%	1.02%
Ratio of net charge-offs to average loans, net of unearned income and deferred fees1.	0.08%	0.08%	0.09%
Ratio of allowance for loan losses to nonperforming loans2.	165.97%	271.34%	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 or more past due and still accruing are excluded.

$ in thousands, except % data	September 30, 2009	September 30, 2008	December 31, 2008
Nonperforming assets:			
Nonaccrual loans	$ 3,888	$ 2,003	$ 1,333
Restructured loans	---	---	---
Total nonperforming loans	3,888	2,003	1,333
Foreclosed property	1,944	1,037	1,984
Total nonperforming assets	$ 5,832	$ 3,040	$ 3,317
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	1.00%	0.55%	0.57%

$ in thousands, except % data	September 30, 2009	September 30, 2008	December 31, 2008
Loans past due 90 days or more and still accruing	$ 2,153	$ 1,324	$ 1,127
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	0.37%	0.24%	0.20%
Impaired loans:			
Total impaired loans	$ 5,812	$ 4,374	$ 3,576
Impaired loans with a valuation allowance	$ 5,812	$ 3,271	$ 2,548
Valuation allowance	(1,718)	(996)	(679)
Impaired loans, net of allowance	$ 4,094	$ 2,275	$ 1,869
Impaired loans with no valuation allowance	$ ---	$ 1,103	$ 1,028
Average recorded investment in impaired loans	$ 5,995	$ 3,861	$ 3,790
Income recognized on impaired loans	$ 137	$ 124	$ 140

Amount of income recognized on a cash basis	$	---	$	---	$	---

There were no nonaccrual loans excluded from impaired loan disclosure at September 30, 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 September 30, 2009 are as follows:

	September 30, 2009			
$ in thousands	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Available for sale:				
U.S. Treasury	$ 2,021	$ 156	$ ---	$ 2,177
U.S. Government agencies and corporations	42,165	486	410	42,241
State and political subdivisions	76,857	2,352	299	78,910
Mortgage-backed securities	17,689	817	---	18,506
Corporate debt securities	22,962	635	327	23,270
Federal Reserve Bank stock-restricted	92	---	---	92
Federal Home Loan Bank stock-restricted	1,677	---	---	1,677
Other securities	2,790	---	206	2,584
Total securities available for sale	$ 166,253	$ 4,446	$ 1,242	$ 169,457

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities held to maturity by major security type as of September 30, 2009 are as follows:

	September 30, 2009			
$ in thousands	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Held to maturity:				
U.S. Government agencies and corporations	$ 29,083	$ 394	$ 208	$ 29,269
State and political subdivisions	93,999	2,294	734	95,559
Mortgage-backed securities	1,536	83	---	1,619
Corporate debt securities	8,168	92	422	7,838
Total securities held to maturity	$ 132,786	$ 2,863	$ 1,364	$ 134,285

Information pertaining to securities with gross unrealized losses at September 30, 2009 and December 31, 2008, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	September 30, 2009			
	Less Than 12 Months		12 Months or More	
$ in thousands	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agencies and corporations	$ 34,556	$ 618	$ ---	$ ---
State and political subdivisions	23,782	401	13,452	632
Mortgage-backed securities	---	---	---	---
Corporate debt and other securities	---	---	10,784	955
Total temporarily impaired securities	$ 58,338	$ 1,019	$ 24,236	$ 1,587

	December 31, 2008							
	Less Than 12 Months				12 Months or More			
$ in thousands		Fair Value		Unrealized Loss		Fair Value		Unrealized Loss
U.S. Government agencies and corporations	$	995	$	4	$	---	$	---
State and political subdivisions		54,480		2,533		1,000		2
Mortgage-backed securities		1,309		9		635		3
Corporate debt securities		13,786		851		12,046		3,255
Other securities		---		---		492		96
Total temporarily impaired securities	$	70,570	$	3,397	$	14,173	$	3,356

The Company had 110 securities with a fair value of $82,574 which were temporarily impaired at September 30, 2009. The total unrealized loss on these securities was $2,606. Of the temporarily impaired total, 43 securities with a fair value of $24,236 and an unrealized loss of $1,587 have been in a continuous loss position for twelve months or more.

A security is impaired when its fair value is less than its amortized cost basis. In determining that its impaired securities were temporarily, and not other-than-temporarily, impaired at September 30, 2009, the Company considered the following factors:

- The Company does not intend to sell any impaired security.
- It is more likely than not that the Company will not be required to sell any impaired security before recovering its amortized cost basis.
- The amortized cost basis of each impaired security does not exceed the present value of its expected cash flows.

Significant volatility and increased risk in the financial markets have been associated with the recent economic downturn. The increase in financial market credit risk affects the Company in the same way as it affects other institutional and individual investors. The Company's investment portfolio includes corporate bonds. If, because of economic hardships, the issuing firms were to default, there could be a delay in the payment of interest or bond principal, or there could be a loss of principal or interest, or both. To date, there have been no defaults in any of the corporate bonds held in the investment portfolio. The Company also holds a large number of municipal bonds. A prolonged and deep recession could negatively impact the ability of states and municipalities to make scheduled principal and interest payments on their outstanding indebtedness. If tax revenues and other sources of income decline, states and municipalities could default on their bonds. To date there have been no defaults among the municipal bonds in the Company's portfolio.

Management regularly monitors the credit quality of the investment portfolio. Changes in ratings are noted and follow-up research on the issuer is undertaken when warranted. Management intends to carefully follow any changes in bond quality. Refer to "Securities" in this report for additional information.

Note (5) Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies." FSP FAS 141(R)-1 amends and clarifies SFAS 141(R) to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company does not expect the adoption of FSP FAS 141(R)-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. The Company does not expect the adoption of FSP FAS 157-4 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." FSP FAS 107-1 and APB 28-1 amends SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, the FSP amends APB Opinion No. 28, "Interim Financial Reporting," to require those disclosures in summarized financial information at interim reporting periods. The FSP is effective for interim periods ending after June 15, 2009. The Company does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." FSP FAS 115-2 and FAS 124-2 amend other-than-temporary impairment guidance for debt securities to make guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and FAS 124-2 are effective for interim and annual periods ending after June 15, 2009. The Company does not expect the adoption of FSP FAS 115-2 and FAS 124-2 to have a material impact on its consolidated financial statements.

In April 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 111 (SAB 111). SAB 111 amends and replaces SAB Topic 5.M. in the SAB Series entitled "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities." SAB 111 maintains the SEC Staff's previous views related to equity securities and amends Topic 5.M. to exclude debt securities from its scope. The Company does not expect the implementation of SAB 111 to have a material impact on its consolidated financial statements.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, "Subsequent Events." SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. The Company does not expect the adoption of SFAS 165 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, "Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140." SFAS 166 provides guidance to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. SFAS 166 must be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Company does not expect the adoption of SFAS 166 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, "Amendments to FASB Interpretation No. 46(R)." SFAS 167 improves financial reporting by enterprises involved with variable interest entities. SFAS 167 will be effective as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Company does not expect the adoption of SFAS 167 to have a material impact on its consolidated financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162." SFAS 168 establishes the FASB Accounting Standards Codification, which will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect the adoption of SFAS 168 to have a material impact on its consolidated financial statements.

In June 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 112 (SAB 112). SAB 112 revises or rescinds portions of the interpretative guidance included in the codification of SABs in order to make the interpretive guidance consistent with current U.S. GAAP. The Company does not expect the adoption of SAB 112 to have a material impact on its consolidated financial statements.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05 (ASU 2009-05), "Fair Value Measurements and Disclosures (Topic 820) – Measuring Liabilities at Fair Value." ASU 2009-05 amends Subtopic 820-10, "Fair Value Measurements and Disclosures – Overall," and provides clarification for the fair value measurement

of liabilities. ASU 2009-05 is effective for the first reporting period including interim period beginning after issuance. The Company does not expect the adoption of ASU 2009-05 to have a material impact on its consolidate financial statements.
In September 2009, the FASB issued Accounting Standards Update No. 2009-12 (ASU 2009-12), “Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).” ASU 2009-12 provides guidance on estimating the fair value of alternative investments. ASU 2009-12 is effective for interim and annual periods ending after December 15, 2009. The Company does not expect the adoption of ASU 2009-12 to have a material impact on its consolidated financial statements.
In October 2009, the FASB issued Accounting Standards Update No. 2009-15 (ASU 2009-15), “Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing.” ASU 2009-15 amends Subtopic 470-20 to expand accounting and reporting guidance for own-share lending arrangements issued in contemplation of convertible debt issuance. ASU 2009-15 is effective for fiscal years beginning on or after December 15, 2009 and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The Company does not expect the adoption of ASU 2009-15 to have a material impact on its consolidated financial statements.

Note (6) Defined Benefit Plan

Components of Net Periodic Benefit Cost:

$ in thousands	Pension Benefits Nine Months ended September 30, 2009	2008
Service cost	$ 264	$ 321
Interest cost	495	462
Expected return on plan assets	(396)	(500)
Amortization of prior service cost	(75)	(75)
Amortization of net obligation at transition	(9)	(11)
Recognized net actuarial loss	252	116
Net periodic benefit cost	$ 531	$ 313

Employer Contributions

NBI's required minimum pension plan contribution for 2009 is $318. The contribution is being paid in quarterly installments.

Note (7) Fair Value Measurements

Generally accepted accounting principles define fair value, establish a framework for measuring fair value, establish a three-level valuation hierarchy for disclosure of fair value measurement and enhance disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Securities Available for Sale

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, securities are classified within Level 2 of the valuation hierarchy and fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level

3 of the valuation hierarchy. Currently, all of the Company's available for sale securities are considered to be Level 2 securities. The Company's restricted investment in the equity of correspondent banks is carried at cost based in the redemption provisions of those entities and is therefore excluded from the table below.

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The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2009.

$ in thousands	Description	Balance as of September 30, 2009	Fair Value Measurements at September 30, 2009 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:					
Available for sale securities		$ 167,688	$ ---	$ 167,688	$ ---

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

Loans Held for Sale

Loans held for sale are required to be measured at the lower of cost or fair value. Market value represents fair value. Management obtains quotes or bids on all or part of these loans directly from the purchasing financial institutions. Premiums received or to be received on the quotes or bids are indicative of the fact that cost is lower than fair value. At September 30, 2009, the entire balance of loans held for sale was recorded at its cost.

Impaired Loans

Generally accepted accounting principles are used to determine impaired loans. Impaired loans are measured at observable market price (if available) or at the fair value of the loan’s collateral (if the loan is collateral dependent). Fair value of the loan’s collateral, when the loan is dependent on collateral, is determined by appraisal or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

The following table summarizes the Company’s impaired loans that were measured at fair value on a nonrecurring basis during the period.

$ in thousands	Description	Balance as of September 30, 2009	Carrying Value at September 30, 2009 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:					
Impaired loans net of valuation allowance		$ 4,094	$ ---	$ ---	$ 4,094

Other Real Estate Owned

Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. We believe that the fair value component in its valuation follows generally accepted accounting principles.

The following table summarizes the Company's other real estate owned that was measured at fair value on a nonrecurring basis during the period.

			Carrying Value at September 30, 2009		
$ in thousands	Description	Balance as of September 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:					
Other real estate owned net of valuation allowance		$ 1,944	$ ---	$ ---	$ 1,944

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The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and Due from Banks, Interest-Bearing Deposits, and Federal Funds Sold

The carrying amounts approximate fair value.

Securities

The fair values of securities, excluding restricted stock, are determined using the same methodology described above for securities available for sale.

Loans Held for Sale

Fair values of loans held for sale are based on commitments on hand from investors or prevailing market prices.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, real estate – commercial, real estate – construction, real estate – mortgage, credit card and other consumer loans. Each loan category is further segmented into fixed and adjustable rate interest terms and by performing and nonperforming categories.
The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan, as well as estimates for prepayments. The estimate of maturity is based on the Company’s historical experience with repayments for loan classification, modified, as required, by an estimate of the effect of economic conditions on lending.
Fair value for significant nonperforming loans is based on estimated cash flows which are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discount rates are determined within management’s judgment, using available market information and specific borrower information.

Deposits

The fair value of demand and savings deposits is the amount payable on demand. The fair value of fixed maturity term deposits and certificates of deposit is estimated using the rates currently offered for deposits with similar remaining maturities.

Accrued Interest

The carrying amount of accrued interest approximates fair value.

Other Borrowed Funds

Other borrowed funds, represents treasury tax and loan deposits and short-term borrowings from the Federal Home Loan Bank. The carrying amount is a reasonable estimate of fair value because the deposits are generally repaid within 120 days from the transaction date.

Commitments to Extend Credit and Standby Letters of Credit

The only amounts recorded for commitments to extend credit, standby letters of credit and financial guarantees written are the deferred fees arising from these unrecognized financial instruments. These deferred fees are not deemed significant at September 30, 2009, and, as such, the related fair values have not been estimated.

The estimated fair values, and related carrying amounts, of the Company’s financial instruments are as follows:

	September 30, 2009	
$ in thousands	Carrying Amount	Estimated Fair Value