

NATIONAL BANKSHARES INC

Form 10-Q

August 09, 2007

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 June 30, 2007.

o Transition Report Pursuant To Section 13 OR 15(d) Or 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 of incorporation)

54-1375874

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

101 Hubbard Street

P.O. Box 90002

Blacksburg, VA 24062-9002

(540) 951-6300

(Address and telephone number of principal executive offices)

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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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b – 2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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 July 31, 2007</u>
Common Stock, \$1.25 Par Value	6,969,034

(This report contains 31 pages)

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

(\$ In thousands, except share data)	(Unaudited) June 30, 2007	December 31, 2006
Assets		
Cash and due from banks	\$ 16,937	\$ 15,283
Interest-bearing deposits	20,570	19,617
Securities available for sale, at fair value	161,293	169,735
Securities held to maturity (fair value approximates \$119,558 at June 30, 2007 and \$115,561 at December 31, 2006)	121,662	115,754
Mortgage loans held for sale	1,064	808
Loans:		
Real estate construction loans	42,646	33,840
Real estate mortgage loans	133,797	126,302
Commercial and industrial loans	213,359	215,244
Loans to individuals	119,430	126,316
Total loans	509,232	501,702
Less unearned income and deferred fees	(1,114)	(1,059)
Loans, net of unearned income and deferred fees	508,118	500,643
Less: allowance for loan losses	(5,000)	(5,157)
Loans, net	503,118	495,486
Bank premises and equipment, net	12,340	12,702
Accrued interest receivable	6,005	5,682
Other real estate owned, net	306	390
Intangible assets and goodwill, net	15,407	15,976
Other assets	18,396	16,770
Total assets	\$ 877,098	\$ 868,203
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 115,936	\$ 101,167
Interest-bearing demand deposits	232,039	233,023
Savings deposits	47,956	47,988
Time deposits	375,388	382,514

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Total deposits	771,319	764,692
Other borrowed funds	141	73
Accrued interest payable	756	863
Other liabilities	6,208	5,820
Total liabilities	778,424	771,448

continued

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 6,975,734 shares in 2007 and 6,980,234 in 2006

8,720

8,725

Retained earnings

94,576

91,123

Accumulated other comprehensive (loss), net

(4,622

)

(3,093

)

Total stockholders' equity

98,674

96,755

Total liabilities and stockholders' equity

\$ 877,098

\$ 868,203

See accompanying notes to the consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended June 30, 2007 and 2006

(Unaudited)

(\$ In thousands, except share and per share data)	June 30, 2007	June 30, 2006
Interest income		
Interest and fees on loans	\$ 9,341	\$ 8,637
Interest on interest-bearing deposits	110	102
Interest on securities – taxable	1,910	1,893
Interest on securities – nontaxable	1,334	1,217
Total interest income	12,695	11,849
Interest expense		
Interest on time deposits \$100,000 or more	1,596	1,103
Interest on other deposits	3,743	3,259
Interest on borrowed funds	31	12
Total interest expense	5,370	4,374
Net interest income	7,325	7,475
Provision for loan losses	13	7
Net interest income after provision for loan losses	7,312	7,468
Noninterest income		
Service charges on deposit accounts	843	855
Other service charges and fees	79	104
Credit card fees	720	636
Trust income	360	365
Other income	257	250
Realized securities gains, net	---	2
Total noninterest income	2,259	2,212
Noninterest expense		
Salaries and employee benefits	2,778	2,929
Occupancy, furniture and fixtures	412	472
Data processing and ATM	322	327
Credit card processing	579	469
Intangibles amortization	285	285
Net costs of other real estate owned	3	---
Other operating expenses	1,125	919

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Total noninterest expense	5,504	5,401
Income before income tax expense	4,067	4,279
Income tax expense	927	1,052
Net income	\$ 3,140	\$ 3,227

continued

Net income per share - basic	\$ 0.45	\$ 0.46
- diluted	\$ 0.45	\$ 0.46
Weighted average number of common		
shares outstanding - basic	6,980,379	7,011,581
- diluted	6,995,903	7,033,626
Dividends declared per share	\$ 0.37	\$ 0.36

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Six Months Ended June 30, 2007 and 2006

(Unaudited)

(\$ In thousands, except share and per share data)	June 30, 2007	June 30, 2006
Interest income		
Interest and fees on loans	\$ 18,378	\$ 16,998
Interest on interest-bearing deposits	384	260
Interest on securities – taxable	3,806	3,696
Interest on securities – nontaxable	2,657	2,478
Total interest income	25,225	23,432
Interest expense		
Interest on time deposits \$100,000 or more	3,179	2,191
Interest on other deposits	7,575	6,407
Interest on borrowed funds	32	14
Total interest expense	10,786	8,612
Net interest income	14,439	14,820
Provision for loan losses	10	24
Net interest income after provision for loan losses	14,429	14,796
Noninterest income		
Service charges on deposit accounts	1,653	1,670
Other service charges and fees	162	213
Credit card fees	1,318	1,160
Trust income	733	745
Other income	521	517
Realized securities gains (losses), net	51	(34
Total noninterest income	4,438	4,271
Noninterest expense		
Salaries and employee benefits	5,619	5,840
Occupancy, furniture and fixtures	897	1,005
Data processing and ATM	580	628
Credit card processing	1,026	882
Intangibles amortization	569	569
Net costs of other real estate owned	61	14
Other operating expenses	2,009	1,962

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Total noninterest expense	10,761	10,900
Income before income tax expense	8,106	8,167
Income tax expense	1,850	1,937
Net income	\$ 6,256	\$ 6,230

continued

Net income per share - basic	\$ 0.90	\$ 0.89
- diluted	\$ 0.89	\$ 0.89
Weighted average number of common		
shares outstanding - basic	6,979,745	7,013,311
- diluted	6,998,302	7,039,303
Dividends declared per share	\$ 0.37	\$ 0.36

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

Six Months Ended June 30, 2007 and 2006

(Unaudited)

(\$ In thousands, except per share data)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income	Total
Balances at December 31, 2005	\$ 8,775	\$ 84,610	\$ (1,446)		\$ 91,939
Net income	---	6,230	---	\$ 6,230	6,230
Dividends (\$0.36 per share)	---	(2,524)	---	---	(2,524)
Exercise of stock options	13	108	---	---	121
Other comprehensive loss, net of tax:					
Unrealized loss on securities available for sale, net of income tax \$(1,011)	---	---	---	(1,878)	---
Reclass adjustment, net of tax \$13	---	---	---	25	---
Other comprehensive loss, net of tax (\$998)	---	---	(1,853)	(1,853)	(1,853)
Comprehensive income	---	---	---	\$ 4,377	---
Stock repurchase	(39)	(701)	---	---	(740)
Balances at June 30, 2006	\$ 8,749	\$ 87,723	\$ (3,299)		\$ 93,173
Balances at December 31, 2006	\$ 8,725	\$ 91,123	\$ (3,093)		\$ 96,755
Net income	---	6,256	---	\$ 6,256	6,256
Dividends (\$0.37 per share)	---	(2,584)	---	---	(2,584)
Exercise of stock options	13	93	---	---	106
Other comprehensive loss, net of tax:					
Unrealized loss on securities available for sale, net of income tax \$(805)	---	---	---	(1,496)	---
Reclass adjustment, net of income tax \$(18)	---	---	---	(33)	---
Other comprehensive loss, net of tax (\$823)	---	---	(1,529)	(1,529)	(1,529)
Comprehensive income	---	---	---	\$ 4,727	---
Stock repurchase	(18)	(312)	---	---	(330)
Balances at June 30, 2007	\$ 8,720	\$ 94,576	\$ (4,622)		\$ 98,674

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Six Months Ended June 30, 2007 and 2006

(Unaudited)

(\$In thousands)	June 30, 2007	June 30, 2006	
Cash flows from operating activities			
Net income	\$ 6,256	\$ 6,230	
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	10	24	
Depreciation of bank premises and equipment	502	506	
Amortization of intangibles	569	569	
Amortization of premiums and accretion of discount, net	118	124	
Gains on disposal of fixed assets	---	(2)
(Gains) losses on sales and calls of securities available for sale, net	(51	)	40
Gains on call of securities held to maturity	---	(3)
(Gains) losses and writedowns on other real estate owned	(81	)	10
Net change in:			
Mortgage loans held for sale	(256	)	(222
Accrued interest receivable	(323	)	(156
Other assets	(803	)	(376
Accrued interest payable	(107	)	(37
Other liabilities	388	59	
Net cash provided by operating activities	\$ 6,222	\$ 6,766	
Cash flows from investing activities			
Net change interest-bearing deposits	\$ (953	)	\$ (3,687
Proceeds from calls, principal payments, sales and maturities of securities available for sale	12,532	7,847	
Proceeds from calls, principal payments and maturities of securities held to maturity	2,283	6,261	
Purchases of securities available for sale	(6,461	)	(10,798
Purchases of securities held to maturity	(8,239	)	(1,458
Purchases of loan participations	(1,928	)	(2,232
Collections of loan participations	2,048	4,084	
Loan originations and principal collections, net	(8,045	)	(4,974
Proceeds from disposal of other real estate owned	390	---	
Recoveries on loans charged off	58	76	
Purchase of bank premises and equipment	(140	)	(475
Proceeds from disposal of bank premises and equipment	---	2	
Net cash used in investing activities	\$ (8,455	)	\$ (5,354

Cash flows from financing activities

Net change in other deposits	\$ 13,753	\$ 10,873
Net change in time deposits	(7,126)	(9,941)
Net change in other borrowed funds	68	(279)
Stock options exercised	106	121

continued

Common stock repurchased	(330	)	(740)
Cash dividends paid	(2,584	)	(2,524)
Net cash provided (used) by financing activities	\$ 3,887		\$ (2,490)
Net change in cash and due from banks	1,654		(1,078)
Cash and due from banks at beginning of period	15,283		20,115	
Cash and due from banks at end of period	\$ 16,937		\$ 19,037	

Supplemental disclosure of cash flow information

Cash paid for interest	\$ 10,893		\$ 8,649	
Cash paid for income taxes	\$ 1,782		\$ 1,741	
Loans charged to the allowance for loan losses	\$ 225		\$ 209	
Loans transferred to other real estate owned	\$ 225		\$ 24	
Unrealized (losses) on securities available for sale	\$ (2,352	)	\$ (2,851)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2007

(Unaudited)

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

Note (1)

The consolidated financial statements of National Bankshares, Inc. (Bankshares) and its wholly-owned subsidiaries, The National Bank of Blacksburg (NBB) and National Bankshares Financial Services, Inc. (NBFS), (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 six months ended June 30, 2007 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 2006 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.

Note (2) Stock-Based Compensation

The Company adopted the National Bankshares, Inc. 1999 Stock Option Plan to give key employees of Bankshares and its subsidiaries an opportunity to acquire shares of National Bankshares, Inc. common stock. The purpose of the 1999 Stock Option Plan is to promote the success of Bankshares and its subsidiaries by providing an incentive to key employees that enhances 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 Bankshares common stock may be granted. The 1999 Stock Option Plan is administered by the Stock Option Committee, which is the NBI Board of Directors' Compensation Committee, made up entirely of independent directors of National Bankshares, Inc. The Stock Option Committee may determine whether options are incentive stock options or nonqualified stock options and may determine the other terms of grants, such as number of shares, term, a vesting schedule, and the exercise price. The 1999 Stock Option Plan limits the maximum term of any option granted to ten years, states that options may be granted at not less than fair market value on the date of the grant and contains certain other limitations on the exercisability of incentive stock options. The options generally vest 25% after one year, 50% after two years, 75% after three years and 100% after four years. At the discretion of the Stock Option Committee options may be awarded with the provision that they may be accelerated upon a change of control, merger, consolidation, sale or dissolution of National Bankshares, Inc. At June 30, 2007, there were 286,000 additional shares available for grant under the plan.

Compensation expense is calculated using the Black-Scholes model and is amortized over the requisite service period using the straight-line method. Please refer to the Company's Form 10-K dated December 31, 2006 for assumptions used. There have been no grants of stock options in 2007.

Options

Shares

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			Weighted- Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2007	161,790	\$	20.46		
Granted	---				
Exercised	(10,000	) \$	10.55		
Forfeited or expired	---				
Outstanding at June 30, 2007	151,790	\$	21.12	6.6	\$ ---
Exercisable at June 30, 2007	151,790	\$	21.12	6.6	\$ ---

Because no options were granted in 2007 and all options were fully vested at December 31, 2006, there is no expense included in net income.

During the six months ended June 30, 2007, there were no stock options granted and 10,000 stock options were exercised with an intrinsic value of \$98,900. For the six months ended June 30, 2006 there were no stock options granted and 10,710 options were exercised with an intrinsic value of \$128,000.

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

(\$ In thousands, except % data)	For the periods ended		
	June 30, 2007	2006	December 31, 2006
Balance at beginning of period	\$ 5,157	\$ 5,449	\$ 5,449
Provision for loan losses			