

NATIONAL BANKSHARES INC
Form 10-Q
August 08, 2018

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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 June 30, 2018

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. 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). Yes No

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

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

Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange act.

Yes No

Note: the text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.

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 August 6, 2018</u>
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Common Stock, \$1.25 Par Value	6,957,974
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(This report contains 62 pages)

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National Bankshares, Inc. and Subsidiaries

Consolidated Balance Sheets

	(Unaudited)	
	June 30, 2018	December 31, 2017
(in thousands, except share and per share data)		
Assets		
Cash and due from banks	\$ 12,530	\$ 12,926
Interest-bearing deposits	29,981	51,233
Securities available for sale, at fair value	467,505	331,387
Securities held to maturity (fair value of \$130,113 at December 31, 2017)	---	127,164
Restricted stock, at cost	1,221	1,200
Loans held for sale	1,118	260
Loans:		
Loans, net of unearned income and deferred fees and costs	690,863	668,069
Less allowance for loan losses	(7,579)	(7,925)
Loans, net	683,284	660,144
Premises and equipment, net	8,757	8,221
Accrued interest receivable	5,400	5,297
Other real estate owned, net	2,582	2,817
Intangible assets and goodwill	5,873	5,898
Bank-owned life insurance	34,212	33,756
Other assets	15,014	16,454
Total assets	\$ 1,267,477	\$ 1,256,757
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 195,949	\$ 182,511
Interest-bearing demand deposits	625,447	622,189
Savings deposits	141,943	140,150
Time deposits	105,442	114,884
Total deposits	1,068,781	1,059,734
Accrued interest payable	51	62
Other liabilities	12,794	12,065
Total liabilities	1,081,626	1,071,861
Commitments and contingencies		
Stockholders' Equity		

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Preferred stock, no par value, 5,000,000 shares authorized; none issued and outstanding	---	---
Common stock of \$1.25 par value. Authorized 10,000,000 shares; issued and outstanding 6,957,974 shares at June 30, 2018 and at December 31, 2017	8,698	8,698
Retained earnings	189,194	185,893
Accumulated other comprehensive loss, net	(12,041)	(9,695)
Total stockholders' equity	185,851	184,896
Total liabilities and stockholders' equity	\$ 1,267,477	\$1,256,757

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended June 30, 2018 and 2017

(Unaudited)

(in thousands, except share and per share data)	June 30, 2018	June 30, 2017
Interest Income		
Interest and fees on loans	\$7,622	\$7,453
Interest on interest-bearing deposits	226	231
Interest on securities – taxable	1,746	1,397
Interest on securities – nontaxable	1,132	1,214
Total interest income	10,726	10,295
Interest Expense		
Interest on time deposits	116	135
Interest on other deposits	1,029	913
Total interest expense	1,145	1,048
Net interest income	9,581	9,247
Provision for loan losses	342	464
Net interest income after provision for loan losses	9,239	8,783
Noninterest Income		
Service charges on deposit accounts	694	692
Other service charges and fees	34	41
Credit and debit card fees	365	295
Trust income	374	361
BOLI income	228	146
Other income	173	192
Realized securities gain, net	---	4
Total noninterest income	1,868	1,731
Noninterest Expense		
Salaries and employee benefits	3,545	3,419
Occupancy and furniture and fixtures	491	469
Data processing and ATM	607	542
FDIC assessment	90	91

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Intangible assets amortization	12	12
Net costs of other real estate owned	164	55
Franchise taxes	320	329
Write-down of insurance receivable	287	---
Other operating expenses	908	1,057
Total noninterest expense	6,424	5,974
Income before income taxes	4,683	4,540
Income tax expense	642	970

(continued)

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Net Income	\$4,041	\$3,570
Basic net income per common share	\$0.58	\$0.51
Fully diluted net income per common share	\$0.58	\$0.51
Weighted average number of common shares outstanding – basic and diluted	6,957,974	6,957,974
Dividends declared per common share	\$0.58	\$0.56

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

Three Months Ended June 30, 2018 and 2017

(Unaudited)

(in thousands)	June 30, 2018	June 30, 2017
Net Income	\$4,041	\$3,570
Other Comprehensive Income, Net of Tax		
Unrealized holding gain (loss) on available for sale securities net of tax of (\$155) and \$874 for the periods ended June 30, 2018 and 2017, respectively	(582)	1,626
Unrealized holding gain on securities transferred from held to maturity to available for sale, net of tax of \$237 for the period ended June 30, 2018	891	---
Other comprehensive income, net of tax	309	1,626
Total Comprehensive Income	\$4,350	\$5,196

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Six Months Ended June 30, 2018 and 2017

(Unaudited)

(in thousands, except share and per share data)	June 30, 2018	June 30, 2017
Interest Income		
Interest and fees on loans	\$15,154	\$14,906
Interest on interest-bearing deposits	398	379
Interest on securities – taxable	3,354	2,799
Interest on securities – nontaxable	2,304	2,449
Total interest income	21,210	20,533
Interest Expense		
Interest on time deposits	237	280
Interest on other deposits	1,989	1,796
Total interest expense	2,226	2,076
Net interest income	18,984	18,457
Provision for (recovery of) loan losses	(130)	523
Net interest income after provision for (recovery of) loan losses	19,114	17,934
Noninterest Income		
Service charges on deposit accounts	1,364	1,357
Other service charges and fees	67	110
Credit and debit card fees	709	539
Trust income	776	762
BOLI income	456	289
Other income	519	520
Realized securities gain, net	---	4
Total noninterest income	3,891	3,581
Noninterest Expense		
Salaries and employee benefits	7,239	6,942
Occupancy and furniture and fixtures	963	907
Data processing and ATM	1,340	1,108
FDIC assessment	181	186

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Intangible assets amortization	25	43
Net costs of other real estate owned	249	84
Franchise taxes	651	651
Write-down of insurance receivable	2,010	---
Other operating expenses	1,930	2,336
Total noninterest expense	14,588	12,257
Income before income taxes	8,417	9,258
Income tax expense	1,080	2,039

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Net Income	\$7,337	\$7,219
Basic net income per common share	\$1.05	\$1.04
Fully diluted net income per common share	\$1.05	\$1.04
Weighted average number of common shares outstanding – basic and diluted	6,957,974	6,957,974
Dividends declared per common share	\$0.58	\$0.56

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

Six Months Ended June 30, 2018 and 2017

(Unaudited)

(in thousands)	June 30, 2018	June 30, 2017
Net Income	\$7,337	\$7,219
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gain (loss) on available for sale securities net of tax of (\$861) and \$1,454 for the periods ended June 30, 2018 and 2017, respectively	(3,237)	2,701
Unrealized holding gain on securities transferred from held to maturity to available for sale, net of tax of \$237 for the period ended June 30, 2018	891	---
Other comprehensive income (loss), net of tax	(2,346)	2,701
Total Comprehensive Income	\$4,991	\$9,920

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, 2018 and 2017

(Unaudited)

(in thousands)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balances at December 31, 2016	\$ 8,698	\$ 178,224	\$ (8,659)) \$ 178,263
Net income	---	7,219	---	7,219
Dividends \$0.56 per share	---	(3,897)	---	(3,897)
Other comprehensive income, net of tax of \$1,454	---	---	2,701	2,701
Balances at June 30, 2017	\$ 8,698	181,546	(5,958)) 184,286
Balances at December 31, 2017	\$ 8,698	\$ 185,893	\$ (9,695)) \$ 184,896
Net income	---	7,337	---	7,337
Dividends \$0.58 per share	---	(4,036)	---	(4,036)
Other comprehensive loss, net of tax of (\$624)	---	---	(2,346)) (2,346)
Balances at June 30, 2018	\$ 8,698	\$ 189,194	\$ (12,041)) \$ 185,851

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Six Months Ended June 30, 2018 and 2017

(Unaudited)

(in thousands)	June 30, 2018	June 30, 2017
Cash Flows from Operating Activities		
Net income	\$7,337	\$7,219
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for (recovery of) loan losses	(130)	523
Depreciation of bank premises and equipment	411	400
Amortization of intangibles	25	43
Amortization of premiums and accretion of discounts, net	30	31
Gain on calls of securities held to maturity, net	---	(4)
Loss and write-down on other real estate owned, net	217	49
Increase in cash value of bank-owned life insurance	(456)	(289)
Origination of mortgage loans held for sale	(5,792)	(4,889)
Proceeds from sale of mortgage loans held for sale	5,016	4,953
Gain on sale of mortgage loans held for sale	(82)	(77)
Write-down of insurance receivable	2,010	---
Net change in:		
Accrued interest receivable	(103)	121
Other assets	54	(2,534)
Accrued interest payable	(11)	(12)
Other liabilities	729	486
Net cash provided by operating activities	9,255	6,020
Cash Flows from Investing Activities		
Net change in interest-bearing deposits	21,252	(8,828)
Proceeds from calls, principal payments, sales and maturities of securities available for sale	5,879	9,334
Proceeds from calls, principal payments and maturities of securities held to maturity	6,430	4,204
Purchase of securities available for sale	(24,263)	(9,318)
Net change in restricted stock	(21)	(30)
Purchase of BOLI	---	(10,000)
Purchase of loan participations	(7,117)	(672)
Collection of loan participations	456	743
Loan originations and principal collections, net	(16,473)	(7,702)

Proceeds from sale of other real estate owned	18	196
Recoveries on loans charged off	124	101
Proceeds from sale and purchases of premises and equipment, net	(947)	(104)
Net cash used in investing activities	(14,662)	(22,076)

(continued)

Table of Contents**Cash Flows from Financing Activities**

Net change in time deposits	(9,442)	(8,673)
Net change in other deposits	18,489	27,588
Cash dividends paid	(4,036)	(3,897)
Net cash provided by financing activities	5,011	15,018
Net change in cash and due from banks	(396)	(1,038)
Cash and due from banks at beginning of period	12,926	13,974
Cash and due from banks at end of period	\$12,530	\$12,936

Supplemental Disclosures of Cash Flow Information

Interest paid on deposits and borrowed funds	\$2,237	\$2,088
Income taxes paid	224	2,151

Supplemental Disclosure of Noncash Activities

Loans charged against the allowance for loan losses	\$340	\$552
Loans transferred to other real estate owned	---	97
Unrealized net gain (loss) on securities available for sale	(2,970)	4,155
Unrealized net gain on securities transferred from held to maturity to available for sale	1,128	---
Fair value of securities transferred from held to maturity to available for sale	119,790	---

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2018

(Unaudited)

\$ in thousands, except 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 six month period ended June 30, 2018 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 2017 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.

Accounting Standards Adopted in 2018

ASU No. 2014-09, “Revenue from Contracts with Customers”

In May 2014, the FASB issued ASU No. 2014-09, “*Revenue from Contracts with Customers.*” The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of

variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Subsequent to the issuance of ASU 2014-09, the FASB issued targeted updates to clarify specific implementation issues including ASU No. 2016-08, “*Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*,” ASU No. 2016-10, “*Identifying Performance Obligations and Licensing*,” ASU No. 2016-12, “*Narrow-Scope Improvements and Practical Expedients*,” and ASU No. 2016-20 “*Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*.” For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application.

Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The Company completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including trust and asset management fees, deposit related fees, interchange fees, merchant income, bank-financed sales of other real estate owned and annuity and insurance commissions. Based on this assessment, the Company concluded that ASU 2014-09 did not materially change the method in which the Company currently recognizes revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on its evaluation, the Company determined that the classification of certain debit and credit card related costs should change (i.e., costs previously recorded as expense is now recorded as contra-revenue). The Company identified \$1,378 previously presented as credit card processing expense for the six months ended June 30, 2017 and \$724 for the three months ended June 30, 2017, and reclassified it to net against credit card fee income. The Company adopted ASU 2014-09 and its related amendments on its required effective date of January 1, 2018 utilizing the full retrospective approach. There was no impact to net income. Consistent with the full retrospective approach, the Company adjusted prior period amounts for the debit and credit card costs reclassifications noted above.

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ASU No. 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities"

In January 2016, the FASB issued ASU No. 2016-01, *"Recognition and Measurement of Financial Assets and Financial Liabilities."* This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP. The provisions of the ASU that apply to the Company are as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (4) require use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (5) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (6) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The adoption of ASU No. 2016-01 on January 1, 2018 did not have a material impact on the Company's Consolidated Financial Statements. In accordance with (4) above, the Company measured the fair value of its loan portfolio and time deposit portfolio as of June 30, 2018 using an exit price notion (see Note 14 *Fair Value of Assets and Liabilities*).

ASU No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost"

In March 2017, the FASB issued ASU No. 2017-07, *"Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost."* Under the new guidance, employers are required to present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Employee Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components of net periodic benefit cost separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. The Company adopted ASU No. 2017-07 on January 1, 2018 and utilized the ASU's practical expedient allowing entities to estimate amounts for comparative periods using the information previously disclosed in their pension and other postretirement benefit plan footnote and re-classified non-servicing components of net periodic pension cost from compensation expense to other noninterest expense. ASU No. 2017-07 did not have a material impact on the Company's Consolidated Financial Statements.

Note 2: Loan Portfolio

The loan portfolio, excluding loans held for sale, was comprised of the following.

	June 30,	December
	2018	31,
		2017
Real estate construction	\$36,223	\$ 34,694
Consumer real estate	170,248	166,965
Commercial real estate	340,582	340,414
Commercial non real estate	46,501	40,518
Public sector and IDA	60,010	51,443
Consumer non real estate	37,906	34,648
Gross loans	691,470	668,682
Less unearned income and deferred fees and costs	(607)	(613)
Loans, net of unearned income and deferred fees and costs	\$690,863	\$ 668,069

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

The allowance for loan losses methodology incorporates individual evaluation of impaired loans and collective evaluation of groups of non-impaired loans. The Company performs ongoing analysis of the loan portfolio to determine credit quality and to identify impaired loans. Credit quality is rated based on the loan's payment history, the borrower's current financial situation and value of the underlying collateral.

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due will not be collected when due according to the contractual terms of the loan agreement. Impaired loans are those loans that have been modified in a troubled debt restructure ("TDR" or "restructure") and larger, non-homogeneous loans that are in nonaccrual or exhibit payment history or financial status that indicate that collection probably will not occur when due according to the loan's terms. Generally, impaired loans are given risk ratings that indicate higher risk, such as "classified" or "other assets especially mentioned." Impaired loans are individually evaluated to determine appropriate reserves and are measured at the lower of the invested amount or the fair value. Impaired loans that are not troubled debt restructures and for which fair value measurement indicates an impairment loss are designated nonaccrual. A restructured loan that maintains current status for at least six months may be in accrual status. Please refer to Note 1: Summary of Significant Accounting Policies for additional information on evaluation of impaired loans and associated specific reserves, and policies regarding nonaccruals, past due status and charge-offs.

Troubled debt restructurings impact the estimation of the appropriate level of the allowance for loan losses. If the restructuring included forgiveness of a portion of principal or accrued interest, the charge-off is included in the historical charge-off rates applied to the collective evaluation methodology. Restructured loans are individually evaluated for impairment, and the amount of a restructured loan's book value in excess of its fair value is accrued as a specific allocation in the allowance for loan losses. TDRs that experience a payment default are examined to determine whether the default indicates collateral dependency or cash flows below those that were used in the fair value measurement. TDRs, as well as all impaired loans, that are determined to be collateral dependent are charged down to fair value. Deficiencies indicated by impairment measurements for TDRs that are not collateral dependent may be accrued in the allowance for loan losses or charged off if deemed uncollectible.

Collectively-Evaluated Loans

The Company evaluated characteristics in the loan portfolio and determined major segments and smaller classes within each segment. These characteristics include collateral type, repayment sources, and (if applicable) the borrower's business model. The methodology for calculating reserves for collectively-evaluated loans is applied at the

class level.

Portfolio Segments and Classes

The segments and classes used in determining the allowance for loan losses are as follows.

Real Estate Construction	Commercial Non Real Estate
Construction, residential	Commercial and industrial
Construction, other	
	Public Sector and IDA
Consumer Real Estate	Public sector and IDA
Equity lines	
Residential closed-end first liens	Consumer Non Real Estate
Residential closed-end junior liens	Credit cards
Investor-owned residential real estate	Automobile
	Other consumer loans
Commercial Real Estate	
Multifamily real estate	
Commercial real estate, owner-occupied	
Commercial real estate, other	

Historical Loss Rates

The Company’s allowance methodology for collectively-evaluated loans applies historical loss rates by class to current class balances as part of the process of determining required reserves. Class loss rates are calculated as the net charge-offs for the class as a percentage of average class balance. The Company averages loss rates for the most recent 8 quarters to determine the historical loss rate for each class.

Two loss rates for each class are calculated: total net charge-offs for the class as a percentage of average class loan balance (“class loss rate”), and total net charge-offs for the class as a percentage of average classified loans in the class (“classified loss rate”). Classified loans are those with risk ratings of “substandard” or lower. Net charge-offs in both calculations include charge-offs and recoveries of classified and non-classified loans as well as those associated with impaired loans. Class historical loss rates are applied to non-classified loan balances at the reporting date, and classified historical loss rates are applied to classified balances at the reporting date.

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Risk Factors

In addition to historical loss rates, risk factors pertinent to credit risk for each class are analyzed to estimate reserves for collectively-evaluated loans. Factors include changes in national and local economic and business conditions, the nature and volume of classes within the portfolio, loan quality, loan officers' experience, lending policies and the Company's loan review system.

The analysis of certain factors results in standard allocations to all segments and classes. These factors include the risk from changes in lending policies, loan officers' average years of experience, unemployment levels, bankruptcy rates, interest rate environment, and competition/legal/regulatory environments. Factors analyzed for each class, with resultant allocations based upon the level of risk assessed for each class, include the risk from changes in loan review, levels of past due loans, levels of nonaccrual loans, current class balance as a percentage of total loans, and the percentage of high risk loans within the class. Additionally, factors specific to each segment are analyzed and result in allocations to the segment. Please refer to Note 1: Summary of Significant Accounting Policies of Form 10-K for a discussion of risk factors pertinent to each class.

Real estate construction loans are subject to general risks from changing commercial building and housing market trends and economic conditions that may impact demand for completed properties and the costs of completion. These risks are measured by market-area unemployment rates, bankruptcy rates, building market trends, and interest rates.

The credit quality of consumer real estate is subject to risks associated with the borrower's repayment ability and collateral value, measured generally by analyzing local unemployment and bankruptcy trends, local housing market trends, and interest rates.

The commercial real estate segment includes loans secured by multifamily residential real estate, commercial real estate occupied by the owner/borrower, and commercial real estate leased to non-owners. Loans in the commercial real estate segment are impacted by economic risks from changing commercial real estate markets, rental markets for multi-family housing and commercial buildings, business bankruptcy rates, local unemployment and interest rate trends that would impact the businesses housed by the commercial real estate.

Commercial non real estate loans are secured by collateral other than real estate, or are unsecured. Credit risk for commercial non real estate loans is subject to economic conditions, generally monitored by local business bankruptcy trends, and interest rates.

Public sector and IDA loans are extended to municipalities and related entities. Credit risk is based upon the entity's ability to repay and interest rate trends.

Consumer non real estate includes credit cards, automobile and other consumer loans. Credit cards and certain other consumer loans are unsecured, while collateral is obtained for automobile loans and other consumer loans. Credit risk stems primarily from the borrower's ability to repay, measured by average unemployment, average personal bankruptcy rates and interest rates.

Factor allocations applied to each class are increased for loans rated special mention and increased to a greater extent for loans rated classified. The Company allocates additional reserves for "high risk" loans. High risk loans include junior

liens, interest only and high loan to value loans.

A detailed analysis showing the allowance roll-forward by portfolio segment and related loan balance by segment follows.

Activity in the Allowance for Loan Losses for the Six Months Ended June 30, 2018

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2017	\$337	\$ 2,027	\$ 3,044	\$ 1,072	\$ 419	\$ 707	\$ 319	\$7,925
Charge-offs	---	---	---	(107)	---	(233)	---	(340)
Recoveries	---	2	25	10	---	87	---	124
Provision for (recovery of) loan losses	36	(29)	(78)	(215)	154	199	(197)	(130)
Balance, June 30, 2018	\$373	\$ 2,000	\$ 2,991	\$ 760	\$ 573	\$ 760	\$ 122	\$7,579

Table of Contents**Activity in the Allowance for Loan Losses for the Six Months Ended June 30, 2017**

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2016	\$438	\$ 1,830	\$ 3,738	\$ 1,063	\$ 330	\$ 644	\$ 257	\$8,300
Charge-offs	---	(138)	(122)	(73)	---	(219)	---	(552)
Recoveries	---	1	36	10	---	54	---	101
Provision for (recovery of) loan losses	(87)	340	116	103	83	218	(250)	523
Balance, June 30, 2017	\$351	\$ 2,033	\$ 3,768	\$ 1,103	\$ 413	\$ 697	\$ 7	\$8,372

Activity in the Allowance for Loan Losses for the Year Ended December 31, 2017

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2016	\$438	\$ 1,830	\$ 3,738	\$ 1,063	\$ 330	\$ 644	\$ 257	\$8,300
Charge-offs	---	(146)	(139)	(82)	---	(452)	---	(819)
Recoveries	---	1	131	23	---	132	---	287
Provision for (recovery of) loan losses	(101)	342	(686)	68	89	383	62	157
Balance, December 31, 2017	\$337	\$ 2,027	\$ 3,044	\$ 1,072	\$ 419	\$ 707	\$ 319	\$7,925

Allowance for Loan Losses as of June 30, 2018

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	\$---	\$ 15	\$ ---	\$ 147	\$ ---	\$ ---	\$ ---	\$162
Collectively evaluated for impairment	373	1,985	2,991	613	573	760	122	7,417
Total	\$373	\$ 2,000	\$ 2,991	\$ 760	\$ 573	\$ 760	\$ 122	\$7,579

Allowance for Loan Losses as of December 31, 2017

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
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					IDA	Estate		
Individually evaluated for impairment	\$---	\$ 16	\$ ---	\$ 160	\$ ---	\$ 1	\$ ---	\$177
Collectively evaluated for impairment	337	2,011	3,044	912	419	706	319	7,748
Total	\$337	\$ 2,027	\$ 3,044	\$ 1,072	\$ 419	\$ 707	\$ 319	\$7,925

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Loans as of June 30, 2018								
	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	\$2,618	\$1,135	\$7,092	\$1,175	\$---	\$22	\$---	\$12,042
Collectively evaluated for impairment	33,605	169,113	333,490	45,326	60,010	37,884	---	679,428
Total	\$36,223	\$170,248	\$340,582	\$46,501	\$60,010	\$37,906	\$---	\$691,470
Loans as of December 31, 2017								
	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	\$2,882	\$1,267	\$6,516	\$1,229	\$---	\$30	\$---	\$11,924
Collectively evaluated for impairment	31,812	165,698	333,898	39,289	51,443	34,618	---	656,758
Total	\$34,694	\$166,965	\$340,414	\$40,518	\$51,443	\$34,648	\$---	\$668,682

A summary of ratios for the allowance for loan losses follows.

	As of and for the			
	Six Months Ended		Year Ended	
	June, 2018	2017	December 31, 2017	
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees and costs	1.10 %	1.28 %	1.19	%
Ratio of net charge-offs to average loans, net of unearned income and deferred fees and costs ⁽¹⁾	0.06 %	0.14 %	0.08	%

⁽¹⁾ Net charge-offs are on an annualized basis.

A summary of nonperforming assets follows.

	June 30,		December	
	2018	2017	31,	2017
Nonperforming assets:				
Nonaccrual loans	\$---	\$9	\$6	
Restructured loans in nonaccrual	2,687	3,188	2,763	
Total nonperforming loans	2,687	3,197	2,769	
Other real estate owned, net	2,582	3,008	2,817	
Total nonperforming assets	\$5,269	\$6,205	\$5,586	
Ratio of nonperforming assets to loans, net of unearned income and deferred fees and costs, plus other real estate owned	0.76 %	0.94 %	0.83 %	
Ratio of allowance for loan losses to nonperforming loans ⁽¹⁾	282.06 %	261.87 %	286.20 %	

⁽¹⁾ The Company defines nonperforming loans as nonaccrual loans and restructured loans that are nonaccrual. Nonperforming loans do not include loans 90 days past due and still accruing or accruing restructured loans.

A summary of loans past due 90 days or more and impaired loans follows.

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	June 30,		December 31,	
	2018	2017	2017	
Loans past due 90 days or more and still accruing	\$61	\$259	\$51	
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees and costs	0.01 %	0.04 %	0.01 %	
Accruing restructured loans	\$8,337	\$3,711	\$5,134	
Impaired loans:				
Impaired loans with no valuation allowance	\$10,607	\$9,320	\$10,444	
Impaired loans with a valuation allowance	1,435	880	1,480	
Total impaired loans	\$12,042	\$10,200	\$11,924	
Valuation allowance	(162)	(23)	(177)	
Impaired loans, net of allowance	\$11,880	\$10,177	\$11,747	
Average recorded investment in impaired loans ⁽¹⁾	\$12,326	\$12,017	\$13,344	
Interest income recognized on impaired loans, after designation as impaired	\$239	\$192	\$528	
Amount of income recognized on a cash basis	\$---	\$---	\$---	

⁽¹⁾ Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

Nonaccrual loan relationships that meet the Company's balance threshold of \$250 and all TDRs are designated as impaired. The Company also designates as impaired other loan relationships that meet the Company's balance threshold of \$250 and for which the Company does not expect to collect according to the note's contractual terms. No interest income was recognized on nonaccrual loans for the six months ended June 30, 2018 or June 30, 2017 or for the year ended December 31, 2017.

A detailed analysis of investment in impaired loans, associated reserves and interest income recognized, segregated by loan class follows.

Impaired Loans as of June 30, 2018					
	Principal Total	Recorded Investment ⁽¹⁾	Recorded Investment ⁽¹⁾ Which There is No Related Allowance	Recorded Investment ⁽¹⁾ for Which There is a Related Allowance	Related Allowance
Real Estate Construction⁽²⁾					
Construction, other	\$2,618	\$ 2,618	\$ 2,618	\$ ---	\$ ---
Consumer Real Estate⁽²⁾					

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Residential closed-end first liens	701	658	482	176	10
Residential closed-end junior liens	157	157	---	157	5
Investor-owned residential real estate	342	320	320	---	---
Commercial Real Estate⁽²⁾					
Multifamily	298	298	298	---	---
Commercial real estate, owner-occupied	3,980	3,971	3,971	---	---
Commercial real estate, other	3,169	2,823	2,823	---	---
Commercial Non Real Estate⁽²⁾					
Commercial and industrial	1,184	1,175	73	1,102	147
Consumer Non Real Estate⁽²⁾					
Automobile	22	22	22	---	---
Total	\$12,471	\$ 12,042	\$ 10,607	\$ 1,435	\$ 162

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

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	Impaired Loans as of December 31, 2017				
	Principal Total Balance	Recorded Investment⁽¹⁾	Recorded Investment⁽¹⁾ for Which There is No Related Allowance	Recorded Investment⁽¹⁾ for Which There is a Related Allowance	Related Allowance
Real Estate Construction⁽²⁾					
Construction 1-4 family residential	\$2,882	\$ 2,882	\$ 2,882	\$ ---	\$ ---
Consumer Real Estate⁽²⁾					
Residential closed-end first liens	807	768	590	178	10
Residential closed-end junior liens	174	174	---	174	6
Investor-owned residential real estate	347	325	325	---	---
Commercial Real Estate⁽²⁾					
Multifamily real estate	303	303	303	---	---
Commercial real estate, owner occupied	3,619	3,611	3,611	---	---
Commercial real estate, other	2,921	2,602	2,602	---	---
Commercial Non Real Estate⁽²⁾					
Commercial and industrial	1,236	1,229	126	1,103	160
Consumer Non Real Estate⁽²⁾					
Automobile	30	30	5	25	1
Total	\$12,319	\$ 11,924	\$ 10,444	\$ 1,480	\$ 177

(1)Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2)Only classes with impaired loans are shown.

The following tables show the average recorded investment and interest income recognized for impaired loans.

	For the Six Months Ended	
	June 30, 2018 Average Investment	Recorded Income Recognized⁽¹⁾
Real Estate Construction⁽²⁾		
Construction 1-4 family residential	\$2,788	\$ 74
Consumer Real Estate⁽²⁾		

Residential closed-end first liens	667	15
Residential closed-end junior liens	167	5
Investor-owned residential real estate	317	8
Commercial Real Estate⁽²⁾		
Multifamily real estate	301	8
Commercial real estate, owner occupied	4,007	98
Commercial real estate, other	2,852	11
Commercial Non Real Estate⁽²⁾		
Commercial and industrial	1,201	19
Consumer Non Real Estate⁽²⁾		
Automobile	26	1
Total	\$12,326	\$ 239

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

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	For the Six Months Ended	
	June 30, 2017	
	Average Interest	
	Recorded Income	
	Investment Recognized⁽¹⁾	
Real Estate Construction⁽²⁾		
Construction 1-4 family residential	\$3,335	\$ 89
Consumer Real Estate⁽²⁾		
Residential closed-end first liens	603	18
Residential closed-end junior liens	190	6
Investor-owned residential real estate	335	2
Commercial Real Estate⁽²⁾		
Multifamily real estate	887	---
Commercial real estate, owner occupied	3,777	77
Commercial real estate, other	2,681	---
Commercial Non Real Estate⁽²⁾		
Commercial and industrial	207	---
Consumer Non Real Estate		
Automobile	2	---
Total	\$12,017	\$ 192

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

	For the Year Ended	
	December 31, 2017	
	Average Interest	
	Recorded Income	
	Investment Recognized⁽¹⁾	
Real Estate Construction⁽²⁾		
Construction 1-4 family residential	\$3,298	\$ 177
Consumer Real Estate⁽²⁾		
Residential closed-end first liens	781	57
Residential closed-end junior liens	185	11
Investor-owned residential real estate	329	1
Commercial Real Estate⁽²⁾		
Multifamily real estate	748	16

Commercial real estate, owner occupied	4,047	200
Commercial real estate, other	2,638	---
Commercial Non Real Estate⁽²⁾		
Commercial and industrial	1,282	64
Consumer Non Real Estate⁽²⁾		
Automobile	36	2
Total	\$13,344	\$ 528

(1) Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

(2) Only classes with impaired loans are shown.

The Company reviews nonaccrual loans on an individual loan basis to determine whether future payments are reasonably assured. To satisfy this criteria, the Company's evaluation must determine that the underlying cause of the original delinquency or weakness that indicated nonaccrual status has been resolved, such as receipt of new guarantees, increased cash flows that cover the debt service or other resolution. Nonaccrual loans that demonstrate reasonable assurance of future payments and that have made at least six consecutive payments in accordance with repayment terms and timeframes may be returned to accrual status.

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An analysis of past due and nonaccrual loans follows.

June 30, 2018

	30 – 89 Days	90 or More Days Past Due	90 or More Days Past Due and Accruing	Nonaccruals⁽²⁾
Real Estate Construction⁽²⁾				
Construction, other	\$ 22	\$ ---	\$ ---	\$ ---
Consumer Real Estate⁽¹⁾				
Residential closed-end first liens	939	31	31	