NATIONAL BANKSHARES INC
Form 10-K
March 12, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

[x] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2009

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ________ to ________.
Commission File Number: 0-15204

NATIONAL BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

Virginia	54-1375874
(State of incorporation)	(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)

Securities registered pursuant to Section 12(b) of the Act:	Securities registered Pursuant to Section 12(g) of the Act:
None	Common Stock, Par Value $1.25 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [x]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [x]

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 [x] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 period that the registrant was required to submit and post files). Yes [x] No [ ]

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

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 definition of “accelerated filer, large accelerated filer, and smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [x] Non-accelerated filer [ ] Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes [ ] No [x]

The aggregate market value of the voting common stock of the registrant held by stockholders (not including voting common stock held by Directors, Executive Officers and Corporate Governance) on June 30, 2009 (the last business day of the most recently completed second fiscal quarter) was approximately $156,928,684. As of February 24, 2010, the registrant had 6,933,474 shares of voting common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated herein by reference into the Part of the Form 10-K indicated.

Document	Part of Form 10-K into which incorporated
National Bankshares, Inc. 2009 Annual Report to Stockholders	Part II
National Bankshares, Inc. Proxy Statement for the 2010 Annual Meeting of Stockholders	Part III

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES
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Part I
$ in thousands, except per share data

Item 1. Business

History and Business

National Bankshares, Inc. (the Company or NBI) is a financial holding company that was organized in 1986 under the laws of Virginia and is registered under the Bank Holding Company Act of 1956. It conducts most of its operations through its wholly-owned community bank subsidiary, the National Bank of Blacksburg (NBB). It also owns National Bankshares Financial Services, Inc. (NBFS), which does business as National Bankshares Insurance Services and National Bankshares Investment Services.

The National Bank of Blacksburg

The National Bank of Blacksburg, which does business as National Bank, was originally chartered in 1891 as the Bank of Blacksburg. Its state charter was converted to a national charter in 1922 and it became the National Bank of Blacksburg. In 2004, NBB purchased Community National Bank of Pulaski, Virginia. In May, 2006, Bank of Tazewell County, a Virginia bank which since 1996 had also been a wholly-owned subsidiary of NBI, was merged with and into NBB.
NBB is community-oriented, and it offers a full range of retail and commercial banking services to individuals, businesses, non-profits and local governments from its headquarters in Blacksburg, Virginia and its twenty-four branch offices throughout southwest Virginia. NBB has telephone and internet banking and it operates twenty-five automated teller machines in its service area. Lending is focused at small and mid-sized businesses and at individuals. Loan types include commercial, agricultural, real estate, home equity and consumer. Merchant credit card services and business and consumer credit cards are available. Deposit accounts offered include demand deposit accounts, money market deposit accounts, savings accounts and certificates of deposit. NBB offers other miscellaneous services normally provided by commercial banks, such as letters of credit, night depository, safe deposit boxes, travelers checks, utility payment services and automatic funds transfer. NBB conducts a general trust business that has wealth management and trust and estate services for individual and business customers.
At December 31, 2009, NBB had total assets of $978,533 and total deposits of $852,131. NBB’s net income for 2009 was $14,505, which produced a return on average assets of 1.50% and a return on average equity of 12.74%. Refer to Note 12 of the Notes to Consolidated Financial Statements for NBB’s risk-based capital ratios.

National Bankshares Financial Services, Inc.

In 2001, National Bankshares Financial Services, Inc. was formed in Virginia as a wholly-owned subsidiary of NBI. NBFS offers non-deposit investment products and insurance products for sale to the public. NBFS works cooperatively with Infinex Investments, Inc. to provide investments and with Bankers Insurance, LLC for insurance products. NBFS does not significantly contribute to NBI’s net income.

Operating Revenue

The percentage of total operating revenue attributable to each class of similar service that contributed 15% or more of the Company’s total operating revenue for the years ended December 31, 2009, 2008 and 2007 is set out in the following table.

Period	Class of Service	Percentage of Total Revenues

December 31, 2009	Interest and Fees on Loans	63.38%
	Interest on Investments	21.62%
December 31, 2008	Interest and Fees on Loans	62.68%
	Interest on Investments	21.21%
December 31, 2007	Interest and Fees on Loans	62.60%
	Interest on Investments	21.46%

Market Area

NBB's market area in southwest Virginia is made up of the counties of Montgomery, Giles, Pulaski, Tazewell, Wythe, Smyth and Washington. It also includes the independent cities of Radford and Galax, and the portions of Carroll and Grayson Counties that are adjacent to Galax. The bank also serves those portions of Mercer County and McDowell County, West Virginia that are contiguous with Tazewell County, Virginia. Although largely rural, the market area is home to two major universities, Virginia Tech and Radford University, and to three community colleges. Virginia Tech, located in Blacksburg, Virginia, is the area's largest employer and is the Commonwealth's second largest university. A second state supported university, Radford University, is located nearby. Employment at the universities has been stable. In recent years, Virginia Tech's Corporate Research Center has brought several technology related companies to Montgomery County.

In addition to education, the market area has a diverse economic base, with manufacturing, agriculture, tourism, healthcare, retail and service industries all represented. Large manufacturing facilities in the region include Celanese Acetate, the largest employer in Giles County, and Volvo Heavy Trucks, the largest company in Pulaski County. Both of these firms have experienced layoffs within the past several years. In particular in the past year, Volvo Heavy Trucks has made major cuts in its work force in response to a rapid decline in the demand for trucks because of the recent economic downturn. Pulaski and Galax have been centers for furniture manufacturing. In recent years, this industry has been declining because of growing furniture imports and the loss of demand. Several furniture companies have gone out of business in the recent past. Tazewell County is largely dependent on the coal mining industry and on agriculture for its economic base. Coal production is a cyclical industry that also has been negatively affected by the economic decline. Both Montgomery County and Bluefield in Tazewell County are regional retail centers and have facilities to provide basic heath care for the region.

NBB's market area offers the advantages of a good quality of life, scenic beauty, moderate climate and historical and cultural attractions. The region has some recent success attracting retirees, particularly from the Northeast and urban northern Virginia.

Because NBB's market area is economically diverse and includes large public employers, it has historically avoided the most extreme effects of past economic downturns. However, if the current national and state economic problems are severe and prolonged, cutbacks at the state-supported universities and community colleges would have a negative effect on our market. If there were large staff layoffs and smaller student enrollments, both the retail and housing sectors would suffer. In addition, more large layoffs at local manufacturing facilities or plant closings in the market area would negatively affect our business.

Competition

The banking and financial services industry in NBB's market area is highly competitive. The competitive business environment is a result of changes in regulation, changes in technology and product delivery systems and competition from other financial institutions as well as non-traditional financial services. NBB competes for loans and deposits with other commercial banks, credit unions, securities and brokerage companies, mortgage companies, insurance companies, retailers, automobile companies and other nonbank financial service providers. Many of these competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services than NBB. In order to compete, NBB relies upon a deep knowledge of its markets, a service-based business philosophy, personal relationships with customers, specialized services tailored to meet customers' needs and the convenience of office locations. In addition, the bank is generally competitive with other financial institutions in its market area with respect to interest rates paid on deposit accounts, interest rates charged on loans and other service charges on loans and deposit accounts.

Organization and Employment

NBI, NBB and NBFS are organized in a holding company/subsidiary structure. Functions that serve both subsidiaries, including audit, compliance, loan review and human resources, are at the holding company level, and fees are charged to the respective subsidiary for those services. Until May 2006, when it was merged with and into NBB, NBI operated a second wholly-owned bank subsidiary, Bank of Tazewell County.

At December 31, 2009, NBI employed 15 full time employees, NBB had 206 full time equivalent employees and NBFS had 3 full time employees.

Regulation, Supervision and Government Policy

NBI and NBB are subject to state and federal banking laws and regulations that provide for general regulatory oversight of all aspects of their operations. As a result of substantial regulatory burdens on banking, financial institutions like NBI and NBB are at a disadvantage to other competitors who are not as highly regulated, and NBI and NBB's costs of doing business are accordingly higher. A brief summary follows of certain laws, rules and regulations which affect NBI and NBB. Any changes in the laws and regulations governing banking and financial services could have an adverse effect on the business prospects of NBI and NBB. The current economic environment has created uncertainty in this area, as legislators and regulators, through new laws and regulations, attempt to address rapidly evolving problems in the credit and financial services markets. The federal government has increased involvement in and scrutiny of all financial institutions. There is heightened examination focus, particularly on real estate related assets and commercial loans, and there is the ongoing potential for new laws and regulations.

National Bankshares, Inc.

NBI is a bank holding company qualified as a financial holding company under the Federal Bank Holding Company Act (BHCA), which is administered by the Board of Governors of the Federal Reserve System (the Federal Reserve). NBI is required to file an annual report with the Federal Reserve and may be required to furnish additional information pursuant to the BHCA. The Federal Reserve is authorized to examine NBI and its subsidiaries. With some limited exceptions, the BHCA requires a bank holding company to obtain prior approval from the Federal Reserve before acquiring or merging with a bank or before acquiring more than 5% of the voting shares of a bank unless it already controls a majority of shares.

The Bank Holding Company Act. Under the BHCA, a bank holding company is generally prohibited from engaging in nonbanking activities unless the Federal Reserve has found those activities to be incidental to banking. Bank holding companies also may not acquire more than 5% of the voting shares of any company engaged in nonbanking activities. Amendments to the BHCA that were included in the Gramm-Leach-Bliley Act of 1999 (see below) permitted any bank holding company with bank subsidiaries that are well-capitalized, well-managed and which have a satisfactory or better rating under the Community Reinvestment Act (see below) to file an election with the Federal Reserve to become a financial holding company. A financial holding company may engage in any activity that is (i) financial in nature (ii) incidental to a financial activity or (iii) complementary to a financial activity. Financial activities include insurance underwriting, securities dealing and underwriting and providing financial, investment or economic advising services. NBI is a financial holding company.

The Virginia Banking Act. The Virginia Banking Act requires all Virginia bank holding companies to register with the Virginia State Corporation Commission (the Commission). NBI is required to report to the Commission with respect to financial condition, operations and management. The Commission may also make examinations of any bank holding company and its subsidiaries and must approve the acquisition of ownership or control of more than 5% of the voting shares of any Virginia bank or bank holding company.

The Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act (GLBA) permits significant combinations among different sectors of the financial services industry, allows for expansion of financial service activities by bank holding companies and offers financial privacy protections to consumers. GLBA preempts most state laws that prohibit financial holding companies from engaging in insurance activities. GBLA permits affiliations between banks and securities firms in the same holding company structure, and it permits financial holding companies to directly engage in a broad range of securities and merchant banking activities.

The Sarbanes-Oxley Act. The Sarbanes-Oxley Act (SOX) enacted sweeping reforms of the federal securities laws intended to protect investors by improving the accuracy and reliability of corporate disclosures. It impacts all companies with securities registered under the Securities Exchange Act of 1934, including NBI. SOX creates increased responsibility for chief executive officers and chief financial officers with respect to the content of filings with the Securities and Exchange Commission. Section 404 of SOX and related Securities and Exchange Commission rules focused increased scrutiny by internal and external auditors on NBI's systems of internal controls over financial reporting, which is designed to insure that those internal controls are effective in both design and operation. SOX sets out enhanced requirements for audit committees, including independence and expertise, and it includes stronger requirements for auditor independence and limits the types of non-audit services that auditors can provide. Finally, SOX contains additional and increased civil and criminal penalties for violations of securities laws.

Capital Requirements. The Federal Reserve has adopted risk-based capital guidelines that are applicable to NBI. The guidelines provide that the Company must maintain a minimum ratio of 8% of qualified total capital to risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit). At least half of total capital must be comprised of Tier 1 capital, for a minimum ratio of Tier 1 capital to risk-weighted assets of 4%. In addition, the Federal Reserve has established minimum leverage ratio guidelines of 4% for banks that meet certain specified criteria. The leverage ratio is the ratio of Tier 1 capital to total average assets, less intangibles. NBI is expected to be a source of capital strength for its subsidiary bank, and regulators can undertake a number of enforcement actions against NBI if its subsidiary bank becomes undercapitalized. NBI’s bank subsidiary is well capitalized and fully in compliance with capital guidelines.

Bank regulators could choose to raise capital requirements for banking organizations beyond current levels. NBI is unable to predict if higher capital levels may be mandated in the future, although as a result of the recent financial crisis changes in capital requirements seem more likely.

Emergency Economic Stabilization Act of 2008. On October 14, 2008, the U.S. Treasury announced the Troubled Asset Relief Program (TARP) under the Emergency Economic Stabilization Act of 2008. In the program, the Treasury was authorized to purchase up to $250 million of senior preferred shares in qualifying U.S. banks, saving and loan associations and bank and savings and loan holding companies. The amount of

TARP funds was later increased to $350 million. The minimum subscription amount was 1% of risk-weighted assets and the maximum amount was the lesser of $25 billion or 3% of risk-weighted assets. NBI did not participate in TARP.

American Recovery and Reinvestment Act of 2009. The ARRA was enacted in 2009 and includes a wide range of programs to stimulate economic recovery. In addition, it also imposed new executive compensation and corporate governance obligations on TARP Capital Purchase Program recipients. Because NBI did not participate in TARP, it is not affected by these requirements.

The National Bank of Blacksburg

NBB is a national banking association incorporated under the laws of the United States, and the bank is subject to regulation and examination by the Office of the Comptroller of the Currency (OCC). NBB's deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to the limits of applicable law. The OCC, as the primary regulator, and the FDIC regulate and monitor all areas of NBB's operation. These areas include adequacy of capitalization and loss reserves, loans, deposits, business practices related to the charging and payment of interest, investments, borrowings, payment of dividends, security devices and procedures, establishment of branches, corporate reorganizations and maintenance of books and records. NBB is required to maintain certain capital ratios. It must also prepare quarterly reports on its financial condition for the OCC and conduct an annual audit of its financial affairs. OCC requires NBB to adopt internal control structures and procedures designed to safeguard assets and monitor and reduce risk exposure. While appropriate for the safety and soundness of banks, these requirements add to overhead expense for NBB and other banks.

The Community Reinvestment Act. NBB is subject to the provisions of the Community Reinvestment Act (CRA), which imposes an affirmative obligation on financial institutions to meet the credit needs of the communities they serve, including low and moderate income neighborhoods. The OCC monitors NBB's compliance with the CRA and assigns public ratings based upon the bank's performance in meeting stated assessment goals. Unsatisfactory CRA ratings can result in restrictions on bank operations or expansion. NBB received a "satisfactory" rating in its last CRA examination by the OCC.

The Gramm-Leach-Bliley Act. In addition to other consumer privacy provisions, the Gramm-Leach-Bliley Act (GLBA) restricts the use by financial institutions of customers' nonpublic personal information. At the inception of the customer relationship and annually thereafter, NBB is required to provide its customers with information regarding its policies and procedures with respect to handling of customers' nonpublic personal information. GLBA generally prohibits a financial institution from providing a customer's nonpublic personal information to unaffiliated third parties without prior notice and approval by the customer.

The USA Patriot Act. The USA Patriot Act (Patriot Act) facilitates the sharing of information among government entities and financial institutions to combat terrorism and money laundering. The Patriot Act imposes an obligation on NBB to establish and maintain anti-money laundering policies and procedures, including a customer identification program. The bank is also required to screen all customers against government lists of known or suspected terrorists. There is additional regulatory oversight to insure compliance with the Patriot Act.

Consumer Laws and Regulations. There are a number of laws and regulations that regulate banks' consumer loan and deposit transactions. Among these are the Truth in Lending Act, the Truth in Savings Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Electronic Funds Transfer Act and the Fair Debt Collections Practices Act. NBB is required to comply with these laws and regulations in its dealings with customers. There are numerous disclosure and other compliance requirements associated with the consumer laws and regulations.

Deposit Insurance. NBB has deposits that are insured by the Federal Deposit Insurance Corporation (FDIC). FDIC maintains a Deposit Insurance Fund (DIF) that is funded by risk-based insurance premium assessments on insured depository institutions. Assessments are determined based upon several factors, including the level of regulatory capital and the results of regulatory examinations. FDIC may adjust assessments if the insured institution's risk profile changes or if the size of the DIF declines in relation to the total amount of insured deposits. In 2009, because of the troubled economy and the number of failed banks nationwide, there was pressure on the reserve ratio of the DIF. In order to rebuild the Fund and to help maintain public confidence in the banking system, on June 30, 2009, the FDIC imposed a special assessment of five basis points of NBB's FDIC insured assets, minus Tier 1 capital. The special assessment, which was in addition to regular DIF assessments was payable on September 30. In an effort to further strengthen the Fund, on November 12, 2009 the FDIC adopted a rule requiring insured depository institutions (including NBB) to prepay their estimated quarterly regular risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 on December 30, 2009. These changes in FDIC assessments have resulted in significant increased costs to NBB.

On May 20, 2009, the FDIC announced that the increase in deposit insurance to at least $250,000 from $100,000 which became effective in October 2008 would be extended to December 31, 2013.

FDIC announced its Transaction Account Guarantee Program on October 14, 2008. The Transaction Account Guarantee Program, which is a part of the Temporary Liquidity Guarantee Program, provides unlimited coverage for non-interest bearing deposit accounts for FDIC-insured

institutions that elected to participate. NBB elected to participate in this program, and its DIF assessments increased to reflect the additional FDIC coverage. On August 26, 2009 the Transaction Account Guarantee Program was extended to June 30, 2010.
After giving primary regulators an opportunity to first take action, FDIC may initiate an enforcement action against any depository institution it determines is engaging in unsafe or unsound actions or which is in an unsound condition, and the FDIC may terminate that institution's deposit insurance. NBB has no knowledge of any matter that would threaten its FDIC insurance coverage.

Capital Requirements. The same capital requirements that are discussed above with relation to NBI are applied to NBB by the OCC. The OCC guidelines provide that banks experiencing internal growth or making acquisitions are expected to maintain strong capital positions well above minimum levels, without reliance on intangible assets. As indicated above, the recent financial crisis increases the likelihood that capital requirements for banks will be raised.

Limits on Dividend Payments. A significant portion of NBI's income is derived from dividends paid by NBB. As a national bank, NBB may not pay dividends from its capital, and it may not pay dividends if the bank would become undercapitalized, as defined by regulation, after paying the dividend. Without prior OCC approval, NBB's dividend payments in any calendar year are restricted to the bank's retained net income for that year, as that term is defined by the laws and regulations, combined with retained net income from the preceding two years, less any required transfer to surplus.
The OCC and FDIC have authority to limit dividends paid by NBB, if the payments are determined to be an unsafe and unsound banking practice. Any payment of dividends that depletes the bank's capital base could be deemed to be an unsafe and unsound banking practice.

Branching. As a national bank, NBB is required to comply with the state branch banking laws of Virginia, the state in which the bank is located. NBB must also have the prior approval of OCC to establish a branch or acquire an existing banking operation. Under Virginia law, NBB may open branch offices or acquire existing banks or bank branches anywhere in the state. Virginia law also permits banks domiciled in the state to establish a branch or to acquire an existing bank or branch in another state.

Monetary Policy

The monetary and interest rate policies of the Federal Reserve, as well as general economic conditions, affect the business and earnings of NBI. NBB and other banks are particularly sensitive to interest rate fluctuations. The spread between the interest paid on deposits and that which is charged on loans is the most important component of the bank's earnings. In addition, interest earned on investments held by NBI and NBB has a significant effect on earnings. As conditions change in the national and international economy and in the money markets, the Federal Reserve's actions, particularly with regard to interest rates, can impact loan demand, deposit levels and earnings at NBB. It is not possible to accurately predict the effects on NBI of economic and interest rate changes.

Other Legislative and Regulatory Concerns

Particularly because of the uncertain economic conditions and the current political environment, federal and state laws and regulations are regularly proposed that could affect the regulation of financial institutions. New regulations could add to the regulatory burden on banks and other financial service providers and increase the costs of compliance, or they could change the products that can be offered and the manner in which financial institutions do business. We cannot foresee how regulation of financial institutions may change in the future and how those changes might affect NBI.

Company Website

NBI maintains a website at www.nationalbankshares.com. The Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are made available on its website as soon as is practical after the material is electronically filed with the Securities and Exchange Commission. The Company's proxy materials for the 2010 annual meeting of stockholders are also posted on a separate website at www.nationalbanksharesproxy.com.

Item 1A. Risk Factors

If recovery from the economic downturn is slow or if the recession deepens, our credit risk will increase and there could be greater loan losses.
A slow economic recovery or deepening recession is likely to result in a higher rate of business closures and increased job losses in the region in which we do business. These factors would increase the likelihood that more of our customers would become delinquent or default on their loans. A higher level of loan defaults could result in higher loan losses, which could adversely affect our performance.

A slow economic recovery could increase the risk of losses in our investment portfolio.
We hold both corporate and municipal bonds in our investment portfolio. A further prolonged recession or a slow recovery could increase the risk of default by both corporate and government issuers.

If the real estate market remains depressed for an extended period, our business could be negatively affected.
A depressed real estate market can impact us in several ways. First, the demand for new real estate loans will decline, and existing loans may become delinquent. In addition, if there is a general devaluation in real estate, loan collateral values will decline.

Market interest rates are currently low. If market interest rates rise, our net interest income can be negatively affected in the short term.
The direction and speed of interest rate changes affect our net interest margin and net interest income. In the short term, rising interest rates may negatively affect our net interest income, because our interest-bearing liabilities (generally deposits) reprice sooner than our interest-earning assets (generally loans).

The number of bank failures nationwide could significantly increase the cost of FDIC insurance.
Since insured depositary institutions including our bank, bear the full cost of deposit insurance provided by FDIC, the number of bank failures could put additional pressure on a stressed Deposit Insurance Fund. This possibility could in turn lead to higher assessments that could negatively impact our earnings.

If more competitors come into our market area, our business could suffer.
The financial services industry in our market area is highly competitive, with a number of commercial banks, credit unions, insurance companies and stockbrokers seeking to do business with our customers. If there is additional competition from new business or if our existing competitors focus more attention on our market, we could lose customers and our business could suffer.

Increased governmental involvement in and scrutiny of financial institutions could lead to a significant increase in our regulatory burden.
Because of problems in the financial services sector, both federal and state governments could enact new regulations and requirements affecting financial institutions. A significant increase in our regulatory burden or enhanced requirements such as increased capital levels could have a negative effect on profitability.

Item 1B. Unresolved Staff Comments

There are none.

Item 2. Properties

NBB owns and has a branch bank in NBI's headquarters building located at 101 Hubbard Street, Blacksburg, Virginia. The bank's main office is at 100 South Main Street, Blacksburg, Virginia. NBB owns an additional nineteen branch offices and it leases four. NBI owns a building in Pulaski, Virginia that is rented. We believe that existing facilities are adequate for current needs and to meet anticipated growth.

Item 3. Legal Proceedings

NBI, NBB, and NBFS are not currently involved in any material pending legal proceedings.

Item 4. Reserved

Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Common Stock Information and Dividends

National Bankshares, Inc.'s common stock is traded on the NASDAQ Capital Market under the symbol "NKSH". As of December 31, 2009, there were 862 record stockholders of NBI common stock. The following is a summary of the market price per share and cash dividend per share of the common stock of National Bankshares, Inc. for 2009 and 2008.

Common Stock Market Prices

	2009		2008		Dividends per share	
	High	Low	High	Low	2009	2008
First Quarter	$20.50	17.91	$21.98	16.86	$---	$---
Second Quarter	25.80	18.51	20.23	16.16	0.41	0.39
Third Quarter	26.90	24.27	19.90	15.66	---	---
Fourth Quarter	29.21	25.08	20.00	15.00	0.43	0.41

NBI's primary source of funds for dividend payments is dividends from its bank subsidiary, NBB. Bank dividend payments are restricted by regulators, as more fully disclosed in Note 11 of Notes to Consolidated Financial Statements.

On May 13, 2009, NBI's Board of Directors approved the repurchase of up to 100,000 shares of equity securities that are registered by the Company pursuant to Section 12 of the Securities Exchange Act of 1934. During the fourth quarter of 2009 there were no shares repurchased, and 100,000 shares may yet be purchased under the program.

Stock Performance Graph

The following graph compares the yearly percentage change in the cumulative total of stockholder return on NBI common stock with the cumulative return on the NASDAQ Index and a peer group index comprised of southeastern independent community banks and bank holding companies for the five-year period commencing on December 31, 2004. These comparisons assume the investment of $100 in National Bankshares, Inc. common stock and in each of the indices on December 31, 2004, and the reinvestment of dividends.

	2004	2005	2006	2007	2008	2009
NATIONAL BANKSHARES, INC.	100	90	96	71	84	126
INDEPENDENT BANK INDEX	100	108	125	91	73	85
NASDAQ INDEX	100	102	112	122	59	80

The peer group Independent Bank Index is the compilation of the total return to stockholders over the past five years of the following group of 25 independent community banks located in the southeastern states of Alabama, Florida, Georgia, North Carolina, South Carolina, Tennessee, Virginia and West Virginia: Auburn National Bancshares, Inc., United Security Bancshares, Inc., TIB Financial Corp., First Community Bank Corp. of America, Seacoast Banking Corp., Fidelity Southern Corp., Southeastern Banking Corporation, Southwest Georgia Financial Corp., Savannah Bancorp, Inc., PAB Bankshares, Inc., Uwharrie Capital Corp., Four Oaks Fincorp, Inc., Bank of Granite Corp., Carolina Trust Bank, BNC Bancorp, CNB Corporation, Geer Bancshares, Peoples Bancorporation, Inc., First Pulaski National Corporation, National Bankshares, Inc., Monarch Financial Holdings, Inc., American National Bankshares, Inc., Central Virginia Bankshares, Inc., C&F Financial Corporation and First Century Bankshares, Inc.

Item 6. Selected Financial Data

National Bankshares, Inc. and Subsidiaries
Selected Consolidated Financial Data

$ in thousands, except per share data	Years ended December 31,				
	2009	2008	2007	2006	2005
Selected Income Statement Data:					
Interest income	$50,487	$50,111	$50,769	$47,901	$45,380
Interest expense	15,825	18,818	21,745	18,564	14,180
Net interest income	34,662	31,293	29,024	29,337	31,200
Provision for loan losses	1,634	1,119	423	49	567
Noninterest income	8,804	9,087	8,760	8,802	7,613
Noninterest expense	23,853	22,023	20,956	21,670	21,898
Income taxes	3,660	3,645	3,730	3,788	3,924
Net income	14,319	13,593	12,675	12,632	12,424
Per Share Data:					
Basic net income	2.07	1.96	1.82	1.80	1.77
Diluted net income	2.06	1.96	1.82	1.80	1.76
Cash dividends declared	0.84	0.80	0.76	0.73	0.71
Book value	17.61	15.89	15.07	13.86	13.10
Selected Balance Sheet Data at End of Year:					
Loans, net	583,021	569,699	518,435	495,486	487,162
Total securities	297,417	264,999	273,343	285,489	272,541
Total assets	982,367	935,374	887,647	868,203	841,498
Total deposits	852,112	817,848	776,339	764,692	745,649
Stockholders' equity	122,076	110,108	104,800	96,755	91,939
Selected Balance Sheet Daily Averages:					
Loans, net	572,438	533,190	505,070	488,624	487,130
Total securities	298,237	281,367	282,734	271,066	261,743
Total assets	971,538	899,462	867,061	840,080	819,341
Total deposits	846,637	783,774	758,657	741,071	724,015
Stockholders' equity	117,086	108,585	100,597	94,194	90,470
Selected Ratios:					
Return on average assets	1.47 %	1.51 %	1.46 %	1.50 %	1.52 %
Return on average equity	12.23 %	12.52 %	12.60 %	13.41 %	13.73 %
Dividend payout ratio	40.67 %	40.78 %	41.80 %	40.44 %	40.17 %
Average equity to average assets	12.05 %	12.07 %	11.60 %	11.21 %	11.04 %

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
$ in thousands, except per share data

The purpose of this discussion and analysis is to provide information about the results of operations, financial condition, liquidity and capital resources of National Bankshares, Inc. and its subsidiaries (the Company). The discussion should be read in conjunction with the material presented in Item 8, "Financial Statements and Supplementary Data", of this Form 10-K.
Per share data has been adjusted to reflect a 2-for-1 stock split effective March 31, 2006.
Subsequent events have been considered through the date on which the Form 10-K was issued.

Cautionary Statement Regarding Forward-Looking Statements

We make forward-looking statements in this Form 10-K that are subject to significant risks and uncertainties. These forward-looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals, and are based upon our management's views and assumptions as of the date of this report. The words "believes," "expects," "may," "will," "should," "proje "contemplates," "anticipates," "forecasts," "intends," or other similar words or terms are intended to identify forward-lookin statements.
These forward-looking statements are based upon or are affected by factors that could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. These factors include, but are not limited to, changes in:

- interest rates,
- general economic conditions,
- the legislative/regulatory climate,
- monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury, the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation, and the impact of any policies or programs implemented pursuant to the Emergency Economic Stabilization Act of 2008 (EESA) and other financial reform legislation,
- unanticipated increases in the level of unemployment in the Company's trade area,
- the quality or composition of the loan and/or investment portfolios,
- demand for loan products,
- deposit flows,
- competition,
- demand for financial services in the Company's trade area,
- the real estate market in the Company's trade area,
- the Company's technology initiatives, and
- applicable accounting principles, policies and guidelines.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained in this report. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report. This discussion and analysis should be read in conjunction with the description of our "Risk Factors" in Item 1A. of this Form 10-K.
For the past two years, the United States has experienced the effects of a severe global recession, including the historic disruptions in the American financial system that peaked in the fall of 2008. Many economists believe that the recession in the United States has now ended. However, there is no agreement as to the speed of the economic recovery, and unemployment levels are predicted to remain high for an extended period.
The Company was not negatively impacted during the initial phases of the economic slowdown. Its markets did not experience the dramatic declines in real estate values seen in some other areas of the country. In addition, the diverse economy of the Company's market area, including several large employers that are public colleges or universities, helped to insulate the Company from the worst effects of the recession. As the recession continued into 2009, real

estate values in the Company's trade area experienced moderate declines. If the economic recovery is slow or is reversed, it is likely that unemployment will rise in the Company's trade area. Because of the importance to the Company's markets of state funded universities, cutbacks in the funding provided by the state as a result of the recession could also negatively impact employment. This could lead to a higher rate of delinquent loans and an increase in real estate foreclosures. Higher unemployment and the fear of layoffs causes reduced consumer demand for goods and services, which negatively impacts the Company's business and professional customers.
In conclusion, a slow economic recovery could have an adverse effect on all financial institutions, including the Company.

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP).

The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset or relieving a liability. The Company uses historical loss factors as one factor in determining the inherent loss that may be present in the loan portfolio. Actual losses could differ significantly from one previously acceptable method to another method. Although the economics of the Company's transactions would be the same, the timing of events that would impact the transactions could change.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting. The first principle requires that losses be accrued when they are probable of occurring and are estimable. The second requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

Our allowance for loan losses has two basic components, allocated and general. Each of the components is determined based upon estimates that can and do change when actual events occur. The allocated component is determined by establishing an allowance on a loan-by-loan basis for loans that are classified as impaired. The general allowance is determined by utilizing historical loss experience to estimate credit losses for groups of loans in the loan portfolio with similar characteristics. The general allowance is then adjusted after considering qualitative or environmental factors that are likely to cause estimated losses to differ from historical loss experience. Loss estimates are inherently subjective, and our actual losses could be greater or less than the estimates.

Core Deposit Intangibles

Goodwill is subject to at least an annual assessment for impairment by applying a fair value based test. The Company performs impairment testing in the fourth quarter. Additionally, acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the asset can be sold, transferred, licensed, rented, or exchanged, and amortized over its useful life.

The Company amortized intangible assets arising from branch transactions over their useful life. Core deposit intangibles are subject to a recoverability test based on undiscounted cash flows, and to the impairment recognition and measurement provisions required for other long-lived assets held and used.

Overview

National Bankshares, Inc. is a financial holding company incorporated under the laws of Virginia. Located in southwest Virginia, NBI has two wholly-owned subsidiaries, the National Bank of Blacksburg and National Bankshares Financial Services, Inc. The National Bank of Blacksburg, which does business as National Bank from twenty-five office locations, is a community bank. NBB is the source of nearly all of the Company's revenue. National Bankshares Financial Services, Inc. does business as National Bankshares Investment Services and National Bankshares Insurance Services. Income from NBFS is not significant at this time, nor is it expected to be so in the near future.

National Bankshares, Inc. common stock is listed on the NASDAQ Capital Market and is traded under the symbol "NKSH." On June 29, 2009, National Bankshares, Inc. was included in the Russell Investments Russell 3000 and Russell 2000 Indexes.

Performance Summary

The following table presents NBI's key performance ratios for the years ending December 31, 2009 and December 31, 2008:

	12/31/09		12/31/08	
Return on average assets	1.47	%	1.51	%
Return on average equity	12.23	%	12.52	%
Basic net earnings per share	$2.07		$1.96	
Fully diluted net earnings per share	$2.06		$1.96	
Net interest margin (1)	4.23	%	4.12	%
Noninterest margin (2)	1.55	%	1.46	%

(1) Net Interest Margin – Year-to-date tax equivalent net interest income divided by year-to-date average earning assets.
(2) Noninterest Margin – Noninterest income (excluding securities gains and losses) less noninterest expense (excluding the provision for bad debts and income taxes) divided by average year-to-date assets.

The return on average assets for the year ended December 31, 2009 was 1.47%, a decline of 4 basis points from the 1.51% for the year ended

December 31, 2008. The return on average equity declined from 12.52% for the year ended December 31, 2008 to 12.23% for the year ended December 31, 2009. While core earnings were strong in 2009, higher costs for Federal Deposit Insurance Corporation Deposit Insurance Fund assessments had a negative effect on net earnings. The total of FDIC assessments for the year ended December 31, 2009 was $1,727, as compared with $209 for 2008. Please refer to the discussion of "Noninterest Expense" for additional details about FDIC assessments. Reflecting both the effects on NBI's funding costs of the low interest rate environment throughout 2009 and the Company's asset/liability management practices, the net interest margin increased from 4.12% at year-end 2008 to 4.23% at December 31, 2009. This increase helped to offset the effect of higher FDIC assessments. The noninterest margin, which was impacted by the increase in FDIC assessments, increased from 1.46% to 1.55% over the same period.
The higher net interest margin, together with limited increases in controllable noninterest expenses, are largely responsible for the increase in basic net earnings per share, from $1.96 for the year ended December 31, 2008 and $2.07 for the year ended December 31, 2009, in spite of the large increase in FDIC assessments.

Growth

NBI's key growth indicators are shown in the following table:

	12/31/09	12/31/08
Securities	$297,417	$264,999
Loans, net	583,021	569,699
Deposits	852,112	817,848
Total assets	982,367	935,374

Securities, net loans, deposits and total assets all experienced growth when December 31, 2009 and 2008 are compared. Securities grew by $32,418, or 12.2% from $264,999 at December 31, 2008 to $297,417 at December 31, 2009. During 2009, deposits grew at a faster rate than loans, and the excess was invested, increasing the total in securities. Net loans increased by $13,322 or 2.3%, when the two periods are compared. Net loans at year-end 2009 were $583,021, and they were $569,699 at December 31, 2008. Growth in deposits came from municipalities and also from individuals seeking to safeguard principal by avoiding more volatile investments in financial markets. Low interest rate yields in the bond markets also limited their attractiveness as alternative investments. Deposits grew from $817,848 at the end of 2008 to $852,112 at December 31, 2009, an increase of $34,264, or 4.2%. The Company's total assets at December 31, 2009 were $982,367, an increase of $46,993, or 5.0%, when compared with total assets of $935,374 at December 31, 2008.
In both 2008 and 2009, substantially all growth was internally generated and was not the result of acquisitions.

Asset Quality

Key indicators of NBI's asset quality are presented in the following table:

	12/31/09	12/31/08
Nonperforming loans	$6,750	$1,333
Loans past due 90 days or more	1,697	1,127
Other real estate owned	2,126	1,984
Allowance for loan losses to loans	1.17%	1.02%
Net charge-off ratio	0.10%	0.09%

Nonperforming loans at December 31, 2009 were $6,750, or 1.14% of loans net of unearned income and deferred fees, plus other real estate owned. This compares with $1,333 in non-performing loans reported at year-end 2008. Of the nonperforming loans reported at December 31, 2009, all are nonaccrual loans, with the exception of one restructured loan.

One loan of $2,652 is classified as a troubled debt restructuring. Loans past due 90 days or more at year-end 2009 totaled $1,697, an increase of $570, or 50.6%, from $1,127 at December 31, 2008.

The increase in nonperforming loans from 2008 to 2009 has pushed the ratio of non-performing loans to net loans to a level that is higher than it has been for the Company in the recent past. However, the ratio remains manageable and well below that of peers. Sufficient resources have been dedicated to working out problem assets, and exposure to loss is somewhat mitigated because most of the non-performing loans are collateralized. In addition, the Company's conservative loan underwriting policies help to limit potential loss. More information about nonaccrual and past due loans is provided in "Balance Sheet-Loans-Risk Elements".

Management also dedicates sufficient resources to monitoring loan portfolio quality on an ongoing basis. In response to an increase in problem loans, the ratio of the allowance for loan losses to loans grew from 1.02% at December 31, 2008 to 1.17% at the same period in 2009. The increase in the allowance for loan losses also takes into account management's evaluation of the risk of future increases in nonperforming and past due loans. For more information see "Allowance for Loan Losses" above.

The net charge-off ratio was 0.09% at year-end 2008 and 0.10% at December 31, 2009. Other real estate owned grew from $1,984 at December 31, 2008 to $2,126 at the same period in 2009, an increase of $142, or 7.2%. Management anticipates that the level of other real estate owned will increase as a consequence of a higher level of delinquent loans.

Net Interest Income

Net interest income for the period ended December 31, 2009 was $34,662, an increase of $3,369, or 10.8%, when compared to the prior year. Net interest income for the period ended December 31, 2008 was $31,293, an increase of $2,269, or 7.8%, from 2007. The net interest margin for 2009 was 4.23%, compared to 4.12% for 2008. Total interest income for the period ended December 31, 2009 was $50,487, an increase of $376 from the period ended December 31, 2008. Interest expense was down by $2,993 during the same time frame from $18,818 for 2008 to $15,825 for the year ended December 31, 2009. The decline in interest expense came about because higher priced certificates of deposit renewed at a lower interest rate and noninterest-bearing deposits grew at a faster rate than interest-bearing deposits. In summary, the rates paid on the Company's deposit liabilities declined at a more rapid pace than the interest rates on its interest-earning assets.

The amount of net interest income earned is affected by various factors, including changes in market interest rates due to the Federal Reserve Board's monetary policy; the level and composition of the earning assets; and the level and composition of interest-bearing liabilities. The Company has the ability to respond over time to interest rate movements and reduce volatility in the net interest margin. However, the frequency and/or magnitude of changes in market interest rates are difficult to predict and may have a greater impact on net interest income than adjustments by management.

Interest rates are at historic lows, and low and stable interest rates benefit the Company. Offsetting the positive effect of low interest rates is the fact that some higher yielding securities in the Company's investment portfolio may be called when rates are low and are replaced with securities yielding at the lower market rate. Another negative effect of the low interest rate environment is the level of interest earned on overnight funds, including Federal funds and interest bearing deposits. These assets are used primarily to provide liquidity. The yield on these assets in 2009 was 0.25%, while the cost to fund them was 1.73% in the same period.

The primary source of funds used to support the Company's interest-earning assets is deposits. Deposits are obtained in the Company's trade area through traditional marketing techniques. Other funding sources, such as the Federal Home Loan Bank, while available, are only used occasionally. The cost of funds is dependent on interest rate levels and competitive factors. This limits the ability of the Company to react to interest rate movements.

If interest rates remain low and stable, management anticipates that the net interest margin will improve as management is able to price loans and deposits based on rate stability. If interest rates rise quickly, the net interest margin would narrow, because deposit rates would increase at a faster rate than loan rates. If interest rates rise more slowly, the negative effect on the net interest margin would be less pronounced.

Because interest rates are at historic lows, interest rates can only trend up in the future. Management cannot predict the timing and level of interest rate increases.

Analysis of Net Interest Earnings

The following table shows the major categories of interest-earning assets and interest-bearing liabilities, the interest earned or paid, the average yield or rate on the daily average balance outstanding, net interest income and net yield on average interest-earning assets for the years indicated.

	December 31, 2009			December 31, 2008			December 31, 2007		
	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate
Interest-earning assets:									
Loans, net (1)(2)(3)	$579,581	$37,903	6.54 %	$538,868	$37,356	6.93 %	$510,772	$37,549	7.35 %
Taxable securities	134,607	6,273	4.66 %	137,497	6,817	4.96 %	152,422	7,476	4.90 %
Nontaxable securities (1)(4)	162,889	10,154	6.23 %	144,137	8,911	6.18 %	131,864	8,233	6.24 %
Interest-bearing deposits	35,841	90	0.25 %	21,440	449	2.09 %	14,180	726	5.12 %
Total interest-earning assets	$912,918	$54,420	5.96 %	$841,942	$53,533	6.36 %	$809,238	$53,984	6.67 %
Interest-bearing liabilities:									
Interest-bearing demand deposits	$282,532	$3,076	1.09 %	$243,409	$3,486	1.43 %	$223,771	$4,371	1.95 %
Savings deposits	48,992	52	0.11 %	45,796	132	0.29 %	46,943	237	0.50 %
Time deposits	399,873	12,694	3.17 %	381,961	15,188	3.98 %	379,089	17,102	4.51 %
Short-term borrowings	49	3	6.12 %	297	12	4.04 %	626	35	5.59 %
Total interest-bearing liabilities	$731,446	$15,825	2.16 %	$671,463	$18,818	2.80 %	$650,429	$21,745	3.34 %
Net interest income and interest rate spread		$38,595	3.80 %		$34,715	3.56 %		$32,239	3.33 %
Net yield on average interest-earning assets			4.23 %			4.12 %			3.98 %

(1) Interest on nontaxable loans and securities is computed on a fully taxable equivalent basis using a Federal income tax rate of 35% in the three years presented.
(2) Loan fees of $956 in 2009, $859 in 2008 and $851 in 2007 are included in total interest income.
(3) Nonaccrual loans are included in average balances for yield computations.

(4) Daily averages are shown at amortized cost.

Analysis of Changes in Interest Income and Interest Expense

The Company's primary source of revenue is net interest income, which is the difference between the interest and fees earned on loans and investments and the interest paid on deposits and other funds. The Company's net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities and by changes in yields earned on interest-earning assets and rates paid on interest-bearing liabilities. The following table sets forth, for the years indicated, a summary of the changes in interest income and interest expense resulting from changes in average asset and liability balances (volume) and changes in average interest rates (rate).

	2009 Over 2008 Changes Due To			2008 Over 2007 Changes Due To		
	Rates(2)	Volume(2)	Net Dollar Change	Rates(2)	Volume(2)	Net Dollar Change
Interest income: (1)						
Loans	$(2,184)	$2,731	$547	$(2,200)	$2,008	$(192)
Taxable securities	(403)	(141)	(544)	80	(739)	(659)
Nontaxable securities	75	1,168	1,243	(82)	759	677
Interest-bearing deposits	(651)	292	(359)	(547)	270	(277)
Increase (decrease) in income on interest-earning assets	$(3,163)	$4,050	$887	$(2,749)	$2,298	$(451)
Interest expense:						
Interest-bearing demand deposits	$(916)	$506	$(410)	$(1,243)	$358	$(885)
Savings deposits	(89)	9	(80)	(99)	(6)	(105)
Time deposits	(3,179)	685	(2,494)	(2,043)	129	(1,914)
Short-term borrowings	4	(13)	(9)	(8)	(15)	(23)
Increase (decrease) in expense of interest-bearing liabilities	$(4,180)	$1,187	$(2,993)	$(3,393)	$466	$(2,927)
Increase in net interest income	$1,017	$2,863	$3,880	$644	$1,832	$2,476

(1) Taxable equivalent basis using a Federal income tax rate of 35% in 2009, 2008 and 2007.
(2) Variances caused by the change in rate times the change in volume have been allocated to rate and volume changes proportional to the relationship of the absolute dollar amounts of the change in each.

With interest rates remaining at historic lows throughout 2009, interest expense declined by $2,993 when 2009 and 2008 are compared. For the same period, there was an increase of $887 in interest income because of a higher volume of interest-earning assets. The result was an increase of $3,880 in net interest income in 2009 over 2008. $1,017 of the increase was attributable to rates, and $2,863 came from higher volume.

Closer consideration of the components of interest income shows that, when compared to 2008, there was a decline in interest income from loans of $2,184 due to rates, which was offset by an increase of $2,731 because of higher volume. This resulted in a net increase of $547. The interest-earning asset category showing the largest increase over 2008 was nontaxable securities. There was a $1,243 increase from 2008 in that category, with $75 from rates and $1,168 coming from volume.

There were declines in each category of interest expense when 2009 and 2008 are compared. However, the largest decline was in time deposits. Rates accounted for a decline of $3,179 in interest expense for time deposits. This was partially offset by an increase of $685 in interest expense because of volume, creating a decrease of $2,494 in time deposits interest expense, comparing 2009 with 2008. See "Net Interest Income" above for additional information related to the decline in interest expense.

If the volume of interest bearing liabilities were to remain at December 31, 2009 levels and interest rates were to remain low and stable, management anticipates that net interest income would increase in 2010. This is because time deposits expense is expected to continue to decline. However, interest rate increases would have a negative effect on net interest income.

Interest rates fell rapidly during 2008, and in 2008 interest rate expense declined more rapidly than interest income. As compared with 2007, there was a $1,914 decline in interest expense associated with time deposits in 2008. Of the total decline, $2,043 was due to rates, offset by $129 from higher deposit volume. Management focused on deposit pricing in 2008 and took advantage of falling rates to lower interest expense.

From 2007 to 2008 interest on loans was down by $192. Loan interest income attributable to rates was $2,200 lower, offset to a large degree to an increase of $2,008 because of volume. As compared with 2007, there was an increase of $2,476 in net interest income in 2008, $644 of the increase was due to rates and $1,832 due to volume.

Interest Rate Sensitivity

The Company considers interest rate risk to be a significant market risk and has systems in place to measure the exposure of net interest income and fair market values to movement in interest rates. Among the tools available to management is interest rate sensitivity analysis, which provides information related to repricing opportunities. Interest rate shock simulations indicate potential economic loss due to future interest rate changes. Shock analysis is a test that measures the effect of a hypothetical, immediate and parallel shift in interest rates. The following table shows the results of a rate shock and the effects on net income and return on average assets and return on average equity projected at December 31, 2009 and 2008. For purposes of this analysis, noninterest income and expenses are assumed to be flat.

Rate Shift (bp)	Return on Average Assets		Return on Average Equity	
	2009	2008	2009	2008
300	0.87%	0.83%	8.60%	6.87%
200	1.11%	1.08%	10.84%	8.81%
100	1.33%	1.32%	12.92%	10.71%
(-)100	1.79%	1.81%	17.08%	14.46%
(-)200	1.72%	1.85%	16.40%	14.79%
(-)300	1.59%	1.74%	15.26%	13.93%

Simulation analysis is another tool available to the Company to test asset and liability management strategies under rising and falling rate conditions. As a part of the simulation process, certain estimates and assumptions must be made. These include, but are not limited to, asset growth, the mix of assets and liabilities, rate environment and local and national economic conditions. Asset growth and the mix of assets can, to a degree, be influenced by management. Other areas, such as the rate environment and economic factors, cannot be controlled. In addition, competitive pressures can make it difficult to price deposits and loans in a manner that optimally minimizes interest rate risk. Therefore, actual results may vary materially from any particular forecast or shock analysis. This shortcoming is offset somewhat by the periodic reforecasting of the balance sheet to reflect current trends and economic conditions. Shock analysis must also be updated periodically as a part of the asset and liability management process.

Noninterest Income

	Year Ended		
	December 31, 2009	December 31, 2008	December 31, 2007
Service charges on deposits	$3,314	$3,425	$3,291
Other service charges and fees	343	326	330
Credit card fees	2,803	2,808	2,740
Trust fees	1,053	1,231	1,333
Bank-owned life insurance income	756	684	592
Other income	491	438	423
Realized securities gains	44	175	51
Total noninterest income	$8,804	$9,087	$8,760

Service charges on deposit accounts totaled $3,314 for the year ended December 31, 2009. This is a decline of $111, or 3.2%, from $3,425 for the year ended December 31, 2008. Service charges on deposit accounts increased $134, or 4.1% from 2007 to 2008. This expense category is affected by the number of deposit accounts, the level of service charges and the number of checking account overdrafts. The 2009 decline resulted from a decrease in fees from

checking account overdrafts and fees for checks returned for insufficient funds. An increase in the level of service charges in mid-2008 accounted for the growth in 2008.
Other service charges and fees included charges for official checks, income from the sale of checks to customers, safe deposit box rent, fees from letters of credit and income from commissions on the sale of credit life, accident and health insurance. These fees were $343 for the year ended December 31, 2009, up by $17, or 5.2%, over the $326 for 2008. The total for the year ended December 31, 2008 was $4 lower than the $330 posted for the year ended December 31, 2007. Both the $17 increase in 2009 and the $4 decrease in 2008 in other service charges and fees were the result of small changes in several categories of fees, none of which is significant by itself.
At $2,803 credit card fees for the year ended December 31, 2009, were $5 lower than the $2,808 reported for the year ended December 31, 2008. From 2007 to 2008, credit card fees grew by $68, or 2.5%. The small decline reported for 2009 is due to a lower volume of merchant transaction fees and credit card fees, while the 2008 increase is from internally generated growth in those same types of fees.
Trust fees, at $1,053, were down by $178, or 14.5%, when the years ended December 31, 2009 and 2008 are compared. At December 31, 2008

trust fees were $1,231, a decline of $102, or 7.7%, from 2007. Trust fees are generated from a number of different types of accounts, including estates, personal trusts, employee benefit trusts, investment management accounts, attorney-in-fact accounts and guardianships. Trust income varies depending on the number and type of accounts under management and financial market conditions. The significant declines in the financial markets in 2008 and early 2009 negatively affected Trust fee income in both years. The number of accounts under management decreased in 2009 and in 2008, and the mix of account types also affected the level of Trust fees in both periods.

Noninterest income from bank-owned life insurance (BOLI) increased $72, or 10.5%, from $684 for the year ended December 31, 2008 to $756 for 2009. It grew from $592 to $684 from December 31, 2007 to December 31, 2008, an increase of $92, or 15.5%. The Company purchased additional BOLI in mid-2008. The additional insurance purchase and the performance of the variable rate policies are the source of growth in BOLI income for 2009 and 2008.

Other income is income that cannot be classified in another category. Some examples include net gains from the sales of fixed assets, rent from foreclosed properties and revenue from investment and insurance sales. Other income for the year 2009 was $491, an increase of $53, or 12.1%, when compared with $438 for the year ended December 31, 2008. Other income for 2008 increased by $15, or 3.5%, when compared with 2007. Included in other income for 2009 was $150 in income attributable to a contract signing incentive with a check and document supplier, offset by a decline of $59 in commission from investment sales at NBFS. The increase in 2008 over 2007 was largely attributable to an increase in investment services commission.

During the first quarter of 2008, the Company recognized $290 in a one-time gain from the initial public offering of Visa, Inc. stock. When the credit card processor went public, the Company was required to sell a portion of its Class B shares. This gain, offset by losses in called investment securities was the source of the $175 in realized securities gains/losses reported for the year ended December 31, 2008. Realized securities gains in 2009 have come solely from gains in called securities. Therefore, the $44 in 2009 realized securities gains declined $131 from the 2008 total. Likewise for 2007, in the year prior to the one-time Visa, Inc. stock gain, realized securities gains from called securities were at $51.

Noninterest Expense

		Year Ended	
	December 31, 2009	December 31, 2008	December 31, 2007
Salaries and employee benefits	$11,336	$11,168	$10,773
Occupancy, furniture and fixtures	1,792	1,751	1,743
Data processing and ATM	1,371	1,381	1,149
FDIC assessment	1,727	209	89
Credit card processing	2,121	2,105	2,146
Intangibles amortization	1,093	1,119	1,138
Net costs of other real estate owned	393	100	81
Franchise taxes	885	823	578
Other operating expenses	3,135	3,367	3,259
Total noninterest expense	$23,853	$22,023	$20,956

Salaries and benefits expense increased $168, or 1.5%, from $11,168 for the year ended December 31, 2008 to $11,336 for the year ended December 31, 2009. When 2007 and 2008 are compared, salary and benefits expense grew by $395, or 3.7%, from $10,773 to $11,168. The modest increase in 2009 is the result of the Company's efforts to control salary costs. Higher benefits expense in 2008, including a larger contribution to the employee stock ownership plan, accounted for a large part of that year's increase.

Occupancy, furniture and fixtures expense was $1,792 for the year ended December 31, 2009, an increase of $41, or 2.3%, from the prior year. The 2008 total was $1,751, an increase of $8, or 0.5%, from the $1,743 reported at year-end 2007. The small increases reported in both 2009 and 2008 are reflective of the Company's emphasis on containing controllable expenses. On June 30, 2009, NBB consolidated one of its Tazewell, Virginia branch offices with a nearby office. Although this closure at mid-year did not produce significant cost savings in 2009, it is expected to assist in the Company's future efforts to control its occupancy expense particularly if efforts to sell the buildings are successful.

Data processing and ATM expense was $1,371 in 2009, $1,381 in 2008 and $1,149 in 2007. Expenses in this category were higher in 2008 than in 2007 because of costs associated with branch capture and merchant capture, as well as higher depreciation costs. The 2008 installation costs were not repeated in 2009, explaining a portion of the $10 decline in data processing and ATM expense from 2008 to 2009. These savings were partially offset by an investment in replacement computers. This category is expected to likely increase in 2010 because the Company has undertaken a planned replacement of its host computer. That is expected to be complete in the first quarter of the year.

There was a significant increase in assessments for the Federal Deposit Insurance Corporation Deposit Insurance Fund when December 31, 2008 and December 31, 2009 are compared. The total for 2008 was $209, and the 2009 total was $1,727. The increase is a combination of an FDIC special assessment of five basis points of total NBB assets, less Tier 1 capital, as of June 30, 2009, which was payable on September 30, 2009, and a higher level of regular quarterly payments. The FDIC assessment increased from $89 to $209 from 2007 to 2008. This is because NBB had credits toward its Deposit Insurance Fund assessments in 2008 that were not available in 2009. As has been discussed, on November 12, 2009, the FDIC adopted a rule requiring all insured depositary institutions (including NBB) to prepay on December 30, 2009 their estimated quarterly regular risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, 2012. Given the severity of the recession and the slow pace of recovery, the Company has no assurance that the FDIC will not impose additional future special assessments or increases in regular assessments on NBB and other banks in order to main the integrity of the Deposit Insurance Fund. The Company cannot predict if or when FDIC assessments will increase.

Credit card processing expense was $2,121 for the period ended December 31, 2009, a nominal increase of $16 from 2008's total of $2,105. Credit card processing expense in 2008 totaled $2,105. Credit card processing expense in 2008 declined $41, or 1.9%, from $2,146 in 2007. This expense is driven by the volume of credit card, debit card and merchant account transactions and by the level of merchant discount fees. It is subject to a degree of variability.

The expense for intangibles and goodwill amortization is related to acquisitions. There were no acquisitions in the last year, and certain expenses from past transactions have been fully amortized. This accounts for the $26, or 2.3% decline in 2009, from $1,119 for 2008 to $1,093 for 2009. It is also the reason for the $19, or 1.7%, decline reported for 2008.

Net costs of other real estate owned have increased from $100 for the period ended December 31, 2008 to $393 in 2009. From 2007 to 2008, net costs of other real estate owned increased from $81 to $100. This expense category varies with the number of foreclosed properties owned by NBB and with the expense associated with each. It has increased in 2009 as the total of other real estate owned includes write-downs on other real estate owned plus other costs associated with carrying these properties, offset by gains on the sale of other real estate. In 2009, write-downs on other real estate were $309. This compares with $11 in 2008. Other costs for these properties in 2009 were $78, while they were $94 in 2008. There was a total of $6 in sale of other real estate for 2009 and $5 in gains for 2008. Management anticipates that the total of other real estate owned will continue to increase as the slow economy impacts businesses and individuals.

Franchise taxes were $885 for the period ended December 31, 2009 and $823 for 2008. They increased from $578 to $823 from 2007 to 2008. State bank franchise taxes are based upon total equity, which increased in both 2008 and 2009.

The category of other operating expenses includes noninterest expense items such as professional services, stationery and supplies, telephone costs and charitable donations. For the year ended December 31, 2009, other operating expenses were $3,135. This compares with $3,367 for 2008 and $3,259 for 2007. Declines of $298 in professional fees, $56 in courier expenses and $40 in postage cost all contributed to the $232, or 6.9%, decline between 2008 and 2009. From 2007 to 2008, professional fees increased by $167 and charitable donations grew by $59.

Income Taxes

Income tax expense for 2009 was $3,660 compared to $3,645 in 2008 and $3,730 in 2007. Tax exempt income is the primary difference between expected and actual income tax expense. The Company's effective tax rates for 2009, 2008 and 2007 were 20.36%, 21.15% and 22.74%, respectively. The Company is subject to the 35% marginal tax rate. See Note 10 of the Notes to Consolidated Financial Statements for addition information relating to income taxes.

Effects of Inflation

The Company's consolidated statements of income generally reflect the effects of inflation. Since interest rates, loan demand and deposit levels are related to inflation, the resulting changes are included in net income. The most significant item which does not reflect the effects of inflation is depreciation expense. Historical dollar values used to determine depreciation expense do not reflect the effects of inflation on the market value of depreciable assets after their acquisition.

Provision and Allowance for Loan Losses

In 2009, the Company experienced increases in all categories of nonperforming assets. Nonaccrual loans increased by $5,417 and loans past due 90 days or more rose by $570. Other real estate owned increased by $142. These changes were attributable to the worsening economy in the Company's market area.

Even though it trended up throughout the year, the deterioration in asset quality became increasingly apparent in the fourth quarter. Based on the Company's internal analysis, the allowance for loan losses was raised to $6,926, which brought the ratio of the allowance for loan losses to 1.17%. This ratio was 1.02% at December 31, 2008. The provision for loan losses for 2009 was $1,634, an increase of $515 over 2008. Net charge-offs levels for 2009 and 2008 are comparable.

While these levels of nonperforming assets are high for the Company, they are quite low when compared with its peers. The current level of nonperforming assets is manageable in management's opinion. Core earnings remain strong, and there are sufficient resources available to handle these accounts.

As previously mentioned, the increase in nonperforming assets is primarily the result of local economic conditions created by the recent national recession. There is some evidence to suggest that the recession has ended and a recovery has begun. Even if so, there is a high degree of uncertainty surrounding the speed of recovery. For that reason, management is unable to predict with any degree of certainty whether and how much its asset quality may continue to deteriorate. Based on current information, management believes the level of nonperforming assets will continue to compare well with its peers, but also be high when compared to its own historic level. Please see "Critical Accounting Policies" above for additional information.

Summary of Loan Loss Experience

A. Analysis of the Allowance for Loan Losses

The following tabulation shows average loan balances at the end of each period; changes in the allowance for loan losses arising from loans charged off and recoveries on loans previously charged off by loan category; and additions to the allowance which have been charged to operating expense:

	December 31,				
	2009	2008	2007	2006	2005
Average net loans outstanding	$579,581	$538,868	$505,070	$488,624	$487,130
Balance at beginning of year	5,858	5,219	5,157	5,449	5,729
Charge-offs:					
Commercial and industrial loans	83	146	---	101	373
Real estate mortgage loans	181	24	66	6	50
Real estate construction loans	---	---	64	---	---
Loans to individuals	383	441	341	352	678
Total loans charged off	647	611	471	459	1,101
Recoveries:					
Commercial and industrial loans	3	37	18	29	55
Real estate mortgage loans	16	---	2	1	35
Real estate construction loans	---	---	---	---	---
Loans to individuals	62	94	90	88	164
Total recoveries	81	131	110	118	254
Net loans charged off	566	480	361	341	847
Additions charged to operations	1,634	1,119	423	49	567
Balance at end of year	$6,926	$5,858	$5,219	$5,157	$5,449
Net charge-offs to average net loans outstanding	0.10 %	0.09 %	0.07 %	0.07 %	0.17 %

Factors influencing management's judgment in determining the amount of the loan loss provision charged to operating expense include the quality of the loan portfolio as determined by management, the historical loan loss experience, diversification as to type of loans in the portfolio, the amount of secured as compared with unsecured loans and the value of underlying collateral, banking industry standards and averages, and general economic conditions.

B. Allocation of the Allowance for Loan Losses

The allowance for loan losses has been allocated according to the amount deemed necessary to provide for anticipated losses within the categories of loans for the years indicated as follows:

	December 31,									
	2009		2008		2007		2006		2005	
	Allowance Amount	Percent of Loans in Each Category to Total Loans	Allowance Amount	Percent of Loans in Each Category to Total Loans	Allowance Amount	Percent of Loans in Each Category to Total Loans	Allowance Amount	Percent of Loans in Each Category to Total Loans	Allowance Amount	Percent of Loans in Each Category to Total Loans
Commercial and industrial loans	$ 2,670	48.05%	$2,861	42.70%	$1,894	41.32%	$1,651	42.90%	$1,478	53.52%
Real estate mortgage loans	980	28.01%	1,213	28.22%	951	27.73%	935	25.17%	1,212	23.79%
Real estate construction loans	1,941	7.72%	614	10.54%	396	8.90%	342	6.75%	420	5.50%
Loans to individuals	1,049	16.22%	1,048	18.54%	1,830	22.05%	1,867	25.18%	2,190	17.19%
Unallocated	286		122		148		362		149	
	$ 6,926	100.00%	$5,858	100.00%	$5,219	100.00%	$5,157	100.00%	$5,449	100.00%

Balance Sheet

On December 31, 2009, the Company had total assets of $982,367, an increase of $46,993, or 5.0%, over the total of $935,374 on December 31, 2008. For 2009, the growth in assets was entirely internally generated and was not the result of acquisitions. Total assets at December 31, 2008 were up by $47,727, or 5.4%, over the total in 2007.

Loans

A. Types of Loans

	December 31,				
	2009	2008	2007	2006	2005
Commercial and industrial loans	$283,998	$246,218	$216,830	$215,244	$206,389
Real estate mortgage loans	165,542	162,757	145,542	126,302	117,421
Real estate construction loans	45,625	60,798	46,697	33,840	27,116
Loans to individuals	95,844	106,907	115,704	126,316	142,598
Total loans	$591,009	$576,680	$524,773	$501,702	$493,524
Less unearned income and deferred fees	(1,062)	(1,123)	(1,119)	(1,059)	(913)
Total loans, net of unearned income	$589,947	$575,557	$523,654	$500,643	$492,611

Less allowance for loans losses	(6,926)	(5,858)	(5,219)	(5,157)	(5,449)
Total loans, net	$583,021	$569,699	$518,435	$495,486	$487,162

B. Maturities and Interest Rate Sensitivities

	December 31, 2009			
	< 1 Year	1 – 5 Years	After 5 Years	Total
Commercial and industrial	$110,241	$143,881	$29,876	$283,998
Real estate construction	42,023	3,602	---	45,625
Total	152,264	147,483	29,876	329,623
Less loans with predetermined interest rates	50,159	11,172	26,205	87,536
Loans with adjustable rates	$102,105	$136,311	$3,671	$242,087

C. Risk Elements

Nonaccrual, Past Due and Restructured Loans.

The following table presents aggregate amounts for nonaccrual loans, restructured loans, other real estate owned net, and accruing loans which are contractually past due ninety days or more as to interest or principal payments.

	December 31,				
	2009	2008	2007	2006	2005
Nonaccrual loans:					
Commercial and industrial	$1,455	$1,333	$1,144	$---	$171
Real estate mortgage	---	---	---	---	---
Real estate construction	2,643	---	---	---	---
Loans to individuals	---	---	6	---	7
Total nonperforming loans	$4,098	$1,333	$1,150	$---	$178
Restructured loans:					
Commercial and industrial	2,652	---	---	---	---
Real estate mortgage	---	---	---	---	---
Real estate construction	---	---	---	---	---
Loans to individuals	---	---	---	---	---
Total restructured loans	2,652	---	---	---	---
Total nonperforming loans	$6,750	$1,333	$1,150	$---	$178
Other real estate owned, net	2,126	1,984	263	390	376
Total nonperforming assets	$8,876	$3,317	$1,413	$390	$554
Accruing loans past due 90 days or more:					
Commercial and industrial	$762	$663	$984	$338	$142
Real estate mortgage	864	394	55	274	247
Real estate construction	---	---	---	---	---
Loans to individuals	71	70	142	69	157
	$1,697	$1,127	$1,181	$681	$546

Loan loss and other industry indicators related to asset quality are presented in the Loan Loss Data table.

Loan Loss Data Table

	2009		2008		2007	
Provision for loan losses	$1,634		$1,119		$423	
Net charge-offs to average net loans	0.10	%	0.09	%	0.07	%
Allowance for loan losses to loans, net of unearned income and deferred fees	1.17	%	1.02	%	1.00	%
Allowance for loan losses to nonperforming loans	102.61	%	439.46	%	453.83	%
Allowance for loan losses to nonperforming assets	78.03	%	176.61	%	369.36	%
Nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	1.50	%	0.23	%	0.27	%
Nonaccrual loans	$4,098		$1,333		$1,150	
Restructured loans	2,652		---		---	
Other real estate owned, net	2,126		1,984		263	
Total nonperforming assets	$8,876		$3,317		$1,413	
Accruing loans past due 90 days or more	$1,697		$1,127		$1,181	

Nonperforming loans include nonaccrual loans and restructured loans, but do not include accruing loans 90 days or more past due. Impaired loans, or loans in which management has identified a weakness, but which may or may not be nonperforming, are presented in Note 5 of Notes to Consolidated Financial Statements. Total impaired loans at December 31, 2009 were $7,680, including nonaccrual loans of $4,098 and one restructured loan of $2,652. Impaired loans at December 31, 2008 and 2007 were $1,333 and $1,150, respectively. All impaired loans in 2008 and 2007 were nonaccrual loans.

Securities

The total amortized cost of securities available for sale at December 31, 2009 was $165,532, and total fair value was $168,041. This represents an increase of $20,814, or 14.1% when compared with the fair value of securities available for sale of $147,227 at December 31, 2008.

At December 31, 2009, the total amortized cost of securities held to maturity was $129,376 and fair value was $129,892. This compares with amortized cost of $117,772 and fair value of $117,277 at the same period in 2008 and represents an increase of $12,615, or 10.8%, when fair value for the two periods is compared.

Additional information about securities available for sale and securities held to maturity can be found below in Note 3 of the Notes to Consolidated Financial Statements.

Both categories of securities increased during 2009 because funds were available when loan opportunities did not keep pace with deposit growth and because of the improved performance of the financial market during the year.

The financial markets have experienced increased volatility and increased risk during the economic downturn. The risk in financial markets affects the Company in the same way that it affects other institutional and individual investors. The Company's investment portfolio includes corporate bonds. If, because of economic hardship, the corporate issuers were to default, there could be a delay in the payment of interest, or there could be a loss of principal and accrued interest. To date, there have been no defaults in any of the corporate bonds held in the portfolio. The Company's investment portfolio also contains a large percentage of municipal bonds. The recession and a slow recovery could negatively impact the ability of states and municipalities to make scheduled principal and interest payments on their outstanding indebtedness. If their income from taxes and other sources declines significantly because of the recession, states and municipalities could default on their bond obligations. The risk is at this point hypothetical, because there have been no defaults among the municipal bonds in the Company's investment portfolio.

In making investment decisions, management follows internal policy guidelines that help to limit risk by specifying parameters for both security quality and geographic and industry concentrations. Management regularly monitors the quality of the investment portfolio and tracks changes in financial markets. The value of individual securities will be written down if a decline in fair value is considered to be other than temporary, given the totality of the circumstances.

Maturities and Associated Yields

The following table presents the maturities for securities available for sale and held to maturity at their carrying values as of December 31, 2009 and weighted average yield for each range of maturities.

	Maturities and Yields											
$ in thousands, except percent data	December 31, 2009											
	< 1 Year		1-5 Years		5-10 Years		> 10 Years		None		Total	
Available for Sale:												
U.S. Treasury	$---		$2,177		$---		$---		$---		$2,177	
	---		3.97	%	---		---		---		3.97	%
U.S. Government agencies	3,019		6,313		6,955		31,300		---		47,587	
	4.50	%	4.51	%	4.38	%	4.24	%	---		4.31	%
Mortgage-backed securities	714		4,188		6,109		6,005		---		17,016	
	4.79	%	4.53	%	5.07	%	5.29	%	---		5.00	%
States and political subdivision – taxable	---		2,741		181		---		---		2,922	
	---		4.60	%	7.94	%	---		---		4.81	%
States and political subdivision – nontaxable (1)	4,200		32,915		20,474		13,894		---		71,483	
	5.23	%	5.80	%	6.05	%	5.62	%	---		5.81	%
Corporate	2,951		16,675		3,016		---		---		22,642	
	3.73	%	4.82	%	5.30	%	---		---		4.74	%
Federal Home Loan Bank stock	---		---		---		---		1,677		1,677	
	---		---		---		---		0.01	%	0.01	%
Federal Reserve Bank stock	---		---		---		---		92		92	
	---		---		---		---		6.00	%	6.00	%
Other securities	767		---		---		---		1,678		2,445	
	0.12	%	---		---		---		2.77	%	1.94	%
Total	$11,651		$65,009		$36,735		$51,199		$3,447		$168,041	
	4.30	%	5.23	%	5.52	%	4.74	%	1.51	%	5.00	%
Held to Maturity:												
U.S. Government agencies	$2,999		$3,997		$---		$18,082		$---		$25,078	
	4.64	%	4.69	%	---		4.64	%	---		4.65	%
Mortgage-backed securities	---		---		---		1,458		---		1,458	
	---		---		---		5.57	%	---		5.57	%
States and political subdivision – taxable	---		2,000		---		2,038		---		4,038	
	---		5.32	%	---		4.99	%	---		5.15	%
States and political subdivision – nontaxable (1)	6,750		21,141		12,895		49,850		---		90,636	
	5.87	%	6.24	%	5.93	%	6.18	%	---		6.14	%
Corporate	2,001		4,165		2,000		---		---		8,166	
	5.51	%	4.55	%	5.03	%	---		---		4.90	%
Total	$11,750		$31,303		$14,895		$71,428		$---		$129,376	
	5.49	%	5.76	%	5.81	%	5.74	%	---		5.73	%

(1) Rates shown represent weighted average yield on a fully taxable basis.

The majority of mortgage-backed securities and collateralized mortgage obligations held at December 31, 2009 were backed by U.S. agencies. Certain holdings are required to be periodically subjected to the Federal Financial Institution Examination Council's (FFIEC) high risk mortgage security test. These tests address possible fluctuations in the average life and variances caused by the change in rate times the change in volume have been allocated to rate and volume changes proportional to the relationship of the absolute dollar amounts of the change in each. Except for U.S. Government securities, the Company has no securities with any issuer that exceeds 10% of stockholders' equity.

Deposits

Total deposits increased by $34,264, or 4.2%, from $817,848 at December 31, 2008 to $852,112 at December 31, 2009. Total deposits grew $41,509, or 5.4%, from $776,339 at December 31, 2007 to the same period in 2008. A portion of the increase in both 2009 and 2008 is attributable to a higher level of municipal deposits. Also, because of upheaval in the financial markets since the last quarter of 2008, many customers appear to be seeking the safety of insured deposits while other forms of investments are uncertain and volatile. The increases in total deposits for 2009 and 2008 were internally generated and not the result of acquisitions.

A. Average Amounts of Deposits and Average Rates Paid

Average amounts and average rates paid on deposit categories are presented below:

	Year Ended December 31,					
	2009		2008		2007	
	Average Amounts	Average Rates Paid	Average Amounts	Average Rates Paid	Average Amounts	Average Rates Paid
Noninterest-bearing demand deposits	$ 115,241	---	$ 112,608	---	$ 108,854	---
Interest-bearing demand deposits	282,532	1.09%	243,409	1.43%	223,771	1.95%
Savings deposits	48,992	0.11%	45,796	0.29%	46,943	0.50%
Time deposits	399,872	3.17%	381,961	3.98%	379,089	4.51%
Average total deposits	$ 846,637	2.16%	$ 783,774	2.80%	$ 758,657	3.34%

B. Time Deposits of $100,000 or More

The following table sets forth time certificates of deposit and other time deposits of $100,000 or more:

	December 31, 2009				
	3 Months or Less	Over 3 Months Through 6 Months	Over 6 Months Through 12 Months	Over 12 Months	Total
Total time deposits of $100,000 or more	$25,725	$35,128	$70,862	$17,551	$149,266

Derivatives and Market Risk Exposures

The Company is not a party to derivative financial instruments with off-balance sheet risks such as futures, forwards, swaps, and options. The Company is a party to financial instruments with off-balance sheet risks such as commitments to extend credit, standby letters of credit, and recourse obligations in the normal course of business to meet the financing needs of its customers. See Note 14, of Notes to Consolidated Financial Statements for additional information relating to financial instruments with off-balance sheet risk. Management does not plan any future involvement in high risk derivative products. The Company has investments in mortgage-backed securities, principally GNMA's and FNMA's, with a fair value of approximately $5,540. See Note 3 of Notes to Consolidated Financial Statements for additional information relating to securities.

The Company's securities and loans are subject to credit and interest rate risk, and its deposits are subject to interest rate risk. Management considers credit risk when a loan is granted and monitors credit risk after the loan is granted. The Company maintains an allowance for loan losses to absorb losses in the collection of its loans. See Note 5 of Notes to Consolidated Financial Statements for information relating to the allowance for loan losses. See Note 15 of

Notes to Consolidated Financial Statements for information relating to concentrations of credit risk. The Company has an asset/liability program to manage its interest rate risk. This program provides management with information related to the rate sensitivity of certain assets and liabilities and the effect of changing rates on profitability and capital accounts.

The effects of changing interest rates are primarily managed through adjustments to the loan portfolio and deposit base, to the extent competitive factors allow. The investment portfolio is generally longer term. Adjustments for asset and liability management concerns are addressed when securities are called or mature and funds are subsequently reinvested. Historically, securities have been sold for reasons related to credit quality or regulatory limitations. Few, if any, securities available for sale have been disposed of for the express purpose of managing interest rate risk. No trading activity for this purpose is planned in the foreseeable future, though it does remain an option.

While the asset/liability planning program is designed to protect the Company over the long-term, it does not provide near-term protection from interest rate shocks, as interest rate sensitive assets and liabilities do not by their nature move up or down in tandem in response to changes in the overall rate environment. The Company's profitability in the near term may be temporarily negatively affected in a period of rapidly rising or rapidly falling rates, because it takes some time for the Company to change its rates to adjust to a new interest rate environment. See Note 16 of Notes to Consolidated Financial Statements for information relating to fair value of financial instruments and comments concerning interest rate sensitivity.

Liquidity

Liquidity measures the Company's ability to provide sufficient cash flow to meet its financial commitments, to fund additional loan demand and to handle withdrawals of existing deposits. Sources of liquidity include deposits, loan principal and interest repayments, sales, calls and maturities of securities and short-term borrowing. The Company also has other available sources of liquidity. They include lines of credit with a correspondent bank, advances from the Federal Home Loan Bank and Federal Reserve Bank discount window borrowings.

Net cash provided by operating activities was $14,874 for the year ended December 31, 2009. This compares with $15,864 and $15,528 for 2008 and 2007, respectively.

Net cash used in investing activities in 2009 was $46,737. Net cash used in investing activities was $51,341 in 2008 and $20,102 in 2007.

Net cash provided by financing activities was $28,441 in 2009, compared to $35,469 in 2008 and $5,615 in 2007.

NBB has been able to readily attract deposits at reasonable rates in its market area. It has long had an internal policy designed to keep the loan to deposit ratio within a range of 65% to 75%, which helps to maintain liquidity. At December 31, 2009, the loan to deposit ratio was 69.2%. In addition, management keeps a reasonable percentage of the Company's laddered investment portfolio in investments that are categorized as available for sale. These factors, together with those cited above, contribute to the Company's sound liquidity levels.

At December 31, 2009, management is unaware of any commitment or trend that would have a material and adverse effect on liquidity.

Recent Accounting Pronouncements

See Note 1 of Notes to Consolidated Financial Statements for information relating to recent accounting pronouncements.

Capital Resources

Total stockholders' equity at December 31, 2009 was $122,076, an increase of $11,968, or 10.9%, from the $110,108 at December 31, 2008. The two largest factors in determining 2009 stockholders' equity were retained earnings of $14,319, less dividends to stockholders of $5,823. There was also $49 in exercised stock options.

Total stockholders' equity grew by $5,308, or 5.06%, from $104,800 on December 31, 2007 to $110,108 on December 31, 2008. Earnings, net of the change in unrealized gains and losses for securities available for sale and dividends paid, accounted for most of the increase in 2008. Exercised stock options provided $75 in 2008, while the total was offset by $562 in repurchased common stock.

The Tier I and Tier II risk-based capital ratios at December 31, 2009 were 16.3% and 17.3%, respectively. Capital ratios are significantly above the regulatory minimum requirements of 4.0% for Tier I and 8.0% for Tier II. The Tier I and Tier II risk-based capital ratios at December 31, 2008 were 15.2% and 16.1%, respectively.

Off-Balance Sheet Arrangements

The Company's off-balance sheet arrangements are detailed in the table below.

	Payments Due by Period				
		Less Than			More Than
	Total	1 Year	1-3 Years	3-5 Years	5 Years

Commitments to extend credit	$133,816	$133,816	$---	$---	$---
Standby letters of credit	11,953	11,953	---	---	---
Mortgage loans with potential recourse	25,487	25,487	---	---	---
Operating leases	1,171	222	454	419	76
Total	$172,427	$171,478	$454	$419	$76

In the normal course of business the Company's banking affiliate extends lines of credit to its customers. Amounts drawn upon these lines vary at any given time depending on the business needs of the customers.

Standby letters of credit are also issued to the bank's customers. There are two types of standby letters of credit. The first is a guarantee of payment to facilitate customer purchases. The second type is a performance letter of credit that guarantees a payment if the customer fails to

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perform a specific obligation. Revenue from these letters was approximately $61 in 2009.

While it would be possible for customers to draw in full on approved lines of credit and letters of credit, historically this has not occurred. In the event of a sudden and substantial draw on these lines, the Company has its own lines of credit on which it can draw funds. A sale of loans or investments would also be an option.

The Company sells mortgages on the secondary market for which there are recourse agreements should the borrower default.

Operating leases are for buildings used in the Company’s day-to-day operations.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Information about market risk is set forth above in the “Interest Rate Sensitivity” and “Derivatives and Market Risk Exposure” sections of the Management’s Discussion and Analysis.

Item 8. Financial Statements and Supplementary Data

Consolidated Balance Sheets

$ in thousands, except share data	December 31, 2009	2008
Assets		
Cash and due from banks	$12,894	$16,316
Interest-bearing deposits	32,730	29,656
Securities available for sale, at fair value	168,041	147,227
Securities held to maturity (fair value approximates $129,892 at December 31, 2009 and $117,277 at December 31, 2008)	129,376	117,772
Mortgage loans held for sale	126	348
Loans:		
Real estate construction loans	45,625	60,798
Real estate mortgage loans	165,542	162,757
Commercial and industrial loans	283,998	246,218
Loans to individuals	95,844	106,907
Total loans	591,009	576,680
Less unearned income and deferred fees	(1,062)	(1,123)
Loans, net of unearned income and deferred fees	589,947	575,557
Less allowance for loan losses	(6,926)	(5,858)
Loans, net	583,021	569,699
Premises and equipment, net	10,628	11,204
Accrued interest receivable	6,250	5,760
Other real estate owned, net	2,126	1,984
Intangible assets and goodwill	12,626	13,719
Other assets	24,549	21,689
Total assets	$982,367	$935,374
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	$122,549	$109,630
Interest-bearing demand deposits	310,629	256,416
Saving deposits	51,622	45,329
Time deposits	367,312	406,473
Total deposits	852,112	817,848
Other borrowed funds	---	54
Accrued interest payable	336	655
Other liabilities	7,843	6,709
Total liabilities	860,291	825,266
Commitments and contingencies	---	---
Stockholders' equity:		