NATIONAL BANKSHARES INC
Form 10-Q
November 09, 2009

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

FORM 10-Q

[x]QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2009
[ ]TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________
Commission File Number 0-15204

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

Virginia (State or other jurisdiction of incorporation or organization)	54-1375874 (I.R.S. Employer Identification No.)
101 Hubbard Street P. O. Box 90002 Blacksburg, VA (Address of principal executive offices)	24062-9002 (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [x] Yes [ ] No

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

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

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

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

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

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

(This report contains 30 pages)

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES

Form 10-Q
Index

Part I - Financial Information		Page
Item 1	Financial Statements	3
	Consolidated Balance Sheets, September 30, 2009 (Unaudited) and December 31, 2008	3
	Consolidated Statements of Income for the Three Months Ended September 30, 2009 and 2008 (Unaudited)	4
	Consolidated Statements of Income for the Nine Months Ended September 30, 2009 and 2008 (Unaudited)	5
	Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2009 and 2008 (Unaudited)	6
	Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2009 and 2008 (Unaudited)	7-8
	Notes to Consolidated Financial Statements (Unaudited)	9-17
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	17-25
Item 3	Quantitative and Qualitative Disclosures About Market Risk	25
Item 4	Controls and Procedures	25
Part II - Other Information		
Item 1	Legal Proceedings	25
Item 1A	Risk Factors	25
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	25
Item 3	Defaults Upon Senior Securities	25
Item 4	Submission of Matters to a Vote of Security Holders	25

Item 5	Other Information	26
Item 6	Exhibits	26
Signatures		26
Index of Exhibits		27

2

Part I
Financial Information

Item 1. Financial Statements

National Bankshares, Inc. and Subsidiaries
Consolidated Balance Sheets

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

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

See accompanying notes to consolidated financial statements.

3

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

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

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

See accompanying notes to consolidated financial statements.

4

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

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

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

See accompanying notes to consolidated financial statements.

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

$ in thousands, except per share data	Common Stock	Retained Earnings	Accumulated Other Compre-hensive Income (Loss)	Compre-hensive Income	Total
Balances at December 31, 2007	$ 8,690	$ 97,810	$ (1,700)		$
Net income	---	10,265	---	$ 10,265	vertical-align:bottom;padding-left:2px;padding-top:2px;paddin
Net loss per share of Common Stock attributable to common stockholders, basic and diluted	$ (0.12)			GG	$ (2.20)
Weighted average number of shares of Common Stock outstanding, basic and diluted	5,172,260				5,172,260

The accompanying notes are an integral part of this pro forma financial statement.

Preferred Apartment Communities, Inc.
Notes to Unaudited Pro Forma Consolidated Financial Statements

1. Basis of Presentation

Preferred Apartment Communities, Inc., or the Company, was formed as a Maryland corporation on September 18, 2009, and has elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended (the "Code") effective with its tax year ended December 31, 2011. The Company was formed primarily to acquire and operate multifamily properties in select targeted markets throughout the United States. As part of its business strategy, the Company may enter into forward purchase contracts or purchase options for to-be-built multifamily communities and may make mezzanine loans, provide deposit arrangements, or provide performance assurances, as may be necessary or appropriate, in connection with the construction of multifamily communities and other properties. As a secondary strategy, the Company also may acquire or originate senior mortgage loans, subordinate loans or mezzanine debt secured by interests in multifamily properties, membership or partnership interests in multifamily properties and other multifamily related assets and invest not more than 10% of its total assets in other real estate related investments, as determined by its manager as appropriate for the Company. The Company is externally managed and advised by Preferred Apartment Advisors, LLC, or its Manager, a Delaware limited liability company and related party.

On January 17, 2013, the Company issued 40,000 shares of its Series B Convertible Preferred Stock, or Series B Preferred Stock, at a purchase price of $1,000 per share through a private placement transaction. The net proceeds totaled approximately $37.6 million after commissions. The Series B Preferred Stock will automatically be converted into shares of Common Stock following, and subject to, stockholder approval, at a conversion price of $7.00 per common share. The conversion would result in the issuance of approximately 5,714,274 shares of Common Stock. The Company plans to file a resale registration statement by no later than April 15, 2013 for the purpose of registering the resale of the underlying shares of Common Stock into which the shares of Series B Preferred Stock are convertible following stockholder approval. The Series B Preferred Stock pays dividends at the same rate as those declared on our Common Stock, on an as-converted basis.

On January 23, 2013, the Company acquired three multifamily communities: McNeil Ranch, a 192 unit community in Austin, Texas, for approximately $21.0 million; Lake Cameron, a 328 unit community in Raleigh, North Carolina, for approximately $30.5 million; and Ashford Park, a 408 unit community in Atlanta, Georgia for approximately $39.6 million. These three communities are referred to collectively as the Acquired Properties.

The attached Pro Forma Consolidated Balance Sheet and Pro Forma Consolidated Statement of Operations include four columns. The first column labeled "PAC REIT Historical" represents the actual financial position and results of operations of the Company as of and for the year ended December 31, 2012. The second column, entitled "Acquired Properties" on the Pro Forma Consolidated Balance Sheet represents the pro forma adjustments required in order to reflect the balance sheet impact of acquiring the three properties. The second column, entitled "Acquired Properties" on the Pro Forma Consolidated Statement of Operations represents the actual revenues and expenses of the three properties during the year ended December 31, 2012. The "Other" column on the Pro Forma Consolidated Balance Sheet represents the pro forma adjustments required to reflect the closing of the Series B Preferred Stock Offering, and on the Pro Forma Consolidated Statement of Operations represents the pro forma adjustments required to reflect expense adjustments to reflect the depreciation on the properties, amortization of the debt financing and lease intangible costs, additional management fees that would have been due pursuant to the third amended and restated management agreement, or Management Agreement, and the accrual of dividends on the Series B Preferred Stock Offering.

F-8

Preferred Apartment Communities, Inc.
Notes to Unaudited Pro Forma Consolidated Financial Statements (continued)

2. Adjustments to Unaudited Pro Forma Consolidated Balance Sheet

(A)To reflect the purchase price allocation of the Acquired Properties:

Land	$ 16,700,000
Building and improvements	60,278,288
Furniture fixtures & equipment	8,015,930
In-place leases	5,647,619
Customer relationships	851,260
Deposits	1,044,116
Receivables and other assets	158,806
Accounts payable, deposits and accrued expenses	(1,327,737)
Below-market leases	(277,195)
Net assets acquired	$ 91,091,087

On January 23, 2013, the Company closed the purchase transactions of the Acquired Properties. For the purpose of these pro forma financial statements, the Company is assumed to have purchased the Acquired Properties with a combination of cash from the Series B Preferred Stock Offering and debt financing. The costs of the acquired tangible and intangible assets are allocated based on estimates of their fair value. The fair value of the buildings is estimated on an as-if-vacant basis, based on relevant information obtained in connection with the acquisition of these properties and is to be depreciated on a straight-line basis over its estimated remaining useful life of 30 years. The estimated fair value of acquired in-place leases are the costs the Company would have incurred to lease the property to the occupancy level of the property at the date of acquisition. The acquired furniture, fixtures & equipment are to be depreciated on a straight-line basis over their estimated remaining useful lives. For five-year life assets totaling approximately $4.4 million, the remaining useful life is estimated to be 2.5 years. For ten-year life assets totaling approximately $3.6 million, the remaining useful life is estimated to be five years.

The allocation of purchase price is based on the Company's best estimates and is subject to change based on the final determination of the fair value of assets acquired. In, addition, the purchase price is subject to any working capital adjustments that may occur at closing, but these adjustments are not expected to be significant.

Net proceeds from debt financing on Accquired Properties	$ 59,045,000
Less:	
Purchase price of Acquired Properties	(91,091,087)
Property acquisition costs, reduced for amounts incurred at December 31, 2012	(1,105,521)
Deferred loan costs	(835,794)
	$ (33,987,402)

The pro forma adjustment to additional paid-in capital of $1,105,521 represents acquisition costs incurred subsequent to December 31, 2012 related to the Acquired Properties.

(B) To reflect the issuance of 40,000 shares of Series B Preferred Stock and the cash proceeds to the Company:

Gross proceeds from preferred stock offering	$ 40,000,000
less: commissions	(2,400,000)
less: deferred offering costs incurred in 2013	(330,757)
Net proceeds to the Company	$ 37,269,243

F-9

Preferred Apartment Communities, Inc.
Notes to Unaudited Pro Forma Consolidated Financial Statements (continued)

As of December 31, 2012, the Company had already incurred offering costs totaling $232,795, plus an additional $330,757 during 2013. These costs are reflected as an adjustment to the pro forma Additional Paid-In Capital as part of the offering transaction.

Reconciliation of the Additional Paid-In Capital Adjustment:

Proceeds from Series B Offering	$ 37,600,000
Less: Deferred offering costs	(563,552)
	37,036,448
Less: par value of Preferred Stock	(400)
APIC adjustment	$ 37,036,048

(C) On January 23, 2013, the Company refinanced the Acquired Properties with seven year mortgage financing totaling $59,045,000 and bearing interest at a fixed rate of 3.13% per annum. In conjunction with securing the new financing, the Company incurred a total of $932,089 in loan acquisition costs, which are to be amortized over the lives of the mortgages using the effective interest method. Included in this total is $96,295 of non-refundable mortgage application deposits, which were paid in 2012 and classified as other assets. The Unaudited Consolidated Pro Forma Balance Sheet shows this reclassification adjustment from other assets to deferred loan costs, as well as the incurrence of the new mortgage debt as of December 31, 2012.

3. Adjustments to Unaudited Pro Forma Consolidated Statement of Operations

The adjustments to the Pro Forma Consolidated Statement of Operations for the year ended December 31, 2012 are as follows:

(AA) Included in the Company’s allocation of the Acquired Properties’ purchase prices to the fair values of assets and liabilities acquired were the values of below market leases, which totaled $277,195. These liabilities were amortized over the average remaining lease term, which was approximately six months.

(BB) Effective with the purchase of the three properties by the Company, the property management fee will increase from 3.25% of monthly gross rental income to 4% of monthly gross rental income, as stipulated in the Management Agreement. The pro forma adjustment reflects this additional cost burden on the properties’ operations.

(CC) Reflected in the pro forma adjustment is the Company's estimate of the depreciation charges that would have been incurred by the properties assuming the purchase had occurred effective January 1, 2012. The pro forma adjustment assumes a straight-line depreciation method using a 30 year life for buildings, five to ten years for acquired building improvements and furniture fixtures and equipment, and for acquired intangible assets, approximately six months based upon the average remaining lease term for acquired leases in place. The values of customer relationship intangible assets are amortized over the average remaining lease term plus the average estimated renewal period, the total of which approximated twelve months.

(DD) The estimated asset management fee is based on 0.5% of the total value of the Company's assets based on their adjusted cost before reduction for depreciation, amortization, impairment charges and cumulative acquisition costs charged to expense in accordance with GAAP (adjusted cost will include the purchase price, acquisition expenses, capital expenditures and other customarily capitalized costs). In calculating the pro forma asset management fee adjustment, the Company added management fees calculated on the acquired gross assets, as adjusted, plus the pro forma acquisition costs and deferred loan costs incurred on the Acquired Properties.

(EE) Reflected in the pro forma adjustment is the Company's estimate of interest expense incurred on the debt financings used to acquire the three properties, based upon the actual fixed 3.13% interest rate that was negotiated when the loans closed on January 23, 2012. The interest rates negotiated result in an annual interest expense of $1,981,264. Included in this amount is annual amortization expense of $133,156 of loan origination costs, which totaled

Preferred Apartment Communities, Inc.
Notes to Unaudited Pro Forma Consolidated Financial Statements (continued)

$932,089. The pro forma adjustment assumes a straight-line amortization method, which approximates the effective yield method, assuming a 7 year term on the debt financings.

(FF) The terms of the Series B Preferred Stock include a required conversion to Common Stock, conditional upon approval by the current holders of Common Stock by vote on May 9, 2013. From the date of issue until conversion, holders of the Series B Preferred Stock are entitled to dividends on a pro rata basis at the same rate as dividends declared on the Company's Common Stock, calculated on an as-converted basis. If the conversion is not approved by holders of the Company's Common Stock, the Series B Preferred Stock will begin accruing dividends at 15% per annum. The Pro Forma Statement of Operations does not assume conversion to Common Stock during the twelve-month period ended December 31, 2012. The adjustment presented for dividends to preferred stockholders is calculated based upon the Common Stock dividends per share actually declared during 2012, which totaled $0.545 per share of Common Stock.

(GG) Calculation of pro forma net loss per share of Common Stock:
Net loss per share:

Net loss attributable to the Company	$(7,772,092)
Dividends to preferred stockholders	(3,565,085)
Earnings attributable to unvested restricted stock	(17,094)
Net loss attributable to common stockholders	$(11,354,271)
Weighted average number of shares of Common Stock - basic	5,172,260
Effect of dilutive securities:	—
Weighted average number of shares of Common Stock - diluted	5,172,260
Loss per weighted average share - basic and diluted	$(2.20)

Since the Company reported a net loss for the pro forma period presented, the effect of all potential common stock equivalents was antidilutive for purposes of calculating loss per weighted average share.

F-11