

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2023

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

Blacksburg, Virginia 24062-9002

(Address of principal executive offices) (Zip Code)

(540) 951-6300

(Registrant's telephone number, including area code)

(Not applicable)

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$1.25 per share	NKSH	Nasdaq Capital Market

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

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

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

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

Outstanding shares of common stock at November 7, 2023

5,891,739

NATIONAL BANKSHARES, INC.

Form 10-Q

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Item 1. Financial Statements

Part I
Financial Information
National Bankshares, Inc.
Consolidated Balance Sheets

(in thousands, except share and per share data)	(Unaudited) September 30, 2023	December 31, 2022
Assets		
Cash and due from banks	\$ 13,089	\$ 12,403
Interest-bearing deposits	40,353	59,026
Securities available for sale, at fair value	591,552	656,852
Restricted stock, at cost	1,264	941
Mortgage loans held for sale	82	-
Loans:		
Loans, net of unearned income and deferred fees and costs	848,975	852,744
Less allowance for credit losses	(10,181)	(8,225)
Loans, net	838,794	844,519
Premises and equipment, net	11,091	10,371
Accrued interest receivable	6,180	6,001
Other real estate owned, net	662	662
Goodwill	5,848	5,848
Bank-owned life insurance	43,327	43,312
Other assets	39,660	37,616
Total assets	\$ 1,591,902	\$ 1,677,551
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 303,166	\$ 327,713
Interest-bearing demand deposits	789,148	933,269
Savings deposits	184,801	214,114
Time deposits	187,885	67,629
Total deposits	1,465,000	1,542,725
Accrued interest payable	551	106
Other liabilities	10,238	12,033
Total liabilities	1,475,789	1,554,864
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, no par value, 5,000,000 shares authorized; none issued and outstanding	-	-
Common stock of \$1.25 par value and additional paid in capital. Authorized 10,000,000 shares; issued and outstanding 5,891,739 (including 2,052 unvested) shares at September 30, 2023 and 5,889,687 at December 31, 2022	7,383	7,362
Retained earnings	198,394	199,091
Accumulated other comprehensive loss, net	(89,664)	(83,766)
Total stockholders' equity	116,113	122,687
Total liabilities and stockholders' equity	\$ 1,591,902	\$ 1,677,551

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Income
(Unaudited)

(in thousands, except share and per share data)	Three Months Ended September 30,	
	2023	2022
Interest Income		
Interest and fees on loans	\$ 9,816	\$ 8,816
Interest on interest-bearing deposits	439	506
Interest on securities – taxable	4,084	3,425
Interest on securities – nontaxable	340	408
Total interest income	14,679	13,155
Interest Expense		
Interest on time deposits	1,452	31
Interest on other deposits	4,584	722
Interest on borrowings	3	-
Total interest expense	6,039	753
Net interest income	8,640	12,402
(Recovery of) provision for credit losses	(401)	252
Net interest income after (recovery of) provision for credit losses	9,041	12,150
Noninterest Income		
Service charges on deposit accounts	642	661
Other service charges and fees	151	51
Credit and debit card fees, net	395	448
Trust income	505	492
BOLI income	253	239
Gain on sale of mortgage loans	22	40
Other income	147	209
Total noninterest income	2,115	2,140
Noninterest Expense		
Salaries and employee benefits	4,462	4,144
Occupancy, furniture and fixtures	547	476
Data processing and ATM	978	774
FDIC assessment	190	114
Net costs of other real estate owned	14	68
Franchise taxes	339	375
Professional services	251	254
Other operating expenses	684	531
Total noninterest expense	7,465	6,736
Income before income taxes	3,691	7,554
Income tax expense	617	1,392
Net Income	\$ 3,074	\$ 6,162
Basic net income per common share	\$ 0.52	\$ 1.03
Diluted net income per common share	\$ 0.52	\$ 1.03
Weighted average number of common shares outstanding, basic	5,889,687	5,974,961
Weighted average number of common shares outstanding, diluted	5,889,939	5,974,961
Dividends declared per common share	\$ -	\$ -

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Comprehensive Loss
Three Months Ended September 30, 2023 and 2022
(Unaudited)

(in thousands)	September 30,	
	2023	2022
Net Income	\$ 3,074	\$ 6,162
Other Comprehensive Loss, Net of Tax		
Unrealized holding loss on available for sale securities net of tax of (\$4,099) and (\$7,822) for the periods ended September 30, 2023 and September 30, 2022, respectively	(15,421)	(29,424)
Other comprehensive loss, net of tax	(15,421)	(29,424)
Total Comprehensive Loss	\$ (12,347)	\$ (23,262)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Income
(Unaudited)

(in thousands, except share and per share data)	Nine Months Ended September 30,	
	2023	2022
Interest Income		
Interest and fees on loans	\$ 28,793	\$ 25,240
Interest on interest-bearing deposits	1,207	757
Interest on securities – taxable	12,268	8,847
Interest on securities – nontaxable	1,052	1,283
Total interest income	43,320	36,127
Interest Expense		
Interest on time deposits	2,865	105
Interest on other deposits	11,352	1,950
Interest on borrowings	300	-
Total interest expense	14,517	2,055
Net interest income	28,803	34,072
(Recovery of) provision for credit losses	(389)	696
Net interest income after (recovery of) provision for credit losses	29,192	33,376
Noninterest Income		
Service charges on deposit accounts	1,871	1,826
Other service charges and fees	253	157
Credit and debit card fees, net	1,276	1,423
Trust income	1,431	1,374
BOLI income	1,771	718
Gain on sale of investment	2,971	-
Gain on sale of mortgage loans	93	136
Loss on sale of securities	(3,332)	-
Other income	771	909
Total noninterest income	7,105	6,543
Noninterest Expense		
Salaries and employee benefits	13,361	12,133
Occupancy, furniture and fixtures	1,500	1,432
Data processing and ATM	2,730	2,354
FDIC assessment	561	336
Net costs of other real estate owned	29	78
Franchise taxes	1,072	1,108
Professional services	1,555	693
Other operating expenses	1,878	1,526
Total noninterest expense	22,686	19,660
Income before income taxes	13,611	20,259
Income tax expense	2,105	3,637
Net Income	\$ 11,506	\$ 16,622
Basic net income per common share	\$ 1.95	\$ 2.77
Fully diluted net income per common share	\$ 1.95	\$ 2.77
Weighted average number of common shares outstanding, basic	5,889,687	6,008,607
Weighted average number of common shares outstanding, diluted	5,889,778	6,008,607
Dividends declared per common share	\$ 1.73	\$ 0.72

National Bankshares, Inc.
Consolidated Statements of Comprehensive Income (Loss)
Nine Months Ended September 30, 2023 and 2022
(Unaudited)

(in thousands)	September 30,	
	2023	2022
Net Income	\$ 11,506	\$ 16,622
Other Comprehensive Loss, Net of Tax		
Unrealized holding loss on available for sale securities net of tax of (\$2,268) and (\$23,431) for the periods ended September 30, 2023 and September 30, 2022, respectively	(8,530)	(88,143)
Reclassification adjustment for loss included in net income, net of tax of \$700 in 2023	2,632	-
Other comprehensive loss, net of tax	(5,898)	(88,143)
Total Comprehensive Income (Loss)	\$ 5,608	\$ (71,521)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Changes in Stockholders' Equity
(Unaudited)
Three Months Ended September 30, 2023 and 2022

(in thousands except share data)	Common Stock and Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balances at June 30, 2022	\$ 7,476	\$ 191,545	\$ (62,777)	\$ 136,244
Net income	-	6,162	-	6,162
Common stock repurchased, 23,500 shares	(29)	(766)	-	(795)
Other comprehensive loss, net of tax of (\$7,822)	-	-	(29,424)	(29,424)
Balances at September 30, 2022	\$ 7,447	\$ 196,941	\$ (92,201)	\$ 112,187
Balances at June 30, 2023	\$ 7,367	\$ 195,320	\$ (74,243)	\$ 128,444
Net income	-	3,074	-	3,074
Other comprehensive loss, net of tax of (\$4,099)	-	-	(15,421)	(15,421)
Stock based compensation	16	-	-	16
Balances at September 30, 2023	\$ 7,383	\$ 198,394	\$ (89,664)	\$ 116,113

See accompanying notes to consolidated financial statements.

Nine Months Ended September 30, 2023 and 2022

(in thousands except share data)	Common Stock and Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balances at December 31, 2021	\$ 7,580	\$ 188,229	\$ (4,058)	\$ 191,751
Net income	-	16,622	-	16,622
Common stock repurchased, 106,662 shares	(133)	(3,591)	-	(3,724)
Cash dividends of \$0.72 per share	-	(4,319)	-	(4,319)
Other comprehensive loss, net of tax of (\$23,431)	-	-	(88,143)	(88,143)
Balances at September 30, 2022	\$ 7,447	\$ 196,941	\$ (92,201)	\$ 112,187
Balances at December 31, 2022	\$ 7,362	\$ 199,091	\$ (83,766)	\$ 122,687
Adoption of ASU 2016-13	-	(2,014)	-	(2,014)
Net income	-	11,506	-	11,506
Cash dividends of \$1.73 per share	-	(10,189)	-	(10,189)
Other comprehensive loss, net of tax of (\$1,568)	-	-	(5,898)	(5,898)
Stock based compensation	21	-	-	21
Balances at September 30, 2023	\$ 7,383	\$ 198,394	\$ (89,664)	\$ 116,113

See accompanying notes to the consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2023 and 2022
(Unaudited)

(in thousands)	September 30, 2023	September 30, 2022
Cash Flows from Operating Activities		
Net income	\$ 11,506	\$ 16,622
Adjustments to reconcile net income to net cash provided by operating activities:		
(Recovery of) provision for credit losses	(389)	696
Depreciation of bank premises and equipment	544	449
Amortization of premiums and accretion of discounts, net	806	972
Gain on disposal of fixed assets	-	(4)
Loss on sales of securities available for sale, net	3,332	-
Losses and write-downs on other real estate owned, net	-	50
Loss on sales of repossessed assets	5	-
Increase in cash value of bank-owned life insurance	(734)	(718)
Origination of mortgage loans held for sale	(6,689)	(6,348)
Proceeds from sale of mortgage loans held for sale	6,700	7,099
Gain on sale of mortgage loans held for sale	(93)	(136)
Equity based compensation expense	21	-
Net change in:		
Accrued interest receivable	(179)	(718)
Other assets	59	33
Accrued interest payable	445	(8)
Other liabilities	(2,002)	282
Net cash provided by operating activities	<u>13,332</u>	<u>18,271</u>
Cash Flows from Investing Activities		
Proceeds from calls, principal payments, sales and maturities of securities available for sale	53,696	33,465
Purchase of securities available for sale	-	(117,341)
Net change in restricted stock	(323)	(96)
Purchase of loan participations	(5,118)	(10,965)
Collection of loan participations	6,686	4,513
Loan originations and principal collections, net	1,958	(43,479)
Proceeds from sale of repossessed assets	13	-
Recoveries on loans charged off	235	153
Proceeds from sale and purchases of premises and equipment, net	(1,264)	(906)
BOLI settlement	712	-
Net cash provided by (used in) investing activities	<u>56,595</u>	<u>(134,656)</u>
Cash Flows from Financing Activities		
Net change in time deposits	120,256	(1,945)
Net change in other deposits	(197,981)	78,007
Common stock repurchased	-	(3,724)
Cash dividends paid	(10,189)	(4,319)
Net cash (used in) provided by financing activities	<u>(87,914)</u>	<u>68,019</u>

(Continued)

Net change in cash and due from banks	(17,987)	(48,366)
Cash and due from banks at beginning of period	71,429	138,789
Cash and due from banks at end of period	\$ 53,442	\$ 90,423

Supplemental Disclosures of Cash Flow Information

Interest paid on deposits and borrowings	\$ 14,072	\$ 2,063
Income taxes paid	3,997	3,441

Supplemental Disclosure of Noncash Activities

Loans charged against the allowance for credit losses	\$ 232	\$ 316
Loans transferred to repossessed assets	11	-
Unrealized holding loss on securities available for sale	(7,466)	(111,574)
Lease liabilities arising from obtaining right-of-use assets	-	104

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Notes to Consolidated Financial Statements
September 30, 2023
(Unaudited)

\$ in thousands, except per share data

Note 1: General

The consolidated financial statements of National Bankshares, Inc. (“NBI”) and its wholly-owned subsidiaries, The National Bank of Blacksburg (the “Bank” or “NBB”) and National Bankshares Financial Services, Inc. (“NBFS”) (collectively, the “Company”), conform to accounting principles generally accepted in the United States of America (“GAAP”) and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of the Company’s management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the three and nine month periods ended September 30, 2023 are not necessarily indicative of results of operations for the full year or any other interim period. The interim period consolidated financial statements and financial information included in this Form 10-Q should be read in conjunction with the notes to consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2022 (“2022 Form 10-K”). The Company posts all reports required to be filed under the Securities Exchange Act of 1934 on its web site at www.nationalbankshares.com.

Risks and Uncertainties

The Company is closely monitoring risks that may impact its business, including high inflation, along with U.S. monetary policy maneuvers to reduce inflation. Inflation and U.S. monetary policy maneuvers to reduce it may impact the Company’s customers’ demand for banking services and ability to qualify for and/or repay loans. These risks could adversely affect the Company’s business, financial condition, results of operations, cash flows, credit risk, asset valuations and capital position.

Recent Accounting Pronouncements

In October 2023, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2023-06, “Disclosure Improvements: Codification Amendments in Response to the SEC’s Disclosure Update and Simplification Initiative”. This ASU incorporates certain U.S. Securities and Exchange Commission (SEC) disclosure requirements into the FASB Accounting Standards Codification. The amendments in the ASU are expected to clarify or improve disclosure and presentation requirements of a variety of Codification Topics, allow users to more easily compare entities subject to the SEC’s existing disclosures with those entities that were not previously subject to the requirements, and align the requirements in the Codification with the SEC’s regulations. For entities subject to the SEC’s existing disclosure requirements and for entities required to file or furnish financial statements with or to the SEC in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer, the effective date for each amendment will be the date on which the SEC removes that related disclosure from its rules. For all other entities, the amendments will be effective two years later. However, if by June 30, 2027, the SEC has not removed the related disclosure from its regulations, the amendments will be removed from the Codification and not become effective for any entity. The Company does not expect the adoption of ASU 2023-06 to have a material impact on its consolidated financial statements.

In July 2023, the FASB issued ASU 2023-03, “Presentation of Financial Statements (Topic 205), Income Statement—Reporting Comprehensive Income (Topic 220), Distinguishing Liabilities from Equity (Topic 480), Equity (Topic 505), and Compensation—Stock Compensation (Topic 718)”. This ASU amends the FASB Accounting Standards Codification for Securities and Exchange Commission (“SEC”) paragraphs pursuant to SEC Staff Accounting Bulletin No. 120, SEC Staff Announcement at the March 24, 2022 EITF Meeting, and Staff Accounting Bulletin Topic 6.B, Accounting Series Release 280—General Revision of Regulation S-X: Income or Loss Applicable to Common Stock. ASU 2023-03 is effective upon addition to the FASB Codification. The Company does not expect the adoption of ASU 2023-03 to have a material impact on its consolidated financial statements.

In March 2020, the FASB issued ASU 2020-04 “Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” These amendments provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference the London Interbank Offered Rate (“LIBOR”) or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. Subsequently, in January 2021, the FASB issued ASU 2021-01 “Reference Rate Reform (Topic 848): Scope.” This ASU clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. The ASU also amends the expedients and exceptions in Topic 848 to capture the incremental consequences of

the scope clarification and to tailor the existing guidance to derivative instruments affected by the discounting transition. An entity may elect to apply ASU 2021-01 on contract modifications that change the interest rate used for margining, discounting, or contract price alignment retrospectively as of any date from the beginning of the interim period that includes March 12, 2020, or prospectively to new modifications from any date within the interim period that includes or is subsequent to January 7, 2021, up to the date that financial statements are available to be issued. An entity may elect to apply ASU 2021-01 to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020, and to new eligible hedging relationships entered into after the beginning of the interim period that includes March 12, 2020. The Company has a small number of participation loans that reference LIBOR. The Company is working with the primary banks to determine appropriate actions.

In December 2022, the FASB issued ASU 2022-06, “Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848”. ASU 2022-06 extends the period of time preparers can utilize the reference rate reform relief guidance in Topic 848. The objective of the guidance in Topic 848 is to provide relief during the temporary transition period, so the FASB included a sunset provision within Topic 848 based on expectations of when LIBOR would cease being published. In 2021, the UK Financial Conduct Authority delayed the intended cessation date of certain tenors of LIBOR to June 30, 2023.

To ensure the relief in Topic 848 covers the period of time during which a significant number of modifications may take place, the ASU defers the sunset date of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The ASU is effective for all entities upon issuance. The Company is assessing ASU 2022-06 and its impact on the Company’s transition away from LIBOR for its loan and other financial instruments.

Recently Adopted Accounting Standards

ASU 2016-13

On January 1, 2023, the Company adopted ASU 2016-13 “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” and related ASUs. Prior to adoption, the Company followed applicable GAAP and used an incurred loss model to estimate an allowance for loan losses and a liability for credit risk on unfunded commitments. The Company also used a methodology to determine whether securities in an unrealized loss position were other-than-temporarily impaired and whether credit risk was present.

ASU 2016-13 makes significant changes to the accounting for credit losses on financial instruments presented on an amortized cost basis and disclosures about them. The new current expected credit loss (“CECL”) impairment model requires an estimate of expected credit losses, measured over the contractual life of an instrument, which considers historical experience, current conditions and reasonable and supportable forecasts of future economic conditions. The standard provides significant flexibility and requires a high degree of judgment with regards to pooling financial assets with similar risk characteristics and adjusting the relevant historical loss information in order to develop an estimate of expected lifetime losses. ASU 2016-13 permits the use of estimation techniques that are practical and relevant to the Company’s circumstances, as long as they are applied consistently over time and faithfully estimate expected credit losses in accordance with the standard.

The Company applied the standard’s provisions as a cumulative-effect adjustment of \$2,014, net of tax, to retained earnings as of January 1, 2023. On the adoption date, the allowance for credit losses (“ACL”) on loans increased from \$8,225 to \$10,567 and the ACL for unfunded commitments increased from \$35 to \$242. Based upon the nature and characteristics of our securities portfolios (including issuer specific matters) at the adoption date, macroeconomic conditions and forecasts at that date, and other management judgments, adoption did not result in an ACL on securities available for sale. Results for reporting periods beginning after January 1, 2023 will be presented under Topic 326, while periods prior to January 1, 2023 will be reported in accordance with GAAP applicable for the time period. The following presents the Company’s policies governing determination of the ACL on its financial instruments.

ACL on Securities Available for Sale

The Company evaluates securities available for sale that are in an unrealized loss position on the reporting date. Securities are analyzed to determine whether the decline in the fair value below the amortized cost basis (impairment) is due to credit-related factors or noncredit-related factors. Any impairment that is not credit-related is recognized in other comprehensive income, net of applicable taxes. Credit-related impairment is recognized as an ACL on the Consolidated Balance Sheets, limited to the amount by which the amortized cost basis exceeds the fair value, with a corresponding adjustment to earnings. Both the ACL and the adjustment to net income may be subsequently reversed if conditions change. If the Company intends to sell an impaired security, or more likely than not will be required to sell such a security, before recovering its amortized cost basis, the entire impairment amount must be recognized in earnings with a corresponding adjustment to the security’s amortized cost basis. Because the security’s amortized cost basis would be adjusted to fair value, there would be no ACL in this situation.

In evaluating impairment, the Company considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuers’ financial condition, among other factors. If the Company determines a credit impairment, the ACL on securities available for sale would be established through a provision for credit losses on securities available for sale in the Consolidated Statements of Income. If the Company’s management believes it has confirmed that the loss on a security is uncollectible, or when either of the criteria regarding intent or requirement to sell is met, the loss is charged against the ACL. Accrued interest receivable is excluded from the estimate of credit losses.

ACL on Loans (“ACLL”)

The Company estimates the ACCL based on amortized cost basis, which is the amount at which the loan is originated, adjusted for net deferred fees or costs, collection of cash, and charge-offs. In the event that collection of principal becomes uncertain, the Company has policies in place to reverse accrued interest in a timely manner. Therefore, the Company has made a policy election to exclude accrued interest from the measurement of the ACCL. Intrinsic to the Company’s policy on estimating the ACCL are policies regarding loan pools, nonaccruals, past due status, collateral valuation, charge-offs and risk ratings. Please refer to the Company’s 2022 Form 10-K, Note 1: Summary of Significant Accounting Policies for additional information on these policies.

The Company measures expected credit losses on loans on a collective (pool) basis, when the loans share similar risk characteristics, such as collateral type and intended use, repayment source, and (if applicable) the borrower’s business model. The Company has identified the following pools of loans with similar risk characteristics for measuring expected credit losses:

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

The Company’s methodologies for estimating the ACCL consider available relevant information about the collectability of cash flows, including historical losses, reasonable and supportable forecasts of economic conditions, and current economic and portfolio conditions. The difference between cash flow estimates and amortized cost is the ACCL.

The Company uses a discounted cash flow (“DCF”) method for all of its pools except for bankcards, which are measured using the historical loss rate adjusted for the forecast. For loans using the DCF method, cash flows are projected at the instrument level and discounted using the loan’s effective interest rate. Cash flows are generated using each loan’s payment attributes, adjusted for pool-level information on the probability of default (“PD”), loss given default and prepayment speeds. Default is defined as full or partial charge-off, nonaccrual status or past due 90 days or more. PDs for each pool are calculated using the Company’s historical data, modified by peer data, to ensure a full economic cycle is reflected in the estimate. PDs are then adjusted for the forecast.

The Company designated national unemployment as its forecast variable. Multiple forecasts from reputable and independent third parties are sourced to inform the Company’s reasonable and supportable forecasting of current expected credit losses. The forecast is applied over a horizon selected by the Company’s management at each reporting date, typically of one year and not to exceed two years, after which loss rates revert to long term historical loss experience on a straight line basis over a period determined by the Company’s management, of up to three years. The forecast horizon and reversion period are applied consistently to the entire portfolio.

The results of DCF calculations are modified by allocations for qualitative factors to account for changes in variables that may affect credit risk. The Company considers and allocates for changes in lending policies, management experience, economic conditions, loans past due, competitive, legal and regulatory environments and other factors. Qualitative factors are benchmarked to historical data and are adjusted based upon quantitative analysis.

Loans that do not share risk characteristics are evaluated on an individual basis. The Company designates loans that have been determined to meet the regulatory definitions of “special mention” or “classified” (together known as “criticized”) as individually evaluated. The fair value of individually evaluated loans is measured using the fair value of collateral (“collateral method”) or the DCF method.

The collateral method is applied to individually evaluated loans for which foreclosure is probable. The collateral method is also applied to individually evaluated loans when borrowers are experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral (“collateral dependent”). The ACCL is measured based on the difference between the fair value of the collateral and the amortized cost basis of the loan as of the measurement date. When repayment is expected to be from the operation of the collateral, the ACCL is calculated as the amount by which the amortized cost basis of the loan exceeds the present value of expected cash flows from the operation of the collateral. When repayment is expected to be from the sale of the collateral, the ACCL is calculated as the amount by which the loan’s amortized cost basis exceeds the fair value of the underlying collateral less estimated cost to sell. The ACCL may be zero if the fair value of the collateral at the measurement date exceeds the amortized cost basis of the loan.

The DCF method is applied to individually evaluated loans that do not meet the criteria for collateral method measurement. Cash flows are projected and discounted using the same method as for collectively evaluated loans, but the PD is increased to reflect increased risk, up to 100% for nonaccrual loans.

Expected credit losses are reflected in the ACLL through a charge to provision for credit losses on the Consolidated Statements of Income. When the Company deems all or a portion of a loan to be uncollectible the appropriate amount is written off against the ACLL. The Company applies judgment to determine when a financial asset is deemed uncollectible; however, generally speaking, an asset will be considered uncollectible no later than when all efforts at collection have been exhausted. Subsequent recoveries, if any, are credited to the ACLL when received.

ACL on Unfunded Commitments

Financial instruments include off-balance sheet credit instruments such as undrawn portions of revolving lines of credit, commercial letters of credit, and loan commitments that have not yet been funded. The contractual amount of those instruments represents the Company's exposure to credit loss in the event of nonperformance by the borrower. The Company records an ACL on unfunded commitments, unless the commitments to extend credit are unconditionally cancelable. The estimate includes consideration of the likelihood that funding will occur, which is based on a historical funding study derived from internal information, and an estimate of expected credit losses on commitments expected to be funded over its estimated life, which are the same loss rates that are used in computing the ACLL. The ACL on unfunded commitments is recorded as a liability on the Company's Consolidated Balance Sheets, included in other liabilities, and is adjusted through the provision for credit loss expense in the Company's Consolidated Statements of Income.

ASU 2022-02

On January 1, 2023, concurrent with its adoption of ASU 2016-13, the Company adopted ASU 2022-02, "Financial Instruments-Credit Losses (Topic 326), Troubled Debt Restructurings and Vintage Disclosures." The amendments eliminate the accounting guidance for troubled debt restructurings ("TDRs") by creditors that have adopted the CECL model and enhance the disclosure requirements for loan refinancings and restructurings made with borrowers experiencing financial difficulty. Disclosures about periods prior to adoption will be presented under GAAP applicable for that period.

Similar to its policy under previous GAAP, the Company continues to identify modifications to loans and to determine whether the borrower is experiencing financial difficulty. If the Company determines that the borrower is experiencing financial difficulty, the loan is designated for financial reporting purposes. Loans that are modified for borrowers experiencing financial difficulty are evaluated to determine whether the credit risk falls within the regulatory definition of "criticized" and requires individual evaluation. Under previous GAAP, modifications to loans when the borrower was experiencing financial difficulty were designated as TDR and were individually evaluated for the duration of the loan.

Note 2: Loans and Allowance for Credit Losses

Loans

The following table presents the composition of the loan portfolio, excluding mortgage loans held for sale, as of the dates indicated.

	September 30, 2023	December 31, 2022
Real estate construction	\$ 64,181	\$ 54,579
Consumer real estate	226,671	221,052
Commercial real estate	424,765	437,888
Commercial non real estate	42,940	57,652
Public sector and IDA	51,591	48,074
Consumer non real estate	39,269	33,948
Gross loans	\$ 849,417	\$ 853,193
Less unearned income and deferred fees and costs	(442)	(449)
Loans, net of unearned income and deferred fees and costs	\$ 848,975	\$ 852,744
Allowance for credit losses on loans	(10,181)	(8,225)
Total loans, net	\$ 838,794	\$ 844,519

Accrued interest receivable on loans, which is excluded from the amortized cost of loans, totaled \$2,760 at September 30, 2023 and \$2,516 at December 31, 2022.

Past Due and Nonaccrual Loans

The following tables present the aging of past due loans, by loan pool, as of the dates indicated.

	September 30, 2023					
	Accruing Current Loans	Accruing Loans 30 – 89 Days Past Due	Accruing Loans 90 or More Days Past Due	Nonaccrual Loans	Total Loans	Accruing and Nonaccrual 90 or More Days Past Due
Real Estate Construction						
Construction, 1-4 family residential	\$ 16,995	\$ -	\$ -	\$ -	\$ 16,995	\$ -
Construction, other	47,165	21	-	-	47,186	-
Consumer Real Estate						
Equity line	16,631	23	-	-	16,654	-
Residential closed-end first liens	122,839	679	7	85	123,610	92
Residential closed-end junior liens	5,009	13	-	-	5,022	-
Investor-owned residential real estate	81,385	-	-	-	81,385	-
Commercial Real Estate						
Multifamily residential real estate	133,188	-	-	-	133,188	-
Commercial real estate owner-occupied	116,089	288	-	2,429	118,806	236
Commercial real estate, other	172,771	-	-	-	172,771	-
Commercial Non Real Estate						
Commercial and industrial	42,452	4	17	467	42,940	252
Public Sector and IDA						
States and political subdivisions	51,591	-	-	-	51,591	-
Consumer Non-Real Estate						
Credit cards	4,570	4	-	-	4,574	-
Automobile	11,933	42	2	-	11,977	3
Other consumer loans	22,615	98	5	-	22,718	5
Total	\$ 845,233	\$ 1,172	\$ 31	\$ 2,981	\$ 849,417	\$ 588

December 31, 2022

	Accruing Current Loans	Accruing Loans 30 – 89 Days Past Due	Accruing Loans 90 or More Days Past Due	Nonaccrual Loans	Total Loans	Accruing and Nonaccrual 90 or More Days Past Due
Real Estate Construction						
Construction, 1-4 family residential	\$ 12,538	\$ -	\$ -	\$ -	\$ 12,538	\$ -
Construction, other	42,041	-	-	-	42,041	-
Consumer Real Estate						
Equity line	15,010	16	-	-	15,026	-
Residential closed-end first liens	121,807	750	-	91	122,648	91
Residential closed-end junior liens	2,446	-	-	-	2,446	-
Investor-owned residential real estate	80,524	408	-	-	80,932	-
Commercial Real Estate						
Multifamily residential real estate	127,312	-	-	-	127,312	-
Commercial real estate owner-occupied	126,640	-	-	2,493	129,133	252
Commercial real estate, other	181,443	-	-	-	181,443	-
Commercial Non Real Estate						
Commercial and industrial	57,373	16	-	263	57,652	-
Public Sector and IDA						
States and political subdivisions	48,074	-	-	-	48,074	-
Consumer Non-Real Estate						
Credit cards	4,592	3	2	-	4,597	2
Automobile	9,833	102	-	-	9,935	-
Other consumer loans	19,317	93	6	-	19,416	6
Total	\$ 848,950	\$ 1,388	\$ 8	\$ 2,847	\$ 853,193	\$ 351

The following table presents nonaccrual loans, by loan class, as of the dates indicated:

	CECL			Incurred Loss	
	September 30, 2023			December 31, 2022	
	Nonaccrual Loans			Nonaccrual Loans	
	With No Allowance	With an Allowance	Total		
Consumer Real Estate					
Residential closed-end first liens	\$ -	\$ 85	\$ 85	\$	91
Commercial Real Estate					
Commercial real estate owner-occupied	-	2,429	2,429	-	2,493
Commercial Non Real Estate					
Commercial and industrial	-	467	467	-	263
Total	\$ -	\$ 2,981	\$ 2,981	\$	2,847

During the three and nine months ended September 30, 2023, no accrued interest receivable was reversed against interest income.

The following table presents certain past due indicators as of the dates indicated.

	September 30,		December 31,
	2023	2022	2022
Ratio of ACLL to nonaccrual loans	341.53 %	284.18%	288.90 %
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees and costs	0.00 %	0.01%	0.00 %

Allowance for Credit Losses on Loans

The following tables present the activity in the ACLL by portfolio segment for the periods indicated:

Activity in the Allowance for Credit Losses on Loans for the Nine Months Ended September 30, 2023

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2022	\$ 450	\$ 2,199	\$ 3,642	\$ 930	\$ 319	\$ 506	\$ 179	\$ 8,225
Adoption of ASU 2016-13	(21)	1,261	700	216	(15)	72	129	2,342
Charge-offs	-	(17)	-	(11)	-	(204)	-	(232)
Recoveries	-	103	37	4	-	91	-	235
Provision for (recovery of) credit losses	133	(353)	(212)	(300)	10	156	177	(389)
Balance, September 30, 2023	\$ 562	\$ 3,193	\$ 4,167	\$ 839	\$ 314	\$ 621	\$ 485	\$ 10,181

Activity in the Allowance for Loan Losses for the Nine Months Ended September 30, 2022

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2021	\$ 422	\$ 1,930	\$ 3,121	\$ 1,099	\$ 297	\$ 444	\$ 361	\$ 7,674
Charge-offs	-	(13)	-	(2)	-	(301)	-	(316)
Recoveries	-	29	36	10	-	78	-	153
Provision for (recovery of) loan losses	225	266	452	(329)	39	263	(220)	696
Balance, September 30, 2022	\$ 647	\$ 2,212	\$ 3,609	\$ 778	\$ 336	\$ 484	\$ 141	\$ 8,207

Activity in the Allowance for Loan Losses for the Year Ended December 31, 2022

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2021	\$ 422	\$ 1,930	\$ 3,121	\$ 1,099	\$ 297	\$ 444	\$ 361	\$ 7,674
Charge-offs	-	(13)	-	(2)	-	(352)	-	(367)
Recoveries	-	29	49	11	-	123	-	212
Provision for (recovery of) loan losses	28	253	472	(178)	22	291	(182)	706
Balance, December 31, 2022	\$ 450	\$ 2,199	\$ 3,642	\$ 930	\$ 319	\$ 506	\$ 179	\$ 8,225

The following tables present information about the ACLL for individually evaluated loans and collectively evaluated loans by portfolio segment as of the dates indicated.

Allowance for Credit Losses on Loans as of September 30, 2023

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated	\$ -	\$ 78	\$ 548	\$ 248	\$ -	\$ 1	\$ -	\$ 875
Collectively evaluated	562	3,115	3,619	591	314	620	485	9,306
Total	\$ 562	\$ 3,193	\$ 4,167	\$ 839	\$ 314	\$ 621	\$ 485	\$ 10,181

Allowance for Loan Losses as of December 31, 2022

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non- Real Estate	Unallocated	Total
Individually evaluated	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated	450	2,199	3,642	930	319	506	179	8,225
Total	\$ 450	\$ 2,199	\$ 3,642	\$ 930	\$ 319	\$ 506	\$ 179	\$ 8,225

The following tables present information about individually evaluated loans and collectively evaluated loans by portfolio segment as of the dates indicated.

Loans as of September 30, 2023

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Total
Individually evaluated	\$ 288	\$ 1,059	\$ 8,826	\$ 473	\$ -	\$ 12	\$ 10,658
Collectively evaluated	63,893	225,612	415,939	42,467	51,591	39,257	838,759
Total	\$ 64,181	\$ 226,671	\$ 424,765	\$ 42,940	\$ 51,591	\$ 39,269	\$ 849,417

Loans as of December 31, 2022

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non- Real Estate	Total
Individually evaluated	\$ -	\$ 186	\$ 2,583	\$ 263	\$ -	\$ -	\$ 3,032
Collectively evaluated	54,579	220,866	435,305	57,389	48,074	33,948	850,161
Total	\$ 54,579	\$ 221,052	\$ 437,888	\$ 57,652	\$ 48,074	\$ 33,948	\$ 853,193

The following table presents ratios pertaining to the ACLL as of the dates and for the periods indicated.

	As of and for the		
	Nine Months Ended		Year Ended
	September 30,	September 30,	December 31,
	2023	2022	2022
Ratio of ACLL to the end of period loans, net of unearned income and deferred fees and costs	1.20 %	0.96%	0.96 %
Ratio of net charge-offs, annualized, to average loans, net of unearned income and deferred fees and costs	0.00 %	0.03%	0.02 %

In accordance with CECL, the Company identifies individually evaluated loans when their risk characteristics become different from their pool. Under previous GAAP, the Company identified loans for potential impairment through a variety of means, including, but not limited to, ongoing loan review, renewal processes, delinquency data, market communications, and public information. When the Company determined that it was probable all principal and interest amounts due would not be collected in accordance with the contractual terms of the loan agreement, the loan was generally deemed impaired and individually evaluated. For further information on the impairment process under previous GAAP, please refer to the Company's 2022 Form 10-K. A summary of individually evaluated loans as of the date indicated follows.

Individually Evaluated Loans under Incurred Loss as of December 31, 2022

	Principal Balance	Recorded Investment ⁽¹⁾	Recorded Investment ⁽¹⁾ for Which There is No Related Allowance	Recorded Investment ⁽¹⁾ for Which There is a Related Allowance	Related Allowance
Consumer Real Estate					
Investor-owned residential real estate	\$ 186	\$ 186	\$ 186	\$ -	\$ -
Commercial Real Estate					
Commercial real estate, owner occupied	3,248	2,583	2,583	-	-
Commercial Non Real Estate					
Commercial and industrial	285	263	263	-	-
Total	\$ 3,719	\$ 3,032	\$ 3,032	\$ -	\$ -

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

The following table shows the average recorded investment and interest income recognized for individually evaluated loans under the incurred loss model for the period indicated. Only classes with individually evaluated loans are presented.

	For the Nine Months Ended September 30, 2022	
	Average Recorded Investment ⁽¹⁾	Interest Income Recognized
Consumer Real Estate		
Investor-owned residential real estate	\$ 189	\$ 9
Commercial Real Estate		
Commercial real estate, owner occupied	2,601	4
Commercial Non-Real Estate		
Commercial and industrial	277	-
Total	\$ 3,067	\$ 13

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

Collateral Dependent Loans

The Company reviews individually evaluated loans to identify collateral dependency. Loans are collateral dependent when repayment is expected substantially through the operation or sale of the collateral and the borrower is experiencing financial difficulty. The Company adopted the practical expedient provided by ASU 2016-13 to measure the ACL on collateral dependent loans based upon the fair value of the collateral. Fair value of the collateral is adjusted for liquidation costs/discounts. If the fair value of the collateral falls below the amortized cost of the loan, the shortfall is recognized in the ACLL. If the fair value of the collateral exceeds the amortized cost, no ACL is required. As of September 30, 2023, one of the Company's individually evaluated loans was considered collateral dependent.

All collateral loans are secured by real estate as of September 30, 2023. The following table details the amortized cost of the collateral dependent loan as of the date indicated:

September 30, 2023	Balance	Related Allowance
Consumer Real Estate		
Residential closed-end first lien	\$ 7	-
Total Loans	\$ 7	-

Credit Quality

The Company categorizes loans by risk based on relevant information about the ability of borrowers to service their debt, including: collateral and financial information, historical payment experience, credit documentation and current economic trends, among other factors. At origination, each loan is assigned a risk rating. Ongoing analysis of the loan portfolio adjusts risk ratings on an individual loan basis to reflect updated information. General descriptions of risk ratings are as follows:

- Pass: loans with acceptable credit quality are rated pass.
- Special mention: loans with potential weaknesses due to challenging economic or financial conditions are rated special mention.
- Classified: loans with well-defined weaknesses that heighten the risk of default are rated classified.

The following table presents the amortized cost basis of the loan portfolio, by year of origination, loan class, and credit quality, as of the date indicated.

September 30, 2023	Term Loans Amortized Cost Basis by Origination Year						Revolving	Revolving Loans Converted to Term	Total
	Prior	2019	2020	2021	2022	2023			
Construction, residential									
Pass	\$ -	\$ -	\$ 233	\$ 121	\$ 3,787	\$ 2,705	\$ 10,149	\$ -	\$ 16,995
Construction, other									
Pass	\$ 3,196	\$ 1,111	\$ 1,411	\$ 23,163	\$ 11,577	\$ 4,375	\$ 2,065	\$ -	\$ 46,898
Classified	-	-	-	288	-	-	-	-	288
Total	\$ 3,196	\$ 1,111	\$ 1,411	\$ 23,451	\$ 11,577	\$ 4,375	\$ 2,065	\$ -	\$ 47,186
Equity lines									
Pass	\$ 53	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 16,553	\$ 6	\$ 16,612
Classified	-	-	-	-	-	-	42	-	42
Total	\$ 53	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 16,595	\$ 6	\$ 16,654
Residential closed-end first liens									
Pass	\$ 33,129	\$ 5,874	\$ 14,784	\$ 32,074	\$ 28,768	\$ 8,681	\$ -	\$ -	\$ 123,310
Classified	300	-	-	-	-	-	-	-	300
Total	\$ 33,429	\$ 5,874	\$ 14,784	\$ 32,074	\$ 28,768	\$ 8,681	\$ -	\$ -	\$ 123,610
YTD gross charge-offs	\$ -	\$ -	\$ 17	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 17
Residential closed-end junior liens									
Pass	\$ 1,749	\$ 118	\$ -	\$ 175	\$ 1,395	\$ 1,570	\$ -	\$ 15	\$ 5,022
Investor-owned residential real estate									
Pass	\$ 23,141	\$ 5,215	\$ 14,348	\$ 19,475	\$ 13,888	\$ 3,093	\$ 1,409	\$ 99	\$ 80,668
Classified	717	-	-	-	-	-	-	-	717
Total	\$ 23,858	\$ 5,215	\$ 14,348	\$ 19,475	\$ 13,888	\$ 3,093	\$ 1,409	\$ 99	\$ 81,385
Multifamily residential real estate									
Pass	\$ 42,874	\$ 1,823	\$ 11,820	\$ 40,944	\$ 26,874	\$ 8,853	\$ -	\$ -	\$ 133,188
Commercial real estate, owner occupied									
Pass	\$ 43,438	\$ 11,295	\$ 23,661	\$ 4,843	\$ 16,731	\$ 7,757	\$ 2,255	\$ -	\$ 109,980
Special mention	6,396	-	-	-	-	-	-	-	6,396
Classified	2,430	-	-	-	-	-	-	-	2,430
Total	\$ 52,264	\$ 11,295	\$ 23,661	\$ 4,843	\$ 16,731	\$ 7,757	\$ 2,255	\$ -	\$ 118,806
Commercial real estate, other									
Pass	\$ 70,064	\$ 22,033	\$ 19,300	\$ 36,272	\$ 22,600	\$ 1,957	\$ 545	\$ -	\$ 172,771

Commercial and industrial

Pass	\$ 6,100	\$ 494	\$ 1,189	\$ 13,059	\$ 7,439	\$ 6,634	\$ 7,552	\$ -	\$ 42,467
Classified	231	-	-	-	7	-	235	-	473
Total	\$ 6,331	\$ 494	\$ 1,189	\$ 13,059	\$ 7,446	\$ 6,634	\$ 7,787	\$ -	\$ 42,940
YTD gross charge-offs	\$ -	\$ 11	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 11

Public sector and IDA

Pass	\$ 20,942	\$ 14	\$ 239	\$ 17,683	\$ 6,438	\$ 6,275	\$ -	\$ -	\$ 51,591
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Credit cards

Pass	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,574	\$ -	\$ 4,574
YTD gross charge-offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 35	\$ -	\$ 35

Automobile

Pass	\$ 95	\$ 307	\$ 680	\$ 1,846	\$ 3,146	\$ 5,900	\$ -	\$ -	\$ 11,974
Classified	-	3	-	-	-	-	-	-	3
Total	\$ 95	\$ 310	\$ 680	\$ 1,846	\$ 3,146	\$ 5,900	\$ -	\$ -	\$ 11,977
YTD gross charge-offs	\$ -	\$ -	\$ -	\$ 1	\$ 38	\$ -	\$ -	\$ -	\$ 39

Other consumer

Pass	\$ 136	\$ 380	\$ 941	\$ 2,273	\$ 6,770	\$ 11,206	\$ 1,003	\$ -	\$ 22,709
Classified	-	-	-	-	1	8	-	-	9
Total	\$ 136	\$ 380	\$ 941	\$ 2,273	\$ 6,771	\$ 11,214	\$ 1,003	\$ -	\$ 22,718
YTD gross charge-offs	\$ -	\$ -	\$ -	\$ 19	\$ 42	\$ 6	\$ 63	\$ -	\$ 130

Total Loans

Pass	\$ 244,917	\$ 48,664	\$ 88,606	\$ 191,928	\$ 149,413	\$ 69,006	\$ 46,105	\$ 120	\$ 838,759
Special Mention	6,396	-	-	-	-	-	-	-	6,396
Classified	3,678	3	-	288	8	8	277	-	4,262
Total	\$ 254,991	\$ 48,667	\$ 88,606	\$ 192,216	\$ 149,421	\$ 69,014	\$ 46,382	\$ 120	\$ 849,417
YTD gross charge-offs	\$ -	\$ 11	\$ 17	\$ 20	\$ 80	\$ 6	\$ 98	\$ -	\$ 232

The following table presents the recorded investment by loan pool and credit quality as of December 31, 2022.

	December 31, 2022		
	Pass	Special Mention	Classified
Real Estate Construction			
Construction, 1-4 family residential	\$ 12,538	\$ -	\$ -
Construction, other	41,741	-	300
Consumer Real Estate			
Equity lines	15,026	-	-
Residential closed-end first liens	122,187	-	461
Residential closed-end junior liens	2,446	-	-
Investor-owned residential real estate	80,143	-	603
Commercial Real Estate			
Multifamily residential real estate	127,312	-	-
Commercial real estate owner-occupied	126,550	-	-
Commercial real estate, other	181,443	-	-
Commercial Non Real Estate			
Commercial and industrial	57,381	-	8
Public Sector and IDA			
States and political subdivisions	48,074	-	-
Consumer Non-Real Estate			
Credit cards	4,597	-	-
Automobile	9,932	-	3
Other consumer	19,398	-	18
Total	\$ 848,768	\$ -	\$ 1,393

Loan Modifications to Borrowers Experiencing Financial Difficulty

The Company modifies loans for a variety of reasons. At the date of modification, the Company assesses whether the borrower is experiencing financial difficulty. If the borrower is experiencing financial difficulty, the loan's risk rating is evaluated and is typically changed to special mention or classified, which results in individual evaluation of the loan for the ACLL. The Company modified one loan to a borrower experiencing financial difficulty during the nine month period ended September 30, 2023. No loans were modified for borrowers experiencing financial difficulty during the three months period ended September 30, 2023. During the three and nine month periods ended September 30, 2022, no loans were modified for borrowers experiencing financial difficulty.

The following table presents the amortized cost basis as of September 30, 2023 of the loan modified for a borrower experiencing financial difficulty.

	Interest Only Payments		
	Amortized Cost Basis	% of Portfolio	Financial Effect
Commercial Real Estate			
Commercial real estate owner-occupied	\$ 6,396	5.38 %	6 months of interest only payments, after which remaining balance will be re-amortized to the contractual maturity date.

The Company closely monitors the performance of the loans that are modified to borrowers experiencing financial difficulty. The commercial real estate owner-occupied loan is in current status as of September 30, 2023.

The Company analyzed its modified loan portfolio for loans that defaulted during the three and nine month period ended September 30, 2023, and that were modified within 12 months prior to default. The Company designates three circumstances that indicate default: one or more payments that occur more than 90 days past the due date, charge-off, or foreclosure after the date of modification. Of the Company's modifications at September 30, 2023, none were modified within 12 months prior to default.

ACL on Unfunded Commitments

The following table presents the balance and activity in the ACL for unfunded commitments for the nine months ended September 30, 2023:

Allowance for Credit Losses on Unfunded Commitments	
Balance, December 31, 2022	\$ 35
Adoption of ASU 2016-13	207
Provision for credit losses	21
Balance, September 30, 2023	\$ 263

Note 3: Securities

The amortized cost and estimated fair value of securities available for sale along with gross unrealized gains and losses as of the dates indicated are summarized as follows:

	September 30, 2023				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
Available for Sale:					
U.S. Treasuries	\$ 995	\$ -	\$ 47	\$ -	\$ 948
U.S. Government agencies and corporations	353,845	-	57,856	-	295,989
States and political subdivisions	179,672	-	42,603	-	137,069
Mortgage-backed securities	161,067	-	8,955	-	152,112
Corporate debt securities	6,504	-	1,070	-	5,434
Total securities available for sale	\$ 702,083	\$ -	\$ 110,531	\$ -	\$ 591,552

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale:				
U.S. Treasuries	\$ 992	\$ -	\$ 56	\$ 936
U.S. Government agencies and corporations	391,538	39	55,002	336,575
States and political subdivisions	190,192	26	38,018	152,200
Mortgage-backed securities	170,694	22	9,239	161,477
Corporate debt securities	6,501	-	837	5,664
Total securities available for sale	\$ 759,917	\$ 87	\$ 103,152	\$ 656,852

No allowance for credit loss on securities available for sale was recorded as of September 30, 2023.

Accrued interest receivable on securities, included in accrued interest receivable on the Consolidated Balance Sheets, totaled \$3,420 at September 30, 2023 and \$3,485 at December 31, 2022.

The deferred tax asset for the net unrealized loss on securities available for sale was \$23,211 as of September 30, 2023 and \$21,644 as of December 31, 2022. The deferred tax asset is included in other assets on the Consolidated Balance Sheets.

The amortized cost and fair value of single maturity securities available for sale at September 30, 2023, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities included in these totals are categorized by final maturity.

	September 30, 2023	
	Amortized Cost	Fair Value
Available for Sale:		
Due in one year or less	\$ 1,755	\$ 1,730
Due after one year through five years	154,209	140,650
Due after five years through ten years	293,046	239,668
Due after ten years	253,073	209,504
Total securities available for sale	\$ 702,083	\$ 591,552

Information pertaining to securities with gross unrealized losses aggregated by investment category and length of time that the individual securities have been in a continuous loss position, as of the dates indicated, follows.

	September 30, 2023			
	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasuries	\$ -	\$ -	\$ 948	\$ 47
U.S. Government agencies and corporations	-	-	295,989	57,856
States and political subdivisions	845	41	135,979	42,562
Mortgage-backed securities	1,664	39	150,448	8,916
Corporate debt securities	-	-	5,434	1,070
Total temporarily impaired securities	\$ 2,509	\$ 80	\$ 588,798	\$ 110,451

	December 31, 2022			
	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasuries	\$ 936	\$ 56	\$ -	\$ -
U.S. Government agencies and corporations	144,574	12,699	190,950	42,303
States and political subdivisions	94,657	18,373	52,134	19,645
Mortgage-backed securities	144,198	7,326	15,165	1,913
Corporate debt securities	4,843	655	821	182
Total temporarily impaired securities	\$ 389,208	\$ 39,109	\$ 259,070	\$ 64,043

The Company evaluates securities available for sale that are in unrealized loss positions to determine whether the impairment is due to credit-related factors or noncredit-related factors. Consideration is given to the extent to which the fair value is less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2023, the Company had 577 securities with a fair value of \$591,307 in an unrealized loss position. The Company reviews securities in an unrealized loss position to evaluate credit risk. The Company considers payment history, risk ratings from external parties, financial statements for municipal and corporate securities, public statements from issuers and other available credible published sources in evaluating credit risk. No credit risk was found and no ACL on securities available for sale was recorded as of September 30, 2023. The unrealized losses are attributed to noncredit-related factors, including changes in interest rates and other market conditions. The Company does not have the intent to sell any of these securities and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. The contractual terms of the investments do not permit the issuers to settle the securities at a price less than the cost basis of the investments. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline.

Restricted Stock.

The Company holds restricted stock that is reported separately from available for sale securities. As a member of the Federal Reserve and the Federal Home Loan Bank of Atlanta (“FHLB”), NBB is required to maintain certain minimum investments in the common stock of those entities. Required levels of investment are based upon NBB’s capital and a percentage of qualifying assets. The Company purchases stock from or sells stock back to the correspondents based on their calculations. The stock is held by member institutions only and is not actively traded.

Redemption of FHLB stock is subject to certain limitations and conditions. At its discretion, the FHLB may declare dividends on the stock. In addition to dividends, NBB also benefits from its membership with FHLB through eligibility to borrow from the FHLB, using as collateral NBB’s capital stock investment in the FHLB and qualifying NBB real estate mortgage loans totaling \$510,786 at September 30, 2023. The Company’s management reviews for impairment based upon the ultimate recoverability of the cost basis of the FHLB stock, and at September 30, 2023, did not determine any impairment.

Note 4: Defined Benefit Plan

The following tables present components of Net Periodic Benefit Cost for the periods indicated:

	Pension Benefits	
	Three Months Ended September 30,	
	2023	2022
Service cost	\$ 203	\$ 324
Interest cost	273	204
Expected return on plan assets	(518)	(629)
Amortization of prior service cost	-	-
Recognized net actuarial loss	17	110
Net periodic benefit (income) cost	\$ (25)	\$ 9

	Pension Benefits	
	Nine Months Ended September 30,	
	2023	2022
Service cost	\$ 609	\$ 972
Interest cost	819	612
Expected return on plan assets	(1,553)	(1,887)
Amortization of prior service cost	-	-
Recognized net actuarial loss	52	330
Net periodic benefit (income) cost	\$ (73)	\$ 27

The service cost component of net periodic benefit cost is included in salaries and employee benefits expense in the Consolidated Statements of Income. All other components are included in other noninterest expense in the Consolidated Statements of Income. No contributions to the defined benefit plan have been made during 2023.

Note 5: Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP requires that valuation techniques maximize the use of the observable inputs and minimize the use of the unobservable inputs. GAAP also establishes a fair value hierarchy which prioritizes the valuation inputs into three broad levels. Based on the underlying inputs, each fair value measurement in its entirety is reported in one of the three levels. These levels are:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including:

- quoted prices in active markets for similar assets and liabilities,
- quoted prices for identical or similar assets and liabilities in less active markets,
- inputs other than quoted prices that are observable, and
- model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

Fair value is best determined by quoted market prices. However, in cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, fair value estimates may not be realized in an immediate settlement of the instrument. Accounting guidance for fair value excludes certain financial instruments and all nonfinancial instruments from disclosure requirements. Consequently, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company. The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the consolidated financial statements.

Financial Instruments Measured at Fair Value on a Recurring Basis

Securities Available for Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). The carrying value of restricted Federal Reserve Bank of Richmond and FHLB stock approximates fair value based upon the redemption provisions of each entity and is therefore excluded from the following tables. The following tables present the balances of financial assets measured at fair value on a recurring basis as of the dates indicated.

September 30, 2023

Description	Balance	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
U.S. Treasuries	\$ 948	\$ -	\$ 948	\$ -
U.S. Government agencies and corporations	295,989	-	295,989	-
States and political subdivisions	137,069	-	137,069	-
Mortgage-backed securities	152,112	-	152,112	-
Corporate debt securities	5,434	-	5,434	-
Total securities available for sale	\$ 591,552	\$ -	\$ 591,552	\$ -

December 31, 2022

Description	Balance	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
U.S. Treasuries	\$ 936	\$ -	\$ 936	\$ -
U.S. Government agencies and corporations	336,575	-	336,575	-
States and political subdivisions	152,200	-	152,200	-
Mortgage-backed securities	161,477	-	161,477	-
Corporate debt securities	5,664	-	5,664	-
Total securities available for sale	\$ 656,852	\$ -	\$ 656,852	\$ -

The Company's securities portfolio is valued using Level 2 inputs. The Company relies on an independent third party vendor to provide market valuations. The inputs used to determine value include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data including market research publications. The third party vendor also monitors market indicators, industry activity and economic events as part of the valuation process. Central to the final valuation is the assumption that the indicators used are representative of the fair value of securities held within the Company's portfolio. Level 2 inputs are subject to a certain degree of uncertainty and changes in these assumptions or methodologies in the future, if any, may impact securities fair value, deferred tax assets or liabilities, or expense.

Financial Instruments Measured at Fair Value on a Non-Recurring Basis

Certain financial instruments are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the consolidated financial statements.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale at September 30, 2023 or December 31, 2022.

Collateral Dependent Loans

Loans that do not share risk characteristics with the rest of their class and that are collateral dependent are individually evaluated on a non-recurring basis using the fair value of collateral. If the fair value of the collateral is lower than the loan's amortized cost basis, the shortfall is recognized in the ACLL. When repayment is expected from the operation of the collateral, fair value is estimated as the present value of expected cash flows from the operation of the collateral. When repayment is expected from the sale of the collateral, fair value is estimated using measurement techniques discussed below and discounted by the estimated cost to sell. The ACLL may be zero if the fair value of the collateral at the measurement date exceeds the amortized cost basis of the financial asset.

For loans secured by real estate, fair value of collateral is determined by the "as-is" value of appraisals or third party evaluations that are less than 24 months of age. Appraisals are prepared by independent, licensed appraisers. Appraisals are based upon observable market data analyzed through an income or sales valuation approach. Valuation falls within Level 2 categorization. The Company may further discount appraisals for marketing strategies, which results in Level 3 categorization.

The value of business equipment is based upon an outside appraisal (Level 2) if deemed significant, or the net book value on the applicable business' financial statements (Level 3) if not considered significant. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3).

As of September 30, 2023, one consumer real estate loan with a balance of \$7 was collateral dependent. The valuation was based upon a third party evaluation (Level 2) and did not result in a specific allocation. As of December 31, 2022, measurement of the Company's impaired loans did not result in any specific allocations.

Other Real Estate Owned ("OREO")

Certain assets such as OREO are measured at fair value less cost to sell. Valuation of OREO is determined using current appraisals from independent parties, a Level 2 input. The Company works with a realtor to determine the list price, which may be set at appraised value or at a different amount based on the realtor's advice and management's judgement of marketability. Discounts to appraisals for selling costs or for marketability result in a Level 3 estimate.

The following table summarizes the Company's OREO that was measured at fair value on a nonrecurring basis as of the dates indicated.

Date	Description	Balance	Level 1	Level 2	Level 3
September 30, 2023	OREO, net of valuation allowance	\$ 662	\$ -	\$ -	\$ 662
December 31, 2022	OREO, net of valuation allowance	662	-	-	662

The following table presents information about OREO and Level 3 Fair Value Measurements as of the dates indicated.

Date	Valuation Technique	Unobservable Input	Range (Weighted Average)
September 30, 2023	Discounted appraised value	Selling cost	7.00%
September 30, 2023	Discounted appraised value	Discount for lack of marketability	34.72%
December 31, 2022	Discounted appraised value	Selling cost	7.00%
December 31, 2022	Discounted appraised value	Discount for lack of marketability	34.72%

At September 30, 2023 and December 31, 2022, the Company held a single OREO property, measured using appraised value, discounted for marketability and selling cost. During 2022, the Company reduced the list price as part of a marketing strategy and recorded an additional discount for marketability.

There is uncertainty in determining discounts to appraised value. If the final sale price is different from the list price, the amount of selling costs will also be different from those estimated. Future changes to marketability assumptions or updated appraisals may indicate a lower fair value, with a corresponding impact to net income. Ultimate proceeds from the sale of OREO property may be less than the estimated fair value, reducing net income.

Fair Value Summary

The following presents the recorded amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of the dates indicated. Fair values are estimated using the exit price notion.

	September 30, 2023			
	Recorded Amount	Level 1	Level 2	Level 3
Financial Assets:				
Cash and due from banks	\$ 13,089	\$ 13,089	\$ -	\$ -
Interest-bearing deposits	40,353	40,353	-	-
Securities available for sale, at fair value	591,552	-	591,552	-
Restricted securities	1,264	-	1,264	-
Mortgage loans held for sale	82	-	82	-
Loans, net	838,794	-	-	792,126
Accrued interest receivable	6,180	-	6,180	-
Bank-owned life insurance	43,327	-	43,327	-
Financial Liabilities:				
Deposits	\$ 1,465,000	\$ -	\$ 1,277,115	\$ 186,480
Accrued interest payable	551	-	551	-

	December 31, 2022			
	Recorded Amount	Level 1	Level 2	Level 3
Financial Assets:				
Cash and due from banks	\$ 12,403	\$ 12,403	\$ -	\$ -
Interest-bearing deposits	59,026	59,026	-	-
Securities available for sale, at fair value	656,852	-	656,852	-
Restricted securities	941	-	941	-
Loans, net	844,519	-	-	781,749
Accrued interest receivable	6,001	-	6,001	-
Bank-owned life insurance	43,312	-	43,312	-
Financial Liabilities:				
Deposits	\$ 1,542,725	\$ -	\$ 1,475,096	\$ 67,542
Accrued interest payable	106	-	106	-

Note 6: Components of Accumulated Other Comprehensive Loss

The following tables provide information about components of accumulated other comprehensive loss as of the dates indicated:

	Net Unrealized Loss on Securities	Adjustments Related to Pension Benefits	Accumulated Other Comprehensive Loss
Balance at June 30, 2022	\$ (55,865)	\$ (6,912)	\$ (62,777)
Unrealized holding loss on available for sale securities, net of tax of (\$7,822)	(29,424)	-	(29,424)
Balance at September 30, 2022	\$ (85,289)	\$ (6,912)	\$ (92,201)
Balance at June 30, 2023	\$ (71,898)	\$ (2,345)	\$ (74,243)
Unrealized holding loss on available for sale securities, net of tax of (\$4,099)	(15,421)	-	(15,421)
Balance at September 30, 2023	\$ (87,319)	\$ (2,345)	\$ (89,664)

	Net Unrealized Gain (Loss) on Securities	Adjustments Related to Pension Benefits	Accumulated Other Comprehensive Loss
Balance at December 31, 2021	\$ 2,854	\$ (6,912)	\$ (4,058)
Unrealized holding loss on available for sale securities, net of tax of (\$23,431)	(88,143)	-	(88,143)
Balance at September 30, 2022	\$ (85,289)	\$ (6,912)	\$ (92,201)
Balance at December 31, 2022	\$ (81,421)	\$ (2,345)	\$ (83,766)
Unrealized holding loss on available for sale securities, net of tax of (\$2,268)	(8,530)	-	(8,530)
Reclassification adjustment, net of tax of \$700	2,632	-	2,632
Balance at September 30, 2023	\$ (87,319)	\$ (2,345)	\$ (89,664)

Note 7: Revenue Recognition

Substantially all of the Company's revenue is generated from contracts with customers. Noninterest revenue streams such as service charges on deposit accounts, other service charges and fees, credit and debit card fees, trust income, and annuity and insurance commissions are recognized in accordance with Accounting Standards Codification ("ASC") Topic 606, "Revenue from Contracts with Customers". Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as financial guarantees, derivatives, and certain credit card fees are outside the scope of the guidance. Noninterest revenue streams within the scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of monthly service fees, overdraft and nonsufficient funds fees, ATM fees, wire transfer fees, and other deposit account related fees. The Company's performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Wire transfer fees, overdraft and nonsufficient funds fees and other deposit account related fees are transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time.

Other Service Charges and Fees

Other service charges include safe deposit box rental fees, check ordering charges, and other service charges. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Check ordering charges are transactional based, and therefore the Company's performance obligation is satisfied, and related revenue recognized, at a point in time.

Credit and Debit Card Fees

Credit and debit card fees are primarily comprised of interchange fee income and merchant services income. Interchange fees are earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa and MasterCard. Merchant services income mainly represents commission fees based upon merchant processing volume. The Company's performance obligation for interchange fee income and merchant services income are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. In compliance with Topic 606, credit and debit card fee income is presented net of associated expense.

Trust Income

Trust income is primarily comprised of fees earned from the management and administration of trusts and estates and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end through a direct charge to customers' accounts. The Company does not earn performance-based incentives. Estate management fees are based upon the size of the estate. A partial fee is recognized half-way through the estate administration and the remainder of the fee is recognized when remaining assets are distributed and the estate is closed.

Insurance and Investment

Insurance income primarily consists of commissions received on insurance product sales. The Company acts as an intermediary between the Company's customer and the insurance carrier. The Company's performance obligation is generally satisfied upon the issuance of the insurance policy. Shortly after the insurance policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue.

Investment income consists of recurring revenue streams such as commissions from sales of mutual funds and other investments. Commissions from the sale of mutual funds and other investments are recognized on trade date, which is when the Company has satisfied its performance obligation. The Company also receives periodic service fees (i.e., trailers) from mutual fund companies typically based on a percentage of net asset value. Trailer revenue is recorded over time, usually monthly or quarterly, as net asset value is determined.

OREO Gains and Losses

The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer.

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the periods indicated.

Noninterest Income	Three Months Ended September 30,	
	2023	2022
<i>In-scope of Topic 606:</i>		
Service charges on deposit accounts	\$ 642	\$ 661
Other service charges and fees	151	51
Credit and debit card fees, net	395	448
Trust income	505	492
Insurance and Investment (included within Other Income on the Consolidated Statements of Income)	142	143
Noninterest Income (in-scope of Topic 606)	\$ 1,835	\$ 1,795
Noninterest Income (out-of-scope of Topic 606)	280	345
Total noninterest income	\$ 2,115	\$ 2,140

Noninterest Income	Nine Months Ended September 30,	
	2023	2022
<i>In-scope of Topic 606:</i>		
Service charges on deposit accounts	\$ 1,871	\$ 1,826
Other service charges and fees	253	157
Credit and debit card fees, net	1,276	1,423
Trust income	1,431	1,374
Insurance and Investment (included within Other Income on the Consolidated Statements of Income)	539	491
Noninterest Income (in-scope of Topic 606)	\$ 5,370	\$ 5,271
Noninterest Income (out-of-scope of Topic 606)	1,735	1,272
Total noninterest income	\$ 7,105	\$ 6,543

Note 8: Leases

The Company's leases are recorded under ASC Topic 842, "Leases". The Company examines its contracts to determine whether they are or contain a lease. A contract with a lease is further examined to determine whether the lease is a short-term, operating or finance lease. As permitted by ASC Topic 842, the Company elected not to capitalize short-term leases, defined by the standard as leases with terms of 12 months or less. The Company also elected the practical expedient not to separate non-lease components from lease components within a single contract.

Right-of-use assets and lease liabilities are recognized for operating and finance leases. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor. Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease.

Lease payments

Lease payments for short-term leases are recognized as lease expense on a straight-line basis over the lease term, or for variable lease payments, in the period in which the obligation was incurred. Payments for leases with terms longer than 12 months are included in the determination of the lease liability. Payments may be fixed for the term of the lease or variable. Variable payments result when the lease agreement includes a clause providing for escalation of lease payments at specified dates. If the escalation factor is known, such as a specified percentage increase per year or a stated increase at a specified time, the variable payment is included in the cash flows used to determine the lease liability. If the variable payment is based upon an unknown escalator, such as the consumer price index at a future date, the increase is not included in the cash flows used to determine the lease liability. One of the Company's leases provides a known escalator that is included in the determination of the lease liability. The remaining leases do not have variable payments during the term of the lease.

Options to Extend, Residual Value Guarantees, and Restrictions and Covenants

Of the Company's six operating leases as of September 30, 2023, four leases offer the option to extend the lease term. Two of the leases have two options of five years each and one lease has two options of three years each. Another lease has one option to extend the term for an additional five years. The Company exercised a previous option to extend this lease in 2020. At the time of capitalization, the Company was not reasonably certain whether it would exercise the options and did not include the time period in the calculation of the lease liability. The lease agreements provide that the lease payment will increase at the exercise date based on the Consumer Price Index for All Urban Consumers ("CPI-U"). Because the CPI-U at the exercise date is unknown, the increase is not included in the cash flows determining the lease liability. None of the Company's leases provide for residual value guarantees and none provide restrictions or covenants that would impact dividends or require incurring additional financial obligations.

The contracts in which the Company is lessee are with parties external to the Company and not related parties. The Company's lease right of use asset is included in other assets and the lease liability is included in other liabilities. The following tables present information about leases as of the dates and for the periods indicated:

	September 30, 2023	December 31, 2022
Lease liability	\$ 1,205	\$ 1,444
Right-of-use asset	\$ 1,175	\$ 1,415
Weighted average remaining lease term	4.58 years	5.14 years
Weighted average discount rate	3.29 %	3.29%

Lease Expense	For the Three Months Ended September 30,	
	2023	2022
Operating lease expense	\$ 91	\$ 84
Short-term lease expense	10	1
Total lease expense	\$ 101	\$ 85
Cash paid for amounts included in lease liabilities	\$ 100	\$ 83
Right-of-use assets obtained in exchange for operating lease liabilities commencing during the period	\$ -	\$ 79

Lease Expense	For the Nine Months Ended September 30,	
	2023	2022
Operating lease expense	\$ 275	\$ 238
Short-term lease expense	11	2
Total lease expense	\$ 286	\$ 240
Cash paid for amounts included in lease liabilities	\$ 286	\$ 239
Right-of-use assets obtained in exchange for operating lease liabilities commencing during the period	\$ -	\$ 104

The following table presents a maturity schedule of undiscounted cash flows that contribute to the lease liability:

Undiscounted Cash Flow for the Period	As of September 30, 2023
Twelve months ending September 30, 2024	\$ 351
Twelve months ending September 30, 2025	289
Twelve months ending September 30, 2026	219
Twelve months ending September 30, 2027	187
Twelve months ending September 30, 2028	189
Thereafter	64
Total undiscounted cash flows	\$ 1,299
Less: discount	(94)
Lease liability	\$ 1,205

The contracts in which the Company is lessee are not with related parties.

Note 9: Stock Based Compensation

The Company's 2023 Stock Incentive Plan ("the Plan") was approved by shareholders at the annual shareholder's meeting on May 9, 2023. The Plan provides for the grant of various forms of stock-based compensation awards that may be settled in, or based upon the value of, the Company's common stock. The maximum number of shares available for issuance under the Plan is 120,000 shares. For further information on the Plan, refer to the Company's Proxy Statement filed with the SEC on March 10, 2023 and the Company's S-8 filed with the SEC on June 7, 2023.

Restricted Stock Awards

Under the Plan, part of the June 2023 semi-annual retainer for non-employee directors was paid in restricted stock awards ("RSAs"). A summary of changes in the Company's nonvested RSAs under the Plan for the three months ended September 30, 2023 follows:

	Shares	Weighted-Average Grant- Date Fair Value
Nonvested at July 1, 2023	2,052	\$ 30.70
Granted	-	-
Nonvested at September 30, 2023	2,052	\$ 30.70

The RSAs have a one year vesting period. Expense for the RSAs will be recognized over the vesting period based on the fair value of the stock at the issue date. Stock based compensation expense charged against income was \$16 for the three months ended September 30, 2023 and \$21 for the nine months ended September 30, 2023. As of September 30, 2023, expense of \$42 related to the nonvested RSAs is expected to be recognized over the coming 8 months.

Note 10: Earnings Per Share

The factors used in the earnings per share computation for the periods indicated are presented below:

<i>\$ in thousands, except per share amounts</i>	For the Three Months Ended September 30,					
	2023			2022		
	Net Income (Numerator)	Common Shares¹ (Denominator)	Per Share	Net Income (Numerator)	Common Shares¹ (Denominator)	Per Share
Basic earnings per share	\$ 3,074	5,889,687	\$ 0.52	\$ 6,162	5,974,961	\$ 1.03
Dilutive shares for restricted stock awards:		252			-	
Diluted earnings per share	\$ 3,074	5,889,939	\$ 0.52	\$ 6,162	5,974,961	\$ 1.03

<i>\$ in thousands, except per share amounts</i>	For the Nine Months Ended September 30,					
	2023			2022		
	Net Income (Numerator)	Common Shares¹ (Denominator)	Per Share	Net Income (Numerator)	Common Shares¹ (Denominator)	Per Share
Basic earnings per share	\$ 11,506	5,889,687	\$ 1.95	\$ 16,622	6,008,607	\$ 2.77
Dilutive shares for restricted stock awards:		91			-	
Diluted earnings per share	\$ 11,506	5,889,778	\$ 1.95	\$ 16,622	6,008,607	\$ 2.77

(1) Weighted average outstanding

RSA grants are disregarded in the computation of diluted earnings per share if they are determined to be anti-dilutive. There were no anti-dilutive RSAs for the three or nine month periods ended September 30, 2023.

Item 2. 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 financial condition and results of operations of the Company. Please refer to the financial statements and other information included in this report as well as the Company's 2022 Form 10-K for an understanding of the following discussion and analysis. References in the following discussion and analysis to "we" or "us" refer to the Company unless the context indicates that the reference is to the Bank.

Cautionary Statement Regarding Forward-Looking Statements

We make forward-looking statements in this Form 10-Q that are subject to significant risks and uncertainties. These forward-looking statements include statements regarding our profitability, liquidity, allowance for credit losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals, and are based upon management's views and assumptions as of the date of this report. The words "believes," "expects," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends," or other similar words or terms are intended to identify forward-looking 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, effects of or changes in:

- interest rates,
- national and local economic conditions,
- 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 Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Consumer Financial Protection Bureau and the Federal Deposit Insurance Corporation, and the impact of any policies or programs implemented pursuant to financial reform legislation,
- unanticipated increases in the level of unemployment in the Company's market,
- the quality or composition of the loan and/or investment portfolios,
- the sufficiency of the Company's allowance for credit losses,
- demand for loan products,
- deposit flows, including impact on liquidity
- competition,
- demand for financial services in the Company's market,
- the real estate market conditions in the Company's market,
- laws, regulations and policies impacting financial institutions,
- adverse developments in the financial industry generally, such as the recent bank failures, responsive measures to mitigate and manage such developments, related supervisory and regulatory actions and costs, and related impacts on customer behavior,
- technological risks and developments, and cyber-threats, attacks or events,
- the Company's technology initiatives,
- geopolitical conditions, including acts or threats of terrorism and/or military conflicts, or actions taken by the U.S. or other governments in response to acts or threats of terrorism and/or military conflicts,
- the occurrence of significant natural disasters, including severe weather conditions, floods, health related issues, and other catastrophic events,
- the Company's ability to identify, attract, and retain experienced management, relationship managers, and support personnel, particularly in a competitive labor environment,
- performance by the Company's counterparties or vendors,
- applicable accounting principles, policies and guidelines, and
- the impact of public health events, including the adverse impact on our business and operations and on our customers.

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 the most recently filed Form 10-K.

Overview

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. NBI common stock is listed on the Nasdaq Capital Market and is traded under the symbol "NKSH."

NBI has two wholly-owned subsidiaries; the National Bank of Blacksburg and National Bankshares Financial Services, Inc. NBB is a community bank and does business as National Bank from 24 office locations and three loan production offices. NBB is the source

of nearly all of the Company's revenue. NBFS 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.

The Company is pleased to announce plans for a new branch in Roanoke, Virginia, expected to open in 2024. The full service branch will expand our already successful loan production office and enhance our service in the Roanoke Valley.

Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with GAAP. The financial information contained within our statements is, to a significant extent, based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value obtained when earning income, recognizing an expense, recovering an asset or relieving a liability. Although the economics of the Company's transactions may not change, the timing of events that would impact the transactions could change.

Critical accounting policies are most important to the portrayal of the Company's financial condition or results of operations and require management's most difficult, subjective, and complex judgments about matters that are inherently uncertain. If conditions occur that differ from our assumptions, depending upon the severity of such differences, the Company's financial condition or results of operations may be materially impacted. The Company designated as critical those policies governing the allowance for credit losses, goodwill and the pension plan. The Company evaluates its critical accounting estimates and assumptions on an ongoing basis and updates them as needed. Please refer to the Company's 2022 Form 10-K, Note 1: Summary of Significant Accounting Policies for information on these and other accounting policies. For information on the Company's policies on the ACLL beginning with adoption of CECL on January 1, 2023, please refer to Note 1: General.

Cybersecurity

The Company considers cybersecurity risk to be one of the greatest risks to its business. We have deployed a multi-faceted approach to limit the risk and impact of unauthorized access to customer accounts and to information relevant to customer accounts. We use digital technology safeguards, internal policies and procedures, and employee training to reduce the exposure of our systems to cyber-intrusions. The Company also requires assurances from key vendors regarding their cybersecurity.

We control functionalities of online and mobile banking to reduce risk. We do not offer online account openings or loan originations. We do not permit customers to submit address changes through online banking, and we limit the dollar amount of online banking transfers to other banks. We require a special vetting process for commercial customers who wish to originate ACH transfers and for customers who submit wire requests through online banking.

Further, the Company has a program to identify, mitigate and manage its cybersecurity risks. The program includes penetration testing and vulnerability assessment, technological defenses such as antivirus software, patch management, firewall management, email and web protections, an intrusion prevention system, a cybersecurity insurance policy which covers some but not all losses arising from cybersecurity breaches, as well as ongoing employee training. The cost of these measures was \$64 for the three months ended September 30, 2023 and \$95 for the three months ended September 30, 2022. For the nine months ended September 30, 2023 and September 30, 2022, the expense was \$192 and \$282 respectively. These costs are included in various categories of noninterest expense.

However, it is not possible to fully eliminate exposure. The potential for financial and reputational losses due to cyber-breaches is increased by the possibility of human error, unknown system susceptibilities, and the rising sophistication of cyber-criminals to attack systems, disable safeguards and gain access to accounts and related information. We maintain insurance for these risks but insurance policies are subject to exceptions, exclusions and terms whose applications have not been widely interpreted in litigation. Accordingly, insurance can provide less than complete protection against the losses that result from cybersecurity breaches and pursuing recovery from insurers can result in significant expense. In addition, some risks such as reputational damage and loss of customer goodwill, which can result from cybersecurity breaches, cannot be insured against.

Non-GAAP Financial Measures

This report refers to certain financial measures that are computed under a basis other than GAAP ("non-GAAP"). The Company uses certain non-GAAP financial measures to provide meaningful supplemental information regarding the Company's operational performance and to enhance investors' overall understanding of such financial performance. The methodology for determining these non-GAAP measures may differ among companies and are supplementary to our financial condition, results of operations and cash flows computed in accordance with GAAP. Details on non-GAAP measures follow.

Adjusted Return on Average Assets and Adjusted Return on Average Equity

The adjusted return on average assets and adjusted return on average equity are measures of profitability, calculated by annualizing net income and dividing by average year-to-date assets or equity, respectively. Larger nonrecurring income or expenses are not annualized, in order to reduce distortion within the ratios. The tables below present the reconciliation of adjusted annualized net income, which is not a measurement under GAAP, for the three and nine month periods ended September 30, 2023 and 2022.

	Three Months Ended September 30,	
	2023	2022
Annualized Net Income		
Net income (GAAP)	\$ 3,074	\$ 6,162
Less: items deemed by management to be non-recurring:		
Provision recovery, net of tax of \$84 for the period ended September 30, 2023	(317)	-
Total non-recurring items	(317)	-
Adjusted net income	\$ 2,757	\$ 6,162
Adjusted net income, annualized	\$ 10,938	\$ 24,447
Add: total non-recurring items	317	-
Annualized net income for ratio calculation (non-GAAP)	\$ 11,255	\$ 24,447
Return on average assets (GAAP)	0.77 %	1.41 %
Adjusted return on average assets (non-GAAP)	0.71 %	1.41 %
Return on average equity (GAAP)	9.63 %	17.61 %
Adjusted return on average equity (non-GAAP)	8.89 %	17.61 %

	Nine Months Ended September 30,	
	2023	2022
Annualized Net Income		
Net income (GAAP)	\$ 11,506	\$ 16,622
Less: items deemed by management to be non-recurring:		
Partnership income net of tax of (\$44) and (\$77) for the periods ended September 30, 2023 and 2022, respectively ⁽¹⁾	(164)	(290)
Loss on sale of securities, net of tax of \$700	2,632	-
Provision recovery, net of tax of \$82	(307)	-
Proxy contest-related expense, net of tax of \$161 ⁽²⁾	607	-
Gain on sale of investment, net of tax of (\$624)	(2,347)	-
Gain on BOLI settlement ⁽³⁾	(1,037)	-
Total non-recurring items	(616)	(290)
Adjusted net income	\$ 10,890	\$ 16,332
Adjusted net income, annualized	\$ 14,560	\$ 21,836
Add: total non-recurring items	616	290
Annualized net income for ratio calculation (non-GAAP)	\$ 15,176	\$ 22,126
Return on average assets (GAAP)	0.95 %	1.29 %
Adjusted return on average assets (non-GAAP)	0.94 %	1.29 %
Return on average equity (GAAP)	12.13 %	14.11 %
Adjusted return on average equity (non-GAAP)	11.97 %	14.04 %

(1) Partnership income is included in other income in the Consolidated Statements of Income.

(2) Proxy contest-related expense is included in professional services in the Consolidated Statements of Income.

(3) Gain on BOLI investment is included in BOLI income in the Consolidated Statements of Income.

Net Interest Margin

The Company uses the net interest margin to measure profit on interest generating activities, as a percentage of total interest-earning assets. The Company's net interest margin is calculated on a fully taxable equivalent ("FTE") basis. The portion of interest income that is nontaxable is grossed up to the tax equivalent by adding the tax benefit based on a tax rate of 21%. Annualized FTE net interest income is divided by total average earning assets to calculate the net interest margin. The following tables present the reconciliation of tax equivalent net interest income, which is not a measurement under GAAP, to net interest income, for the periods indicated.

	Three Months Ended September 30,		
	2023		2022
Net Interest Income, FTE			
Total interest income (GAAP)	\$	14,679	\$ 13,155
FTE adjustment		229	232
Total interest income (non-GAAP)		14,908	13,387
Total interest expense (GAAP)		6,039	753
Net interest income, FTE (non-GAAP)	\$	8,869	\$ 12,634
Average balance of interest-earning assets	\$	1,581,042	\$ 1,697,254
Net interest margin		2.23%	2.95 %

	Nine Months Ended September 30,		Twelve Months Ended
	2023	2022	December 31, 2022
Net Interest Income, FTE			
Total interest income (GAAP)	\$	43,320	\$ 36,127
FTE adjustment		648	689
Total interest income (non-GAAP)		43,968	36,816
Total interest expense (GAAP)		14,517	2,055
Net interest income, FTE (non-GAAP)	\$	29,451	\$ 34,761
Average balance of interest-earning assets	\$	1,605,202	\$ 1,665,680
Net interest margin		2.45%	2.79 %

Further detail on the net interest margin is provided under the Net Interest Income discussion.

Efficiency Ratio

The efficiency ratio is computed by dividing noninterest expense by the sum of FTE net interest income and noninterest income, excluding certain items the Company's management deems unusual or non-recurring. This is a non-GAAP financial measure that the Company believes provides investors with important information regarding operational efficiency. The components of the efficiency ratio calculation for the periods indicated are summarized in the following table.

	Three Months Ended September 30,	
	2023	2022
Noninterest expense (GAAP)	\$ 7,465	\$ 6,736
Total Income for Efficiency Ratio		
Noninterest income (GAAP)	2,115	2,140
Net interest income, FTE (non-GAAP)	8,869	12,634
Total income for efficiency ratio (non-GAAP)	\$ 10,984	\$ 14,774
Efficiency ratio	67.96%	45.59%

	Nine Months Ended September 30,		Twelve Months Ended
	2023	2022	December 31, 2022
Noninterest Expense for Efficiency Ratio			
Noninterest expense (GAAP)	\$ 22,686	\$ 19,660	\$ 26,958
Less: proxy contest-related expense	(768)	-	-
Noninterest expense for efficiency ratio (non-GAAP)	\$ 21,918	\$ 19,660	\$ 26,958
Total Income for Efficiency Ratio			
Noninterest income (GAAP)	\$ 7,105	\$ 6,543	\$ 12,401
Less: Loss on sale of securities	3,332	-	-
Less: Gain on sale of investment	(2,971)	-	(3,823)
Less: Gain on BOLI settlement	(1,037)	-	-
Noninterest income (non-GAAP)	6,429	6,543	8,578
Net interest income, FTE (non-GAAP)	29,451	34,761	47,945
Total income for efficiency ratio (non-GAAP)	\$ 35,880	\$ 41,304	\$ 56,523
Efficiency ratio	61.09%	47.60%	47.69%

Performance Summary

The following tables presents the Company's key performance indicators for the three and nine month periods ended September 30, 2023 and September 30, 2022 and the year ended December 31, 2022.

	<u>Three Months Ended September 30,</u>	
	2023	2022
Net Income	\$ 3,074	\$ 6,162
Return on average assets	0.77 %	1.41 %
Adjusted return on average assets ⁽¹⁾	0.71 %	1.41 %
Return on average equity	9.63 %	17.61 %
Adjusted return on average equity ⁽¹⁾⁽²⁾	8.89 %	17.61 %
Basic diluted earnings per share ⁽²⁾	\$ 0.52	\$ 1.03
Fully diluted earnings per share ⁽²⁾⁽⁴⁾	\$ 0.52	\$ 1.03
Net interest margin ⁽¹⁾	2.23 %	2.95 %
Efficiency ratio ⁽¹⁾	67.96 %	45.59 %

	Nine Months Ended September 30, 2023	Nine Months Ended September 30, 2022	Twelve Months Ended December 31, 2022
Net Income	\$ 11,506	\$ 16,622	\$ 25,932
Return on average assets	0.95 %	1.29 %	1.52 %
Adjusted return on average assets ⁽¹⁾	0.94 %	1.29 %	1.52 %
Return on average equity	12.13 %	14.11 %	17.81 %
Adjusted return on average equity ⁽¹⁾⁽³⁾	11.97 %	14.04 %	17.81 %
Basic earnings per share ⁽³⁾	\$ 1.95	\$ 2.77	\$ 4.33
Fully diluted earnings per share ⁽³⁾⁽⁴⁾	\$ 1.95	\$ 2.77	\$ 4.33
Net interest margin ⁽¹⁾	2.45 %	2.79 %	2.88 %
Efficiency ratio ⁽¹⁾	61.09 %	47.60 %	47.69 %

⁽¹⁾ See "Non-GAAP Financial Measures" above.

⁽²⁾ During the three months ended September 30, 2022, the Company repurchased 23,500 shares under its publicly announced stock repurchase plan. The repurchase reduced stockholders equity by \$795.

⁽³⁾ During the nine months ended September 30, 2022, the Company repurchased 106,662 shares under its publicly announced stock repurchase plan. The repurchase reduced stockholders equity by \$3,724.

⁽⁴⁾ During the second quarter of 2023, the Company granted 2,052 of restricted stock awards with a one year vesting period.

Net income for the three and nine month periods ended September 30, 2023 decreased when compared with the three and nine month periods ended September 30, 2022. Results for 2023 reflected the impact of the Federal Reserve's interest rate increases as well as key noninterest income and expense items that are discussed below. Results for the year ended December 31, 2022 included pre-tax income of \$3,823 from the sale of a private equity investment.

Net Interest Income

The following tables show 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 periods indicated.

	Three Months Ended September 30,					
	2023			2022		
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
Interest-earning assets:						
Loans ⁽¹⁾⁽²⁾⁽⁴⁾⁽⁵⁾	\$ 843,546	\$ 9,924	4.67 %	\$ 849,929	\$ 8,900	4.15 %
Taxable securities ⁽⁶⁾⁽⁷⁾	640,578	4,084	2.53 %	683,490	3,425	1.99 %
Nontaxable securities ⁽¹⁾⁽⁶⁾	64,415	461	2.84 %	74,670	556	2.95 %
Interest-bearing deposits	32,503	439	5.36 %	89,165	506	2.25 %
Total interest-earning assets	\$ 1,581,042	\$ 14,908	3.74 %	\$ 1,697,254	\$ 13,387	3.13 %
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 799,772	\$ 4,358	2.16 %	\$ 936,368	\$ 686	0.29 %
Savings deposits	192,702	226	0.47 %	217,637	36	0.07 %
Time deposits	163,476	1,452	3.52 %	78,198	31	0.16 %
Borrowings	207	3	5.75 %	-	-	-
Total interest-bearing liabilities	\$ 1,156,157	\$ 6,039	2.07 %	\$ 1,232,203	\$ 753	0.24 %
Net interest income and interest rate spread		\$ 8,869	1.67 %		\$ 12,634	2.89 %
Net yield on average interest-earning assets			2.23 %			2.95 %

	Nine Months Ended September 30,					
	2023			2022		
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
Interest-earning assets:						
Loans ⁽¹⁾⁽³⁾⁽⁴⁾⁽⁵⁾	\$ 850,543	\$ 29,068	4.57 %	\$ 829,133	\$ 25,484	4.11 %
Taxable securities ⁽⁶⁾⁽⁷⁾	657,575	12,268	2.49 %	662,824	8,847	1.78 %
Nontaxable securities ⁽¹⁾⁽⁶⁾	65,649	1,425	2.90 %	75,806	1,728	3.05 %
Interest-bearing deposits	31,435	1,207	5.13 %	97,917	757	1.03 %
Total interest-earning assets	\$ 1,605,202	\$ 43,968	3.66 %	\$ 1,665,680	\$ 36,816	2.96 %
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$ 834,575	\$ 10,846	1.74 %	\$ 911,926	\$ 1,839	0.27 %
Savings deposits	200,170	506	0.34 %	216,691	111	0.07 %
Time deposits	131,398	2,865	2.92 %	79,981	105	0.18 %
Borrowings	8,287	300	4.84 %	-	-	-
Total interest-bearing liabilities	\$ 1,174,430	\$ 14,517	1.65 %	\$ 1,208,598	\$ 2,055	0.23 %
Net interest income and interest rate spread		\$ 29,451	2.01 %		\$ 34,761	2.73 %
Net yield on average interest-earning assets			2.45 %			2.79 %

(1) Interest on nontaxable loans and securities is computed on a fully taxable equivalent basis using a Federal income tax rate of 21%.

(2) Included in interest income are loan fees of \$56 and \$82 for the three months ended September 30, 2023 and 2022, respectively.

(3) Included interest income are loan fees of \$162 and \$195 for the nine months ended September 30, 2023 and 2022, respectively.

(4) Nonaccrual loans are included in average balances for yield computations.

(5) Includes loans held for sale.

(6) Daily averages are shown at amortized cost.

(7) Includes restricted stock.

The 525 basis point increase in the Federal Reserve's benchmark interest rate between March 2022 and July 2023 expanded the yield on earning assets when the three months and nine month periods ended September 30, 2023 and September 30, 2022 are compared. Many of the Company's loans are adjustable with repricing dates in the future. If rates remain at the current level or increase, repricing will continue to contribute to improved interest income.

The rapidity and magnitude of the Federal Reserve's rate increases stimulated competition for deposits that resulted in higher cost of funds and compressed net interest margin when results for 2023 are compared with 2022. The Company continuously monitors its deposit base and funding costs. Further information on the Company's funds management and deposit strategy is discussed under the Deposits section below.

Noninterest Income

	Three Months Ended September 30,		
	2023	2022	Percent Change
Service charges on deposits	\$ 642	\$ 661	(2.87) %
Other service charges and fees	151	51	196.08 %
Credit and debit card fees, net	395	448	(11.83) %
Trust income	505	492	2.64 %
BOLI income	253	239	5.86 %
Gain on sale of mortgage loans	22	40	(45.00) %
Other income	147	209	(29.67) %
Total noninterest income	\$ 2,115	\$ 2,140	(1.17) %

	Nine Months Ended September 30,		
	2023	2022	Percent Change
Service charges on deposits	\$ 1,871	\$ 1,826	2.46 %
Other service charges and fees	253	157	61.15 %
Credit and debit card fees, net	1,276	1,423	(10.33) %
Trust income	1,431	1,374	4.15 %
BOLI income	1,771	718	146.66 %
Gain on sale of mortgage loans	93	136	(31.62) %
Gain on sale of investment	2,971	-	100.00 %
Other income	771	909	(15.18) %
Loss on sale of securities	(3,332)	-	(100.00) %
Total noninterest income	\$ 7,105	\$ 6,543	8.59 %

Noninterest income decreased slightly when the three months ended September 30, 2023 are compared with the three months ended September 30, 2022, but increased when the nine month periods are compared. Information on key drivers follows.

Service charges on deposits include fees for non-sufficient funds and overdrafts. During the third quarter of 2023, the Company modified its policy to exempt from charge small overdrafts on deposit accounts, and small items that overdraw deposit accounts. The policy change is intended to address recent industry-wide regulatory comments and build goodwill with the Company's deposit base.

The increase from 2022 in other service charges and fees reflected a loan transaction-related fee recorded during the three months ended September 30, 2023. Lower volume in both credit and debit card activity and in mortgage origination decreased the related income, when results for 2023 are compared with those of 2022.

During the second quarter of 2023, the Company recognized a gain on the sale of its VISA Class B securities, as well as a gain of \$1,037 included in BOLI income above from the settlement of a policy. The Company also recorded a loss on the sale of securities during the second quarter. The sale of securities is discussed in more detail under the Securities section below.

Noninterest Expense

	Three Months Ended September 30,		
	2023	2022	Percent Change
Salaries and employee benefits	\$ 4,462	\$ 4,144	7.67 %
Occupancy, furniture and fixtures	547	476	14.92 %
Data processing and ATM	978	774	26.36 %
FDIC assessment	190	114	66.67 %
Net costs of other real estate owned	14	68	(79.41)%
Franchise taxes	339	375	(9.60)%
Professional services	251	254	(1.18)%
Other operating expenses	684	531	28.81 %
Total noninterest expense	\$ 7,465	\$ 6,736	10.82 %

	Nine Months Ended September 30,		
	2023	2022	Percent Change
Salaries and employee benefits	\$ 13,361	\$ 12,133	10.12 %
Occupancy, furniture and fixtures	1,500	1,432	4.75 %
Data processing and ATM	2,730	2,354	15.97 %
FDIC assessment	561	336	66.96 %
Net costs of other real estate owned	29	78	(62.82)%
Franchise taxes	1,072	1,108	(3.25)%
Professional services	1,555	693	124.39 %
Other operating expenses	1,878	1,526	23.07 %
Total noninterest expense	\$ 22,686	\$ 19,660	15.39 %

Noninterest expense increased when the three and nine months ended September 30, 2023 are compared with the same periods of 2022. Information on key drivers follows.

The Company increased its base compensation during 2022 in order to attract and retain talent, which is reflected in 2023 salaries and employee benefits expense. Occupancy, furniture and fixtures expense includes annual increases to lease expense based upon inflation measures and also higher depreciation and utilities expense. Data processing and ATM expense reflects support for new products and investment in new technology. FDIC insurance expense increased due to an increase in the FDIC's general assessment rate from 2022 to 2023. Professional services include legal and other expenses for the Company's response to a threatened proxy contest from an activist shareholder during 2023, which amounted to \$768 for the nine months ended September 30, 2023. The Company does not anticipate any further material expense for this matter. Pension non-service cost, which is included in other operating expense, increased \$87 and \$261, respectively, when three and nine month periods ended September 30, 2023 and September 30, 2022 are compared. The expense is determined by actuarial calculations.

Income Tax

The Company's effective tax rate was 16.72% and 18.43% for the three month periods ended September 30, 2023 and 2022, respectively. For the nine months ended September 30, 2023 and 2022, the Company's effective tax rate was 15.47% and 17.95%, respectively. The Company's effective tax rate is lower than the statutory rate of 21% due to investments in tax-advantaged loans and securities, and in 2023, the gain from settlement of a BOLI policy.

Asset Quality

Key indicators of the Company's asset quality are presented in the following table.

	September 30, 2023	September 30, 2022	December 31, 2022
Nonaccrual loans	\$ 2,981	\$ 2,888	\$ 2,847
Loans past due 90 days or more, and still accruing	31	48	8
Other real estate owned	662	907	662
ACLL to loans net of unearned income and deferred fees and costs	1.20 %	0.96%	0.96%
Net charge-off ratio	0.00 %	0.03%	0.02%
Ratio of nonperforming assets to loans, net of unearned income and deferred fees and costs, plus other real estate owned	0.43 %	0.44%	0.41%
Ratio of ACLL to nonperforming loans	341.53 %	284.18%	288.90%

The Company adopted the CECL model on January 1, 2023, resulting in an increase to the Allowance for Credit Losses for Loans ("ACLL") of \$2,342, from \$8,225 at December 31, 2022. For information on the Company's policies on the ACLL, please refer to Note 1: General of this Form 10-Q. For information on the Company's application of previous GAAP in determining the allowance for loan losses, please refer to the Company's 2022 Form 10-K, Note 1: Summary of Significant Accounting Policies.

The Company's risk analysis under the CECL model at September 30, 2023 determined an ACLL of \$10,181, or 1.20% of loans net of unearned income and deferred fees and costs. This compares with an allowance of \$8,225 as of December 31, 2022, or 0.96% of loans. The allowance for loan losses at September 30, 2022 was \$8,207 or 0.96% of loans. To determine the appropriate level of the ACLL, the Company considers credit risk for individually evaluated loans and for groups of loans evaluated collectively.

Individually Evaluated Loans

Individually evaluated loans were \$10,658 as of September 30, 2023, an increase from \$3,032 as of December 31, 2022. The increase was due to a change in the way that the Company identifies individually evaluated loans under CECL. Please refer to Note 1: General for information on the Company's identification of individually evaluated loans. As of September 30, 2023, one individually evaluated loan was collateral dependent but was adequately collateralized and did not result in an individual allocation. The remaining individually evaluated loans were measured using the DCF method, resulting in an allocation of \$875.

Collectively Evaluated Loans

Collectively evaluated loans totaled \$838,759, with an ACLL of \$9,306 as of September 30, 2023. At December 31, 2022, collectively evaluated loans totaled \$850,161, with an allowance of \$8,225.

Collectively evaluated loans are divided into pools based upon risk characteristics. Utilizing historical loss information, the Company calculates a probability of default and loss given default for each pool, which is adjusted for a reasonable and supportable forecast. Loan pools are allocated additional loss estimates based upon the Company's analysis of qualitative factors including economic measures, asset quality indicators, loan characteristics, and changes to internal Company policies and management.

Reasonable and Supportable Forecast

To estimate cash flows, the Company adjusted its historical loss information with a forecast of the national unemployment rate. The forecast applied at September 30, 2023 projects that unemployment will rise over the next 12 months, which increases the loss estimate. The Company determined that 12 months represents a reasonable and supportable forecast period as of September 30, 2023, and set a period of 12 months to revert to historical losses on a straight-line basis.

Qualitative Factors: Economic

The Company sources economic data pertinent to its market from the most recently available publications, including business and personal bankruptcy filings, the residential vacancy rate and the inventory of new and existing homes.

Higher bankruptcy filings indicate heightened credit risk and increase the ACLL, while lower bankruptcy filings have a beneficial impact on credit risk. Compared with data available at December 31, 2022, business and personal bankruptcy filings increased.

Residential vacancy rates and housing inventory impact the Company's residential construction customers and the consumer real estate market. Higher levels increase credit risk. The residential vacancy rate available at September 30, 2023 improved from the data incorporated into the December 31, 2022 calculation, resulting in a lower allocation. Housing data available as of September 30, 2023 showed higher inventory than at December 31, 2022, resulting in a higher allocation.

Qualitative Factors: Asset Quality Indicators

Accruing past due loans are analyzed at the class level and compared with previous levels. Increases in past due loans indicate heightened credit risk. Accruing loans past due 30-89 days were 0.14% of total loans at September 30, 2023, a decrease from 0.16% at December 31, 2022.

Qualitative Factors: Other Considerations

The Company considers other factors that impact credit risk, including the interest rate environment, the competitive, legal and regulatory environments, changes in lending policies and loan review, changes in lending management, and high risk loans.

The interest rate environment impacts variable rate loans. The Federal Reserve's aggressive interest rate increases beginning in March 2022 have increased payments on certain adjustable rate loans, which may increase credit risk. The Company allocates additional reserve each time the Federal Reserve increases rates. After the rate increase has been in effect for one year, the allocation may be removed under the assumption that the impact of the change has become integrated to the portfolio. For the calculation as of September 30, 2023, the Company removed allocations for interest rate increases that occurred between March and September 2022.

The competitive, legal and regulatory environments were evaluated for changes that would affect credit risk. Higher competition for loans increases credit risk, while lower competition decreases credit risk. Competition remained at similar levels to those at December 31, 2022. The legal and regulatory environments also remain in a similar posture to December 31, 2022.

Lending policies, loan review procedures and management's experience influence credit risk. Except for the adoption of CECL, policies and procedures remain similar to those at December 31, 2022. The Company added an allocation for the retirement of a long term credit administration manager.

Levels of high risk loans are considered in the determination of the level of the ACLL. A decrease in the level of high risk loans within a class decreases the required allocation for the loan class, and an increase in the level of high risk loans within a class increases the required allocation for the loan class. Total high risk loans increased from the level at December 31, 2022, resulting in an increased allocation.

Unallocated Surplus

The unallocated surplus as of September 30, 2023 is \$485, or 5.00% in excess of the calculated requirement. The unallocated surplus at December 31, 2022 was \$179, or 2.23% in excess of the calculated requirement. The surplus provides some mitigation of current economic uncertainty that may impact credit risk.

Conclusion

The calculation of the appropriate level for the ACLL incorporates analysis of multiple factors and requires management's prudent and informed judgment. The Company augmented the calculated requirement with an unallocated surplus. Based on analysis of historical indicators, asset quality and economic factors, management believes the level of ACLL is reasonable for the credit risk in the loan portfolio as of September 30, 2023.

(Recovery of) Provision for Credit Losses

The calculation of the ACLL resulted in a recovery of previously recognized provision of \$401 for the three month period ended September 30, 2023, compared with a provision of \$252 for the three month period ended September 30, 2022. The recovery for the nine month period ended September 30, 2023 was \$389, compared with provision of \$696 for the nine months ended September 30, 2022. The recovery in 2023 reflected reversal of allocations for interest rate increases taken in 2022, forecast projections for lower unemployment than that forecasted at December 31, 2022, a slight decrease in total loans, and changes in factors detailed in "Asset Quality" above.

Loan Modifications

In the ordinary course of business the Company modifies loan terms on a case-by-case basis for a variety of reasons. Modifications may include rate reductions, payment extensions of varying lengths of time, a change in amortization term or method or other arrangements. Modifications to consumer loans generally involve short-term payment extensions to accommodate specific, temporary circumstances. Modifications to commercial loans may include, but are not limited to, changes in interest rate, maturity, amortization and financial covenants.

The Company reviews modifications to determine whether the borrower is experiencing financial difficulty, including indicators of default, bankruptcy, going concern, insufficient projected cash flows and inability to obtain financing from other sources. If a modification is made to a borrower experiencing financial difficulty, the loan's risk rating is downgraded to special mention or classified, resulting in individual evaluation for the ACL. During the nine months ended September 30, 2023, the Company modified one loan totaling \$6,396 for a borrower who was experiencing financial difficulty. The loan was individually evaluated for the ACLL as of September 30, 2023.

Modifications for Borrowers Who Were Not Experiencing Financial Difficulty

During the three and nine month periods ended September 30, 2023 and 2022, the Company modified loans in the normal course of business for borrowers who were not experiencing financial difficulty. During the three months ended September 30, 2023, the Company modified 186 loans totaling \$23,054. During the nine months ended September 30, 2023, the Company modified 581 loans totaling \$65,089. During the three months ended September 30, 2022, the Company provided 187 modifications to loans totaling \$27,389. For the nine months ended September 30, 2022, the Company provided 652 modifications to loans totaling \$101,347.

Other Real Estate Owned

As of September 30, 2023, OREO of \$662 is comprised of one construction property. One loan secured by real estate of \$7 was in process of foreclosure, which may increase OREO in future quarters. It is not possible to accurately predict the future total of OREO because property sold at foreclosure may be acquired by third parties and OREO properties are regularly marketed and sold. The Company continues to monitor risk levels within the loan portfolio. If the Company's market experiences an economic downturn, real estate values could decline and foreclosure activity could increase. A decline in value may result in loss recognition for OREO, while an increase in foreclosures may increase the number of OREO properties.

Key Assets and Liabilities

NBI's key assets and liabilities and their change from December 31, 2022 are shown in the following table.

	September 30, 2023	December 31, 2022	Percent Change
Interest-bearing deposits	\$ 40,353	\$ 59,026	(31.64) %
Securities available for sale, at fair value	591,552	656,852	(9.94) %
Loans, net	838,794	844,519	(0.68) %
Total assets	1,591,902	1,677,551	(5.11) %
Deposits	1,465,000	1,542,725	(5.04) %

Average Balances

Year-to-date daily averages for the major balance sheet categories are as follows:

Assets	September 30, 2023	December 31, 2022	Percent Change
Interest-bearing deposits	\$ 31,435	\$ 88,963	(64.67) %
Securities available for sale, at fair value	627,908	683,183	(8.09) %
Loans, net	839,764	825,110	1.78 %
Total assets	1,614,757	1,705,614	(5.33) %

Liabilities and stockholders' equity

Noninterest-bearing demand deposits	\$ 302,568	\$ 338,269	(10.55) %
Interest-bearing demand deposits	834,575	910,989	(8.39) %
Savings deposits	200,170	216,414	(7.51) %
Time deposits	131,398	77,686	69.14 %
Stockholders' equity	126,792	145,641	(12.94) %

Increased competition resulted in decreased customer deposits and reduced the funds available for the Company to invest in interest bearing deposits. Changes in securities, loans, deposits and stockholders' equity are discussed below.

Securities

	September 30, 2023	December 31, 2022	Percent Change
Amortized cost	\$ 702,083	\$ 759,917	(7.61) %
Unrealized loss	(110,531)	(103,065)	(7.24) %
Securities available for sale, at fair value	\$ 591,552	\$ 656,852	(9.94) %

As part of its interest rate risk management, the Company periodically evaluates its position in financial assets. During the first half of 2023, the Company strategically selected and sold securities with an amortized cost of \$46,850, realizing a loss of \$3,332. The strategy for the sales prioritized enhancement of long-term earnings. Though not a primary objective, proceeds from the sales also bolstered liquidity. There were no sales of securities during 2022.

Securities available for sale are presented at fair value as of each reporting date. Most of the Company's securities were purchased during periods prior to the Federal Reserve's interest rate increases that began in March of 2022. The fair value of bonds moves inversely to interest rate changes, as well as expectations of interest rate changes. The Company's Asset Liability Management Committee is closely monitoring interest rate risk on all of the Company's financial assets and liabilities. At this time, there are no credit risk concerns on securities available for sale and no associated ACL. Please refer to Note 1: General and Note 3: Securities for additional information.

Loans

	September 30, 2023	December 31, 2022	Percent Change
Not	\$ 64,181	\$ 54,579	17.59 %
Consumer real estate	226,671	221,052	2.54 %
Commercial real estate	424,765	437,888	(3.00) %
Commercial non real estate	42,940	57,652	(25.52) %
Public sector and IDA	51,591	48,074	7.32 %
Consumer non real estate	39,269	33,948	15.67 %
Less: unearned income and deferred fees and costs	(442)	(449)	(1.56) %
Loans, net of unearned income and deferred fees and costs	\$ 848,975	\$ 852,744	(0.44) %

Loans decreased slightly from December 31, 2022, as higher interest rates decreased demand. The Company is positioned to continue to make every loan that meets its underwriting standards.

Deposits

	September 30, 2023	December 31, 2022	Percent Change
Noninterest-bearing demand deposits	\$ 303,166	\$ 327,713	(7.49) %
Interest-bearing demand deposits	789,148	933,269	(15.44) %
Saving deposits	184,801	214,114	(13.69) %
Time deposits	187,885	67,629	177.82 %
Total deposits	\$ 1,465,000	\$ 1,542,725	(5.04) %

Competition for deposits began impacting the Company during the latter part of 2022 and has continued during 2023. The Company implemented competitive pricing on CDs, raised offering rates on other deposits and negotiated with depositors to strengthen the deposit base, at costs well below the cost of borrowing.

The Company's depositors within its market area are diverse, including individuals, businesses and municipalities. The Company does not have any brokered deposits. Depositors are insured up to the FDIC maximum of \$250 thousand. Municipal deposits, which account for approximately 24% of the Company's deposits, have additional security from bonds pledged as collateral, in accordance with state regulation. Of the Company's non-municipal deposits, approximately 20% are uninsured.

Capital Resources

	September 30, 2023	December 31, 2022	Percent Change
Common stock and additional paid in capital	\$ 7,383	\$ 7,362	0.29 %
Retained earnings	198,394	199,091	(0.35) %
Accumulated other comprehensive loss	(89,664)	(83,766)	(7.04) %
Total stockholders' equity	\$ 116,113	\$ 122,687	(5.36) %

The decrease in stockholders' equity reflects an increase in the unrealized loss on securities available for sale, the adoption of CECL at January 1, 2023, payment of a special one-time cash dividend and the Company's normal semi-annual dividend, partially offset by net income for the nine months ended September 30, 2023.

The Company's stockholders approved a new equity compensation plan at the annual meeting held in May 2023. Under the plan, part of the June 2023 semi-annual retainer for non-employee directors was paid in a restricted stock grant. The equity compensation plan aims to align decision making with long-term value creation for the Company's shareholders.

The Company qualifies as a small bank holding company under the Federal Reserve's Small Bank Holding Company Policy Statement, which exempts bank holding companies with less than \$3 billion in assets from reporting consolidated regulatory capital ratios and from minimum regulatory capital requirements. NBB is subject to various capital requirements administered by banking agencies, including an additional capital conservation buffer in order to make capital distributions or discretionary bonus payments. Risk-based capital ratios are calculated in compliance with OCC rules based on the Basel III Capital Rules. The Bank's ratios are well above the required minimums as of September 30, 2023. Risk based capital ratios for NBB are shown in the following tables.

	NBB	Regulatory Capital Minimum Ratios	Regulatory Capital Minimum Ratios with Capital Conservation Buffer
Common Equity Tier I Capital Ratio	17.83%	4.50%	7.00%
Tier I Capital Ratio	17.83%	6.00%	8.50%
Total Capital Ratio	18.79%	8.00%	10.50%
Leverage Ratio	11.71%	4.00%	4.00%

Liquidity

Liquidity measures the Company's ability to meet its financial commitments at a reasonable cost. Demands on the Company's liquidity include funding additional loan demand and accepting withdrawals of existing deposits. The Company has diverse liquidity sources, including customer and purchased deposits, customer repayments of loan principal and interest, sales, calls and maturities of securities, Federal Reserve discount window borrowing, short-term borrowing, and FHLB advances. Periodically during 2023, the Company accessed FHLB borrowings to reinforce liquidity. The advances were fully repaid, due to the success of the Company's deposit strategy. As of September 30, 2023, the Company did not have purchased deposits, discount window borrowings or short-term borrowings.

The Company considers its security portfolio for typical liquidity needs, within accounting, legal and strategic parameters. Portions of the securities portfolio are pledged to meet state requirements for public funds deposits. Discount window borrowings also require pledged securities. Increased/decreased liquidity from public funds deposits or discount window borrowings results in increased/decreased liquidity from pledging requirements. The Company monitors public funds pledging requirements and unpledged available for sale securities accessible for liquidity needs.

Regulatory capital levels determine the Company's ability to use purchased deposits and the Federal Reserve discount window. As of September 30, 2023, the Company is considered well capitalized and does not have any restrictions on purchased deposits or borrowing ability at the Federal Reserve discount window.

As of September 30, 2023, the Company had \$301,515 of borrowing capacity from the FHLB and an unsecured federal funds line of credit with an unaffiliated bank of \$10,000, with no amounts advanced against those lines. Additionally, the Company had \$176,210 of unused capacity at the Federal Reserve Bank discount window.

The Company monitors factors that may increase its liquidity needs. Some of these factors include deposit trends, large depositor activity, maturing deposit promotions, interest rate sensitivity, maturity and repricing timing gaps between assets and liabilities, the level of unfunded loan commitments and loan growth. As of September 30, 2023, the Company's liquidity is sufficient to meet projected trends.

To monitor and estimate liquidity levels, the Company performs stress testing under varying assumptions on credit sensitive liabilities and the sources and amounts of balance sheet and external liquidity available to replace outflows. The Company's Contingency

Funding Plan sets forth avenues for rectifying liquidity shortfalls. As of September 30, 2023, the analysis indicated adequate liquidity under the tested scenarios.

The Company utilizes several other strategies to maintain sufficient liquidity. Loan and deposit growth are managed to keep the loan to deposit ratio within the Company's internally-set target range. As of September 30, 2023, the loan to deposit ratio was 57.95%. The investment strategy takes into consideration the term of the investment, and securities in the available for sale portfolio are laddered based upon projected funding needs.

Off-Balance Sheet Arrangements

In the normal course of business, NBB extends lines of credit and letters of credit to its customers. Depending on their needs, customers may draw upon lines of credit at any time in any amount up to a pre-approved limit. Financial letters of credit guarantee payments to facilitate customer purchases. Performance letters of credit guarantee payment if the customer fails to complete a specific obligation.

While it would be possible for customers to fully draw on approved lines of credit and for beneficiaries to call all letters of credit, historically this has not occurred. In the event of a sudden and substantial draw on these lines, the Company would be able to access multiple options, including its lines of credit with correspondents, raising additional deposits, or selling securities available for sale or loans. The Company estimates an ACL on unfunded loan commitments under the CECL model.

The Company sells mortgages on the secondary market. Our agreement with the purchaser provides for strict underwriting and documentation requirements. Violation of the representations and warranties of the agreement would entitle the purchaser to recourse provisions. The Company has determined that its risk in this area is not significant because of a low volume of secondary market mortgage loans and high underwriting standards. The Company estimates a potential loss reserve for recourse provisions that is not material as of September 30, 2023. To date, no recourse provisions have been invoked. If funds were needed, the Company would access the same sources as noted above for funding lines and letters of credit. There were no material changes in off-balance sheet arrangements during the nine months ended September 30, 2023.

Contractual Obligations

The Company had no finance lease or purchase obligations and no long-term debt at September 30, 2023.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

The Company's management evaluated, with the participation of the Company's principal executive officer and principal financial officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e)) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report. Based on that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective as of September 30, 2023 to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified by the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the three months ended September 30, 2023, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Because of the inherent limitations in all control systems, the Company believes that no system of controls, no matter how well designed and operated, can provide absolute assurance that all control issues have been detected.

Part II

Other Information

Item 1. Legal Proceedings

There are no pending or threatened legal proceedings to which the Company or any of its subsidiaries is a party or to which the property of the Company or any of its subsidiaries is subject that, in the opinion of management, may materially impact the financial condition of the Company.

Item 1A. Risk Factors

Please refer to the “Risk Factors” previously disclosed in Item 1A of our 2022 Annual Report on Form 10-K and the factors discussed under “Cautionary Statement Regarding Forward-Looking Statements” in Part I. Item 2 of this Form 10-Q.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Index of Exhibits

Exhibit No.	Description	
3(i)	Amended and Restated Articles of Incorporation of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3.1 of the Form 8-K filed on March 16, 2006)
3(ii)	Amended and Restated Bylaws of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3(ii) of the Form 8-K filed on January 11, 2023)
4	Specimen copy of certificate for National Bankshares, Inc. common stock	(incorporated herein by reference to Exhibit 4(a) of the Annual Report on Form 10-K for fiscal year ended December 31, 1993)
10	National Bankshares, Inc. 2023 Stock Incentive Plan	(incorporated by reference to Appendix A of the Proxy Statement for the Annual Meeting of Shareholders held on May 9, 2023, filed on March 24, 2023)
+31(i)	Section 302 Certification of Chief Executive Officer	Filed herewith
+31(ii)	Section 302 Certification of Chief Financial Officer	Filed herewith
+32(i)	18 U.S.C. Section 1350 Certification of Chief Executive Officer	Filed herewith
+32(ii)	18 U.S.C. Section 1350 Certification of Chief Financial Officer	Filed herewith
+101	The following materials from National Bankshares, Inc.’s Quarterly Report on Form 10-Q for the period ended September 30, 2023 are formatted in iXBRL (Inline Extensible Business Reporting Language), furnished herewith: (i) Consolidated Balance Sheets at September 30, 2023 and December 31, 2022; (ii) Consolidated Statements of Income for	Filed herewith

the three and nine month periods ended September 30, 2023 and 2022;
(iii) Consolidated Statements of Comprehensive Income (Loss) for the three and nine month periods ended September 30, 2023 and 2022;
(iv) Consolidated Statements of Changes in Stockholders' Equity for the three and nine month periods ended September 30, 2023 and 2022;
(v) Consolidated Statements of Cash Flows for the nine month periods ended September 30, 2023 and 2022; and (vi) Notes to Consolidated Financial Statements.

104 Cover Page Interactive Data File (formatted in Inline XBRL and contained in Exhibit 101) Filed herewith

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL BANKSHARES, INC.

Date: November 8, 2023

/s/ F. Brad Denardo

By: F. Brad Denardo
Chairman, President and
Chief Executive Officer
(Principal Executive Officer)

Date: November 8, 2023

/s/ Lora M. Jones

By: Lora M. Jones
Treasurer and
Chief Financial Officer
(Principal Financial Officer)
(Principal Accounting Officer)

CERTIFICATIONS

I, F. Brad Denardo, certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bankshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2023

/s/ F. Brad Denardo
F. Brad Denardo
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

I, Lora M. Jones, certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bankshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2023

/s/ Lora M. Jones
Lora M. Jones
Treasurer and
Chief Financial Officer
(Principal Financial Officer)

Exhibit 32 (i)

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Form 10-Q of National Bankshares, Inc. for the quarter ended September 30, 2023, I, F. Brad Denardo, Chairman, President and Chief Executive Officer (Principal Executive Officer) of National Bankshares, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended September 30, 2023, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended September 30, 2023, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

/s/ F. Brad Denardo

F. Brad Denardo
Chairman, President and Chief Executive Officer
(Principal Executive Officer)
November 8, 2023

Exhibit 32 (ii)

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Form 10-Q of National Bankshares, Inc. for the quarter ended September 30, 2023, I, Lora M. Jones, Treasurer and Chief Financial Officer (Principal Financial Officer) of National Bankshares, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended September 30, 2023, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended September 30, 2023, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

/s/ Lora M. Jones

Lora M. Jones
Treasurer and
Chief Financial Officer
(Principal Financial Officer)
November 8, 2023