

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

**[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 0-14773

NATIONAL BANCSHARES CORPORATION

exact name of registrant as specified in its charter

Ohio

State of incorporation

34-1518564

IRS Employer

Identification No.

112 West Market Street, Orrville, Ohio 44667

Address of principal executive offices

Registrant's telephone number: (330) 682-1010

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No _____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes X No _____

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

Large accelerated filer []

Non-accelerated filer []

Accelerated filer []

Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes _____ No X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 29, 2010.

Common Stock, Without Par Value: 2,205,973 Shares Outstanding

NATIONAL BANCSHARES CORPORATION

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Item 1. Financial Statements**NATIONAL BANCSHARES CORPORATION**
CONSOLIDATED BALANCE SHEETS (Unaudited)*(dollars in thousands)*

	June 30, <u>2010</u>	December 31, <u>2009</u>
ASSETS		
Cash and due from banks	\$ 25,975	\$ 8,124
Time deposits with other financial institutions	9,444	13,580
Securities available for sale	131,734	130,241
Restricted equity securities	3,219	3,218
Loans held for sale	143	316
Loans, net of allowance for loan losses:		
June 30, 2010 - \$2,560; December 31, 2009 - \$2,906	191,078	194,071
Premises and equipment, net	11,074	9,033
Goodwill	4,723	4,723
Identified intangible assets	152	197
Accrued interest receivable	1,249	1,334
Cash surrender value of life insurance	2,820	2,771
Other assets	<u>2,729</u>	<u>2,620</u>
Total assets	<u>\$ 384,340</u>	<u>\$ 370,228</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	\$ 58,557	\$ 54,290
Interest bearing	<u>250,523</u>	<u>237,083</u>
Total deposits	309,080	291,373
Repurchase agreements	6,980	6,105
Federal funds purchased	-	3,300
Federal Reserve Bank note account	107	315
Federal Home Loan Bank advances	25,000	27,000
Accrued interest payable	368	408
Accrued expenses and other liabilities	<u>2,828</u>	<u>2,824</u>
Total liabilities	344,363	331,325
SHAREHOLDERS' EQUITY		
Common stock, no par value; 6,000,000 shares authorized; 2,289,528 shares issued	11,447	11,447
Additional paid-in capital	4,761	4,752
Retained earnings	21,954	21,856
Treasury stock, at cost (83,555 shares)	(1,639)	(1,639)
Accumulated other comprehensive income	<u>3,454</u>	<u>2,487</u>
Total shareholders' equity	<u>39,977</u>	<u>38,903</u>
Total liabilities and shareholders' equity	<u>\$ 384,340</u>	<u>\$ 370,228</u>

See accompanying notes to consolidated financial statements.

NATIONAL BANCSHARES CORPORATION
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (Unaudited)

(dollars in thousands, except per share data)

	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Interest and dividend income				
Loans, including fees	\$ 2,638	\$ 2,564	\$ 5,240	\$ 5,149
Securities:				
Taxable	938	1,409	1,967	2,873
Nontaxable	293	171	564	333
Federal funds sold and other	<u>51</u>	<u>5</u>	<u>107</u>	<u>5</u>
Total interest and dividend income	3,920	4,149	7,878	8,360
Interest expense				
Deposits	557	861	1,129	1,798
Short-term borrowings	13	9	26	23
Federal Home Loan Bank advances	<u>249</u>	<u>266</u>	<u>510</u>	<u>530</u>
Total interest expense	<u>819</u>	<u>1,136</u>	<u>1,665</u>	<u>2,351</u>
Net interest income	3,101	3,013	6,213	6,009
Provision for loan losses	<u>615</u>	<u>228</u>	<u>1,122</u>	<u>351</u>
Net interest income after provision for loan losses	2,486	2,785	5,091	5,658
Noninterest income				
Checking account fees	272	259	534	506
Visa check card interchange fees	112	83	210	161
Deposit and miscellaneous service fees	80	64	163	132
Mortgage banking activities	50	122	101	142
Securities gains, net	-	156	76	308
Loss on sale of other real estate owned	-	-	(11)	-
Other	<u>98</u>	<u>72</u>	<u>164</u>	<u>149</u>
Total noninterest income	612	756	1,237	1,398
Noninterest expense				
Salaries and employee benefits	1,357	1,340	2,735	2,674
Data processing	256	230	497	446
Net occupancy	304	262	598	527
FDIC Assessment	145	279	266	396
Professional and consulting fees	210	140	392	253
Franchise tax	87	81	177	165
Maintenance and repairs	43	37	113	100
Amortization of intangibles	23	57	45	113
Telephone	58	53	116	100
Marketing	66	48	131	96
Director fees and pension	68	57	140	110
Software expense	50	54	93	99
Postage and supplies	75	64	155	145
Other	<u>260</u>	<u>243</u>	<u>473</u>	<u>456</u>
Total noninterest expense	<u>3,002</u>	<u>2,945</u>	<u>5,931</u>	<u>5,680</u>
Income before income tax expense	96	596	397	1,376
Income tax expense (benefit)	<u>(62)</u>	<u>142</u>	<u>(54)</u>	<u>349</u>
Net income	158	454	451	1,027

(Continued)

NATIONAL BANCSHARES CORPORATION
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (Unaudited)

<i>(Continued)</i>	Three months ended		Six months ended	
	<u>June 30, 2010</u>	<u>June 30, 2009</u>	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Other comprehensive income (loss):				
Unrealized appreciation (depreciation) in fair value of securities available for sale, net of taxes of \$(193), \$46, \$(524) and \$(250)	325	(90)	1,017	486
Reclassification adjustment for realized gains included in earnings, net of taxes of \$0, \$53, \$26 and \$105	<u>-</u>	<u>(103)</u>	<u>(50)</u>	<u>(203)</u>
Total other comprehensive income (loss), net of taxes	<u>325</u>	<u>(193)</u>	<u>967</u>	<u>283</u>
Comprehensive income	<u>\$ 483</u>	<u>\$ 261</u>	<u>\$ 1,418</u>	<u>\$ 1,310</u>
Weighted average basic and diluted common shares outstanding	<u>2,205,973</u>	<u>2,202,368</u>	<u>2,205,973</u>	<u>2,202,368</u>
Basic and diluted earnings per common share	<u>\$ 0.07</u>	<u>\$ 0.21</u>	<u>\$ 0.20</u>	<u>\$ 0.47</u>
Dividends declared per common share	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.16</u>	<u>\$ 0.16</u>

See accompanying notes to consolidated financial statements.

NATIONAL BANCSHARES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

(dollars in thousands, except per share data)

	Six months ended,	
	June 30, 2010	June 30, 2009
Balance at beginning of period	\$ 38,903	\$ 36,881
Comprehensive income		
Net income	451	1,027
Other comprehensive income	<u>967</u>	<u>283</u>
Total comprehensive income	1,418	1,310
Stock-based compensation	9	23
Cash dividends declared (\$0.16 per share in 2010 and 2009)	<u>(353)</u>	<u>(353)</u>
Balance at end of period	<u>\$ 39,977</u>	<u>\$ 37,861</u>

See accompanying notes to consolidated financial statements.

NATIONAL BANCSHARES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(dollars in thousands, except per share data)

	Six months ended	
	June 30, 2010	June 30, 2009
Net cash from operating activities	\$ 1,958	\$ 921
Cash flows from investing activities		
Proceeds from time deposits with other financial institutions	4,136	-
Securities available for sale		
Proceeds from maturities and repayments	19,463	15,611
Proceeds from sales	1,988	5,615
Purchases	(21,732)	(24,333)
Purchases of property and equipment	(2,402)	(1,989)
Proceeds from the sale of other real estate owned	35	-
Proceeds from the sale of an impaired loan	930	-
Purchase of loans	(1,184)	(1,151)
Net change in loans	<u>1,938</u>	<u>2,517</u>
Net cash from investing activities	3,172	(3,730)
Cash flows from financing activities		
Net change in deposits	17,707	15,191
Net change in short-term borrowings	(2,633)	(6,211)
Proceeds from Federal Home Loan Bank advances	-	4,000
Repayments of Federal Home Loan Bank advances	(2,000)	(1,000)
Dividends paid	<u>(353)</u>	<u>(353)</u>
Net cash from financing activities	<u>12,721</u>	<u>11,627</u>
Net change in cash and cash equivalents	17,851	8,818
Beginning cash and cash equivalents	<u>8,124</u>	<u>11,001</u>
Ending cash and cash equivalents	<u>\$ 25,975</u>	<u>\$ 19,819</u>
Supplemental Disclosures		
Cash paid for interest	\$ 1,705	\$ 2,554
Cash paid for income taxes	\$ 470	\$ 140
Supplemental noncash disclosures:		
Transfer from loans to other real estate owned	\$ 41	\$ 54

See accompanying notes to consolidated financial statements.

Note 1 – Basis of Presentation

(dollars in thousands)

Company Organization and Financial Presentation

The accompanying consolidated financial statements include the accounts of National Bancshares Corporation (the “Company”) and its wholly owned subsidiaries, First National Bank, Orrville, Ohio (the “Bank”) and NBOH Properties, LLC. The Bank has a minority interest in First Kropf Title, LLC. The Bank’s investment in First Kropf Title, LLC is immaterial to the consolidated financial statements. All significant intercompany transactions and balances have been eliminated.

The Company provides a broad range of financial services to individuals and companies in Medina, Stark, Summit and Wayne Counties, Ohio. While the Company’s chief decision makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all the Company’s banking operations are considered by management to be aggregated in one reportable operating segment.

The consolidated balance sheet as of June 30, 2010, the consolidated statements of income and comprehensive income for the three and six month periods ended June 30, 2010 and 2009, and the condensed consolidated statements of changes in shareholders’ equity and the condensed consolidated statements of cash flows for the six month periods ended June 30, 2010 and 2009, have been prepared by the Company without audit. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

The consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q, but do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These statements should be read in conjunction with the consolidated financial statements and footnotes in the Company’s annual report on Form 10-K for the year ended December 31, 2009. Operating results for the six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

The Company believes that the disclosures are adequate to make the information presented not misleading; however, the results of operations and other data presented for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year.

Use of Estimates

To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses, fair values of financial instruments and carrying value of intangible assets are particularly subject to change.

Cash Flows

Cash and cash equivalents include cash, deposits with other banks with original maturities under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits with other banks, repurchase agreements and other short-term borrowings.

Earnings Per Common Share

Earnings per common share is net income divided by the weighted average number of shares outstanding during the period. Diluted earnings per share includes the dilutive effect of additional potential common shares issuable under stock options. 48,400 and 53,000 stock options were not considered in computing diluted earnings per common share for the periods ending June 30, 2010 and 2009, respectively, because they were antidilutive.

Note 2 – Securities
(dollars in thousands)

Securities consist of the following at June 30, 2010 and December 31, 2009:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>June 30, 2010</u>				
U.S. Government and federal agency	\$ 4,354	\$ 62	\$ -	\$ 4,416
State and municipal	34,541	1,081	(58)	35,564
Corporate bonds and notes	2,864	53	-	2,917
Mortgage-backed: residential	84,719	4,123	(11)	88,831
Equity securities	23	-	(17)	6
Total	<u>\$ 126,501</u>	<u>\$ 5,319</u>	<u>\$ (86)</u>	<u>\$ 131,734</u>
<u>December 31, 2009</u>				
U.S. Government and federal agency	\$ 819	\$ -	\$ -	\$ 819
State and municipal	28,019	763	(99)	28,683
Corporate bonds and notes	7,640	137	-	7,777
Mortgage-backed: residential	89,972	3,058	(87)	92,943
Equity securities	23	-	(4)	19
Total	<u>\$ 126,473</u>	<u>\$ 3,958</u>	<u>\$ (190)</u>	<u>\$ 130,241</u>

	<u>For the six months ended June 30, 2010</u>	<u>June 30, 2009</u>
Sales of available for sale securities were as follows:		
Proceeds	\$ 1,988	\$ 5,615
Gross gains	76	308
Gross losses	-	-

	<u>For the three months ended June 30, 2010</u>	<u>June 30, 2009</u>
Sales of available for sale securities were as follows:		
Proceeds	\$ -	\$ 2,311
Gross gains	-	156
Gross losses	-	-

The tax provision related to these net realized gains and losses was \$26 and \$105, respectively for the six months ended June 30, 2010 and 2009.

The fair value of securities at June 30, 2010 by contractual maturity were as follows. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 5,415	\$ 5,445
Due from one to five years	4,685	4,835
Due from five to ten years	17,087	17,657
Due after ten years	14,572	14,960
Mortgage-backed: residential	84,719	88,831
Equity securities	23	6
Total	<u>\$ 126,501</u>	<u>\$ 131,734</u>

Securities pledged at June 30, 2010 and December 31, 2009 had a carrying amount of \$72,858 and \$45,882 and were pledged to secure public deposits and repurchase agreements.

At June 30, 2010 and December 31, 2009, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

Securities with unrealized losses at June 30, 2010 and December 31, 2009, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
<u>June 30, 2010</u>						
State and municipal	\$ 4,329	\$ (25)	\$ 461	\$ (33)	\$ 4,790	\$ (58)
Mortgage-backed: residential	2,628	(11)	-	-	2,628	(11)
Equity securities	<u>6</u>	<u>(17)</u>	<u>-</u>	<u>-</u>	<u>6</u>	<u>(17)</u>
Total temporarily impaired	<u>\$ 6,963</u>	<u>\$ (53)</u>	<u>\$ 461</u>	<u>\$ (33)</u>	<u>\$ 7,424</u>	<u>\$ (86)</u>

	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
<u>December 31, 2009</u>						
State and municipal	\$ 4,375	\$ (60)	\$ 455	\$ (39)	\$ 4,830	\$ (99)
Mortgage-backed: residential	11,761	(87)	-	-	11,761	(87)
Equity securities	<u>19</u>	<u>(4)</u>	<u>-</u>	<u>-</u>	<u>19</u>	<u>(4)</u>
Total temporarily impaired	<u>\$ 16,155</u>	<u>\$ (151)</u>	<u>\$ 455</u>	<u>\$ (39)</u>	<u>\$ 16,610</u>	<u>\$ (190)</u>

Management believes the unrealized losses of securities as of June 30, 2010 are the result of fluctuations in interest rates and do not reflect deterioration in the credit quality of the securities. Accordingly management considers these unrealized losses to be temporary in nature. The Company does not have the intent to sell and does not believe it is more likely than not the Company will be required to sell these securities before their recovery.

The unrealized losses on securities reported in the previous table have not been recognized into income because the related securities are of high credit quality, management has the intent and ability to hold for the foreseeable future, and the decline in fair value is largely due to changes in market interest rates or normally expected market pricing fluctuations. The fair value of debt securities is expected to recover as the securities approach their maturity date.

Note 3 – Allowance for Loan Losses

(dollars in thousands)

The activity in the allowance for loan losses for the periods indicated was as follows:

	<u>For the six months ended</u>	
	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Beginning balance	\$ 2,906	\$ 1,718
Provision for loan losses	1,122	351
Loans charged-off	(1,482)	(80)
Recoveries	<u>14</u>	<u>3</u>
Ending balance	<u>\$ 2,560</u>	<u>\$ 1,992</u>

Individually impaired loans were as follows:

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Loans with no allocated allowance for loan losses	\$ 283	\$ 2,069
Loans with allocated allowance for loan losses	2,044	3,692
Amount of the allowance for loan losses allocated	511	916

The impact on interest income of impaired loans was not significant to the consolidated statements of income.

Impaired loans are generally measured for impairment using the fair value of the collateral supporting the loan. Evaluating impaired loan collateral is based on level 3 inputs utilizing outside appraisals adjusted by management for sales costs and other assumptions regarding market conditions to arrive at fair value.

Nonaccrual loans and loans past due 90 days still on accrual were as follows:

	June 30, 2010	December 31, 2009
Loans past due over 90 days still on accrual	\$ 535	\$ 458
Nonaccrual loans	2,778	4,716

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

Note 4 – Interest-Rate Swaps

(dollars in thousands)

The Company utilizes interest-rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position, not for speculation. The notional amount of the interest-rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest-rate swap agreements.

The Company implemented a program in 2009 whereby it lends to its borrowers at a fixed rate with the loan agreement containing a two-way yield maintenance provision. The program has one participant as of June 30, 2010. If the borrower prepays the loan, the yield maintenance provision will result in a prepayment penalty or benefit depending on the interest rate environment at the time of the prepayment. This provision represents an embedded derivative which is required to be bifurcated from the host loan contract. As a result of bifurcating the embedded derivative, the Company records the transaction with the borrower as a floating rate loan and a pay floating / receive fixed interest-rate swap. To offset the risk of the interest-rate swap with the borrower, the Company enters into an interest-rate swap with an outside counterparty that mirrors the terms of the interest-rate swap between the Company and the borrower. Both interest-rate swaps are carried as freestanding derivatives with their changes in fair value reported in current earnings. The interest-rate swaps are not designated as hedges. The change in the fair value of the interest-rate swap between the Company and its borrower was an increase of \$41 for the six months ended June 30, 2010, which was offset by an equal decrease in value during the six months ended June 30, 2010 on the interest-rate swap with an outside counterparty, with the result that there was no impact on income as of June 30, 2010.

Summary information about the interest-rate swaps not designated as hedges between the Company and its borrower as of June 30, 2010 is as follows:

Notional amount	\$ 1,514
Weighted average receive rate	5.33%
Weighted average pay rate	3.27%
Weighted average maturity (years)	3.5
Fair value of interest-rate swaps	\$ 45

Summary information about the interest-rate swaps between the Company and outside parties as of June 30, 2010 is as follows:

Notional amount	\$ 1,514
Weighted average pay rate	5.33%
Weighted average receive rate	3.27%
Weighted average maturity (years)	3.5
Fair value of interest-rate swaps	\$ (45)

The fair value of the interest-rate swaps at June 30, 2010 is reflected in other assets and other liabilities with a corresponding offset to noninterest income.

Note 5 – Stock-Based Compensation

(dollars in thousands, except per share information)

The Corporation's 2008 Equity Incentive Plan ("the Plan"), which is shareholder-approved, permits the grant of stock options or restricted stock awards, to its officers, employees, consultants and non-employee directors for up to 223,448 shares of common stock.

Option awards are granted with an exercise price equal to the market price of the Corporation's common stock at the date of grant; those option awards have vesting periods determined by the Corporation's compensation committee and have terms that shall not exceed 10 years.

On May 20, 2008, the Corporation granted options to purchase 58,000 shares of stock to directors and certain key officers, all of which remained outstanding at June 30, 2010. The exercise price of the options is \$18.03 per share. The options vest in five equal installments over a five-year period and have a term of 10 years. 4,600 and 5,000 options were forfeited during 2010 and 2009, leaving 48,400 outstanding at June 30, 2010. All remaining options are expected to vest.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. (Employee and management options are tracked separately.) The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferrable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of options granted of \$1.83 per option was determined using the following weighted-average assumptions as of grant date.

Risk-free interest rate	3.19%
Expected term (years)	6.5
Expected stock price volatility	13.76%
Dividend yield	3.60%

The total compensation cost that has been charged against income for the plan was \$5 and \$11 for the quarters ended June 30, 2010 and 2009 and \$9 and \$23 for the six month periods ended June 30, 2010 and 2009. The total income tax benefit was \$2 and \$4 for the quarters ended June 30, 2010 and 2009 and \$3 and \$8 for the six month periods ended June 30, 2010 and 2009. As of June 30, 2010, there was \$23 of total unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost is expected to be recognized over a weighted-average period of 2.9 years. At June 30, 2010, 20,800 options are vested and the outstanding options have no intrinsic value. The weighted average remaining contractual term is 7.9 years.

Note 6 – Fair Value

(dollars in thousands)

ASC 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the relationship to other benchmark quoted securities (Level 2 inputs).

The fair value of servicing rights is based on market prices for comparable mortgage servicing contracts, when available, or alternatively based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. The Corporation is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 2 inputs).

The fair value of derivatives is based on valuation models using observable market data as of the measurement date (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less cost to sell. Fair Values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Loans held for sale are carried at the lower of cost or fair value, as determined by outstanding commitments, from third party investors.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements at June 30, 2010 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Available for sale securities:			
U.S. Government and federal agency	\$ -	\$ 4,416	\$ -
State and municipal	-	35,564	-
Corporate bonds and notes	-	2,917	-
Mortgage-backed securities - residential	-	88,831	-
Equity securities	6	-	-
Interest rate swaps	-	45	-

Fair Value Measurements at June 30, 2010 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:			
Interest rate swaps	\$ -	\$ 45	\$ -

Fair Value Measurements at December 31, 2009 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Available for sale securities:			
U.S. Government and federal agency	\$ -	\$ 819	\$ -
State and municipal	-	28,683	-
Corporate bonds and notes	-	7,777	-
Mortgage-backed securities - residential	-	92,943	-
Equity securities	19	-	-
Interest rate swaps	-	4	-

Fair Value Measurements at December 31, 2009 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:			
Interest rate swaps	\$ -	\$ 4	\$ -

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

Fair Value Measurements at June 30, 2010 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Impaired loans	\$ -	\$ -	\$ 1,533
Other real estate owned	-	-	99

Fair Value Measurements at December 31, 2009 Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:			
Impaired loans	\$ -	\$ -	\$ 3,626
Other real estate owned	-	-	58

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal amount of \$2,044, with a valuation allowance of \$511, resulting in an additional provision of \$1,062 for loan loss in the six months ended June 30, 2010. Impaired loans had a principal amount of \$4,542, with a valuation allowance of \$916, resulting in an additional provision of \$1,091 for loan loss in the year ended December 31, 2009.

Other real estate owned measured at fair value less costs to sell, had a net carrying amount of \$99, which is made up of the outstanding balance of \$174, net of a valuation allowance of \$75 at June 30, 2010. There were no write-downs of other real estate owned for the periods ending June 30, 2010 and 2009. Other real estate owned measured at fair value less costs to sell, had a net carrying amount of \$58, which is made up of the outstanding balance of \$133, net of a valuation allowance of \$75 at December 31, 2009, resulting in a write-down of \$75 for the year ending December 31, 2009.

Carrying amount and estimated fair values of financial instruments at June 30, 2010 were as follows:

	For the six months ended			
	June 30, <u>2010</u>		December 31, <u>2009</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets				
Cash and cash equivalents	\$ 25,975	\$ 25,975	\$ 8,124	\$ 8,124
Time deposits with other financial institutions	9,444	9,444	13,580	13,580
Securities available for sale	131,734	131,734	130,241	130,241
Restricted equity securities	3,219	na	3,218	na
Loans held for sale	143	143	316	316
Loans, net	191,078	191,853	194,071	194,103
Accrued interest receivable	1,249	1,249	1,334	1,334
Interest rate swaps	45	45	4	4
Financial liabilities				
Deposits	\$ 309,080	\$ 310,016	\$ 291,373	\$ 292,045
Short-term borrowings	7,087	7,087	9,720	9,720
Federal Home Loan Bank advances	25,000	25,671	27,000	27,779
Accrued interest payable	368	368	408	408
Interest rate swaps	45	45	4	4

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, time deposits with other financial institutions, interest bearing deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. Security fair values are determined as previously described. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of restricted equity securities due to restrictions placed on its transferability. The fair value of off-balance-sheet items is not considered material.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

FORWARD-LOOKING INFORMATION

This Form 10-Q contains forward-looking statements as referenced in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to many risks and uncertainties. When used herein, the terms “anticipates,” “plans,” “expects,” “believes,” and similar expressions as they relate to the Company or its management are intended to identify such forward looking statements. Actual results could differ materially from those indicated by the forward-looking statements. Risks and uncertainties that could cause or contribute to differences include, changes in the regulatory environment, changes in business conditions and inflation, risks associated with credit quality and other factors discussed in the Company's filings with the U.S. Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2009. The Company assumes no obligation to update any forward-looking statement.

GENERAL

The Company's results of operations are dependent primarily on net interest income, provision for loan losses, noninterest income and its ability to control costs. Net interest income is the difference (“spread”) between the interest income earned on loans and securities and the cost of funds, consisting of interest paid on deposits, Federal Home Loan Bank advances and short-term funds. The interest rate spread is affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows. The provision for loan losses is significantly affected by the relative strength or weakness of the local economy. The Company's net income is also affected by, among other things, loan fee income, service charges, gains on securities and loans, operating expenses, FDIC assessment expense and franchise and income taxes. The Company's operating expenses principally consist of employee compensation and benefits, occupancy and other general and administrative expenses. The Company's results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities. Additionally, future changes in applicable laws, regulations or government policies may also materially impact the Company.

OVERVIEW

Total assets increased to \$384.3 million as of June 30, 2010, from \$370.2 million at December 31, 2009.

Basic and diluted earnings per share for the first six months of 2010 totaled \$0.20 per share. Net income for the first six months of 2010 was \$451 thousand compared to \$1,027 thousand for the same period of 2009 or \$0.20 and \$0.47 basic and diluted per share, respectively. Net income was positively impacted by an increase in net interest income and negatively impacted by an increase in the provision for loan losses and noninterest expense.

Net interest income for the six month period ended June 30, 2010 increased 3.4% compared to the same period in 2009 despite a declining interest rate environment. The improvement in net interest margin was driven by an 8.0% increase in average earning assets and growth in lower cost core deposits. The provision for loan losses increased to \$1.1 million for the six months ended June 30, 2010 compared to \$351 thousand for the same period in 2009. The increase in the provision was primarily related to the specific loss allocation, attributable to the deterioration during 2010 of two adversely classified loans. Noninterest income for the first six months of 2010 decreased \$161 thousand compared to the same period in 2009, primarily related to the decrease in net gains recorded on the sale of securities from \$308 thousand in 2009 to \$76 thousand in 2010.

Noninterest expense for the first six months of 2010 increased \$251 thousand compared to the same period in 2009 due primarily to an increase in professional and consulting fees. The increase in professional and consulting fees was due to an increase in legal fees related to loan collection efforts and a document imaging project. Income tax expense (benefit) was \$(54) thousand for the six months ended June 30, 2010 compared to \$349 thousand for the same period in 2009.

Office of the Controller of the Currency (“OCC”) regulations requires banks to maintain certain minimum levels of regulatory capital. Additionally, the regulations establish a framework for the classification of banks into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Generally, an institution is considered well-capitalized if it has a core (Tier 1) capital ratio of at least 5.0% (based on adjusted total assets); a core (Tier 1) risk-based capital ratio of at least 6.0%; and a total risk-based capital ratio of at least 10.0%. The Bank had capital ratios above the minimum to be well-capitalized at June 30, 2010 and December 31, 2009.

The Company is not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on liquidity, capital resources or operations or any current recommendations by its regulators which would have a material effect if implemented. The Company has not engaged in sub-prime lending activities and does not plan to engage in those activities in the future.

FINANCIAL CONDITION – JUNE 30, 2010, COMPARED TO DECEMBER 31, 2009

Balance Sheet

Cash and due from banks increased \$17.9 million to \$26.0 million at June 30, 2010.

Securities available for sale increased \$1.5 million due to the purchase of \$21.7 million of securities, offset by maturities and repayments of \$19.5 million and \$2.0 million in sales. The net unrealized gains on securities increased to \$5.2 million as of June 30, 2010 compared to \$3.8 million net unrealized gains on securities as of December 31, 2009.

Loans decreased \$3.3 million during the first six months of 2010. Average loans have increased from \$181.6 million for the six month period ended June 30, 2009 to \$193.3 million for the same period in 2010. The loan demand in the Bank’s primary market remains soft. However, the Bank continues to focus on enhancing it’s ability to originate commercial loans and improving demand for commercial loan products.. Commercial and commercial real estate loans have increased \$19.1 million over the last twelve month period. The Bank began offering Small Business Administration (SBA) guaranteed loan services in 2009. \$1.2 million of SBA guaranteed loans were originated during the six months ending June, 30, 2010.

Loans at June 30, 2010 and December 31, 2009 were as follows:
(dollars in thousands)

	June 30, 2010	December 31, 2009
Collateralized by real estate:		
Commercial	\$ 68,014	\$ 65,139
Residential	47,116	50,390
Home Equity	27,597	26,526
Construction and land development	11,890	12,395
	154,617	154,450

(dollars in thousands)

	June 30, 2010	December 31, 2009
Other:		
Consumer	11,935	12,343
Commercial	24,965	26,792
Other	<u>2,508</u>	<u>3,830</u>
	<u>194,025</u>	<u>197,415</u>
Unearned and deferred income	(387)	(438)
Allowance for loan losses	<u>(2,560)</u>	<u>(2,906)</u>
Total	<u>\$ 191,078</u>	<u>\$ 194,071</u>

Allowance for loan losses is a valuation allowance for probable incurred credit losses. This account is increased by the provision for loan losses and decreased by charge-offs less recoveries. The allowance balance required is established using the following methodology:

- All problem loans, impaired loans, past due loans and non-performing loans are closely monitored and analyzed by management on an ongoing basis. A classification rating is assigned to problem loans based on information about specific borrower situations and estimated collateral values. These loans are classified as either special mention, substandard, doubtful or loss.
- Specific problem loans, past due loans or non-performing loans are identified and analyzed individually in an effort to determine the expected probable incurred loss on these specifically identified loans.
- For problem loans that are not analyzed individually, a provision is established based on a historical migration analysis. The historical migration analysis identifies the percentage of problem loans that have been ultimately charged-off historically and over what time periods such loans have been charged off. Historical migration percentages are reviewed and adjusted by management to reflect various factors such as the growth and change in mix of the loan portfolio and by Comptroller of the Currency regulatory guidance. Non-individually analyzed loans are pooled and evaluated by loan type. The probable incurred loss on these pooled past due loans is estimated using historical loan loss experience.
- National and local economic conditions and other factors are also considered in determining the adequacy of the allowance for loan losses.
- A percentage of the allowance is allocated to specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.
- The allowance for loan losses is reviewed on a regular basis to determine the adequacy of the allowance.

The allowance for loan losses to total loans outstanding was 1.32% as of June 30, 2010, which is a decrease from 1.48% at December 31, 2009. The decrease in the allowance for loan losses was primarily related to a \$1.1 million partial charge-off of a commercial credit and a \$270 thousand charge-off of a commercial real estate loan sold in the second quarter. These loans were graded substandard and considered impaired as of December 31, 2009. Management allocated \$720 thousand of the allowance for loan losses to these two loans as of December 31, 2009. The provision for loan losses for the six months ended June 30, 2010 was \$1.1 million, compared to \$351 thousand for the same period in 2009. Net charge-offs were \$1.5 million for the six months ended June 30, 2010, compared to \$77 thousand for the same period in 2009.

The ratio of non-performing loans to total loans was 1.71% (\$3.3 million) for June 30, 2010 compared to 2.67% (\$5.2 million) for December 31, 2009. Non-performing loans consist of loans that have been placed on non-accrual status and loans past due over 90 days and still accruing interest. Loans past due 30 through 89 days and still accruing decreased from \$1.7 million as of December 31, 2009 to \$1.3 million as of June 30, 2010.

Adversely classified assets at June 30, 2010 and December 31, 2009 were as follows:

(dollars in thousands)

	June 30, 2010		December 31, 2009	
	<u>Amount</u>	<u>Percent of total loans</u>	<u>Amount</u>	<u>Percent of total loans</u>
Classified loans:				
Special mention	\$ 1,782	0.9%	\$ 2,841	1.4%
Substandard	8,287	4.2%	11,783	6.0%
Doubtful	-	0.0%	-	0.0%
Loss	<u>-</u>	<u>0.0%</u>	<u>-</u>	<u>0.0%</u>
Total classified loans	10,069	5.1%	14,624	7.4%
Other real estate owned	<u>99</u>	<u>0.1%</u>	<u>104</u>	<u>0.1%</u>
Total classified assets	<u>\$ 10,168</u>	<u>5.2%</u>	<u>\$ 14,728</u>	<u>7.5%</u>

Total classified loans decreased from \$14.6 million at December 31, 2009 to \$10.1 million at June 30, 2010. The Bank's classification ratio was 28.0% and 39.5% as of June 30, 2010 and December 31, 2009. The classification ratio is calculated using total adversely classified assets (excluding special mention loans) divided by Tier 1 capital plus allowance for loan losses. Management believes the allowance for loan losses is adequate as of June 30, 2010.

Total deposits increased \$17.7 million as of June 30, 2010 compared to December 31, 2009. Interest bearing demand deposits have increased \$3.0 million due primarily to an increase in local governmental deposit accounts. Historically noninterest-bearing demand accounts have fluctuated based upon the liquidity needs of our customers.

Deposits at June 30, 2010 and December 31, 2009 were as follows:

(dollars in thousands)

	June 30, 2010	December 31, 2009
Demand, noninterest-bearing	\$ 58,558	\$ 54,290
Demand, interest-bearing	120,864	117,862
Savings	50,170	46,371
Time, \$100,000 and over	22,619	15,712
Time, other	56,869	57,138
	<u>\$ 309,080</u>	<u>\$ 291,373</u>

Shareholders' Equity

Total shareholders' equity increased \$1.1 million to \$40.0 million as of June 30, 2010 from \$38.9 million as of December 31, 2009. Net income for the six months ended June 30, 2010 was \$451 thousand, while dividends declared were \$353 thousand. Accumulated other comprehensive income increased from \$2.5 million on December 31, 2009 to \$3.5 million as of June 30, 2010.

The Bank is subject to regulatory capital requirements. The following is a summary of the actual and required regulatory capital amounts and ratios. Management believes the capital position of the Bank remains strong.

(dollars in thousands)

June 30, 2010	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets	\$ 30,022	12.89%	\$ 18,639	8.00%	\$ 23,299	10.00%
Tier 1 capital to risk-weighted assets	27,462	11.79%	9,320	4.00%	13,977	6.00%
Tier 1 capital to average assets	27,462	7.48%	14,686	4.00%	18,358	5.00%

December 31, 2009	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets	\$ 29,842	12.46%	\$ 19,161	8.00%	\$ 23,952	10.00%
Tier 1 capital to risk-weighted assets	26,936	11.25%	9,581	4.00%	14,371	6.00%
Tier 1 capital to average assets	26,936	7.40%	14,562	4.00%	18,202	5.00%

Statements of Cash Flows

Net cash from operating activities for the first six months of 2010 was \$2.0 million compared to \$921 thousand for the same period of 2009. Net cash from investing activities for the first six months of 2010 was \$3.2 million, compared to \$(3.7) million for the first six months of 2009. Net cash from financing activities was \$12.7 million for the first six months of 2010 compared to \$11.6 million for the first six months of 2009. The increase in cash and cash equivalents was \$17.9 million during the first six months of 2010, primarily related to an increase in local governmental deposit accounts. Total cash and cash equivalents was \$26.0 million as of June 30, 2010 compared to \$8.1 million at December 31, 2009.

**COMPARISON OF RESULTS OF OPERATIONS FOR THE SIX MONTH PERIODS ENDED
June 30, 2010 and 2009**

Net income for the first six months of 2010 was \$451 thousand or \$0.20 per basic and diluted earnings per share compared to \$1,027 thousand or \$0.47 per basic and diluted earnings per share for the same period in 2009. The decrease was due primarily to an increase in the provision for loan losses and an increase in noninterest expense, partially offset by an increase in net interest income.

Annualized return on average equity ("ROAE") and average assets ("ROAA") for the first six months of 2010 were 2.28% and 0.24%, respectively, compared with 5.48% and 0.60% for the first six months of 2009.

(dollars in thousands)	2010			Six months ended June 30, 2009		
	<u>Daily Average Balance</u>	<u>Interest</u>	<u>Average yield/cost (1)</u>	<u>Daily Average Balance</u>	<u>Interest</u>	<u>Average yield/cost (1)</u>
Assets						
Interest earning assets:						
Securities:						
Taxable	\$ 100,131	\$ 1,967	4.08%	\$ 114,320	\$2,873	5.14%
Nontaxable	30,754	855	5.73%	16,944	505	6.10%
(tax equivalent basis) (2)						
Federal funds sold	-	-	0.00%	7,180	4	0.11%
Interest bearing deposits	22,308	107	0.96%	773	1	0.26%
Net loans (including nonaccrual loans)	<u>193,266</u>	<u>5,240</u>	<u>5.42%</u>	<u>181,583</u>	<u>5,149</u>	<u>5.67%</u>
Total interest-earning assets	<u>346,459</u>	<u>8,169</u>	<u>4.72%</u>	<u>320,800</u>	<u>8,532</u>	<u>5.32%</u>
All other assets	<u>27,001</u>			<u>23,837</u>		
Total assets	<u>\$ 373,460</u>			<u>\$ 344,637</u>		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities:						
Interest-bearing checking	\$ 118,609	341	0.57%	\$ 103,637	656	1.27%
Savings	47,705	37	0.16%	48,856	76	0.31%
Time, \$100,000 and over	17,344	158	1.82%	12,998	173	2.66%
Time, other	56,995	593	2.08%	59,800	893	2.99%
Federal Home Loan Bank advances	25,481	510	4.00%	24,657	530	4.30%
Other funds purchased	<u>10,592</u>	<u>26</u>	<u>0.49%</u>	<u>10,555</u>	<u>23</u>	<u>0.44%</u>
Total interest-bearing liabilities	<u>276,726</u>	<u>1,665</u>	<u>1.20%</u>	<u>260,503</u>	<u>2,351</u>	<u>1.80%</u>
Demand deposits	53,890			43,252		
Other liabilities	3,329			3,425		
Shareholders' equity	<u>39,515</u>			<u>37,457</u>		
Total liabilities and shareholders' equity	<u>\$ 373,460</u>			<u>\$ 344,637</u>		
Net interest income						
(tax equivalent basis) (2)		<u>\$ 6,504</u>			<u>\$6,181</u>	
Interest rate spread (3)			3.52%			3.52%
Net yield on interest-earning assets (4)			3.75%			3.85%
Ratio of average interest-earning assets to average interest-bearing liabilities			125.20%			123.15%

(1) Average yields are computed using annualized interest income and expense for the periods.

(2) Tax equivalence based on highest statutory rate of 34%.

(3) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(4) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

Interest and dividend income totaled \$7.9 million, a decrease of \$482 thousand for the six months ended June 30, 2010 compared to the same period in 2009. Adjusted on a fully tax-equivalent ("FTE") basis the yield on earning assets in the first six months of 2010 was 4.72% compared to 5.32% in the first six months of 2009.

Interest expense totaled \$1.7 million, a decrease of \$686 thousand or 29.2% for the six months ended June 30, 2010 as compared to the same period in 2009. The average cost for interest bearing liabilities was 1.20% compared to 1.80% for the first six months of 2009.

The decrease of 60 basis points from the first six months of 2010 is the result of change in the average volume in the mix of interest bearing liabilities and declining interest rates.

Net interest income increased \$204 thousand, or 3.4% for the six month period ended June 30, 2010 as compared to June 30, 2009. During the first six months of 2010, the interest rate spread was unchanged on a FTE basis when compared to the first six months of 2009.

Provision for loan losses totaled \$1.1 million for the first six months of 2010 compared to \$351 thousand for the same period in 2009. The increase in the provision for loan losses is primarily related to the deterioration in 2010 of two loan relationships mentioned earlier in the allowance for loan loss section.

Non-performing loans were \$3.3 million as of June 30, 2010, compared to \$5.2 million as of December 31, 2009. Adversely classified loans decreased to \$10.1 million at June 30, 2010 compared to \$14.6 million as of December 31, 2009. Adversely classified loans are credits that Bank management has graded special mention, doubtful and substandard. Loans past due 30 through 89 days and still accruing decreased from \$1.7 million as of December 31, 2009 to \$1.3 million as of June 30, 2010.

Each quarter, management reviews the adequacy of the allowance for loan losses by reviewing the overall quality and risk profile of the Company's loan portfolio, by reviewing specific problem credits and assessing the potential for losses based on expected cash flows or collateral values, by reviewing trends in problem loan levels, by updating loss history for the Company's loans, by analyzing the growth and change in mix of the portfolio, and by analyzing economic trends that are believed to impact the Company's borrowers. Management reviewed all of these factors and determined the allowance for loan losses was adequate as of June 30, 2010.

Noninterest income for the six months ended June 30, 2010 decreased to \$1.2 million or 11.5%, from \$1.4 million for the same period in 2009. The change is primarily related to the decrease in net gains recorded on the sale of securities from \$308 thousand in 2009 to \$76 thousand in 2010.

Noninterest expense for the six months ended June 30, 2010 was \$5.9 million, an increase of 4.4% from \$5.7 million for the same period in 2009. The increase in professional and consulting fees was due to an increase in legal fees related to loan collection expenses and a the costs associated with a project to convert all loan files from paper to digital images (a document imaging project).

Income tax expense (benefit) was \$(54) thousand for the six months ended June 30, 2010 which represents a decrease of \$403 thousand compared to the same period in 2009. Lower pre-tax income and an increase in interest income from tax-exempt securities for the six months ended June 30, 2010, compared to the same period in 2009, are the primary factors causing the decrease in income tax expense.

Quarters ended June 30, 2010 and June 30, 2009 income statement highlights:

- Net interest income increased \$88 thousand, compared to the same period in 2009. The change was driven by an increase in average earning assets and growth in lower cost core deposit funding.
- Interest income decreased \$229 thousand or 5.5%, primarily related to a decrease in interest income from taxable securities, partially offset by an increase in interest income from loans and nontaxable securities.
- Interest expense decreased \$317 thousand or 27.9%, primarily related to deposit interest expense.
- The provision for loan losses was \$615 thousand in the quarter ended June 30, 2010 compared to \$228 for the same period in 2009. The increase in the provision for loan losses was primarily related to an increase in the specific allocation for two loan relationships. \$1.4 million of loan charge-offs were recorded for these two loan relationships during the second quarter of 2010
- Mortgage banking income decreased from \$122 thousand for the three months ended June 30, 2010 to \$50 thousand for the same period in 2010. The change was due to a decrease in the volume of loans sold in 2010 compared to 2009.
- Securities gains (losses), net decreased from \$156 thousand for the quarter ended June 30, 2009, compared to \$0 for the same period in 2010. No securities were sold during the quarter ended June 30, 2010.
- FDIC Assessment expense decreased from \$279 thousand in the quarter ended June 30, 2009 to \$145 thousand for the same period in 2010. The change was due to a special FDIC assessment levied on all FDIC-insured institutions in 2009, partially offset by an increase in FDIC assessment rates in 2010.
- Income tax expense (benefit) was \$(62) thousand for the three months ended June 30, 2010, a decrease of \$204 thousand compared to the same period in 2009. Lower pre-tax income and an increase in interest income from tax-

exempt securities for the quarter ended June 30, 2010, compared to the same period in 2009, are the primary causes of the decrease.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Economic Value of Equity

The economic value of equity, (EVE), is the difference between the net present value of the assets and the net present value of liabilities. EVE can be thought of as the liquidation value of the Bank on the date the calculation is made. Calculating EVE involves using a discount rate to calculate the net present value of assets and liabilities after making assumptions about the duration of assets and liabilities. As interest rates change, the discount rate changes and the change in interest rates effects the duration of assets and liabilities. If interest rates fall, for example, the duration of loans shortens since borrowers tend to prepay.. Conversely the duration of loans increases if interest rates rise since borrowers are inclined to hold on to the favorable rate they were able to obtain in the lower interest rate environment.

The Board of Directors has established revised limits on a decline in the economic value of equity (EVE) and earnings at risk (EAR) given changes in interest rates. These limits are that EVE shall not decline by more than 10%, 20% and 30% given a 1%, 2% and 3% increase or decrease in interest rates respectively and that EAR shall not be greater than 8%, 16% or 24% given a 1%, 2% or 3% increase or decrease in interest rates respectively. The following illustrates our equity at risk in the economic value of equity model.

June 30, 2010

Basis Point Change in Rates	<u>+300 bp</u>	<u>+200 bp</u>	<u>+100 bp</u>	<u>-100 bp</u>	<u>-200 bp</u>	<u>-300 bp</u>
Increase (decrease) in EVE	(12.77)%	(6.36)%	(1.14)%	(6.39)%	<i>nm</i>	<i>nm</i>

December 31, 2009

Basis Point Change in Rates	<u>+300 bp</u>	<u>+200 bp</u>	<u>+100 bp</u>	<u>-100 bp</u>	<u>-200 bp</u>	<u>-300 bp</u>
Increase (decrease) in EVE	(13.4)%	(7.4)%	(2.3)%	(4.4)%	<i>nm</i>	<i>nm</i>

nm – not meaningful

The Bank is in compliance with the interest rate risk policy limits related to EVE as of June 30, 2010 and December 31, 2009.

Earnings at Risk

Earnings at risk, is the amount by which net interest income will be affected given a change in interest rates. The interest income and interest expense for each category of earning assets and interest bearing liabilities is recalculated after making up and down assumptions about the change in interest rates. Changes in prepayment speeds and repricing speeds are also taken into account when computing earnings at risk given a change in interest rates.

The following illustrates the effect on earnings or EAR given rate increases of 100 to 300 basis points and decreases in interest rates of 100 to 300 basis points.

June 30, 2010

Basis Point Change in Rates	<u>+300 bp</u>	<u>+200 bp</u>	<u>+100 bp</u>	<u>-100 bp</u>	<u>-200 bp</u>	<u>-300 bp</u>
Increase (decrease) in Earnings	0.59%	0.49%	0.38%	(1.53)%	<i>nm</i>	<i>nm</i>

December 31, 2009

Basis Point Change in Rates	<u>+300 bp</u>	<u>+200 bp</u>	<u>+100 bp</u>	<u>-100 bp</u>	<u>-200 bp</u>	<u>-300 bp</u>
Increase (decrease) in Earnings	(1.6)%	(1.1)%	(0.3)%	(0.1)%	<i>nm</i>	<i>nm</i>

nm – not meaningful

The Bank is in compliance with the interest rate risk policy limits related to EAR as of June 30, 2010 and December 31, 2009.

Item 4T. Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2010, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were, to the best of their knowledge, effective as of June 30, 2010, in timely alerting them to material information relating to the Company (including its consolidated subsidiary) required to be included in the Company's periodic SEC filings.

There were no changes in the Company's internal controls over financial reporting during the six months ended June 30, 2010 that materially affected or are reasonably likely to materially affect the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings - None
Item 1A.	Risk Factors - There have been no significant changes in the Company's risk factors as outlined in the Company's Form 10-K for the period ending December 31, 2009.
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds - None
Item 3.	Defaults Upon Senior Securities - None
Item 4.	Removed and Reserved
Item 5.	Other Information - None
Item 6.	Exhibits

Exhibit No. Under Reg. <u>S-K, Item 601</u>	Description of Exhibits	If incorporated by Reference, Documents with Which Exhibit Was Previously Filed with SEC
(3.1)	Amended Articles of Incorporation	Annual Report 10-K filed 3/26/04 File No. 000-14773
(3.2)	Code of Regulations	Annual Report 10-K filed 3/26/04 File No. 000-14773
(10.1)	Directors Defined Benefit Plan Agreement	Annual Report 10-K filed 3/29/01 File No. 000-14773
(10.2)	Employment Agreement entered into By David C. Vernon and National Bancshares and First National Bank	Special Report 8-K filed 12/7/06
(10.3)	Special Separation Agreement of James R. VanSickle	Quarterly Report 10-Q filed 8/14/07 File No. 000-14473
(10.4)	Special Separation Agreement of Thomas R. Poe	Quarterly Report 10-Q filed 11/14/2009 File No. 000-14773
(11)	Computation of Earnings per Share	See Consolidated Statements of Income and Comprehensive Income Page 4
(31.1)	Certification	
(31.2)	Certification	
(32)	Certification	

No other exhibits are required to be filed herewith pursuant to Item 601 of Regulation S-K.

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 Bancshares Corporation

Date: July 29, 2010

/s/David C. Vernon
David C. Vernon, President and
Chief Executive Officer

Date: July 29, 2010

/s/James R. VanSickle
James R. VanSickle, Chief Financial Officer

CERTIFICATIONS

I, David C. Vernon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bancshares Corporation;
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: July 29, 2010

/s/ David C. Vernon
David C. Vernon, President and
Chief Executive Officer

CERTIFICATIONS

I, James R. VanSickle, certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bancshares Corporation;
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: July 29, 2010

/s/James R. VanSickle
James R. VanSickle, Chief Financial Officer

SECTION 1350 CERTIFICATION OF QUARTERLY REPORT ON FORM 10-Q
OF
NATIONAL BANCSHARES CORPORATION
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2010

The undersigned are the President and Chief Financial Officer of National Bancshares Corporation (the “Registrant”). This Certification is made pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This Certification accompanies the Quarterly Report on Form 10-Q of the Registrant for the quarterly period ended June 30, 2010.

We certify that such Quarterly Report on Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in such 10-Q Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

This Certification is executed as of July 29, 2010

/s/ David C. Vernon
David C. Vernon, President and
Chief Executive Officer

/s/ James R. VanSickle
James R. VanSickle, Chief Financial Officer