



SAFE AND SOUND  
SINCE 1891

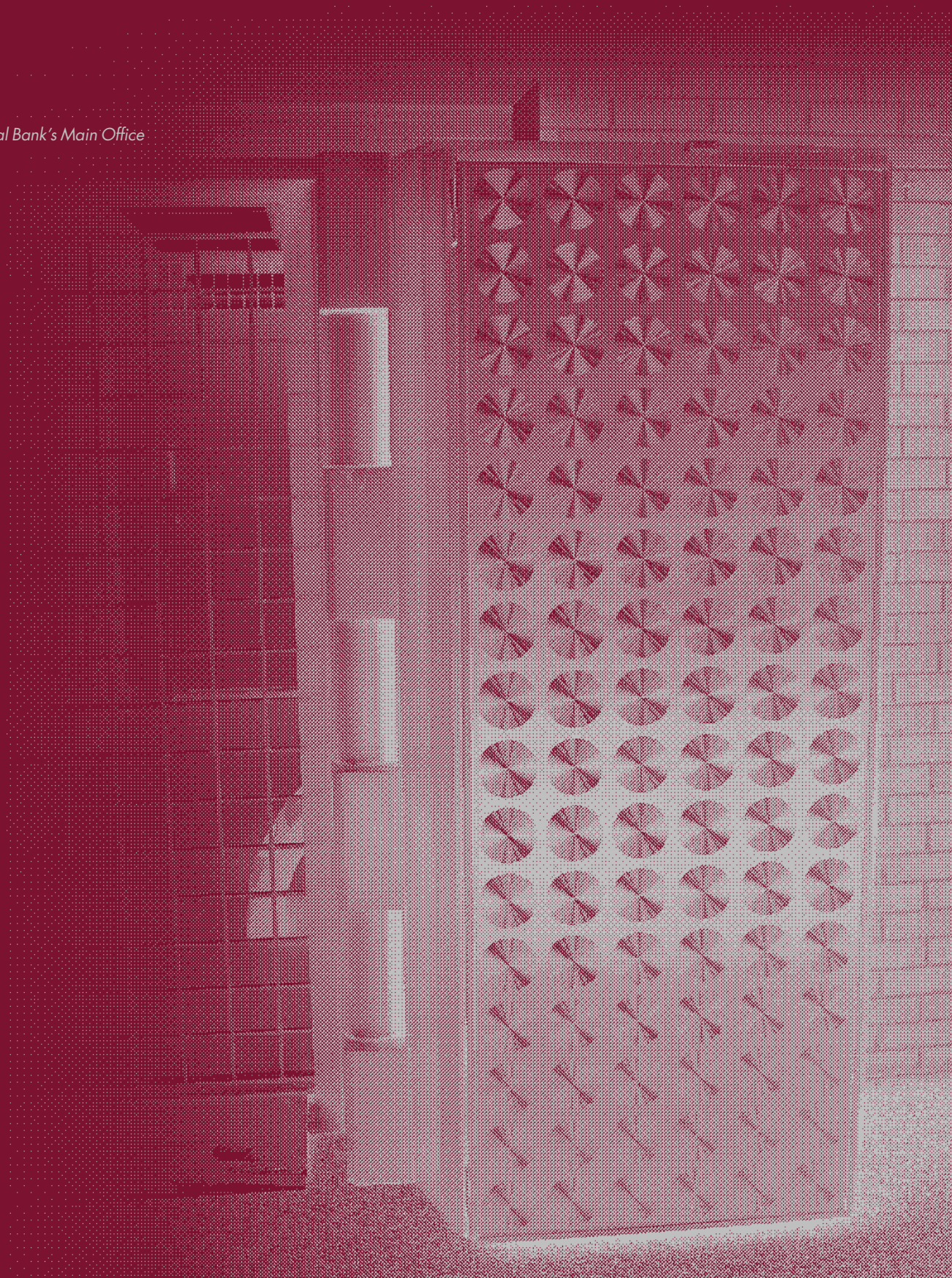
NATIONAL BANKSHARES, INC.

2008 ANNUAL REPORT

## OUR MISSION

**National Bankshares, Inc. strives to be an exceptional community bank holding company dedicated to providing shareholder value by offering financial services to customers through subsidiary financial institutions and affiliated companies in an efficient, friendly, personalized, and cost-effective manner. We recognize that to do this, our financial institutions must retain the ability to make decisions locally and must actively participate in the communities they serve. We are committed to offering competitive and fair employment opportunities and to maintaining the highest standards in all aspects of our business.**

*The unique vault door at National Bank's Main Office in Blacksburg, built in 1962.*



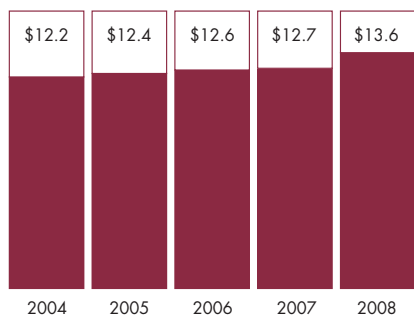


# FINANCIAL

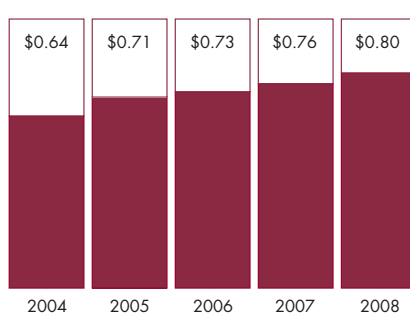
## HIGHLIGHTS

\$ in thousands, except per share data	2008	2007	2006	2005	2004
Net income	<b>\$ 13,593</b>	12,675	12,632	12,424	12,230
Basic net income per share	<b>1.96</b>	1.82	1.80	1.77	1.74
Diluted net income per share	<b>1.96</b>	1.82	1.80	1.76	1.73
Cash dividends per share	<b>0.80</b>	0.76	0.73	0.71	0.64
Book value per share	<b>15.89</b>	15.07	13.86	13.10	12.38
Loans, net	<b>569,699</b>	518,435	495,486	487,162	472,199
Total securities	<b>264,999</b>	273,343	285,489	272,541	250,708
Total assets	<b>935,374</b>	887,647	868,203	841,498	796,154
Total deposits	<b>817,848</b>	776,339	764,692	745,649	705,932
Stockholders' equity	<b>110,108</b>	104,800	96,755	91,939	87,088

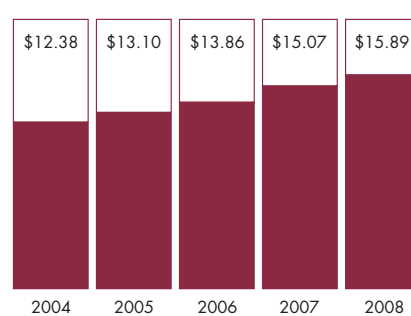
**NET INCOME** (in millions)



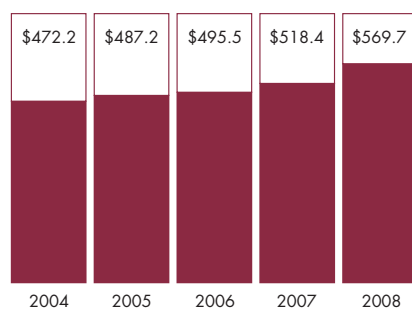
**CASH DIVIDENDS**



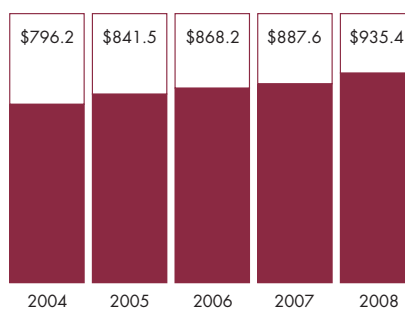
**BOOK VALUE**



**NET LOANS** (in millions)



**TOTAL ASSETS** (in millions)



**WE TAKE SERIOUSLY THE RESPONSIBILITY OF PRESERVING OUR CAREFUL AND CONSERVATIVE HERITAGE IN THE COMMUNITIES WE SERVE. WE FOCUS ON PROFITABILITY, RATHER THAN GROWTH FOR THE SAKE OF GROWTH. WHEN WE MAKE LOANS, WE KNOW OUR CUSTOMERS AND WE HAVE A CREDIT CULTURE THAT VALUES THOSE RELATIONSHIPS. WE THINK THAT SIMPLER IS BETTER, IN BOTH LOANS AND INVESTMENTS. AT TIMES, THIS APPROACH MAY SEEM A BIT OLD FASHIONED, BUT IT HAS SERVED US WELL.**



# MESSAGE

## TO OUR STOCKHOLDERS

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In a year that has been notable for a steady stream of bad financial news, it is particularly nice to report to you that National Bankshares, Inc. had record earnings in 2008. We achieved these results by sticking to the basics of community banking and doing only what we know we can do well. There were still good loans to be made in our southwest Virginia markets. Deposit totals grew, because depositors were confident that their hard-earned savings would remain safe in the 117 year-old National Bank. Finally, the professionals who work in National Bank's Trust department and in National Bankshares Investment and Insurance Services offered personalized service and reassurance to their customers during this period of economic uncertainty.

Net income for the year was over \$13.59 million, 7.24% higher than the nearly \$12.68 million earned in 2007. Basic net income per share increased from \$1.82 last year to \$1.96 in 2008. Total assets at December 31, 2008 were \$935.37 million, up 5.38% from the \$887.65 million we reported at December 31, 2007. Because we maintained solid levels of capital and liquidity throughout 2008, we were able to make loans in our communities all year long. This resulted in a 9.89% increase in net loans, from \$518.44 million at the end of 2007 to nearly \$569.70 million on December 31, 2008. Total deposits increased by 5.35%, from \$776.34 million last year to \$817.85 million at the end of 2008. The return on average assets for the year was 1.51%, and the return on average equity was 12.52%. Of particular interest to stockholders is the growth in stockholders' equity, up from \$104.80 million at December 31, 2007 to \$110.11 million at the end of 2008. Perhaps of even greater interest is the fact that National Bankshares' stockholders shared in this year's good results, with cash dividends increasing from the \$0.76 per share paid in 2007 to \$0.80 per share in 2008.

We ended 2008 with the ratio of nonperforming loans to total loans at a reasonable 0.23%. This compares with 0.22% at the end of 2007. In 2009, we anticipate that the weak economy will have a negative effect on the quality of the loan portfolio. Starting in the last half of 2008, we began to see increases in total nonperforming assets, particularly in the level of other real estate owned. In response to both the higher level of nonperforming assets and growth in the loan portfolio, the allowance for loan losses to total loans was increased to 1.02% by year-end, up from 1.00% at December 31, 2007. We will continue to carefully monitor loan quality. Our loan officers are staying in close contact with their customers so we can work with them during these challenging times.

Despite the fact that the past year's economic upheaval took a great deal of time and attention, we made a conscious effort to look beyond the near term. Your Board of Directors completed an extensive strategic planning initiative, the results of which should

help National Bankshares, Inc. remain in control of its own future. During 2008, we expanded our technology infrastructure by deploying remote check capture in several of our more distant bank offices. This system permits checks and other paper items to be converted to electronic images right in the branch office. The images are then sent by secure connection to the bank's central computer and are then sent on through the national check collection system. So, a paper check never leaves the office where it was first negotiated. Remote check capture has created savings in both time and transportation costs. Looking ahead to 2009, we have plans to upgrade software and to replace a substantial number of personal computers throughout the organization. At National Bankshares, we do not aspire to stay ahead of the technology growth curve, but we do keep up with changes and invest for the future.

As we attempt to adjust to rapidly changing economic circumstances, we are fortunate to work for a company that offers us a historical model for dealing with current challenges. National Bank was founded in 1891. Through good times and bad, it has been a safe and sound bank for generations of depositors and borrowers. At National Bankshares, Inc., we take seriously the responsibility of preserving that careful and conservative heritage in the communities we serve. We focus on profitability, rather than growth for the sake of growth. When we make loans, we know our customers and we have a credit culture that values those relationships. We think that simpler is better, in both loans and investments. At times, this approach may seem a bit old fashioned, but it has served us well. We expect to continue to follow this course through the challenging days ahead.

I would like to thank you for your investment in National Bankshares, Inc. We very much appreciate your ongoing support. Our directors deserve thanks from each of us for their many efforts on behalf of all stockholders. Finally, we would not be able to achieve what we have without the hard work and dedication of over 200 talented employees. It takes all of us to insure National Bankshares' success by continuing our 117 year-old tradition of committed community banking.



James G. Rakes  
Chairman of the Board  
President and Chief Executive Officer





# CONSOLIDATED

## BALANCE SHEETS

\$ in thousands, except per share data

<b>Assets</b>	<b>December 31, 2008</b>	December 31, 2007
Cash and due from banks	\$ 16,316	16,324
Interest-bearing deposits	29,656	29,687
Securities available for sale, at fair value	147,227	158,594
Securities held to maturity (fair value approximates \$117,277 at December 31, 2008 and \$115,463 at December 31, 2007)	117,772	114,749
Mortgage loans held for sale	348	220
Real estate construction loans	60,798	46,697
Real estate mortgage loans	162,757	145,542
Commercial and industrial loans	246,218	216,830
Loans to individuals	106,907	115,704
Total loans	576,680	524,773
Less unearned income and deferred fees	(1,123)	(1,119)
Loans, net of unearned income and deferred fees	575,557	523,654
Less allowance for loan losses	(5,858)	(5,219)
Loans, net	569,699	518,435
Premises and equipment, net	11,204	12,016
Accrued interest receivable	5,760	5,711
Other real estate owned, net	1,984	263
Intangible assets and goodwill	13,719	14,838
Other assets	21,689	16,810
Total assets	\$ 935,374	887,647
<b>Liabilities and Stockholders' Equity</b>		
Noninterest-bearing demand deposits	\$ 109,630	113,361
Interest-bearing demand deposits	256,416	237,772
Savings deposits	45,329	44,349
Time deposits	406,473	380,857
Total deposits	817,848	776,339
Other borrowed funds	54	64
Accrued interest payable	655	792
Other liabilities	6,709	5,652
Total liabilities	825,266	782,847
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. Authorized 10,000,000 shares; issued and outstanding, 6,929,474 in 2008, and 6,952,274 in 2007	8,662	8,690
Retained earnings	105,356	97,810
Accumulated other comprehensive (loss), net	(3,910)	(1,700)
Total stockholders' equity	110,108	104,800
Total liabilities and stockholders' equity	\$ 935,374	887,647

# CONSOLIDATED

## STATEMENTS OF INCOME

\$ in thousands, except per share data

Years ended December 31,

	2008	2007	2006
<b>Interest Income</b>			
Interest and fees on loans	\$ 37,108	37,265	34,879
Interest on interest-bearing deposits	449	726	684
Interest on securities - taxable	6,816	7,476	7,462
Interest on securities - nontaxable	5,738	5,302	4,876
Total interest income	50,111	50,769	47,901
<b>Interest Expense</b>			
Interest on time deposits of \$100,000 or more	6,004	6,519	4,912
Interest on other deposits	12,802	15,191	13,626
Interest on borrowed funds	12	35	26
Total interest expense	18,818	21,745	18,564
Net interest income	31,293	29,024	29,337
Provision for loan losses	1,119	423	49
Net interest income after provision for loan losses	30,174	28,601	29,288
<b>Noninterest Income</b>			
Service charges on deposit accounts	3,425	3,291	3,361
Other service charges and fees	326	330	370
Credit card fees	2,808	2,740	2,396
Trust income	1,231	1,333	1,528
Other income	1,122	1,015	1,117
Realized securities gains, net	175	51	30
Total noninterest income	9,087	8,760	8,802
<b>Noninterest Expense</b>			
Salaries and employee benefits	11,168	10,773	11,466
Occupancy and furniture and fixtures	1,751	1,743	1,957
Data processing and ATM	1,381	1,149	1,234
Credit card processing	2,105	2,146	1,833
Intangible assets amortization	1,119	1,138	1,137
Net costs of other real estate owned	100	81	19
Other operating expenses	4,399	3,926	4,024
Total noninterest expense	22,023	20,956	21,670
Income before income tax expense	17,238	16,405	16,420
Income tax expense	3,645	3,730	3,788
Net income	\$ 13,593	12,675	12,632
Basic net income per share	\$ 1.96	1.82	1.80
Fully diluted net income per share	\$ 1.96	1.82	1.80

# BOARDS

## OF DIRECTORS

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### **NATIONAL BANKSHARES, INC. BOARD OF DIRECTORS**

*Standing, from left:* Lawrence J. Ball, President, Moog Components Group; Jack H. Harry, President, Harry Enterprises, Inc.; William A. Peery, President, Cargo Oil Co., Inc.; Dr. James M. Shuler, Delegate, Virginia House of Delegates. *Seated, from left:* Jack W. Bowling, President, H.T. Bowling, Inc.; Glenn P. Reynolds, President, Reynolds Architects, Inc.; Dr. Mary G. Miller, President, Interactive Design and Development, Inc.; Dr. Jack M. Lewis, President, New River Community College; James G. Rakes, Chairman, President and Chief Executive Officer, National Bankshares, Inc.; Chairman, President and Chief Executive Officer, National Bank; Chairman, President and Treasurer, National Bankshares Financial Services, Inc.





# BOARDS OF DIRECTORS

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## **NATIONAL BANK BOARD OF DIRECTORS**

*Standing, from left:* Dr. J. Lewis Webb, Jr., Dentist; Carl M. McNeil, Realtor, Founder McNeil Real Estate, Inc.; Charles E. Green, III, Financial Planner, AXA Advisors, L.L.C.; James S. Gillespie, Jr., President, Jim Sam Gillespie Farm; Michael E. Dye, Pharmacist/Owner, New Graham Pharmacy; James C. Thompson, Chairman, Thompson & Litton. *Seated from left:* Dr. James M. Shuler, Delegate, Virginia House of Delegates; F. Brad Denardo, Executive Vice President, National Bankshares, Inc., Executive Vice President/Chief Operating Officer, National Bank; Ellen G. Burnop, Co-Owner and President, New River Office Supply; James G. Rakes, Chairman, President and Chief Executive Officer, National Bankshares, Inc., Chairman, President and Chief Executive Officer, National Bank, Chairman, President and Treasurer, National Bankshares Financial Services, Inc.

## **NATIONAL BANK ADVISORY BOARDS**

**MONTGOMERY COUNTY:** Dan A. Dodson, M. Scott Hill, Kathryn S. Oddo, James J. Owen, Arlene A. Saari, James C. Stewart, Marc A. Verniel, T. Cooper Via.

**GILES COUNTY:** Dr. Terry E. Arbogast, Mark E. Collins, Lisa W. Epperly, Dr. Robert C. McCracken, Ross E. Martin, Kenneth L. Rakes, Scarlet B. Ratcliffe, James E. Tyler.

**GALAX:** Thomas L. McChesney, Dr. James A. Williams, Jr., David F. Wilson.

**RADFORD/PULASKI COUNTY:** William K. Cunningham, Jack D. Nunley, Laura B. Turk.

**CHRISTIANSBURG:** Charles R. Beller, III, Gerard W. Higgins, Dr. Kenneth E. Jones, Dr. Peter J. McDonald, L. Scott Wade.

**BLUEFIELD:** Constance M. Saunders.

**RICHLANDS:** Thurmon T. Hackworth, Dr. Marvin D. Harman, Peter M. Mulkey, John M. Warner.

**INTERSTATE:** A. Susan Keene, Stephen A. Lester, II.

# CORPORATE

## INFORMATION

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### **NATIONAL BANKSHARES, INC. EXECUTIVE OFFICERS**

James G. Rakes  
Chairman, President and Chief Executive Officer

David K. Skeens  
Treasurer and Chief Financial Officer

F. Brad Denardo  
Executive Vice President

Marilyn B. Buhyoff  
Secretary and Counsel

### **ANNUAL MEETING**

The Annual Meeting of Stockholders will be held on Tuesday, April 14, 2009 at 3:00 p.m. at Custom Catering Center, 902 Patrick Henry Drive, Blacksburg, Virginia.

### **CORPORATE STOCK**

National Bankshares, Inc. common stock trades on the NASDAQ Capital Market under the symbol "NKSH".

### **FINANCIAL INFORMATION**

Investors and analysts seeking financial information about National Bankshares, Inc. should contact:

James G. Rakes  
Chairman, President and Chief Executive Officer  
(540) 951-6300 or (800) 552-4123  
jrakes@nbbank.com

Written requests may be directed to:  
National Bankshares, Inc.  
P.O. Box 90002, Blacksburg, VA 24062-9002

### **STOCKHOLDER SERVICES AND STOCK TRANSFER AGENT**

Stockholders seeking information about stock transfer requirements, lost certificates, dividends and other stockholder matters should contact:

Marilyn B. Buhyoff  
Secretary and Counsel  
(540) 951-6300 or (800) 552-4123  
mbuhyoff@nbbank.com

- or -  
Transfer Agent  
Registrar and Transfer Company  
10 Commerce Drive  
Cranford, NJ 07016-3572  
(800) 368-5948  
info@rtco.com

A copy of National Bankshares, Inc.'s annual report to the Securities and Exchange Commission on Form 10-K will be furnished without charge to any stockholder upon written request. The Form 10-K and other corporate publications are also available at [www.nationalbankshares.com](http://www.nationalbankshares.com). Proxy materials for the Annual Meeting of Stockholders are available at [www.nationalbanksharesproxy.com](http://www.nationalbanksharesproxy.com).

### **CORPORATE OFFICE**

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Blacksburg, Virginia 24060  
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[www.nationalbankshares.com](http://www.nationalbankshares.com)  
(540) 951-6300 or (800) 552-4123