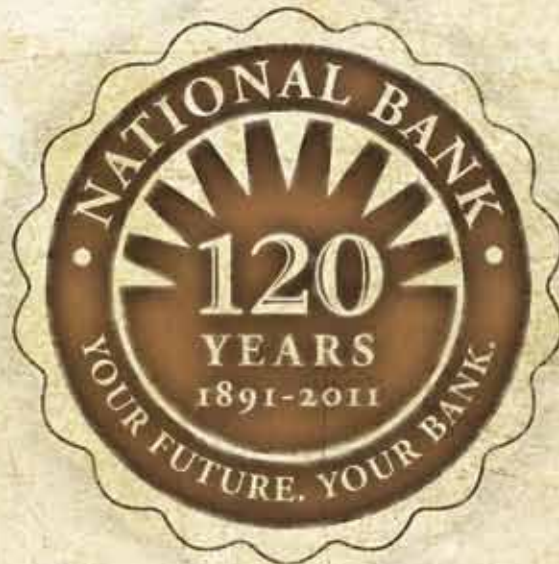


Celebrating 120 Years of Community Banking



National Bankshares, Inc.

Annual Report 2010

THE BANK OF BLACKSBURG

120 YEARS AGO, *the Commonwealth of Virginia issued a charter to a new bank, The Bank of Blacksburg. From our humble beginnings doing business from one room of the Green Hotel, National Bank has grown steadily through the years along with the communities we serve. Today, with 25 locations across southwest Virginia and over \$1 billion in assets, our commitment to friendly, personalized service and local decision making remains the key to our success and our highest priority.*

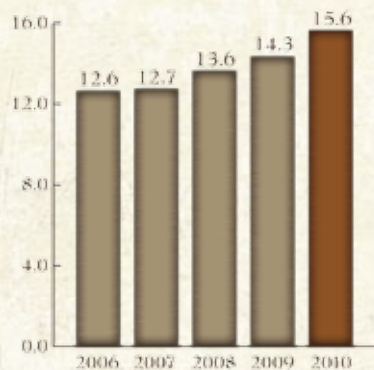


Financial Highlights

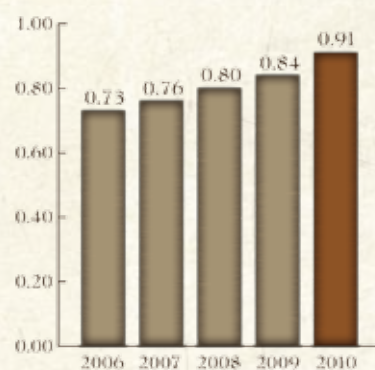
\$ in thousands, except per share data

	2010	2009	2008	2007	2006
<i>Net income</i>	\$ 15,569	\$ 14,319	\$ 13,593	\$ 12,675	\$ 12,632
<i>Basic net income per share</i>	2.25	2.07	1.96	1.82	1.80
<i>Diluted net income per share</i>	2.24	2.06	1.96	1.82	1.80
<i>Cash dividends per share</i>	0.91	0.84	0.80	0.76	0.73
<i>Book value per share</i>	18.63	17.61	15.89	15.07	13.86
<i>Loans, net</i>	568,779	583,021	569,699	518,435	495,486
<i>Total securities</i>	315,907	297,417	264,999	273,343	285,489
<i>Total assets</i>	1,022,238	982,367	935,374	887,647	868,203
<i>Total deposits</i>	884,583	852,112	817,848	776,339	764,692
<i>Stockholders' equity</i>	129,187	122,076	110,108	104,800	96,755

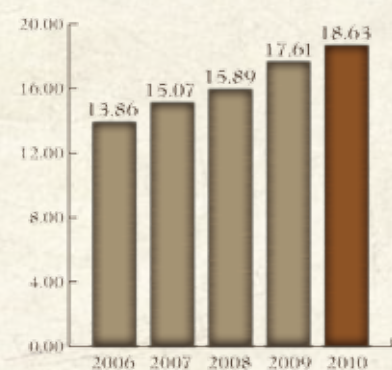
Net Income
dollars in millions



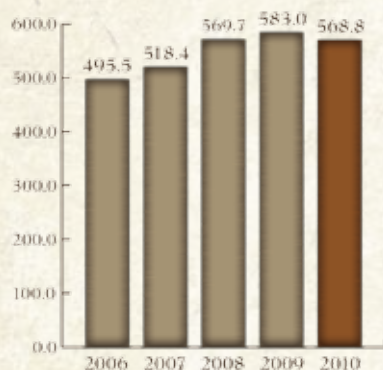
Cash Dividends Per Share
dollars



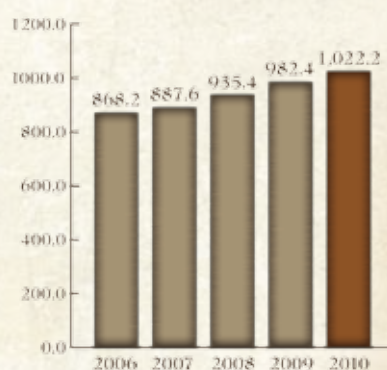
Book Value Per Share
dollars



Loans, Net
dollars in millions



Total Assets
dollars in millions



To Our Stockholders



In conversations with customers, I am sometimes asked how I define the term “community bank”. My answer has always been that a community bank is determined by philosophy, not by size. Recently, I have heard this question more often. This is because National Bankshares, Inc. ended 2010 with total assets of \$1.02 billion, the first time in its history that the Company ended the year with total assets above \$1 billion. While banking regulators and financial analysts might place significance on this figure, we do not.

Our goal is the same as it was in 1986, when National Bankshares, Inc. was founded with total assets of \$116 million. The goal was then, and it is now, to provide state-of-the art financial services in a friendly, professional atmosphere. We do that by hiring excellent local bankers, providing them with good training and technical support, and then letting them do their jobs. We foster a business philosophy that puts the customer first, and our employees enjoy long-term relationships with their customers. I regularly hear from senior

citizens who tell me that they opened their first bank account with us when they were children. They go on to say that they later bought a home with a National Bank mortgage loan. They educated their children with the help of a personal loan from us, and they now have an investment account with the Bank’s Trust Department or with National Bankshares Investment Services. Stories like these reinforce my strong belief that, despite its growth, National Bank remains a community bank.

Management team, from left to right: 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.

As I mentioned, National Bankshares, Inc. will celebrate its 25th anniversary later this year. Although certainly an achievement to be recognized, it pales by comparison to another anniversary celebration in 2011. In May, National Bank will be 120 years old. Alexander Black's idea to open the Bank of Blacksburg in one room of the Green Hotel on Main Street in 1891 has brought financial security to many generations. Many things have changed since the Bank was founded. Tellers record deposits on computers, not in ledger books. Paper checks are now converted to electronic images. Communications between our offices are nearly instantaneous. What has not changed is the desire to help customers by providing them with a full range of quality financial services.

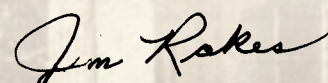
Despite challenges in the national and local economies, National Bankshares, Inc. maintained strong core earnings in 2010. Record net income for the twelve months ended December 31, 2010 was nearly \$15.57 million, an 8.7% increase over the nearly \$14.32 million earned in 2009. Net income for the year was largely the result of higher net interest income and lower noninterest expense. Because interest rates were low and stable throughout the year, total interest income was lower than in 2009. However, total interest expense declined by a greater percentage than interest income, resulting in a 9.58% increase in net interest income, from \$34.66 million for 2009 to over \$37.98 million for 2010. We think it is important to run an efficient business and to contain controllable costs. For the year ended December 31, 2010, noninterest expense was nearly \$23.13 million. This represents a decline of 3.0% from the \$23.85 million reported for 2009.

Our market area is still dealing with the effects of the prolonged economic downturn. It seems as if Southwest Virginia did not feel the full effects of the national recession as early as some other parts of the country. Now the local economy is not recovering as quickly as in certain other regions. Total nonperforming loans increased from \$6.75 million at the end of 2009 to \$8.42 million at December 31, 2010. The ratio of nonperforming assets to loans net of unearned income and deferred fees, plus other real estate owned, increased from 1.50% at year-end 2009 to 1.75% at the end of December 2010. The ratio is high when compared with historical levels here at National Bankshares, but it remains reasonable when compared to peers. We felt it was prudent to increase the provision for loan losses during 2010, and the ratio of the allowance for loan losses to

total loans grew from 1.17% at December 31, 2009 to 1.33% at December 31, 2010. National Bank's lenders are still making many good loans and are working hard to meet the credit needs of our communities. At the end of 2010, National Bankshares, Inc. had net loans of \$568.78 million, a slight 2.44% decline from the \$583.02 million in net loans at December 31, 2009.

During 2010, the focus on traditional community banking served National Bankshares, Inc. well. To keep pace with growth and with changes in technology, the Company invested in a new enterprise server last year. This major computer upgrade was accomplished without interrupting customer service. On July 21, 2010, a new federal law took effect that will touch nearly every aspect of the American financial services industry, including National Bankshares, Inc. and National Bank. The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed by Congress in an attempt to deal with the abuses that led to the financial crisis of 2008. The legislation is massive, and the full impact of the law and its implementing regulations are unknown at this time. What is known is that the entire banking industry, including small- and medium-sized banks and bank holding companies, will share in the costs and the regulatory burden of correcting problems caused by a few large financial services companies. Going forward, we are prepared to devote the resources necessary to comply with the new laws to ensure that National Bankshares, Inc. continues to offer quality products and services well into the future.

Milestones like the anniversaries in 2011 give us an opportunity to reflect on our history and to put current challenges into perspective. They also help us appreciate the important contributions of stockholders, employees and directors, both past and present. I would particularly like to thank you for your confidence and investment in our Company. We are grateful to the Directors and Advisory Directors of National Bankshares, Inc. and National Bank for generously sharing their time and talents. Finally, I want to especially recognize the dedication of our employees, who work hard every day to ensure our Company's future success. We are proud of our heritage as traditional bankers, and we look forward to serving our communities for many years to come.



James G. Rakes
Chairman, President &
Chief Executive Officer

Consolidated Balance Sheets

\$ in thousands, except per share data

<i>Assets</i>	December 31, 2010	December 31, 2009
Cash and due from banks	\$ 9,858	\$ 12,894
Interest-bearing deposits	69,400	32,730
Securities available for sale, at fair value	184,907	168,041
Securities held to maturity (fair value approximates \$129,913 at December 31, 2010 and \$129,892 at December 31, 2009)	131,000	129,376
Mortgage loans held for sale	2,460	126
Loans:		
Real estate construction loans	46,169	45,625
Real estate mortgage loans	173,533	165,542
Commercial and industrial loans	269,818	283,998
Loans to individuals	87,868	95,844
Total loans	577,388	591,009
Less unearned income and deferred fees	(945)	(1,062)
Loans, net of unearned income and deferred fees	576,443	589,947
Less allowance for loan losses	(7,664)	(6,926)
Loans, net	568,779	583,021
Premises and equipment, net	10,470	10,628
Accrued interest receivable	6,016	6,250
Other real estate owned, net	1,723	2,126
Intangible assets and goodwill	11,543	12,626
Other assets	26,082	24,549
Total assets	\$ 1,022,238	\$ 982,367

Liabilities and Stockholders' Equity

Noninterest-bearing demand deposits	\$ 131,540	\$ 122,549
Interest-bearing demand deposits	365,040	310,629
Savings deposits	55,800	51,622
Time deposits	332,203	367,312
Total deposits	884,583	852,112
Accrued interest payable	257	336
Other liabilities	8,211	7,843
Total liabilities	893,051	860,291
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, 6,933,474 shares in 2010 and 2009	8,667	8,667
Retained earnings	123,161	113,901
Accumulated other comprehensive loss, net	(2,641)	(492)
Total stockholders' equity	129,187	122,076
Total liabilities and stockholders' equity	\$ 1,022,238	\$ 982,367

Consolidated Statements of Income

\$ in thousands, except per share data

	Years ended December 31,		
	2010	2009	2008
Interest Income			
Interest and fees on loans	\$ 36,919	\$ 37,578	\$ 37,108
Interest on interest-bearing deposits	128	90	449
Interest on securities – taxable	5,588	6,273	6,816
Interest on securities – nontaxable	6,504	6,546	5,738
Total interest income	49,139	50,487	50,111
Interest Expense			
Interest on time deposits of \$100,000 or more	3,439	5,417	6,004
Interest on other deposits	7,719	10,405	12,802
Interest on borrowed funds	---	3	12
Total interest expense	11,158	15,825	18,818
Net interest income	37,981	34,662	31,293
Provision for loan losses	3,409	1,634	1,119
Net interest income after provision for loan losses	34,572	33,028	30,174
Noninterest Income			
Service charges on deposit accounts	2,858	3,314	3,425
Other service charges and fees	317	343	326
Credit card fees	2,954	2,803	2,808
Trust income	1,118	1,053	1,231
BOLI income	760	756	684
Other income	354	491	438
Realized securities gains (losses), net	(14)	44	175
Total noninterest income	8,347	8,804	9,087
Noninterest Expense			
Salaries and employee benefits	10,963	11,336	11,168
Occupancy and furniture and fixtures	1,875	1,792	1,751
Data processing and ATM	1,499	1,371	1,381
FDIC assessment	1,080	1,727	209
Credit card processing	2,300	2,121	2,105
Intangible assets amortization	1,083	1,093	1,119
Net costs of other real estate owned	214	393	100
Franchise taxes	963	885	823
Other operating expenses	3,150	3,135	3,367
Total noninterest expense	23,127	23,853	22,023
Income before income tax expense	19,792	17,979	17,238
Income tax expense	4,223	3,660	3,645
Net income	\$ 15,569	\$ 14,319	\$ 13,593
Basic net income per share	\$ 2.25	\$ 2.07	\$ 1.96
Fully diluted net income per share	\$ 2.24	\$ 2.06	\$ 1.96

National Bankshares, Inc. Board of Directors



Standing, from left: Jack H. Harry, President, Harry Enterprises, Inc.; Lawrence J. Ball, President, Moog Components Group; William A. Peery, President, Cargo Oil Co., Inc.; Glenn P. Reynolds, President, Reynolds Architects, Inc.

Seated, from left: Jack W. Bowling, President, H.T. Bowling, Inc.; Dr. Mary G. Miller, President, Interactive Design and Development, Inc.; Dr. James M. Shuler, Delegate, Virginia House of Delegates; 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.

National Bank Board of Directors



Standing, from left: **Michael E. Dye**, Pharmacist/Owner, New Graham Pharmacy; **Carl M. McNeil**, Realtor, Founder McNeil Real Estate, Inc.; **Dr. J. Lewis Webb, Jr.**, Retired Dentist; **James C. Thompson**, Chairman, Thompson & Litton, Inc.

Seated from left: **Ellen G. Burnop**, Co-Owner and President, New River Office Supply, Inc.; **Charles E. Green, III**, Financial Planner, AXA Advisors, L.L.C.; **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; **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, Lisa W. Epperly, Dr. Robert C. McCracken, James E. Tyler

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

Christiansburg/Radford/Pulaski County: Charles R. Beller, III, William K. Cunningham, Gerard W. Higgins, Dr. Kenneth E. Jones, Dr. Peter J. McDonald, L. Scott Wade

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

Interstate: A. Susan Keene

Corporate Information

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 12, 2011 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. Proxy materials for the Annual Meeting of Stockholders are available at www.nationalbanksharesproxy.com.

Corporate Office

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Blacksburg, Virginia 24062-9002

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