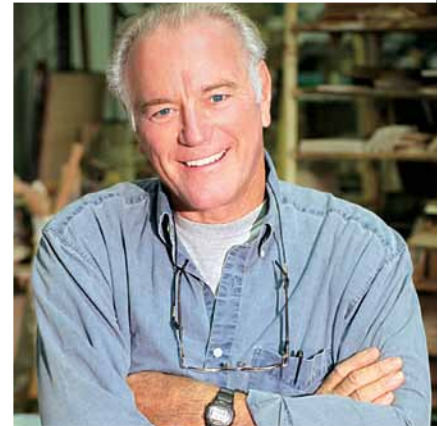




Local  
focus

Personal  
attention



Strength &  
stability



**A future you can bank on**

2012 Annual Report



National Bankshares

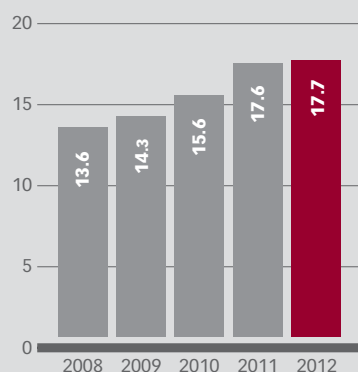
## Financial Highlights

### In 2012, National Bankshares increased net income, total assets and net loans in what remains a challenging economic environment.

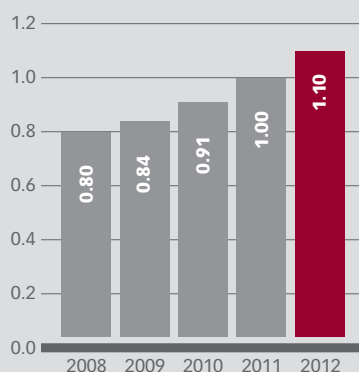
By executing our core philosophy of providing excellent customer service, making prudent loans and serving the needs of our communities, we were able to continue our tradition of rewarding shareholders with an increased dividend.

	2012	2011	2010	2009	2008
Net income	\$ 17,747	\$ 17,638	\$ 15,569	\$ 14,319	\$ 13,593
Basic net income per share	2.56	2.54	2.25	2.07	1.96
Diluted net income per share	2.55	2.54	2.24	2.06	1.96
Cash dividends per share	1.10	1.00	0.91	0.84	0.80
Book value per share	21.60	20.36	18.63	17.61	15.89
Loans, net	583,813	580,402	568,779	583,021	569,699
Total securities	352,043	318,913	315,907	297,417	264,999
Total assets	1,104,361	1,067,102	1,022,238	982,367	935,374
Total deposits	946,766	919,333	884,583	852,112	817,848
Stockholders' equity	150,109	141,299	129,187	122,076	110,108

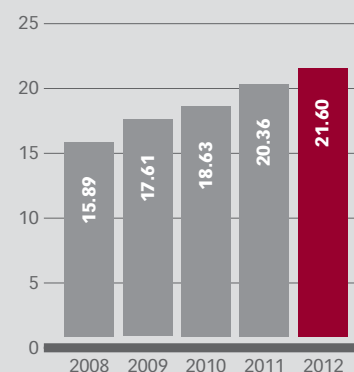
**Net Income**  
(\$ in millions)



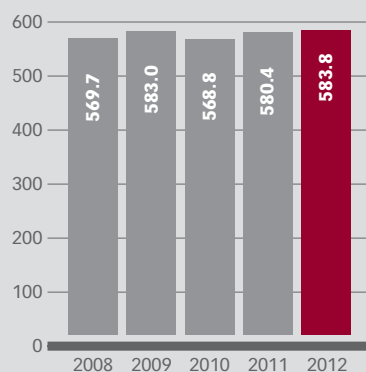
**Cash Dividends Per Share**  
(\$)



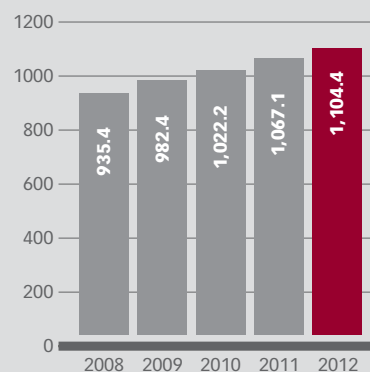
**Book Value Per Share**  
(\$)



**Loans, Net**  
(\$ in millions)



**Total Assets**  
(\$ in millions)



## To Our Shareholders

**We are pleased to provide you with National Bankshares' 2012 financial results. During our 121st year of community banking, we are proud to report to you that we have again achieved record earnings even with the continued economic and regulatory challenges that we are facing and will continue to face.**

### **Increased Earnings in 2012**

In 2012, Bankshares earned close to \$17.75 million, a slight increase over the \$17.64 million earned in 2011. This resulted in a return on average assets of 1.64% and a return on average equity of 12.01%. In spite of the fact that interest rates remain at historically low levels causing our net interest margin to decrease from 4.59% to 4.38%, this increase in earnings resulted primarily from a small increase in our net interest income from \$40.76 million in 2011 to \$40.78 million in 2012 and from a nice improvement in our noninterest income from \$8.41 million in 2011 to \$8.74 million in 2012. We will continue

to work to maximize our net interest margins, control our costs and explore new ways to enhance our revenue streams.

### **Growth in Other Key Areas**

By the end of 2012, your Company has grown to total assets of \$1.10 billion, an increase of 3.49% from \$1.07 billion at December 31, 2011. Our good earnings mentioned above and our increase in total assets has allowed our basic earnings per share to increase to \$2.56 from the \$2.54 reported last year.

>>>



**National Bankshares Executive Officers** (from left): **F. Brad Denardo**, Executive Vice President/Chief Operating Officer; **James G. Rakes**, Chairman, President & Chief Executive Officer; **David K. Skeens**, Senior Vice President/Operations & Risk Management, Treasurer & Chief Financial Officer.

## To Our Shareholders

**Bankshares continues to perform well, and in return for that performance we were pleased to be able to increase the dividends paid to our stockholders to \$1.10 per share from the total dividend of \$1.00 paid in 2011.**

### **Loan Portfolio Offers Challenges**

We continue to have challenges in our loan portfolio. Our total nonperforming loans increased to \$5.62 million at the end of 2012 from \$5.20 million in 2011. Although these numbers compare very favorably with our peer institutions, we are devoting a great deal of attention to them. To further compensate for this increase, our allowance for loan losses at the end of 2012 was increased to \$8.35 million, or 1.41% of outstanding loans, an increase from \$8.07 million, or 1.37% of outstanding loans, at December 31, 2011.

### **Regulations Continue to Increase**

Bankshares and National Bank continue to be subjected to additional regulatory burdens imposed by laws that emanated from the economic downturn. These new regulations limit our ability to realize revenue in certain areas of our Company and they certainly add to our compliance costs. Since there appears to be no end in sight to the new regulations, we will continue to devote the resources necessary to comply with all new requirements while at the same time trying to minimize the impact on our loyal customers.

### **Creating a Better Customer Experience**

We continue to invest in technology that improves our customers' banking experience. In 2012 we introduced an improved version of our Internet Banking that is more user-friendly and now includes paperless eStatements for our customers. Early in 2013 we introduced Mobile Banking. This new product will allow our many customers to manage their accounts anytime and from anywhere through their mobile devices.

### **Delivering Dividends**

The challenges mentioned above notwithstanding, Bankshares continues to perform well, and in return for that performance we were pleased to be able to increase the dividends paid to our stockholders to \$1.10 per share from the total dividend of \$1.00 paid in 2011. This resulted in an increase in the dividend payout ratio to 43.04% in 2012 from the ratio of 39.34% in 2011.

### **Thank You**

As always, we are extremely grateful to the Directors and Advisory Directors of National Bankshares and the National Bank for the time, energy, talents and dedication they continue to give to us. I also want to thank our employees whose efforts continue to prove the value of a community banking model that emphasizes superior customer service and the development of strong business relationships. And lastly, I want to thank you, our stockholders, for your continued support and trust.



*Jim Rakes*

James G. Rakes  
Chairman, President &  
Chief Executive Officer

National Bankshares, Inc. Board of Directors

**National Bankshares recognizes the importance of an active, accountable and representative board of directors in the leadership of our Company.**

We are fortunate to work with leaders from public and private institutions that represent some of the key economic sectors in our region. Their experience, vision and high ethical standards contribute greatly to the success of our Company and we are proud to have them as part of our team.

**Lawrence J. Ball**  
President  
Moog Components Group

**John E. Dooley**  
Chief Executive Officer  
Virginia Tech Foundation, Inc.

**Charles E. Green, III**  
Financial Planner  
AXA Advisors, L.L.C.

**Dr. Jack M. Lewis**  
President  
New River Community College

**William A. Peery**  
President  
Cargo Oil Co., Inc.

**Dr. Mary G. Miller**  
President  
Interactive Design and Development, Inc.

**James G. Rakes**  
Chairman, President and Chief Executive Officer  
National Bankshares, Inc.  
Chairman, President and Chief Executive Officer  
National Bank  
Chairman, President and Chief Executive Officer  
National Bankshares Financial Services, Inc.

**Glenn P. Reynolds**  
President  
Reynolds Architects, Inc.

**Dr. James M. Shuler**  
Delegate  
Virginia House of Delegates, Retired



Standing, from left: **Glenn P. Reynolds, Lawrence J. Ball, William A. Peery, John E. Dooley.**

Seated, from left: **Charles E. Green, III, Dr. Mary G. Miller, Dr. James M. Shuler, Dr. Jack M. Lewis, James G. Rakes.**

## Consolidated Balance Sheets

<b>Assets</b>	<b>December 31, 2012</b>	<b>December 31, 2011</b>
Cash and due from banks	\$ 14,783	\$ 11,897
Interest-bearing deposits	96,597	98,355
Securities available for sale, at fair value	191,504	174,918
Securities held to maturity (fair value approximates \$170,846 at December 31, 2012 and \$151,429 at December 31, 2011)	160,539	143,995
Total securities	352,043	318,913
Mortgage loans held for sale	2,796	2,623
Loans:		
Real estate construction loans	50,313	48,531
Consumer real estate loans	143,262	150,224
Commercial real estate loans	304,308	303,192
Commercial non-real estate loans	37,349	38,832
Public sector and IDA	26,169	15,571
Consumer non real estate loans	31,714	33,072
Total loans	593,115	589,422
Less unearned income and deferred fees	(953)	(952)
Loans, net of unearned income and deferred fees	592,162	588,470
Less allowance for loan losses	(8,349)	(8,068)
Loans, net	583,813	580,402
Premises and equipment, net	10,401	10,393
Accrued interest receivable	6,247	6,304
Other real estate owned, net	1,435	1,489
Intangible assets and goodwill	9,377	10,460
Bank-owned life insurance	20,523	19,812
Other assets	6,346	6,454
Total assets	\$ 1,104,361	\$ 1,067,102
<b>Liabilities and Stockholders' Equity</b>		
Noninterest-bearing demand deposits	\$ 144,252	\$ 142,163
Interest-bearing demand deposits	455,713	404,801
Savings deposits	69,063	61,298
Time deposits	277,738	311,071
Total deposits	946,766	919,333
Accrued interest payable	139	206
Other liabilities	7,347	6,264
Total liabilities	954,252	925,803
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, 6,947,974 shares in 2012 and 6,939,974 shares in 2011	8,685	8,675
Retained earnings	144,162	133,945
Accumulated other comprehensive (loss), net	(2,738)	(1,321)
Total stockholders' equity	150,109	141,299
Total liabilities and stockholders' equity	\$ 1,104,361	\$ 1,067,102

## Consolidated Statements of Income

<b>Interest Income</b>	Years ended December 31,		
	2012	2011	2010
Interest and fees on loans	\$ 35,354	\$ 36,514	\$ 36,919
Interest on interest-bearing deposits	240	155	128
Interest on securities – taxable	6,613	6,745	5,588
Interest on securities – nontaxable	6,463	6,532	6,504
Total interest income	48,670	49,946	49,139
<b>Interest Expense</b>			
Interest on time deposits of \$100,000 or more	1,491	2,019	3,439
Interest on other deposits	6,396	7,165	7,719
Total interest expense	7,887	9,184	11,158
Net interest income	40,783	40,762	37,981
Provision for loan losses	3,134	2,949	3,409
Net interest income after provision for loan losses	37,649	37,813	34,572
<b>Noninterest Income</b>			
Service charges on deposit accounts	2,594	2,617	2,858
Other service charges and fees	243	287	317
Credit card fees	3,278	3,197	2,954
Trust income	1,313	1,087	1,118
BOLI income	814	762	760
Other income	472	449	354
Realized securities gains (losses), net	25	11	(14)
Total noninterest income	8,739	8,410	8,347
<b>Noninterest Expense</b>			
Salaries and employee benefits	12,005	11,357	10,963
Occupancy and furniture and fixtures	1,589	1,599	1,875
Data processing and ATM	1,593	1,701	1,499
FDIC assessment	475	677	1,080
Credit card processing	2,442	2,485	2,300
Intangible assets amortization	1,083	1,083	1,083
Net costs of other real estate owned	208	518	214
Franchise taxes	901	780	963
Other operating expenses	3,100	3,138	3,150
Total noninterest expense	23,396	23,338	23,127
Income before income tax expense	22,992	22,885	19,792
Income tax expense	5,245	5,247	4,223
Net income	\$ 17,747	\$ 17,638	\$ 15,569
Basic net income per common share	\$ 2.56	\$ 2.54	\$ 2.25
Fully diluted net income per common share	\$ 2.55	\$ 2.54	\$ 2.24

## National Bank Board of Directors



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

*Seated from left:* **Dr. James M. Shuler**, Delegate, Virginia House of Delegates, Retired; **Mildred R. Johnson**, Director of Undergraduate Admissions, Virginia Polytechnic Institute and State University; **F. Brad Denardo**, Executive Vice President, National Bankshares, Inc., Executive Vice President/Chief Operating Officer, National Bank, Treasurer, National Bankshares Financial Services, Inc.; **James G. Rakes**, Chairman, President and Chief Executive Officer, National Bankshares, Inc., Chairman, President and Chief Executive Officer, National Bank, Chairman, President and Chief Executive Officer, National Bankshares Financial Services, Inc.

## National Bank Advisory Boards

### **Montgomery County**

Dan A. Dodson, 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





## About National Bankshares

Headquartered in Blacksburg, Virginia, National Bankshares, Inc. is committed to providing comprehensive and personalized financial service solutions for individuals, businesses and institutions in communities throughout Southwest Virginia. We offer a complete line of banking products and services through our primary subsidiary, National Bank, a 121 year-old community bank with 25 branch offices. We also offer a full spectrum of insurance and investment solutions through our financial services subsidiary, National Bankshares Financial Services, Inc.

For more information, visit the National Bankshares website at:  
**[www.nationalbankshares.com](http://www.nationalbankshares.com)**

## Corporate Information

### **National Bankshares, Inc. Executive Officers**

James G. Rakes  
Chairman, President and Chief  
Executive Officer

F. Brad Denardo  
Executive Vice President

David K. Skeens  
Treasurer and Chief Financial Officer

### **Annual Meeting**

The Annual Meeting of Stockholders will be held on Tuesday, April 9, 2013 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](mailto: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:

Bryson J. Hunter  
Secretary and Counsel  
(540) 951-6300 or (800) 552-4123  
[bhunter@nbbank.com](mailto:bhunter@nbbank.com)

or

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

National Bankshares, Inc.  
101 Hubbard Street  
Blacksburg, Virginia 24060  
P.O. Box 90002  
Blacksburg, Virginia 24062-9002  
[www.nationalbankshares.com](http://www.nationalbankshares.com)  
(540) 951-6300 or (800) 552-4123





## National Bankshares

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Blacksburg, Virginia 24062-9002  
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