



National Bankshares



COMMITTED TO COMMUNITY BANKING

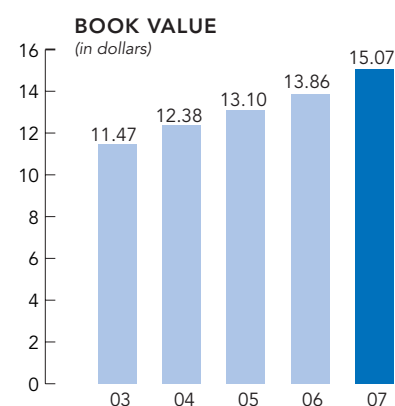
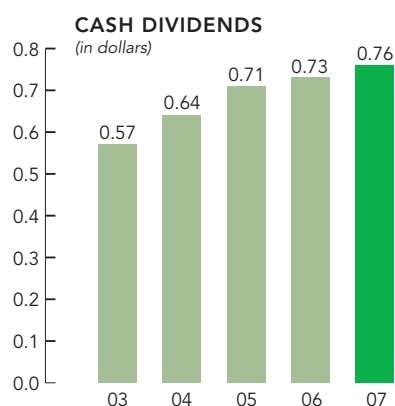
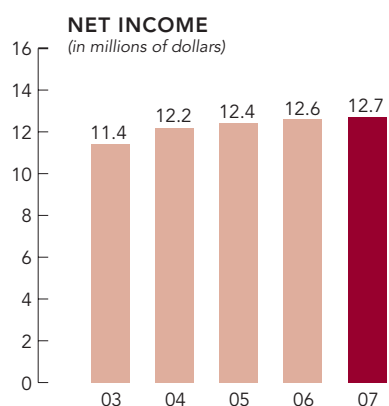
National Bankshares, Inc. strives to be an exceptional community bank holding company dedicated to providing shareholder value by offering financial services to customers through subsidiary financial institutions and affiliated companies in an efficient, friendly, personalized, and cost-effective manner. 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.



CONTENTS

Financial Highlights	1
Letter to Stockholders	2
Consolidated Balance Sheets	4
Consolidated Statements of Income	5
Boards of Directors	6
Corporate Information	8
<i>United States Securities & Exchange Commission Form 10-K located in rear folder</i>	

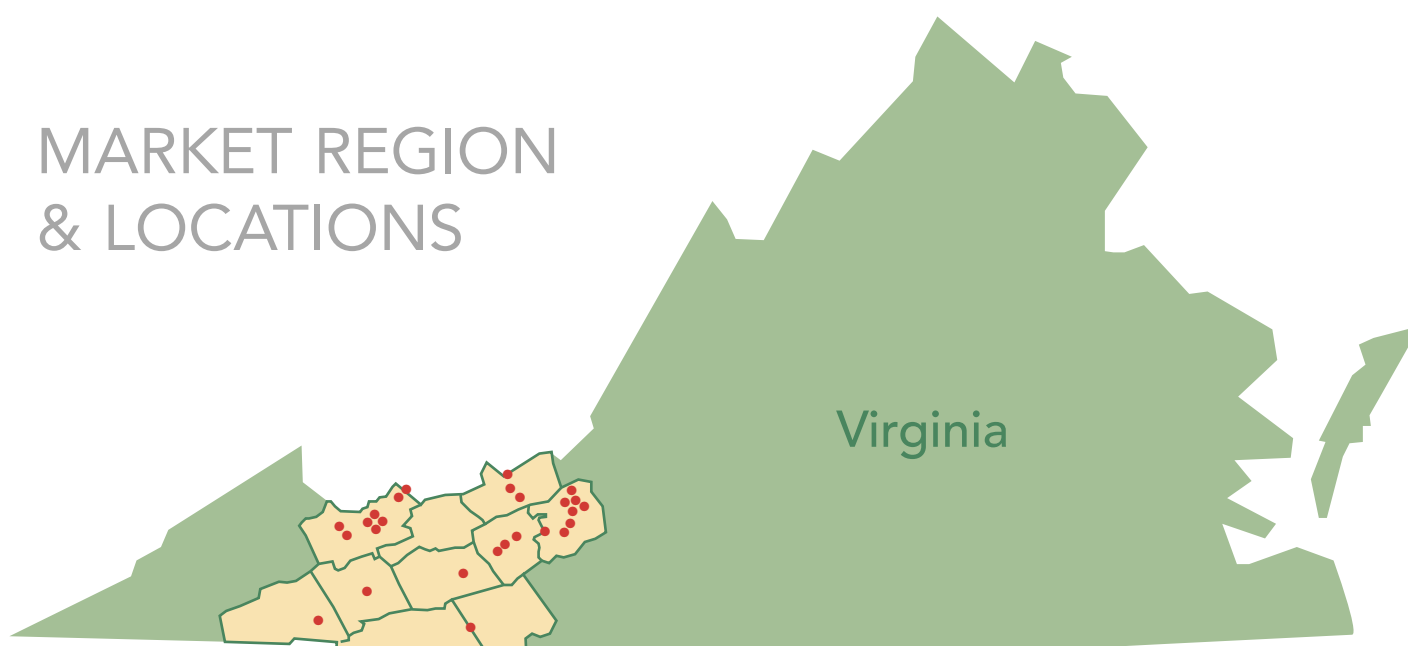
FINANCIAL HIGHLIGHTS



(\$ In thousands, except per share data)

	2007	2006	2005	2004	2003
Net income	\$ 12,675	12,632	12,424	12,230	11,442
Basic net income per share	1.82	1.80	1.77	1.74	1.63
Diluted net income per share	1.82	1.80	1.76	1.73	1.62
Cash dividends per share	0.76	0.73	0.71	0.64	0.57
Book value per share	15.07	13.86	13.10	12.38	11.47
Loans, net	518,435	495,486	487,162	472,199	401,428
Total securities	273,343	285,489	272,541	250,708	230,154
Total assets	887,647	868,203	841,498	796,154	708,560
Total deposits	776,339	764,692	745,649	705,932	625,378
Stockholders' equity	104,800	96,755	91,939	87,088	80,641

MARKET REGION & LOCATIONS



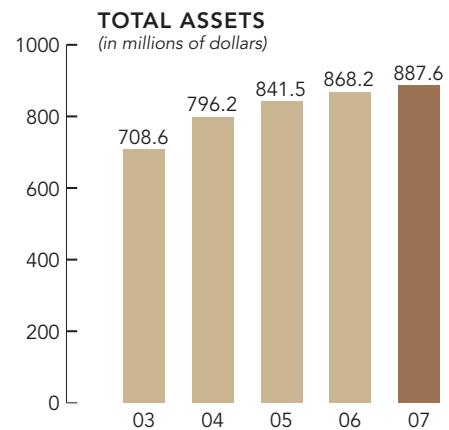
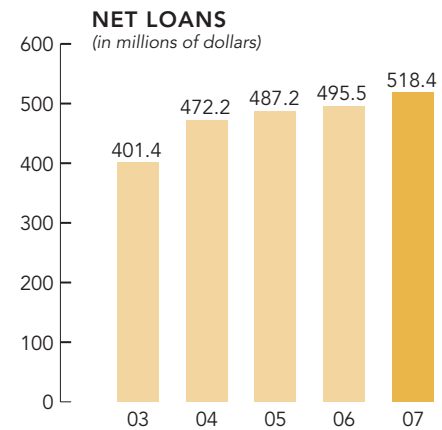


TO OUR SHAREHOLDERS

In these interesting times, I am pleased to report another solid year for National Bankshares, Inc. During 2007, we were challenged with compression of the net interest margin, and we worked to overcome that challenge by adding quality loans to our portfolio and by controlling overhead costs.

The result was 2007 total net income of nearly \$12.68 million, up slightly over the \$12.63 million earned in 2006. Total assets at December 31, 2007 were nearly \$887.65 million, an increase of 2.24% over the same period in 2006. Net loans grew to \$518.44 million, an increase of 4.63% from 2006. The 2006 merger of our two bank subsidiaries resulted in savings in salary and benefits, a decline from \$11.47 million in 2006 to \$10.77 million in 2007, and also in occupancy expense, which dropped to \$1.74 million from \$1.96 million when the two periods are compared. Because of positive earnings, we increased stockholder dividends again this year, from \$0.73 per share in 2006 to \$0.76 per share in 2007.

National Bankshares' loan quality remained very good when viewed from a historical perspective. We did, however, make regular additions to the provision for loan losses during 2007, both because of growth in net loans and because of an increase in total nonperforming assets from 2006's very low level.



During 2007, your Company continued to invest in its technology infrastructure. We took the next step in the Check 21 process and began to exchange electronic images of checks with the Federal Reserve Bank. This process is very efficient, eliminating the need to ship paper checks around the country. It offers us the potential for additional savings, and it allows us to consider a banking future that is not constrained by geography and check delivery deadlines. In our opinion, up-to-date technology is important because it provides a solid platform from which to offer customers a full range of financial products and services.

Our relationship-based business philosophy has guided us since the founding of National Bank in 1891, and it will continue to guide us in the future.

Even though we think that technology is important, we believe that it is even more important for our customers to have a trusted person to help them with their financial transactions. Our office managers have strong and deep connections to the communities they serve. Our business lenders have years of experience in our local markets. National Bank has offered Trust services for over 40 years. The insurance and investment representatives with National Bankshares Financial Services, Inc. believe that excellent customer service will distinguish them from their many competitors. This relationship-based business philosophy has guided us since the founding of National Bank in 1891, and it will continue to guide us in the future.

As we look forward to the challenges of 2008, we intend to stay focused on what we do best. We understand that we cannot be all things to all people. But we do know community banking

in Southwest Virginia, and we are committed to offering our friends and neighbors the very best in financial products and services. On the other hand, National Bank has not stayed in business for nearly 117 years only by looking backward. To insure our progress, the National Bankshares, Inc. Board of Directors has decided to undertake an extensive year-long strategic planning initiative in 2008. This process should assist us in making sound plans for our second century of success.

Finally, I definitely want to thank you for your continued investment in National Bankshares, Inc. Your loyalty and support are very important to us, particularly in a year like 2007, when all bank stock prices were impacted by the troubles of a few large institutions. I also want to thank our dedicated Directors and hardworking employees for their many contributions. Together, we can be proud of National Bankshares, Inc.'s commitment to community banking and its long tradition of service to its customers.



A handwritten signature in black ink that reads "Jim Rakes". The signature is written in a cursive, flowing style.

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

CONSOLIDATED BALANCE SHEETS

\$ in thousands, except share data

	December 31, 2007	December 31, 2006
Assets		
Cash and due from banks	\$ 16,324	15,283
Interest-bearing deposits	29,687	19,617
Securities available for sale, at fair value	158,594	169,735
Securities held to maturity (fair value approximates \$115,463 at December 31, 2007 and \$115,561 at December 31, 2006)	114,749	115,754
Mortgage loans held for sale	220	808
Loans:		
Real estate construction loans	46,697	33,840
Real estate mortgage loans	145,542	126,302
Commercial and industrial loans	216,830	215,244
Loans to individuals	115,704	126,316
Total loans	524,773	501,702
Less unearned income and deferred fees	(1,119)	(1,059)
Loans, net of unearned income and deferred fees	523,654	500,643
Less allowance for loan losses	(5,219)	(5,157)
Loans, net	518,435	495,486
Premises and equipment, net	12,016	12,702
Accrued interest receivable	5,711	5,682
Other real estate owned, net	263	390
Intangible assets and goodwill	14,838	15,976
Other assets	16,810	16,770
Total assets	\$ 887,647	868,203
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 113,361	101,167
Interest-bearing demand deposits	237,772	233,023
Savings deposits	44,349	47,988
Time deposits	380,857	382,514
Total deposits	776,339	764,692
Other borrowed funds	64	73
Accrued interest payable	792	863
Other liabilities	5,652	5,820
Total liabilities	782,847	771,448
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, 6,952,274 in 2007, and 6,980,234 in 2006	8,690	8,725
Retained earnings	97,810	91,123
Accumulated other comprehensive (loss), net	(1,700)	(3,093)
Total stockholders' equity	104,800	96,755
Total liabilities and stockholders' equity	\$ 887,647	868,203

CONSOLIDATED STATEMENTS OF INCOME

\$ in thousands, except share data

	Years ended December 31,		
	2007	2006	2005
Interest Income			
Interest and fees on loans	\$ 37,265	34,879	33,234
Interest on interest-bearing deposits	726	684	508
Interest on securities - taxable	7,476	7,462	6,501
Interest on securities - nontaxable	5,302	4,876	5,137
Total interest income	50,769	47,901	45,380
Interest Expense			
Interest on time deposits of \$100,000 or more	6,519	4,912	3,942
Interest on other deposits	15,191	13,626	10,215
Interest on borrowed funds	35	26	23
Total interest expense	21,745	18,564	14,180
Net interest income	29,024	29,337	31,200
Provision for loan losses	423	49	567
Net interest income after provision for loan losses	28,601	29,288	30,633
Noninterest Income			
Service charges on deposit accounts	3,291	3,361	3,099
Other service charges and fees	330	370	347
Credit card fees	2,740	2,396	2,179
Trust income	1,333	1,528	1,398
Other income	1,015	1,117	590
Realized securities gains, net	51	30	---
Total noninterest income	8,760	8,802	7,613
Noninterest Expense			
Salaries and employee benefits	10,773	11,466	11,265
Occupancy and furniture and fixtures	1,743	1,957	1,931
Data processing and ATM	1,149	1,234	1,455
Credit card processing	2,146	1,833	1,687
Intangible assets amortization	1,138	1,137	1,117
Net costs of other real estate owned	81	19	275
Other operating expenses	3,926	4,024	4,168
Total noninterest expense	20,956	21,670	21,898
Income before income tax expense	16,405	16,420	16,348
Income tax expense	3,730	3,788	3,924
Net income	\$ 12,675	12,632	12,424
Basic net income per share	\$ 1.82	1.80	1.77
Fully diluted net income per share	\$ 1.82	1.80	1.76

BOARD OF DIRECTORS

National Bankshares, Inc.



From left: **Jack W. Bowling**, President, H.T. Bowling, Inc.; **Jack H. Harry**, President, Harry Enterprises, Inc.; **Dr. Mary G. Miller**, President, Interactive Design and Development, Inc.; **William A. Peery**, President, Cargo Oil Co., Inc.; **Dr. James M. Shuler**, Delegate, Virginia House of Delegates; **Lawrence J. Ball**, President, Moog Components Group; **Dr. Jack M. Lewis**, President, New River Community College; **Glenn P. Reynolds**, President, Reynolds Architects, Inc.; **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.

BOARD OF DIRECTORS

National Bank



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



National Bankshares, Inc. Executive Officers

James G. Rakes
Chairman, President and Chief Executive Officer

F. Brad Denardo
Corporate Officer

J. Robert Buchanan
Treasurer

Marilyn B. Buhyoff
Secretary and Counsel

Annual Meeting

The Annual Meeting of Stockholders will be held on Tuesday, April 8, 2008 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

or

J. Robert Buchanan
Treasurer
(540) 951-6300 or (800) 552-4123
bbuchanan@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

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.

Corporate Office

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