



**People-focused.**

**Value-driven.**



**People-focused. Value-driven.**

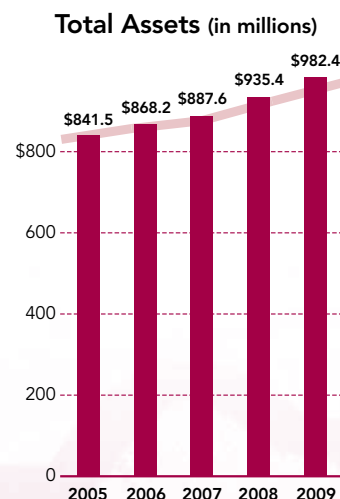
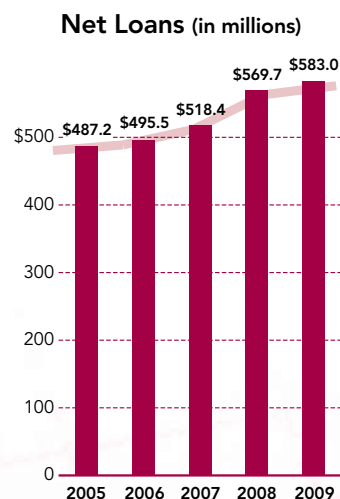
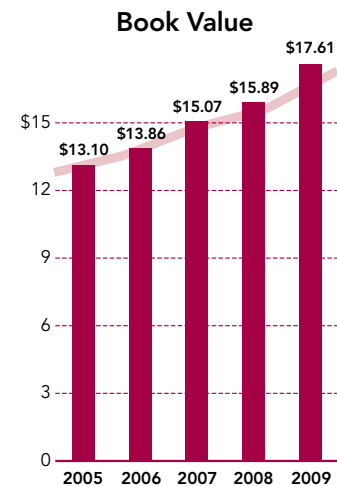
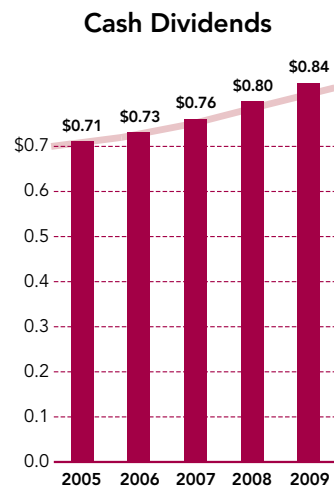
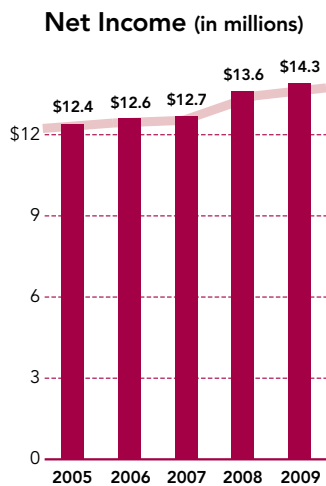
National Bankshares, Inc. traces its roots back to 1891 with the founding of its subsidiary bank, the National Bank of Blacksburg. Today we serve communities across southwest Virginia with 25 convenient banking locations and a complete package of financial services. Through our personalized approach to community banking and our commitment to shareholder value, National Bankshares, Inc. embodies the spirit of a people-focused, value-driven institution.



# Financial Highlights

\$ in thousands, except per share data

	2009	2008	2007	2006	2005
Net income	\$ 14,319	13,593	12,675	12,632	12,424
Basic net income per share	2.07	1.96	1.82	1.80	1.77
Diluted net income per share	2.06	1.96	1.82	1.80	1.76
Cash dividends per share	0.84	0.80	0.76	0.73	0.71
Book value per share	17.61	15.89	15.07	13.86	13.10
Loans, net	583,021	569,699	518,435	495,486	487,162
Total securities	297,417	264,999	273,343	285,489	272,541
Total assets	982,367	935,374	887,647	868,203	841,498
Total deposits	852,112	817,848	776,339	764,692	745,649
Stockholders' equity	122,076	110,108	104,800	96,755	91,939





## 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.

**Management team, from left to right: David K. Skeens, Treasurer and Chief Financial Officer; James G. Rakes, Chairman, President and Chief Executive Officer; Marilyn B. Buhyoff, Secretary and Counsel; F. Brad Denardo, Executive Vice President.**

**These are challenging times for bankers. The financial markets are volatile, and the political climate is negative. The media does not differentiate between those large Wall Street investment banks that caused many of the nation's economic problems and traditional banks, which have continued to work to find solutions to those problems. At National Bankshares, Inc., our strategy for facing today's challenges is to return to the basics. We focus on who we are. We clearly identify what we can do. And we try to do it well.**

I am sure that you are aware that National Bankshares, Inc. is a financial holding company with two subsidiaries, the National Bank of Blacksburg (National Bank) and National Bankshares Financial Services, Inc. National Bank has been a community bank since its founding in 1891. It is a conservative bank. We do not believe that bigger is always better, and we understand that we cannot be all things to all customers. However, we can and do offer those bank products and services, including loans, deposit accounts and Trust services, that most of the residents and businesses in southwest Virginia want and need. Our customers have convenient 24-hour access to their accounts with phone and Internet banking. We are able to provide many products and services at a lower cost than some of our larger competitors. Most importantly, when you deal with National Bank, you experience banking with a personal touch. If you call us during business hours, you will reach a real live person, not a computer. Our lenders develop long-term business relationships with their customers. In fact, a small business customer once told me, "My loans are with National Bank, because I get a banker, not just a bank." Our trained, experienced and friendly employees take great pride in offering excellent service to their customers.


In 2009, National Bankshares' people-focused approach to banking created value for our stockholders. I am pleased to report that your Company posted record net income of nearly \$14.32 million for the year ended December 31, 2009. Net income for 2009 was 5.34% higher than the \$13.59 million earned in 2008. We believe in sharing higher profits with stockholders, and cash dividends grew from \$0.80 per share in 2008 to \$0.84 per share for 2009. Stockholders' equity experienced a nice increase, growing from \$110.11 million at the end of 2008 to nearly \$122.08 million at the same period in 2009.

Record earnings in 2009 came largely from higher net interest income, coupled with limited increases in controllable noninterest expense. Net interest income grew by almost 10.77%, from \$31.29 million for 2008 to \$34.66 million for 2009. A good part of the growth in interest income came from meeting the credit needs

of borrowers in our market area, as our bankers continued to make good loans despite the difficult economy. Net loans, which were at \$583.02 million at the end of 2009, grew by \$13.32 million, or 2.34%, over the total at December 31, 2008. While net interest income was improving, we were keeping careful watch on controllable costs. As a result, total nontinterest expense for the year was only \$1.83 million above 2008 levels, despite FDIC Deposit Insurance Fund assessments climbing by \$1.52 million from 2008 to 2009. National Bankshares, Inc. ended 2009 with total assets of nearly \$982.37 million, an increase of 5.02% over the \$935.37 million at the end of December in 2008.

As many of you well know, our region of the country has not totally escaped the effects of the recession and the slow economic recovery. Fortunately, to date, we have not been as seriously impacted as some other areas. Beginning in the last half of 2008, we started seeing rising levels of total nonperforming assets. Anticipating that this trend would continue during 2009, we increased the provision for loan losses as the year progressed. In 2008, the provision for loan losses was \$1.12 million, and in 2009 we set aside over \$1.63 million. By December 31, 2009, the allowance for loan losses had grown to almost \$6.93 million, from \$5.86 million at the end of 2008. The ratio of the allowance for loan losses to total loans increased from 1.02% at year-end 2008 to 1.17% at December 31, 2009. Because of this preparation and because our earnings and capital levels allow us to approach loan workouts in a deliberate fashion, we feel that we can respond appropriately to the higher level of nonperforming assets that is reported for year-end 2009. Even though nonperforming assets of nearly \$8.88 million at December 31, 2009 is high for our Company, the total remains quite low when compared with peers. The ratio of nonperforming loans to net loans was at 1.14% at year-end, a reasonable level in today's challenging economy.

We want to thank you for the important role you play in our Company. We are grateful for your investment and for your confidence in National Bankshares, Inc. I would like to recognize the contributions of our Directors and Advisory Board members. Their time and expertise are invaluable. Finally, we appreciate the skill and dedication of each of the more than 200 talented employees who work together every day to meet our goals. National Bankshares, Inc. is both people-focused and value-driven. Despite the current challenges, we are proud to be traditional bankers, and we are committed to achieving future success in the communities we serve.



James G. Rakes  
Chairman, President &  
Chief Executive Officer

# Consolidated Balance Sheets

\$ in thousands, except per share data

<b>Assets</b>	<b>December 31, 2009</b>	December 31, 2008
Cash and due from banks	\$ 12,894	\$ 16,316
Interest-bearing deposits	32,730	29,656
Securities available for sale, at fair value	168,041	147,227
Securities held to maturity (fair value approximates \$129,892 at December 31, 2009 and \$117,277 at December 31, 2008)	129,376	117,772
Mortgage loans held for sale	126	348
Loans:		
Real estate construction loans	45,625	60,798
Real estate mortgage loans	165,542	162,757
Commercial and industrial loans	283,998	246,218
Loans to individuals	95,844	106,907
Total loans	591,009	576,680
Less unearned income and deferred fees	(1,062)	(1,123)
Loans, net of unearned income and deferred fees	589,947	575,557
Less allowance for loan losses	(6,926)	(5,858)
Loans, net	583,021	569,699
Premises and equipment, net	10,628	11,204
Accrued interest receivable	6,250	5,760
Other real estate owned, net	2,126	1,984
Intangible assets and goodwill	12,626	13,719
Other assets	24,549	21,689
Total assets	\$ 982,367	\$ 935,374

## Liabilities and Stockholders' Equity

Noninterest-bearing demand deposits	\$ 122,549	\$ 109,630
Interest-bearing demand deposits	310,629	256,416
Savings deposits	51,622	45,329
Time deposits	367,312	406,473
Total deposits	852,112	817,848
Other borrowed funds	---	54
Accrued interest payable	336	655
Other liabilities	7,843	6,709
Total liabilities	860,291	825,266
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 in 2009, and 6,929,474 in 2008	8,667	8,662
Retained earnings	113,901	105,356
Accumulated other comprehensive loss, net	(492)	(3,910)
Total stockholders' equity	122,076	110,108
Total liabilities and stockholders' equity	\$ 982,367	\$ 935,374

# Consolidated Statements of Income

\$ in thousands, except per share data

	Years ended December 31,		
	2009	2008	2007
<b>Interest Income</b>			
Interest and fees on loans	\$ 37,578	\$ 37,108	\$ 37,265
Interest on interest-bearing deposits	90	449	726
Interest on securities - taxable	6,273	6,816	7,476
Interest on securities - nontaxable	6,546	5,738	5,302
Total interest income	50,487	50,111	50,769
<b>Interest Expense</b>			
Interest on time deposits of \$100,000 or more	5,417	6,004	6,519
Interest on other deposits	10,405	12,802	15,191
Interest on borrowed funds	3	12	35
Total interest expense	15,825	18,818	21,745
Net interest income	34,662	31,293	29,024
Provision for loan losses	1,634	1,119	423
Net interest income after provision for loan losses	33,028	30,174	28,601
<b>Noninterest Income</b>			
Service charges on deposit accounts	3,314	3,425	3,291
Other service charges and fees	343	326	330
Credit card fees	2,803	2,808	2,740
Trust income	1,053	1,231	1,333
BOLI income	756	684	592
Other income	491	438	423
Realized securities gains, net	44	175	51
Total noninterest income	8,804	9,087	8,760
<b>Noninterest Expense</b>			
Salaries and employee benefits	11,336	11,168	10,773
Occupancy and furniture and fixtures	1,792	1,751	1,743
Data processing and ATM	1,371	1,381	1,149
FDIC assessment	1,727	209	89
Credit card processing	2,121	2,105	2,146
Intangible assets amortization	1,093	1,119	1,138
Net costs of other real estate owned	393	100	81
Franchise taxes	885	823	578
Other operating expenses	3,135	3,367	3,259
Total noninterest expense	23,853	22,023	20,956
Income before income tax expense	17,979	17,238	16,405
Income tax expense	3,660	3,645	3,730
Net income	\$ 14,319	\$ 13,593	\$ 12,675
Basic net income per share	\$ 2.07	\$ 1.96	\$ 1.82
Fully diluted net income per share	\$ 2.06	\$ 1.96	\$ 1.82

## National Bankshares, Inc. Board of Directors



*Standing, from left:* **William A. Peery**, President, Cargo Oil Co., Inc.; **Lawrence J. Ball**, President, Moog Components Group; **Jack H. Harry**, President, Harry Enterprises, 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:* **James S. Gillespie, Jr.**, President, Jim Sam Gillespie Farm; **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. *Not pictured:* **Michael E. Dye**, Pharmacist/Owner, New Graham Pharmacy.

### 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, Scarlet B. Ratcliffe, 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, Stephen A. Lester, II.

# 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 13, 2010 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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