



OUR GREATEST ASSET

IS YOUR TRUST

2011

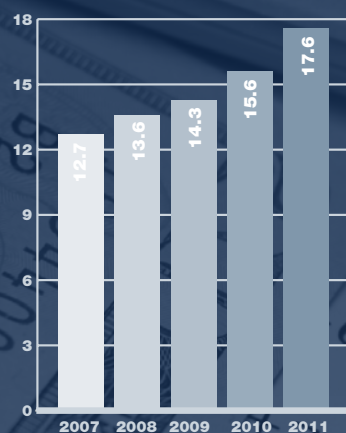
NATIONAL BANKSHARES, INC.  
ANNUAL REPORT

# Financial Highlights

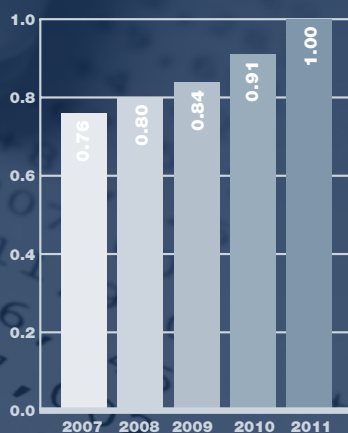
\$ in thousands, except per share data

	2011	2010	2009	2008	2007
Net income	\$ 17,638	\$ 15,569	\$ 14,319	\$ 13,593	\$ 12,675
Basic net income per share	2.54	2.25	2.07	1.96	1.82
Diluted net income per share	2.54	2.24	2.06	1.96	1.82
Cash dividends per share	1.00	0.91	0.84	0.80	0.76
Book value per share	20.36	18.63	17.61	15.89	15.07
Loans, net	580,402	568,779	583,021	569,699	518,435
Total securities	318,913	315,907	297,417	264,999	273,343
Total assets	1,067,102	1,022,238	982,367	935,374	887,647
Total deposits	919,333	884,583	852,112	817,848	776,339
Stockholders' equity	141,299	129,187	122,076	110,108	104,800

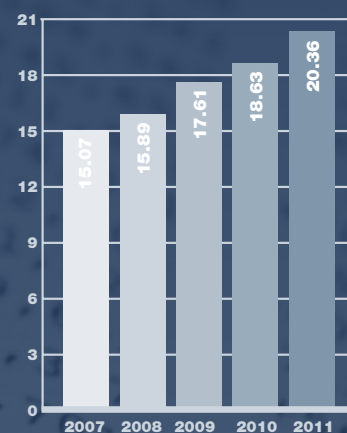
**Net Income**  
dollars in millions



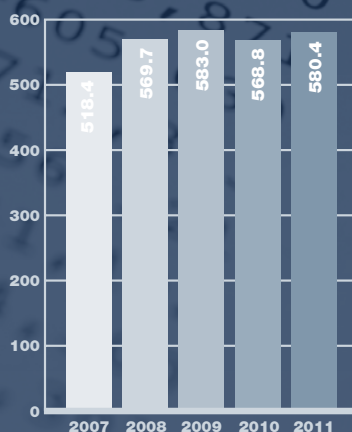
**Cash Dividends Per Share**  
dollars



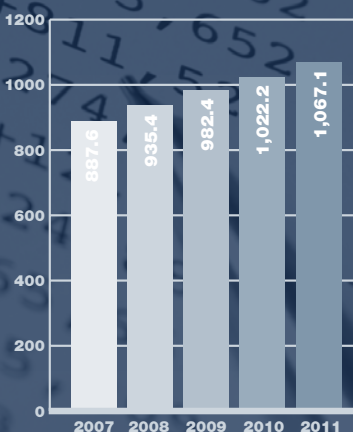
**Book Value Per Share**  
dollars



**Loans, Net**  
dollars in millions



**Total Assets**  
dollars in millions



# 120 Years of Community Banking

In 2011, National Bankshares, Inc. celebrated its 25th anniversary. However, 25 years paled in comparison to National Bank's 120th anniversary celebration in 2011. Many things have changed since Alexander Black opened the Bank in 1891 and since we formed National Bankshares in 1986. While the size of the numbers we report may have increased, what has not changed is the desire to help customers by providing them with a full range of quality financial services. We are able to benefit and improve the lives of generations of customers through true community banking and are recognized for more than just lending money and accepting deposits. Our officers and employees take a personal interest in our customers and in the communities we serve. We are relationship-driven, and personalized service will always be the cornerstone of our Bank.

During the 120th anniversary year of the founding of National Bank, we were able to maintain strong core earnings despite continued challenges in the national and local economies that affect loan growth. Record net income for the twelve months ended December 31, 2011 approached \$17.64 million, a 13.29% increase over the nearly \$15.57 million earned in 2010. Our 2011 record earnings were enhanced by an increase in net interest income, which was driven by an improved net interest margin. Because interest rates remained low throughout the year, total interest income grew only slightly over that of 2010. However, total interest expense declined significantly, resulting in a 7.32% increase in net interest income, from \$37.98 million for 2010 to over \$40.76 million in 2011. The return on average assets for 2011 was 1.71% and the return on average equity was 12.89%. This compares to 1.57% and 12.07%, respectively, for 2010. Basic earnings per share were \$2.54 in 2011 compared to \$2.25 for 2010. National Bankshares, Inc. ended 2011 with total assets of almost \$1.07 billion, up by 4.39% over the roughly \$1.02 billion in total assets reported at December 31, 2010.

Although some of our customers still are dealing with the effects of the recessionary economy, we saw improvement in our asset quality in 2011. Total nonperforming loans decreased from \$8.07 million at the end of 2010 to \$5.20 million at December 31, 2011. The ratio of nonperforming assets to loans net of unearned income and deferred fees, plus other real estate owned, decreased from 1.69% at year-end 2010 to 1.13% at the end of December 2011. National Bank's lenders are still working hard to assist customers with the credit needs of our communities. At the end of 2011, National Bank had net loans of \$580.40 million, a 2.04% increase from the \$568.78 million in net loans at December 31, 2010.

As I reported last year, a new federal law took effect that touches nearly every aspect of the financial services industry, including National Bankshares, Inc. and National Bank. Throughout 2011, banking and securities regulators implemented specific provisions of the Dodd-Frank Act, but the industry is still waiting for implementation of a large part of the Act. As was expected, even small community banks such as ours must bear the cost and the regulatory burden of correcting problems caused by a few large financial services companies. For instance, rules limiting fees that banks can charge took effect in the second half of 2011. While some of these rules exempt banks like us that are less than \$10 billion in size, we believe that a two-tiered fee system will not be practical and that the fees will migrate to those permitted for the banks in excess of \$10 billion due to competitive pressures. Also, we expect additional overhead costs will be necessary to comply with all of the new regulations expected to arise directly or indirectly from the Dodd-Frank Act. While we attempt to mitigate compliance costs, 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.

Despite the additional regulatory pressures, we were pleased to be able to share the National Bankshares' positive operating results with our shareholders in the form of dividends of \$1.00 per share in 2011 compared to \$0.91 in 2010. Our 2011 anniversaries gave us an opportunity to reflect on our history, recent and old, and to put current challenges into perspective while helping us celebrate years of providing safe, secure and trusted banking. We are grateful to the Directors and Advisory Directors of National Bankshares, Inc. and National Bank for generously sharing their time and talents. I also want to recognize our employees' commitment to service which continues to impact those we serve in many positive ways. We remain committed to our community banking focus and to continuously creating long-term value and delivering outstanding results to our shareholders and customers. Thank you for your continued support and for the opportunity to serve you and earn your business each and every day.



James G. Rakes  
Chairman, President & CEO



## Meet Our Team

While we talk a lot about the numbers every year in our Annual Report, it is truly our people – our directors, employees, shareholders and customers – that define the National Bankshares family. In that spirit we're pleased to introduce our senior management team. Experienced bankers and active participants in the community, their vision, leadership and hard work have made our continued success possible.



From left: **Phillip M. Baker**, Senior Vice President/Loans; **David K. Skeens**, Senior Vice President/Operations & Risk Management, Treasurer & Chief Financial Officer; **James G. Rakes**, Chairman, President & Chief Executive Officer; **F. Brad Denardo**, Executive Vice President/Chief Operating Officer; **Lawrence K. Hayes**, Senior Vice President/Information Systems, Chief Information Officer; **Shelby M. Evans**, Vice President/Audit & Compliance.



From left: **Robert E. Bryant**, Senior Vice President/Trust Officer; **Jeffery L. Tickle**, Senior Vice President/Regional Manager; **Bryson J. Hunter**, Senior Vice President, Secretary & Counsel; **Lara E. Ramsey**, Senior Vice President/Administration; **Frederick A. Reed, Jr.**, Senior Vice President/Regional Manager.

# Board of Directors National Bankshares, Inc.



*Standing, from left:* **Glenn P. Reynolds**, President, Reynolds Architects, Inc.; **William A. Peery**, President, Cargo Oil Co., Inc.; **Lawrence J. Ball**, President, Moog Components Group; **Charles E. Green, III**, Financial Planner, AXA Advisors, L.L.C.

*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, Retired; **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 Chief Executive Officer, National Bankshares Financial Services, Inc.

# Consolidated Balance Sheets

\$ in thousands, except per share data

<b>Assets</b>	<b>December 31, 2011</b>	December 31, 2010
Cash and due from banks	\$ 11,897	\$ 9,858
Interest-bearing deposits	98,355	69,400
Securities available for sale, at fair value	174,918	184,907
Securities held to maturity (fair value approximates \$151,429 at December 31, 2011 and \$129,913 at December 31, 2010)	143,995	131,000
Total securities	318,913	315,907
Mortgage loans held for sale	2,623	2,460
Loans:		
Real estate construction loans	48,531	46,169
Consumer real estate loans	150,224	153,405
Commercial real estate loans	303,192	293,171
Commercial non-real estate loans	38,832	37,547
Public sector and IDA	15,571	12,553
Consumer non-real estate loans	33,072	34,543
Total loans	589,422	577,388
Less unearned income and deferred fees	(952)	(945)
Loans, net of unearned income and deferred fees	588,470	576,443
Less allowance for loan losses	(8,068)	(7,664)
Loans, net	580,402	568,779
Premises and equipment, net	10,393	10,470
Accrued interest receivable	6,304	6,016
Other real estate owned, net	1,489	1,723
Intangible assets and goodwill	10,460	11,543
Bank-owned life insurance	19,812	17,252
Other assets	6,454	8,830
<b>Total assets</b>	<b>\$ 1,067,102</b>	<b>\$ 1,022,238</b>

## Liabilities and Stockholders' Equity

Noninterest-bearing demand deposits	\$ 142,163	\$ 131,540
Interest-bearing demand deposits	404,801	365,040
Savings deposits	61,298	55,800
Time deposits	311,071	332,203
Total deposits	919,333	884,583
Accrued interest payable	206	257
Other liabilities	6,264	8,211
Total liabilities	925,803	893,051
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, 6,939,974 shares in 2011 and 6,933,474 shares in 2010	8,675	8,667
Retained earnings	133,945	123,161
Accumulated other comprehensive (loss), net	(1,321)	(2,641)
Total stockholders' equity	141,299	129,187
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,067,102</b>	<b>\$ 1,022,238</b>

# Consolidated Statements of Income

\$ in thousands, except per share data

	Years ended December 31,		
	2011	2010	2009
<b>Interest Income</b>			
Interest and fees on loans	\$ 36,514	\$ 36,919	\$ 37,578
Interest on interest-bearing deposits	155	128	90
Interest on securities – taxable	6,745	5,588	6,273
Interest on securities – nontaxable	6,532	6,504	6,546
Total interest income	49,946	49,139	50,487
<b>Interest Expense</b>			
Interest on time deposits of \$100,000 or more	2,019	3,439	5,417
Interest on other deposits	7,165	7,719	10,405
Interest on borrowed funds	---	---	3
Total interest expense	9,184	11,158	15,825
Net interest income	40,762	37,981	34,662
Provision for loan losses	2,949	3,409	1,634
Net interest income after provision for loan losses	37,813	34,572	33,028
<b>Noninterest Income</b>			
Service charges on deposit accounts	2,617	2,858	3,314
Other service charges and fees	287	317	343
Credit card fees	3,197	2,954	2,803
Trust income	1,087	1,118	1,053
BOLI income	762	760	756
Other income	449	354	491
Realized securities gains (losses), net	11	(14)	44
Total noninterest income	8,410	8,347	8,804
<b>Noninterest Expense</b>			
Salaries and employee benefits	11,357	10,963	11,336
Occupancy and furniture and fixtures	1,599	1,875	1,792
Data processing and ATM	1,701	1,499	1,371
FDIC assessment	677	1,080	1,727
Credit card processing	2,485	2,300	2,121
Intangible assets amortization	1,083	1,083	1,093
Net costs of other real estate owned	518	214	393
Franchise taxes	780	963	885
Other operating expenses	3,138	3,150	3,135
Total noninterest expense	23,338	23,127	23,853
Income before income tax expense	22,885	19,792	17,979
Income tax expense	5,247	4,223	3,660
<b>Net income</b>	\$ 17,638	\$ 15,569	\$ 14,319
<b>Basic net income per common share</b>	\$ 2.54	\$ 2.25	\$ 2.07
<b>Fully diluted net income per common share</b>	\$ 2.54	\$ 2.24	\$ 2.06

# Board of Directors National Bank



*Standing, from left:* **Michael E. Dye**, Pharmacist/Owner, New Graham Pharmacy; **Dr. J. Lewis Webb, Jr.**, Retired Dentist; **Carl N. McNeil**, Realtor, Founder McNeil Real Estate, Inc.

*Seated from left:* **James C. Thompson**, Chairman, Thompson & Litton, Inc.; **Ellen G. Burnop**, Co-Owner and President, New River Office Supply, Inc.; **Dr. James M. Shuler**, Delegate, Virginia House of Delegates, Retired; **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, 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



# Our Locations



# 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

Bryson J. Hunter  
Secretary and Counsel

## Annual Meeting

The Annual Meeting of Stockholders will be held on Tuesday, April 10, 2012 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.  
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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

## **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.



National Bankshares

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