NATIONAL BANKSHARES INC
Form 10-Q
November 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d)Of the Securities Exchange Act of 1934
For the Quarterly Period Ended September 30, 2007.
o Transition Report Pursuant To Section 13 OR 15(d)Or The Securities Exchange Act Of 1934

For the transition period from ________ to ________.

Commission file number 0-15204

NATIONAL BANKSHARES, INC.

(Exact name of Registrant as specified in its Charter)

Virginia	54-1375874
(State of incorporation)	(I.R.S. Employer Identification No.)

101 Hubbard Street

P.O. Box 90002

Blacksburg, VA 24062-9002

(540) 951-6300

(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b – 2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b – 2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 31, 2007
Common Stock, $1.25 Par Value	6,962,174

(This report contains 30 pages)

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES

Form 10-Q

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Part I

Financial Information

Item 1. Financial Statements

National Bankshares, Inc. and Subsidiaries

Consolidated Balance Sheets

($ In thousands, except share data)	**(Unaudited) September 30, 2007**	**December 31, 2006**
Assets		
Cash and due from banks	**$ 12,058**	$ 15,283
Interest-bearing deposits	**6,418**	19,617
Securities available for sale, at fair value	**160,355**	169,735
Securities held to maturity (fair value approximates $119,894 at September 30, 2007 and $115,561 at December 31, 2006)	**120,419**	115,754
Mortgage loans held for sale	**378**	808
Loans:		
Real estate construction loans	**42,826**	33,840
Real estate mortgage loans	**142,618**	126,302
Commercial and industrial loans	**214,056**	215,244
Loans to individuals	**115,850**	126,316
Total loans	**515,350**	501,702
Less unearned income and deferred fees	**(1,104)**	(1,059)
Loans, net of unearned income and deferred fees	**514,246**	500,643
Less: allowance for loan losses	**(5,043)**	(5,157)
Loans, net	**509,203**	495,486
Bank premises and equipment, net	**12,206**	12,702
Accrued interest receivable	**6,125**	5,682
Other real estate owned, net	**192**	390
Intangible assets and goodwill, net	**15,123**	15,976
Other assets	**17,438**	16,770
Total assets	**$ 859,915**	$ 868,203
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	**$ 111,464**	$ 101,167
Interest-bearing demand deposits	**211,276**	233,023
Savings deposits	**45,690**	47,988
Time deposits	**381,561**	382,514

Total deposits	**749,991**	764,692
Other borrowed funds	**66**	73
Accrued interest payable	**807**	863
Other liabilities	**6,282**	5,820
Total liabilities	**757,146**	771,448

continued

Stockholders' Equity		
Preferred stock of no par value.		
Authorized 5,000,000 shares; none issued and outstanding	**---**	---
Common stock of $1.25 par value.		
Authorized 10,000,000 shares; issued and outstanding 6,957,884 shares in 2007 and 6,980,234 in 2006	**8,697**	8,725
Retained earnings	**97,440**	91,123
Accumulated other comprehensive (loss), net	**(3,368)**	(3,093)
Total stockholders' equity	**102,769**	96,755
Total liabilities and stockholders' equity	**$ 859,915**	$ 868,203

See accompanying notes to the consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Three Months Ended September 30, 2007 and 2006

(Unaudited)

($ In thousands, except share and per share data)	**September 30, 2007**	**September 30, 2006**
Interest income		
Interest and fees on loans	**$ 9,367**	$ 8,863
Interest on interest-bearing deposits	**124**	110
Interest on securities – taxable	**1,882**	1,878
Interest on securities – nontaxable	**1,320**	1,191
Total interest income	**12,693**	12,042
Interest expense		
Interest on time deposits $100,000 or more	**1,665**	1,258
Interest on other deposits	**3,775**	3,425
Interest on borrowed funds	**2**	8
Total interest expense	**5,442**	4,691
Net interest income	**7,251**	7,351
Provision for loan losses	**119**	16
Net interest income after provision for loan losses	**7,132**	7,335
Noninterest income		
Service charges on deposit accounts	**814**	862
Other service charges and fees	**85**	79
Credit card fees	**710**	617
Trust income	**286**	314
Other income	**230**	313
Realized securities gains, net	**---**	47
Total noninterest income	**2,125**	2,232
Noninterest expense		
Salaries and employee benefits	**2,621**	2,866
Occupancy, furniture and fixtures	**419**	474
Data processing and ATM	**278**	294
Credit card processing	**559**	479
Intangibles amortization	**284**	284
Net costs of other real estate owned	**10**	2
Other operating expenses	**929**	997

Total noninterest expense	**5,100**	5,396
Income before income tax expense	**4,157**	4,171
Income tax expense	**961**	970
Net income	**$ 3,196**	$ 3,201

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Net income per share - basic	**$ 0.46**	$ 0.46
- diluted	**$ 0.46**	$ 0.46
Weighted average number of common		
shares outstanding - basic	**6,966,685**	6,993,891
- diluted	**6,978,676**	7,014,961
Dividends declared per share	**$ ---**	$ ---

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Income

Nine Months Ended September 30, 2007 and 2006

(Unaudited)

($ In thousands, except share and per share data)	**September 30, 2007**	**September 30, 2006**
Interest income		
Interest and fees on loans	**$ 27,745**	$ 25,861
Interest on interest-bearing deposits	**508**	370
Interest on securities – taxable	**5,688**	5,574
Interest on securities – nontaxable	**3,977**	3,669
Total interest income	**37,918**	35,474
Interest expense		
Interest on time deposits $100,000 or more	**4,844**	3,449
Interest on other deposits	**11,350**	9,832
Interest on borrowed funds	**34**	22
Total interest expense	**16,228**	13,303
Net interest income	**21,690**	22,171
Provision for loan losses	**129**	40
Net interest income after provision for loan losses	**21,561**	22,131
Noninterest income		
Service charges on deposit accounts	**2,467**	2,532
Other service charges and fees	**247**	292
Credit card fees	**2,028**	1,777
Trust income	**1,019**	1,059
Other income	**751**	830
Realized securities gains, net	**51**	13
Total noninterest income	**6,563**	6,503
Noninterest expense		
Salaries and employee benefits	**8,240**	8,706
Occupancy, furniture and fixtures	**1,316**	1,479
Data processing and ATM	**858**	922
Credit card processing	**1,585**	1,361
Intangibles amortization	**853**	853
Net costs of other real estate owned	**71**	16
Other operating expenses	**2,938**	2,959

Total noninterest expense	**15,861**	16,296
Income before income tax expense	**12,263**	12,338
Income tax expense	**2,811**	2,907
Net income	**$ 9,452**	$ 9,431

continued

Net income per share - basic	**$ 1.36**	$ 1.35
- diluted	**$ 1.35**	$ 1.34
Weighted average number of common		
shares outstanding - basic	**6,975,344**	7,006,767
- diluted	**6,991,712**	7,031,118
Dividends declared per share	**$ 0.37**	$ 0.36

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

Nine Months Ended September 30, 2007 and 2006

(Unaudited)

($ In thousands, except per share data)	**Common Stock**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Comprehensive Income**	**Total**
Balances at December 31, 2005	$ 8,775	$ 84,610	$ (1,446)		$ 91,939
Net income	---	9,431	---	$ 9,431	9,431
Dividends ($0.36 per share)		(2,524)			(2,524)
Exercise of stock options	13	108	---	---	121
Other comprehensive loss, net of tax:					
Unrealized loss on securities available for sale, net of income tax $(104)	---	---	---	(194)	---
Reclass adjustment, net of tax $9	---	---	---	17	---
Other comprehensive loss, net of tax ($95)	---	---	(177)	(177)	(177)
Comprehensive income	---	---	---	$ 9,254	---
Stock repurchase	(52)	(935)	---		(987)
Balances at September 30, 2006	$ 8,736	$ 90,690	$ (1,623)		$ 97,803
Balances at December 31, 2006	$ 8,725	$ 91,123	$ (3,093)		$ 96,755
Net income	---	9,452	---	$ 9,452	9,452
Dividends ($0.37 per share)	---	(2,584)	---	---	(2,584)
Exercise of stock options	13	93	---	---	106
Other comprehensive loss, net of tax:					
Unrealized loss on securities available for sale, net of income tax $(130)	---	---	---	(242)	---
Reclass adjustment, net of income tax $(18)	---	---	---	(33)	---
Other comprehensive loss, net of tax ($148)	---	---	(275)	(275)	(275)
Comprehensive income	---	---	---	$ 9,177	---
Stock repurchase	(41)	(644)	---		(685)
Balances at September 30, 2007	**$ 8,697**	**$ 97,440**	**$ (3,368)**		**$ 102,769**

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2007 and 2006

(Unaudited)

($In thousands)	September 30, 2007	September 30, 2006
Cash flows from operating activities		
Net income	**$ 9,452**	$ 9,431
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**129**	40
Depreciation of bank premises and equipment	**761**	752
Amortization of intangibles	**853**	853
Amortization of premiums and accretion of discount, net	**177**	206
Gains on disposal of fixed assets	**(6)**	(4)
(Gains) losses on sales and calls of securities available for sale, net	**(51)**	25
Gains on call of securities held to maturity	**---**	(38)
Losses and writedowns on other real estate owned	**38**	10
Net change in:		
Mortgage loans held for sale	**430**	(223)
Accrued interest receivable	**(443)**	(372)
Other assets	**(520)**	(309)
Accrued interest payable	**(56)**	81
Other liabilities	**462**	691
Net cash provided by operating activities	**$ 11,226**	$ 11,143
Cash flows from investing activities		
Net change interest-bearing deposits	**$ 13,199**	$ (9,499)
Proceeds from calls, principal payments, sales and maturities of securities available for sale	**15,233**	11,748
Proceeds from calls, principal payments and maturities of securities held to maturity	**3,508**	6,448
Proceeds from sale of securities held to maturity	**---**	823
Purchases of securities available for sale	**(6,336)**	(11,225)
Purchases of securities held to maturity	**(8,239)**	(2,458)
Purchases of loan participations	**(3,500)**	(2,232)
Collections of loan participations	**4,720**	1,858
Loan originations and principal collections, net	**(15,368)**	(4,989)
Proceeds from disposal of other real estate owned	**386**	---
Recoveries on loans charged off	**76**	108
Purchase of bank premises and equipment	**(279)**	(720)
Proceeds from disposal of bank premises and equipment	**20**	5

Net cash provided by (used) in investing activities	**$**	**3,420**		$	(10,133	)
Cash flows from financing activities						
Net change in other deposits	**$**	**(13,748**	**)**	$	(25,319)	
Net change in time deposits		**(953**	**)**		22,463	
Net change in other borrowed funds		**(7**	**)**		(281	)
Stock options exercised		**106**			121	

continued

Common stock repurchased	**(685)**	(987)
Cash dividends paid	**(2,584)**	(2,524)
Net cash provided (used) by financing activities	**$ (17,871)**	$ (6,527)
Net change in cash and due from banks	**(3,225)**	(5,517)
Cash and due from banks at beginning of period	**15,283**	20,115
Cash and due from banks at end of period	**$ 12,058**	$ 14,598
Supplemental disclosure of cash flow information		
Cash paid for interest	**$ 16,284**	$ 13,222
Cash paid for income taxes	**$ 2,680**	$ 2,372
Loans charged to the allowance for loan losses	**$ 319**	$ 345
Loans transferred to other real estate owned	**$ 226**	$ 24
Unrealized (losses) on securities available for sale	**$ (423)**	$ (272)

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2007

(Unaudited)

($ In thousands, except share and per share data)

Note (1)

The consolidated financial statements of National Bankshares, Inc. (Bankshares) and its wholly-owned subsidiaries, The National Bank of Blacksburg (NBB) and National Bankshares Financial Services, Inc. (NBFS), (the Company), conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the nine months ended September 30, 2007 are not necessarily indicative of results of operations for the full year or any other interim period. The interim period consolidated financial statements and financial information included in this Form 10-Q should be read in conjunction with the notes to consolidated financial statements included in the Company's 2006 Form 10-K. The Company posts all reports required to be filed under the Securities and Exchange Act of 1934 on its web site at www.nationalbankshares.com.

Note (2) Stock-Based Compensation

The Company adopted the National Bankshares, Inc. 1999 Stock Option Plan to give key employees of Bankshares and its subsidiaries an opportunity to acquire shares of National Bankshares, Inc. common stock. The purpose of the 1999 Stock Option Plan is to promote the success of Bankshares and its subsidiaries by providing an incentive to key employees that enhances the identification of their personal interest with the long term financial success of the Company and with growth in stockholder value. Under the 1999 Stock Option Plan, up to 500,000 shares of Bankshares common stock may be granted. The 1999 Stock Option Plan is administered by the Stock Option Committee, which is the NBI Board of Directors' Compensation Committee, made up entirely of independent directors of National Bankshares, Inc. The Stock Option Committee may determine whether options are incentive stock options or nonqualified stock options and may determine the other terms of grants, such as number of shares, term, a vesting schedule, and the exercise price. The 1999 Stock Option Plan limits the maximum term of any option granted to ten years, states that options may be granted at not less than fair market value on the date of the grant and contains certain other limitations on the exercisability of incentive stock options. The options generally vest 25% after one year, 50% after two years, 75% after three years and 100% after four years. At the discretion of the Stock Option Committee options may be awarded with the provision that they may be accelerated upon a change of control, merger, consolidation, sale or dissolution of National Bankshares, Inc. At September 30, 2007, there were 286,000 additional shares available for grant under the plan.

Compensation expense is calculated using the Black-Scholes model and is amortized over the requisite service period using the straight-line method. Please refer to the Company's Form 10-K dated December 31, 2006 for assumptions used. There have been no grants of stock options in 2007.

Options	**Shares**

		Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2007	161,790	$ 20.46		
Granted	---			
Exercised	(10,000)	$ 10.55		
Forfeited or expired	---			
Outstanding at September 30, 2007	151,790	$ 21.12	6.35	$ ---
Exercisable at September 30, 2007	151,790	$ 21.12	6.35	$ ---

Because no options were granted in 2007 and all options were fully vested at December 31, 2006, there is no expense included in net income.

During the nine months ended September 30, 2007, there were no stock options granted and 10,000 stock options were exercised with an intrinsic value of $88,500. For the nine months ended September 30, 2006 there were no stock options granted and 10,710 options were exercised with an intrinsic value of $129,000.

Note (3) Allowance for Loan Losses, Nonperforming Assets and Impaired Loans

	For the periods ended		
	September 30,		December 31,
($ In thousands, except % data)	**2007**	**2006**	**2006**
Balance at beginning of period	**$ 5,157**	$ 5,449	$ 5,449
Provision for loan losses	**129**	40	49
Loans charged off	**(319)**	(345)	(459)
Recoveries	**76**	108	118
Balance at the end of period	**$ 5,043**	$ 5,252	$ 5,157
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	**0.98 %**	**1.06 %**	1.03 %
Ratio of net charge-offs to average loans, net of unearned income and deferred fees[1.]	**0.06 %**	**0.06 %**	0.07 %
Ratio of allowance for loan losses to nonperforming loans[2.]	**417.47 %**	**1,313.00 %**	--- %

1. Net charge-offs are on an annualized basis.
2. The Company defines nonperforming loans as total nonaccrual and restructured loans. Loans 90 days past due and still accruing are excluded.

	September 30,		**December 31,**
($ In thousands, except % data)	**2007**	**2006**	**2006**
Nonperforming Assets:			
Nonaccrual loans	**$ 1,208**	$ 4	$ ---
Restructured loans	**---**	---	---
Total nonperforming loans	**1,208**	4	---
Foreclosed property	**192**	390	390
Total nonperforming assets	**$ 1,400**	$ 394	$ 390
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	**0.27 %**	0.08 %	0.08 %

	September 30,		**December 31,**
($ In thousands, except % data)	**2007**	**2006**	**2006**
Loans past due 90 days or more and still accruing	**$ 288**	$ 495	$ 681
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	**0.06 %**	0.10 %	0.14 %
Impaired loans			
Total impaired loans	**$ 1,140**	$ ---	$ ---
Impaired loans with a valuation allowance	**---**	---	---
Valuation allowance	**---**	---	---

Impaired loans, net of allowance	**---**	---	---
Impaired loans with no valuation allowance	**$ 1,140**	$ ---	---
Average recorded investment in impaired loans	**$ 1,136**	$ 175	$ 140
Income recognized on impaired loans	**$ ---**	$ ---	$ ---
Amount of income recognized on a cash basis	**$ ---**	$ ---	$ ---

Nonaccrual loans exluded from impaired disclosure under SFAS114 at September 30, 2007 were $68. No income was recognized on these loans at September 30, 2007.

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Note (4) Securities

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities available for the sale by major security type as of September 30, 2007 are as follows:

	September 30, 2007			
		Gross	**Gross**	
	Amortized	**Unrealized**	**Unrealized**	**Fair**
($ In thousands)	**Costs**	**Gains**	**Losses**	**Values**
Available for sale:				
U.S. Treasury	**$ 3,030**	**$ ---**	**$ 66**	**$ 2,964**
U.S. Government Agencies and Corporations	**21,826**	**11**	**93**	**21,744**
State and political subdivisions	**76,092**	**571**	**724**	**75,939**
Mortgage-backed securities	**27,327**	**8**	**340**	**26,995**
Corporate debt securities	**30,469**	**36**	**988**	**29,517**
Federal Reserve Bank stock-restricted	**92**	**---**	**---**	**92**
Federal Home Loan Bank stock-restricted	**1,659**	**---**	**---**	**1,659**
Other securities	**1,312**	**133**	**---**	**1,445**
Total securities available for sale	**$ 161,807**	**$ 759**	**$ 2,211**	**$ 160,355**

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities held to maturity by major security type as of September 30, 2007 are as follows:

	September 30, 2007			
		Gross	**Gross**	
	Amortized	**Unrealized**	**Unrealized**	**Fair**
($ In thousands)	**Costs**	**Gains**	**Losses**	**Values**
Held to Maturity:				
U.S. Government Agencies and Corporations	**$ 42,462**	**$ 26**	**$ 324**	**$ 42,164**
State and political subdivisions	**60,697**	**566**	**433**	**60,830**
Mortgage-backed securities	**2,152**	**7**	**32**	**2,127**
Corporate securities	**15,108**	**105**	**440**	**14,773**
Total securities held to maturity	**$ 120,419**	**$ 704**	**$ 1,229**	**$ 119,894**

Information pertaining to securities with gross unrealized losses at September 30, 2007 and December 31, 2006, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	September 30, 2007			
	Less Than 12 Months		**12 Months or More**	
	Fair	**Unrealized**	**Fair**	**Unrealized**
($ In thousands)	**Value**	**Loss**	**Value**	**Loss**
U.S. Government agencies and corporations	$ 7,820	$ 44	$ 37,068	$ 440
State and political subdivisions	26,412	503	33,245	653
Mortgage-backed securities	9,537	111	17,584	261
Corporate debt securities	1,004	1	35,450	1,427
Total temporarily impaired securities	$ 44,773	$ 659	$ 123,347	$ 2,781

	December 31, 2006			
	Less Than 12 Months		**12 Months or More**	
($ In thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. Government agencies and corporations	$ 22,734	$ 83	$ 38,234	831
State and political subdivisions	14,449	91	30,503	587
Mortgage-backed securities	13,533	46	16,268	296
Corporate debt securities	---	---	35,462	1,495
Total temporarily impaired securities	$ 50,716	$ 220	$ 120,467	$ 3,209

The Company had 254 securities with a fair value of $168,120 which were temporarily impaired at September 30, 2007. The total unrealized loss on these securities was $3,440. Losses are attributed to interest rate movements. Credit quality of the securities portfolio is continuously monitored by management. The Company has the ability and intent to hold these securities until maturity or until the loss in value is recovered. Therefore, the losses associated with these securities are considered temporary at September 30, 2007. All securities shown are above investment grade.

Note (5) Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The Company does not expect the implementation of SFAS 157 to have a material impact on its consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (SFAS 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of this Statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument and is irrevocable. SFAS 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The Company is in the process of evaluating the impact SFAS 159 may have on its consolidated financial statements.

Note (6) Defined Benefit Plan

Components of Net Periodic Benefit Cost

	Pension Benefits	
	Nine Months Ended September 30,	
($ in Thousands)	2007	2006
Service cost	**$ 456**	$ 430
Interest cost	**525**	486
Expected return on plan assets	**(477)**	(395)
Amortization of prior service cost	**6**	(10)
Amortization of net obligation at transition	**(9)**	166
Recognized net actuarial loss	**135**	6
Net periodic benefit cost	**$ 636**	$ 683

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Employer Contributions

Bankshares' pension plan contribution for 2007 is $594. The contribution will be paid in quarterly installments.

National Bankshares, Inc. and Subsidiaries

(In thousands, except per share data)

Item 2.

Management's Discussion and Analysis of Financial Condition and

Results of Operations for the Nine Months Ended September 30, 2007

The purpose of this discussion is to provide information about the financial condition and results of operations of National Bankshares, Inc. and its wholly-owned subsidiaries (the Company), which are not otherwise apparent from the consolidated financial statements and other information included in this report. Refer to the financial statements and other information included in this report as well as the 2006 Annual Report on Form 10-K for an understanding of the following discussion and analysis.

This Quarterly Report on Form 10-Q contains forward-looking statements as described in the Securities Exchange Act of 1934. The Company's actual results could differ materially from those set forth in the forward-looking statements.

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset or relieving a liability. We use historical loss factors as one element in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) SFAS 5, *Accounting for Contingencies,* which requires that losses be accrued when they are probable of occurring and estimable and (ii) SFAS 114, *Accounting by Creditors for Impairment of a Loan,* which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

Our allowance for loan losses has three basic components; the formula allowance, the specific allowance and the unallocated allowance. Each of these components is determined based upon estimates that can and do change when actual events occur. The formula allowance uses a historical loss view and certain qualitative factors as an indicator of future losses and, as a result, could differ from the loss incurred in the future. However, since this history is updated with the most recent loss information, the errors that might otherwise occur are mitigated. The specific allowance uses various techniques to arrive at an estimate of loss. Expected cash flows and fair market value of collateral are used to estimate these losses. The use of these values is inherently subjective and our actual losses could be greater or less than the estimates. The unallocated allowance captures losses that are attributable to various economic events, industry or geographic sectors, whose impact on the portfolio have occurred but have yet to be recognized in either the formula or specific allowance.

Core deposit intangibles

Effective January 1, 2002, the Corporation adopted Financial Accounting Standards Board Statement No. 142, *Goodwill and Other Intangible Assets.* Accordingly, goodwill is no longer subject to amortization over its estimated useful life, but is subject to at least an annual assessment for impairment by applying a fair value based test. Additionally, Statement 142 requires that acquired intangible assets (such as core deposit intangibles) be separately recognized if the benefit of the asset can be sold, transferred, licensed, rented, or exchanged and amortized over its estimated useful life. Branch acquisition transactions were outside the scope of the Statement and therefore any intangible asset arising from such transactions remained subject to amortization over their estimated useful life.

In October 2002, the Financial Accounting Standards Board issued Statement No. 147, *Acquisitions of Certain Financial Institutions.* The Statement amends previous interpretive guidance on the application of the purchase method of accounting to acquisitions of financial institutions, and requires the application of Statement No. 141, *Business Combinations,* and Statement No. 142 to branch acquisitions if such transactions meet the definition of a business combination. The provisions of the Statement do not apply to transactions between two or more mutual enterprises. In addition, the Statement amends Statement No. 144, *Accounting for the Impairment of Long-Lived Assets,* to include in its scope core deposit intangibles of financial institutions. Accordingly, such intangibles are subject to a recoverability test based on undiscounted cash flows, and to the impairment recognition and measurement provisions required for other long-lived assets held and used. The Company has determined that the acquisitions that generated the intangible assets on the consolidated balance sheets in the amount of $9,958 and $10,912 at December 31, 2003 and 2002, respectively, did not constitute the acquisition of a business, and therefore will continue to be amortized.

Overview

National Bankshares, Inc. (NBI) is a financial holding company located in Southwest Virginia. It conducts operations primarily through its full-service banking affiliate, The National Bank of Blacksburg, which does business as National Bank. National Bank has 26 locations in the region. It also has a nonbanking affiliate, National Bankshares Financial Services, Inc., which offers investment and insurance products. Net income derived from the nonbanking affiliate is not significant at this time or in the foreseeable future. NBI is a community bank operation.

Performance Summary

The following table shows NBI's key performance ratios for the period ended September 30, 2007 and December 31, 2006. Per share data has been adjusted to reflect the effects of a March 31, 2006 2-for-1 stock split.

	September 30, 2007			December 31, 2006		
Return on average assets		1.46	%		1.50	%
Return on average equity		12.69	%		13.41	%
Net interest margin (1)		3.99	%		4.13	%
Noninterest margin (2)		1.45	%		1.54	%
Basic net earnings per share	$	1.36		$	1.80	
Fully diluted net earnings per share	$	1.35		$	1.80	

(1) Net Interest Margin: Year-to-date tax-equivalent net interest income divided by year-to-date average earning assets using a tax rate of 35%.
(2) Noninterest Margin: Noninterest income (including securities gains and losses) less noninterest expense (excluding the provision for bad debts and income taxes) divided by average year-to-date assets. This is a non-GAAP financial measure of the level of noninterest income and expense.

The return on average assets for the first three quarters of 2007 was 1.46%, down slightly from the 1.50% for the period ended December 31, 2006. The return on average equity also experienced a decline.

Growth

The following table shows NBI's key growth indicators:

	September 30, 2007	December 31, 2006	Percent Change
Securities	$ 280,774	$ 285,489	(1.65 %)
Loans, net	509,203	495,486	2.77 %
Deposits	751,981	764,692	(1.66 %)
Total assets	859,915	868,203	(0.95 %)

Asset Quality

Key asset quality indicators are shown below:

	September 30, 2007		December 31,2006	
Nonperforming loans	$ 1,208		$ ---	
Loans past due over 90 days	288		681	
Other real estate owned	192		390	
Allowance for loan losses to loans	0.98	%	1.03	%
Net charge-off ratio	0.06	%	0.07	%

This data indicates that the level of nonperforming loans has increased, while the level of loans past due 90 days or more has declined. The increase in nonperforming loans is concentrated in one credit. There has been no specific allocation to the allowance for loan losses for the single additional nonperforming loan, as management believes that this credit is well collateralized. Measures of asset quality remain good when viewed from a historical perspective and when compared with peers. Other real estate owned continues to decline as properties foreclosed upon are sold.

Net Interest Income

Net interest income for the first nine months of 2007 was $21,690, a decrease of $481 or 2.17% over the same period in 2006. There were regular and steady increases in interest rate levels until the third quarter of 2006. Due to the liability-sensitive nature of the Company's balance sheet, funding costs rose at a faster rate than asset yields. This caused the interest rate spread and the related net interest income to decrease. Recent reductions in the federal funds rate by the Federal Reserve Bank should have a positive effect on the net interest margin in the intermediate term.

Data in the table below, suggests that the net interest spread may have stabilized in the first nine months of 2007. It is expected that a gradual improvement in the net interest spread will occur, as interest rate levels have declined.

	For the period ended September 30, 2007		June 30, 2007		March 31, 2007		December 31, 2006	
Loans	7.36	%	7.37	%	7.35	%	7.11	%
Taxable securities	4.94	%	4.92	%	4.95	%	4.89	%
Non-taxable securities	6.23	%	6.32	%	6.36	%	6.25	%
Interest-bearing deposits	5.40	%	5.36	%	5.47	%	5.08	%
Total interest-bearing assets	6.68	%	6.69	%	6.68	%	6.51	%
Interest-bearing demand deposits	1.96	%	1.98	%	2.00	%	1.87	%
Saving deposits	0.45	%	0.50	%	0.50	%	0.50	%
Time deposits	4.51	%	4.48	%	4.47	%	3.94	%
Other borrowings	5.58	%	5.56	%	5.56	%	6.19	%
Total interest-bearing liabilities	3.35	%	3.32	%	3.33	%	2.94	%

Interest rate spread	3.34 %	3.37 %	3.35 %	3.57 %

From December 31, 2006 to September 30, 2007, the yield on loans has increased by 25 basis points. During the same period, the yield on taxable securities has gone up by 5 basis points, with nontaxable securities decreasing a nominal 2 basis points. Among the asset categories interest-bearing deposits, which reprice daily, experienced the highest level of increase.

The table above indicates that the Company's interest rate spread has remained relatively stable throughout 2007. The interest rate spread is compressed and is at a lower level than management considers to be desirable for optimal profitability.

In September of 2007, the Federal Reserve Bank lowered the targeted federal funds rate by 50 basis points, and the prime rate for banks was in turn lowered by the same amount. In general, a reduction in interest rates will, over time, positively impact the Company's interest rate spread. This is because its interest-bearing liabilities re-price at a faster pace than its interest-earning assets. However, future changes in interest rates are difficult to predict because of the number of economic variables in play. It is unknown if the Federal Reserve Bank will cut interest rates further. Higher inflation rates would likely result in future increases in the targeted federal funds rate.

Provision and Allowance for Loan Losses

The provision for loan losses for the nine-month period ended September 30, 2007 was $129. The ratio of the allowance for loan losses to total loans at the end of the first nine months of 2007 was 0.98%, which compares to 1.03% at December 31, 2006. The net charge-off ratio was 0.06% at September 30, 2007 and .07% at December 31, 2006.

The Company regularly reviews asset quality and re-evaluates the allowance for loan losses. During the third quarter of 2007, the Company made provisions of $119 to the Allowance for Loan Losses. These aggregate additions, which were the first significant additions in well over one year, were made based upon management's opinion of current asset quality and loan growth, evaluated in the context of historical loss experience and current economic conditions. (See "Allowance for Loan Losses" under "Critical Accounting Policies".)

Noninterest Income

	September 30, 2007	September 30, 2006	Percent Change	
Service charges on deposits	$ 2,467	$ 2,532	(2.57	%)
Other service charges and fees	247	292	(15.41	%)
Credit card fees	2,028	1,777	14.12	%
Trust fees	1,019	1,059	(3.78	%)
Other income	751	830	(9.52	%)
Realized securities gains (losses)	51	13	292.31	%

Noninterest income is made up of several categories. Following is a description of the catergories, as well as the factors that influence each.

Service charges on deposit accounts consist of a variety of charges imposed on demand deposits, interest-bearing deposits and savings deposit accounts. These include, but are not limited to, the following:

- Demand deposit monthly activity fees
- Service charges for checks for which there are non-sufficient funds or overdraft charges
- ATM transaction fees

The principal factors affecting current or future levels of income from this category are:

- Internally generated growth
- Acquisitions of other banks/branches or de novo branches
- Adjustments to service charge structures

Service charges on deposits were $2,467 at September 30, 2007, a decrease of $65 when compared to the same period in 2006.

Other service charges and fees consist of several categories. The primary categories are listed below.

- Fees for the issuance of official checks
- Safe deposit box rent

- Income from the sale of customer checks
- Income from the sale of credit life and accident and health insurance

Levels of income derived from other service charges and fees vary. Fees for the issuance of official checks and customer check sales tend to grow as the existing franchise grows and as new offices are added. Fee schedules, while subject to change, generally do not by themselves yield a significant increase in income when they change. The most significant growth in safe deposit box rent also comes with an expansion of offices. Safe deposit box fee schedules, which are already at competitive levels, are occasionally adjusted. Income derived from the sale of credit life insurance and accident and health insurance varies with loan volume.

Other service charges and fees at September 30, 2007 were $247, as compared with $292 for the same period the prior year. As indicated above, this category, because of its nature, varies from period to period. The total reported is a combination of declines in several areas, including small declines in income from the sale of checks and letter of credit fees. There was also a decrease in check cashing fees, which were uncharacteristically high in the same period last year.

Credit card fees consist of three types of revenues.

- Credit card transaction fees
- Debit card transaction fees
- Merchant fees

In all three areas, growth is a critical factor for the level of income. For debit and credit cards, the number of accounts, whether obtained from internal growth or by acquisition, is the key factor. Merchant fees also depend on the number of merchants in the Company's program, as well as the type of business and the level of transaction discounts associated with them.

Credit card fees increased by $251, or 14.12%, when September 30, 2007 and September 30, 2006 are compared. The increase was attributable to organic growth, resulting in increased volume.

Trust income is somewhat dependent upon market conditions and the number of estate accounts being handled at any given time. Financial market conditions, which affect the value of trust assets managed, can vary, leading to fluctuations in the related income. Over the past few years and into 2007, the financial markets have experienced a degree of volatility. Income from estates is also unpredictable. Trust income for the first nine months of 2007 was $1,019, a decrease of $40 from the previous year.

Other income is used for types of income that cannot be classified with other categories of noninterest income. The category includes such things as:

- Net gains on the sale of fixed assets
- Rent on foreclosed property
- Income from cash value life insurance
- Other infrequent or minor forms of income
- Revenue from investment and insurance sales

Other income was $751 for the first nine months of 2007, $79 less than for the same period in the prior year. A decline of $78 in revenue derived from the sale of investment products accounted for the decrease.

Realized net gains and (losses) on securities include equity adjustments in certain investments in limited liability companies of which the Company is part owner, as well as sales, maturities and calls of securities. Realized net gains and (losses) were $51 for the period ended September 30, 2007. The majority of this gain was attributable to equity adjustments in investments in the following limited liability companies, Bankers Insurance LLC, Bankers Investments Group LLC and Virginia Title Center LLC.

Noninterest Expense

	September 30, 2007	September 30, 2006	Percent Change
Salaries and employee benefits	$ 8,240	$ 8,706	(5.35 %)
Occupancy and furniture and fixtures	1,316	1,479	(11.02 %)
Data processing and ATM	858	922	(6.94 %)
Credit card processing	1,585	1,361	16.46 %
Intangibles and goodwill amortization	853	853	---
Net costs of other real estate owned	71	16	343.75 %
Other operating expenses	2,938	2,959	(0.71 %)

Noninterest expense includes several categories. A brief description of the factors that affect each follows.

In addition to employee salaries, the salaries and benefits expense category includes the costs of employment taxes and employee fringe benefits. Certain of these are:

- Health insurance
- Employee life insurance
- Dental insurance
- Executive compensation plans (1)
- Qualified Pension plans (1)
- Supplemental retirement plan (salary continuation agreements)
- Employer FICA
- Unemployment taxes

(1) See the 2006 Form 10-K and the Proxy Statement for the 2007 Annual Meeting of Stockholders for further information.

Salaries and employee benefits expense for the period ending September 30, 2007 was $8,240, a decline of $466 when compared to the same period in 2006. Expense attributed to salaries and employee benefits declined for several reasons. First, the consolidation of operations and support functions following the May 2006 merger of the Company’s two bank subsidiaries has resulted in fewer employees through attrition and previously scheduled retirements. For example, at December 31, 2005, the Company employed 263 full time equivalents. At December 31, 2006, the number declined to 249, and it was 239 at September 30, 2007. Second, as compared with the first nine months of 2006, the amount accrued through three quarters of 2007 for the Company's expense associated with employee health insurance plan premiums was down by $466. Third, when the first nine months of 2007 and 2006 are compared, there was a decline of $71 in the expense accrued for the employee stock ownership plan contribution. Higher salary expense from normal merit raises partially offset the reductions described above.

Occupancy expense for the first nine months of 2007 was $1,316, down $163 from the same period in 2006. This category contains several types of expenses, including depreciation, maintenance, lease expense and taxes and insurance. The net decrease from 2006 was due in part to $35 in additional expense for signage in 2006. This additional expense for signs in 2006 was related to the merger of the Company's two banking affiliates. When September 30, 2006 and September 30, 2007 are compared, depreciation for furniture and fixtures decreased by $43. Utilities expense was down by $18. In the third quarter, the Company received State-mandated refunds on its electric bills for earlier overcharges. This accounted for most of the decline in utilities expense. Expense for taxes and insurance were down by $31, as compared with the same period last year.

Data processing and ATM expense at September 30, 2007 decreased by $64 from the same period in 2006. Declines in data processing supplies, maintenance and communications line expense account for the decrease.

Because of increases in volume, credit card processing expenses grew by $224, as compared with September 30, 2007. The increase in credit card expenses was more than offset by the increase in credit card income. (See "Noninterest Income.")

Comparing the first nine months of 2007 with the same period in 2006, net cost of other real estate owned increased by $55. Losses on the sale of OREO property were $31, and $7 in write-downs were taken on properties in the first nine months of 2007. Other foreclosure expense was $33.

Other operating expenses include all other types of expense not classified elsewhere in the Company's statement of income. Other operating expenses decreased by a nominal $21, or 0.71%, when compared with the same period last year.

Balance Sheet

Year-to-date daily averages for the major balance sheet categories are as follows:

Assets		**September 30, 2007**		**December 31, 2006**	**Percent Change**	
Interest-bearing deposits	$	12,581	$	13,457	(6.51	%)
Securities available for sale		164,424		164,421	---	%
Securities held to maturity		120,251		106,645	12.76	%

Mortgage loans held for sale		765		543	40.88	%
Real estate construction loans		40,449		29,308	38.01	%
Real estate mortgage loans		132,869		121,912	8.99	%
Commercial and industrial loans		213,710		232,758	(8.18	%)
Loans to individuals		120,893		110,967	8.95	%
Total Assets		864,570		840,080	2.92	%
Liabilities and stockholders equity						
Noninterest-bearing demand deposits	$	107,818	$	108,977	(1.06	%)
Interest-bearing demand deposits		223,254		221,927	0.60	%
Savings deposits		47,665		51,745	(7.88	%)
Time deposits		378,448		358,422	5.59	%
Other borrowings		814		420	93.81	%
Shareholders’ equity		99,588		94,194	5.73	%

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Securities

Securities available for sale at September 30, 2007 were $160,355, a decline of $9,380 from December 31, 2006. During the same period, securities held to maturity increased by $4,665. The Company's intent is to hold the securities to maturity. The shift to the held to maturity portfolio is designed to mitigate the price volatility that has affected the capital account. Fluctuations in the level of unrealized gains and losses in the securities available for sale portfolio have been significant.

Loans		**At period ended September 30, 2007**		**At period ended December 31, 2006**	**Percent Change**	
Real estate construction	$	42,826	$	33,840	26.55	%
Real estate mortgage		142,618		126,302	12.92	%
Commercial and industrial		214,056		215,244	(0.55	%)
Loans to individuals		115,850		126,316	(8.29	%)
Total loans	$	515,350	$	501,702	2.72	%

The above table indicates that the highest level of growth has been in the category of real estate construction loans. Most of the growth in construction loans has been in commercial projects, not in the currently volatile housing sector.

Nearly all residential construction loans are sold on the secondary market once construction is complete and the loans are converted to permanent mortgages. It is policy to require a commitment for permanent mortgage financing from the secondary market lender prior to approving a residential construction loan. This practice is particularly helpful when the residential real estate market is unpredictable. Most commercial real estate construction loans are converted to permanent financing and held by the Company. Because this category of loans tends to be seasonal, volumes in the second and third quarter are usually higher than in the first and last quarter of the year.

Loan to individuals have declined by 8.29%. Competitive factors, such as the availability of low cost dealer auto loans and other products, such as home equity lines of credit, have made the traditional installment loan less attractive to bank customers.

Deposits		**At period ended September 30, 2007**		**At period ended December 31, 2006**	**Percent Change**	
Noninterest-bearing deposits	$	111,464	$	101,167	10.18	%
Interest-bearing demand deposits		211,276		233,023	(9.33	%)
Saving deposits		45,690		47,988	(4.79	%)
Time deposits		381,561		382,514	(0.25	%)
Total deposits	$	749,991	$	764,692	(1.92	%)

As seen above, total deposits have declined 1.66% from December 31, 2006 to September 30, 2007. Demand deposits increased by 12.15%. Interest-bearing demand deposits decreased by 9.33%.

Liquidity and Capital Resources

Net cash provided by operating activities was $11,226 for the period ended September 30, 2007, which compares to $11,143 for the same period the previous year.

Net cash provided investing activities was $3,420 for the period ended September 30, 2007, compared to net cash of $10,133 used for the period ended September 30, 2006. Net cash used in financing activities was $17,871 for the period ending September 30, 2007.

Management is unaware of any commitment that would have a material and adverse effect on liquidity at September 30, 2007.

Total shareholders' equity grew by $6,014 from December 31, 2006 to September 30, 2007. Earnings net of dividends and the changes in unrealized gains and losses for securities available for sale accounted for the net increase. During the first nine months of 2007, the Company repurchased 33,050 shares of its own stock for approximately $685 at an average price of $21.08 per share (including broker commission). The Tier I and Tier II risk-based capital ratios at September 30, 2007 were 14.98% and 15.82%, respectively. The Company's leverage capital ratio was 10.74%

Derivatives and Off Balance Sheet Items

The Company is not a party to derivative financial instruments with off-balance sheet risks, such as futures, forwards, and swaps. The Company has certain written options related to the origination and sale of mortgage loans. The Company is a party to financial instruments with off-balance sheet risks, such as commitments to extend credit, standby letters of credit, and recourse obligations in the normal course of business, to meet the financing needs of its customers. Management does not plan any future involvement in high- risk derivative products.

The Company's banking affiliate extends lines of credit to its customers in the normal course of business. Amounts drawn upon these lines vary at any given time depending on the business needs of the customers.

Standby letters of credit are also issued to the bank's customers. There are two types of standby letters of credit. The first is a guarantee of payment to facilitate customer purchases. The second type is a performance letter of credit that guarantees a payment if the customer fails to perform a specific obligation.

While it would be possible for customers to draw in full on approved lines of credit and letters of credit, historically this has not occurred. In the event of a sudden and substantial draw on these lines, the Company has its own lines of credit on which it could draw funds. Sale of the loans would also be an option.

The Company also sells mortgages on the secondary market for which there are recourse agreements should the borrower default. During the first nine months of 2007, there have been no significant or unusual changes in this area.

Management's Discussion and Analysis of Financial Condition and

Results of Operations for the Three Months Ended September 30, 2007

Net Interest Income

Net interest income for the three months ended September 30, 2007 was $7,251, a decrease of $100 from the corresponding period in 2006.

Overall the Company is experiencing a compression of the net interest margin. The net interest margin appears, however, to have stabilized. The net interest margin for the first three months of 2007 was 3.96%. For the second three months of 2007 it was 4.03%. For the third quarter of 2007 the net interest margin was $3.98%. While future improvements are anticipated, any improvement will be contingent upon interest rate levels remaining stable.

Noninterest Income

Noninterest income for the period ended September 30, 2007 was $2,125, a decrease of $107 from 2006.
Credit card processing income increased by $93 when the two periods are compared. Income from credit card processing income is volume driven, as is credit card processing expense, which increased by $80 in the third quarter.

As was previously discussed, a decrease in revenues from the sale of investment products was the primary cause of the decline in other income.

Realized gains and losses result from calls of the Company's investment securities equity adjustments in limited liability company's in which the Company is invested. There were no calls or adjustments in the third quarter of 2007, so no income or expense was generated in this category.

The decreases in Trust income and service charges on deposits are volume driven. Because they are affected by volume, the level of income in these areas fluctuates from time to time.

Noninterest Expense

Noninterest expense decreased by $296, or 5.49%, when the three months ended September 30, 2007 and 2006 are compared.

Salaries and fringe benefit expense declined by $245 in the third quarter of 2007, as compared with the third quarter of 2006. The decrease is the result of a lower number of employees, a drop in expense associated with employee health insurance plan premiums and a reduction in expense related to the Company's employee stock ownership plan (ESOP). In the third quarter of 2006, the Company accrued $95 for the ESOP, as compared with an accrual of ($13) in the third quarter this year. The net effect is a reduction of $108 in ESOP expense when the two periods are compared.

Credit card processing expense was $80 higher in the third quarter of 2007 than in the same quarter last year. As noted above, the increase is the result of a higher volume of transactions.

Occupancy and furniture and fixtures costs decreased by $55. The electric bill refunds that were discussed above, together with general cost-control measures, account for the decline.

Other expenses were $68 lower in the third quarter of 2007 than in 2006. There was a net decrease of $55 in the accrual for charitable donations when the three months ended September 30, 2007 is compared to the same period in 2006. General cost-control measures contributed to expense reduction in this category as well.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company considers interest rate risk to be a significant market risk and has systems in place to measure the exposure of net interest income to adverse movement in interest rates. Interest rate shock analyses provide management with an indication of potential economic loss due to future rate changes. There have not been any changes which would significantly alter the results disclosed as of December 31, 2006 in the Company’s Form 10-K.

Item 4. Controls and Procedures

Under the supervision and with the participation of management, including the Company’s principal executive officer and principal financial officer, the Company has conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures as of September 30, 2007. Based on that evaluation, the Company’s principal executive officer and principal financial officer have concluded that these controls and procedures are effective to give reasonable assurance in alerting them in a timely fashion to material information relating to the Company that is required to be included in the reports the Company files under the Act. There were no changes in the Company’s internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Disclosure controls and procedures are the Company’s controls and procedures that are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to allow timely decisions regarding its required disclosure. The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that all control issues have been detected.

Part II

Other Information

Item 1. Legal Proceedings

There were no material legal proceedings for the nine months ended September 30, 2007.

Item 1A. Risk Factors

No material changes from risk factors as previously disclosed.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about our purchases during the third quarter of 2007 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act.

Fiscal Period	Total Number of Shares Purchased	Average Price Paid per Share(1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(2)	Approximate Number of Shares That May Yet Be Purchased Under the Plans or Programs(2)(3)
July	6,000	20.07	6,000	89,000
August	7,050	19.65	7,050	81,950
September	5,000	19.71	5,000	76,950

1. Average price per share includes commissions.
2. On May 9, 2007 the Board approved the repurchase of up to 100,000 shares of common stock in the period from June 1, 2007 through May 31, 2008.

Item 3. Defaults upon Senior Securities

None for the nine months ended September 30, 2007.

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

See Index of Exhibits.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, National Bankshares, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DATE: November 9, 2007 NATIONAL BANKSHARES, INC.

/s/ JAMES G. RAKES
James G. Rakes
Chief Executive Officer

/s/ J. ROBERT BUCHANAN
J. Robert Buchanan
Chief Financial Officer

(1) **Index of Exhibits**

Exhibit No.	**Description**	**Page No. in Sequential System**
3(i)	Articles of Incorporation, as amended, of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3(a) of the Annual Report on Form 10-K for fiscal year ended December 31, 1993)
3(i)	Articles of Amendment to Articles of Incorporation of National Bankshares, Inc., dated April 8, 2003.	(incorporated herein by reference to exhibit 3(i) of the Annual Report on Form 10-K for the fiscal year ended December 31, 2003)
3(i)	Amended and Restated Articles of Incorporation of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3.1 of Form 8-K filed on March 16, 2006)
4(i)	Specimen copy of certificate for National Bankshares, Inc. common stock.	(incorporated herein by reference to Exhibit 4(a) of the Annual Report on Form 10-K for fiscal year ended December 31, 1993)
4(i)		

	Article Four of the Articles of Incorporation of National Bankshares, Inc. included in Exhibit No. 3(a)	(incorporated herein by reference to Exhibit 4(b) of the Annual Report on Form 10-K for fiscal year ended December 31, 1993)
10(ii)(B)	Computer software license agreement dated June 18, 1990, by and between Information Technology, Inc. and The National Bank of Blacksburg	(incorporated herein by reference to Exhibit 10(e) of the Annual Report on Form 10-K for fiscal year ended December 31, 1992)
*10(iii)(A)	National Bankshares, Inc. 1999 Stock Option Plan	(incorporated herein by reference to Exhibit 4.3 of the Form S-8, filed as Registration No. 333-79979 with the Commission on June 4, 1999)

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*10(iii)(A)	Employment Agreement dated January 2002 between National Bankshares, Inc. and James G. Rakes	(incorporated herein by reference to Exhibit 10(iii)(A) of Form 10-Q for the period ended June 30, 2002)
*10(iii)(A)	Employment Lease Agreement dated August 14, 2002, between National Bankshares, Inc. and The National Bank of Blacksburg	(incorporated herein by reference to Exhibit 10(iii)(A)of form 10-Q for the period ended September 30, 2002)
*10(iii)(A)	Change in Control Agreement dated January 5, 2003, between National Bankshares, Inc. and Marilyn B. Buhyoff	(incorporated herein by reference to Exhibit 10 iii (A) of Form 10-K for the period ended December 31, 2002)
*10(iii)(A)	Change in Control Agreement dated January 8, 2003, between National Bankshares, Inc. and F. Brad Denardo	(incorporated herein by reference to Exhibit 10 iii (A) of Form 10-K for the period ended December 31, 2002)
*10(iii)(A)	Salary Continuation Agreement dated February 8, 2006, between the National Bank of Blacksburg and James G. Rakes.	(incorporated herein by reference to Exhibit 10(iii)(A) of Form 8-K filed on February 8, 2006)
*10(iii)(A)	Salary Continuation Agreement dated February 8, 2006, between the National Bank of Blacksburg and F. Brad Denardo.	(incorporated herein by reference to Exhibit 10(iii)(A) of Form 8-K filed on February 8, 2006)
*10(iii)(A)	Salary Continuation Agreement dated February 8, 2006, between Bank of Tazewell County and J. Robert Buchanan.	(incorporated herein by reference to Exhibit 10(iii)(A) of Form 8-K filed on February 8, 2006)
*10(iii)(A)	Salary Continuation Agreement dated February 8, 2006, between National Bankshares, Inc. and Marilyn B. Buhyoff.	(incorporated herein by reference to Exhibit 10(iii)(A) of Form 8-K filed on February 8, 2006)
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* Indicates a management contract or compensatory plan required to be filed herein.

Exhibit No. 31(i)

CERTIFICATIONS UNDER SECTION 906 OF THE SARBANES OXLEY ACT OF 2002

I, James G. Rakes, Chairman, President and Chief Executive Officer of National Bankshares, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bankshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a – 15 (e) and 15d – 15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a – 15(f) and 15d – 15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 9, 2007

/s/ JAMES G. RAKES
James G. Rakes
Chairman
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31(ii)

I, J. Robert Buchanan, Treasurer (Chief Financial Officer) of National Bankshares, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bankshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a – 15 (e) and 15d – 15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a – 15(f) and 15d – 15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2007

/s/ J. ROBERT BUCHANAN
J. Robert Buchanan
Treasurer
(Principal Financial Officer)

Exhibit 32 (i)

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Form 10-Q of National Bankshares, Inc. for the quarter ended September 30, 2007, I, James G. Rakes, President and Chief Executive Officer of National Bankshares, Inc. (Principal Executive Officer), hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended September 30, 2007, fully complies with the requirements of section 13(a) or 15 (d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended September 30, 2007, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

/s/ JAMES G. RAKES
James G. Rakes
Chairman
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 32 (ii)

CERTIFICATION OF CHIEF FINANCIAL OFFICER

PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Form 10-Q of National Bankshares, Inc. for the quarter ended September 30, 2007, I, J. Robert Buchanan, Treasurer (Principal Financial Officer) of National Bankshares, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended September 30, 2007, fully complies with the requirements of section 13(a) or 15 (d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended September 30, 2007, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

/s/ J. ROBERT BUCHANAN
J. Robert Buchanan
Treasurer
(Principal Financial Officer)

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