

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

NATIONAL BANKSHARES INC  
Form 10-Q  
May 09, 2007

-----  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934 For the Quarterly Period Ended March 31, 2007.

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  
(State of incorporation)

54-1375874  
(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  No

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  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b - 2 of the Exchange Act). Yes  No

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 April 30, 2007
-----	-----
Common Stock, \$1.25 Par Value	6,982,334

(This report contains 29 pages)

NATIONAL BANKSHARES, INC. AND SUBSIDIARIES

# Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

Form 10-Q

## Index

Part I Financial Information		Page
-----		
Item 1	Financial Statements	
	Consolidated Balance Sheets, March 31, 2007 (Unaudited) and December 31, 2006	3
	Consolidated Statements of Income for the Three Months Ended March 31, 2007 and 2006 (Unaudited)	5
	Consolidated Statements of Changes in Stockholders' Equity, Three Months Ended March 31, 2007 and 2006 (Unaudited)	
	Consolidated Statements of Cash Flows, Three Months Ended March 31, 2007 and 2006 (Unaudited)	8
	Notes to Consolidated Financial Statements	10
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3	Quantitative and Qualitative Disclosures About Market Risk	2
Item 4	Controls and Procedures	2
Part II Other Information		
-----		
Item 1	Legal Proceedings	2
Item 1A	Risk Factors	2
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	2
Item 3	Defaults Upon Senior Securities	2
Item 4	Submission of Matters to a Vote of Security Holders	2
Item 5	Other Information	2
Item 6	Exhibits	2
Signatures		2
-----		
Index of Exhibits		25
-----		

# Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

## Item 1. Financial Statements

### National Bankshares, Inc. and Subsidiaries Consolidated Balance Sheets

	(Unaudited) March 31, 2007
(\$ In thousands, except share and per share data)	=====
<b>Assets</b>	
Cash and due from banks	\$13,626
Interest-bearing deposits	29,501
Securities available for sale, at fair value	166,167
Securities held to maturity (fair value approximates \$121,638 at March 31, 2007 and \$115,561 at December 31, 2006)	121,838
Mortgage loans held for sale	1,303
<b>Loans:</b>	
Real estate construction loans	39,768
Real estate mortgage loans	127,454
Commercial and industrial loans	215,207
Loans to individuals	121,848
	-----
Total loans	504,277
Less unearned income and deferred fees	(1,103)
	-----
Loans, net of unearned income and deferred fees	503,174
Less: allowance for loan losses	(5,045)
	-----
Loans, net	498,129
	-----
Bank premises and equipment, net	12,545
Accrued interest receivable	5,906
Other real estate owned, net	251
Intangible assets and goodwill, net	15,692
Other assets	16,957
	-----
Total assets	\$881,915
	=====
<b>Liabilities and Stockholders' Equity</b>	
Noninterest-bearing demand deposits	\$110,605
Interest-bearing demand deposits	234,643
Savings deposits	50,077
Time deposits	378,939
	-----
Total deposits	774,264
	-----
Other borrowed funds	71
Accrued interest payable	842
Other liabilities	6,915
	-----
Total liabilities	782,092
	-----

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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 6,981,434 shares in 2007 and 6,980,234 in 2006	8,727
Retained earnings	94,182
Accumulated other comprehensive (loss), net	(3,086)
	-----
Total stockholders' equity	99,823
	-----
Total liabilities and stockholders' equity	\$881,915
	=====

See accompanying notes to the consolidated financial statements.

4

National Bankshares, Inc. and Subsidiaries  
Consolidated Statements of Income  
Three Months Ended March 31, 2007 and 2006  
(Unaudited)

	March 31,
	2007
(\$ In thousands, except share and per share data)	=====
Interest income:	
Interest and fees on loans	\$9,037
Interest on interest-bearing deposits	274
Interest on securities - taxable	1,896
Interest on securities - nontaxable	1,323
	-----
Total interest income	12,530
	-----
Interest expense:	
Interest on time deposits \$100,000 or more	1,583
Interest on other deposits	3,832
Interest on borrowed funds	1
	-----
Total interest expense	5,416
	-----
Net interest income	7,114
Provision for (recovery of) loan losses	(3)
	-----
Net interest income after provision for loan losses	7,117
	-----
Noninterest income:	
Service charges on deposit accounts	810
Other service charges and fees	83
Credit card fees	598

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

Trust income	373
Other income	264
Realized securities gains (losses), net	51
	-----
Total noninterest income	2,179
	-----
Noninterest expense:	
Salaries and employee benefits	2,841
Occupancy, furniture and fixtures	485
Data processing and ATM	258
Credit card processing	447
Intangibles amortization	284
Net costs of other real estate owned	58
Other operating expenses	884
	-----
Total noninterest expense	5,257
	-----
Income before income tax expense	4,039
Income tax expense	923
	-----
Net income	\$3,116
	=====

5

Net income per share - basic	\$0.45
	=====
- diluted	\$0.45
	=====
Weighted average number of common shares outstanding - basic	6,979,094
	=====
- diluted	7,000,683
	=====
Dividends declared per share	\$---
	=====

See accompanying notes to consolidated financial statements.

6

National Bankshares, Inc. and Subsidiaries  
Consolidated Statements of Changes in Stockholders' Equity  
Three Months Ended March 31, 2007 and 2006  
(Unaudited)

(\$ In thousands)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income
	=====	=====	=====	=====

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

Balances, December 31, 2005	\$8,775	\$84,610	\$ (1,446)	
Net income	---	3,003	---	3,003
Other comprehensive loss, net of tax:				
Unrealized loss on securities available for sale, net of income tax \$(265)	---	---	---	(468)
Reclass adjustment, net of tax \$13	---	---	---	
Other comprehensive loss	---	---	(468)	(468)
Comprehensive income	---	---	---	\$2,535
Exercise of stock options	5	36	---	
Stock repurchase	(13)	(242)	---	
Balances, March 31, 2006	\$8,767	\$87,407	\$ (1,914)	
Balances, December 31, 2006	\$8,725	\$91,123	\$ (3,093)	
Net income	---	3,116	---	3,116
Other comprehensive income, net of tax				
Unrealized gains on securities available for sale, net of income tax \$22	---	---	---	
Reclass adjustment, net of income tax \$(18)	---	---	---	(18)
Other comprehensive income	---	---	7	7
Comprehensive income	---	---	---	\$3,123
Exercise of stock options	8	52	---	
Stock repurchase	(6)	(109)	---	
Balances, March 31, 2007	\$8,727	\$94,182	\$ (3,086)	

See accompanying notes to consolidated financial statements.

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

National Bankshares, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
Three Months Ended March 31, 2007 and 2006  
(Unaudited)

(\$In thousands)	March 31, 2007 =====
Cash flows from operating activities:	
Net income	\$3,116
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for (recovery of) loan losses	(3)
Depreciation of bank premises and equipment	247
Amortization of intangibles	284
Amortization of premiums and accretion of discount, net	55
(Gains) on disposal of fixed assets	---
(Gains) losses on sales and calls of securities available for sale, net	(51)
Losses and writedowns on other real estate owned	37
(Increase) decrease in:	
Mortgage loans held for sale	(495)
Accrued interest receivable	(224)
Other assets	(191)
Increase (decrease) in:	
Accrued interest payable	(21)
Other liabilities	1,095
Net cash provided by operating activities	\$3,849
Cash flows from investing activities:	
Net (increase) in interest-bearing deposits	\$(9,884)
Proceeds from calls, principal payments, sales and maturities of securities available for sale	7,799
Proceeds from calls, principal payments and maturities of securities held to maturity	130
Purchases of securities available for sale	(4,198)
Purchases of securities held to maturity	(6,240)
Purchases of loan participations	---
Collections of loan participations	281
Net (increase) decrease in loans to customers	(3,076)
Proceeds from disposal of other real estate owned	230
Recoveries on loans charged off	27
Purchase of bank premises and equipment	(90)
Proceeds from disposal of bank premises and equipment	---
Net cash (used in) investing activities	\$(15,021)
Cash flows from financing activities:	
Net increase in other deposits	\$13,147
Net (decrease) in time deposits	(3,575)

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

Net (decrease) in other borrowed funds	(2)
Stock options exercised	60
Stock repurchased	(115)
Net cash provided by financing activities	\$9,515
Net (decrease) in cash and due from banks	(1,657)
Cash and due from banks at beginning of period	15,283
Cash and due from banks at end of period	\$13,626
Supplemental disclosure of cash flow information:	
Cash paid for interest	\$5,437
Cash paid for income taxes	\$44
Loans charged to the allowance for loan losses	\$136
Loans transferred to other real estate owned	\$128
Unrealized gains (losses) on securities available for sale	\$11

See accompanying notes to consolidated financial statements.

9

National Bankshares, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
March 31, 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 three months ended March 31, 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](http://www.nationalbankshares.com).

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

### 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 March 31, 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.

10

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	(6,000)	9.92		
Forfeited or expired	---			
	---			
Outstanding at March 31, 2007	155,790	\$20.87	6.8	\$44
	=====	=====	===	===
Exercisable at March 31, 2007	155,790	\$20.87	6.8	\$44
	=====	=====	===	===

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 three months ended March 31, 2007, there were no stock options granted and 6,000 stock options were exercised with an intrinsic value of \$83,000. For the three months ended March 31, 2006 there were no stock options granted and 4,000 options were exercised with an intrinsic value of \$54,000.

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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

	For the periods ended		
	March 31,	December 31,	
	2007	2006	2006
(\$ In thousands, except % data)			
Balance at beginning of period	\$5,157	\$5,449	\$5,449
Provision for (recovery of) loan losses	(3)	17	49
Loans charged off	(136)	(87)	(459)
Recoveries	27	39	118
Balance at the end of period	\$5,045	\$5,418	\$5,157
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	1.00%	1.11%	1.03%
Ratio of net charge-offs to average loans, net of unearned income and deferred fees(1.)	0.09%	0.04%	0.07%
Ratio of allowance for loan losses to nonperforming loans(2.)	445.76%	5,889.13%	1,322.31%

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.

11

	March 31,		December 31,
	2007	2006	2006
(\$ In thousands, except % data)			
Nonperforming Assets:			
Nonaccrual loans	\$1,132	\$92	\$---
Restructured loans	---	---	---
Total nonperforming loans	1,132	92	---
Foreclosed property	251	390	390
Total nonperforming assets	\$1,383	\$482	\$390
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	0.27%	0.10%	0.08%

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

	March 31,		December 31,
	2007	2006	2006
Loans Past due 90 days or more and still accruing	\$327	\$184	\$681
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	0.06%	0.04%	0.14%
Impaired loans			
Total impaired loans	\$1,132	\$92	---
Impaired loans with a valuation allowance	---	---	---
Valuation allowance	---	---	---
Impaired loans, net of allowance	---	---	---
Impaired loans with no valuation allowance	\$1,132	\$92	---
Average recorded investment in impaired loans	\$818	\$133	\$140
Income recognized on impaired loans	---	\$2	---
Amount of income recognized on a cash basis	---	\$2	---

Nonaccrual loans excluded from impaired loan disclosure under FASB 114 at March 31, 2007 were \$0.

12

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 March 31, 2007 are as follows:

	March 31, 2007		
(\$ In thousands)	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses
Available for sale:			

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

U.S. Treasury	\$3,032	\$---	\$99
U.S. Government Agencies and Corporations	21,810	2	180
State and political subdivisions	76,852	763	545
Mortgage-backed securities	30,425	18	259
Corporate debt securities	31,509	84	924
Federal Reserve Bank stock-restricted	92	---	---
Federal Home Loan Bank stock-restricted	1,704	---	---
Other securities	1,763	120	---
<b>Total securities available for sale</b>	<b>\$167,187</b>	<b>\$987</b>	<b>\$2,007</b>

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities held to maturity by major security type as of March 31, 2007 are as follows:

(\$ In thousands)	March 31, 2007		
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses
<b>Held to Maturity:</b>			
U.S. Government Agencies and Corporations	\$41,459	\$12	\$508
State and political subdivisions	61,405	737	179
Mortgage-backed securities	2,355	10	18
Corporate securities	16,619	164	418
<b>Total securities held to maturity</b>	<b>\$121,838</b>	<b>\$923</b>	<b>\$1,123</b>

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

March 31, 2007

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

(\$ In thousands)	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized
U.S. Government agencies and corporations	\$13,773	\$ (65)	\$44,743	\$ (7)
State and political subdivisions	18,675	(118)	34,041	(6)
Mortgage-backed securities	5,964	(17)	20,441	(2)
Corporate debt securities	---	---	35,589	(1,3)
<b>Total temporarily impaired securities</b>	<b>\$38,412</b>	<b>\$ (200)</b>	<b>\$134,814</b>	<b>\$ (2,9)</b>

December 31, 2006

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

The Company had 233 securities with a fair value of \$173,226 which were temporarily impaired at March 31, 2007. The total unrealized loss on these securities was \$3,130. 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. Therefore, the losses associated with these securities are considered temporary at March 31, 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

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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

14

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. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS 157, "Fair Value Measurements". The Company is in the process of evaluating the impact SFAS 159 may have on its consolidated financial statements but does not intend to adopt the Statement early.

### Note (6) Defined Benefit Plan

#### Components of Net Periodic Benefit Cost

	Pension Benefits	
	Three Months Ended March 31,	
(\$ in Thousands)	2007	2006
Service cost	\$ 152	\$ 143
Interest cost	175	161
Expected return on plan assets	(159)	(143)
Amortization of prior service cost	2	(3)
Amortization of net obligation at transition	(3)	2
Recognized net actuarial (gain)/loss	45	53
	\$ 212	\$ 213

#### Employer Contributions

Bankshares' pension plan contribution for 2007 has not yet been finally determined. The estimated contribution is \$722. 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 Three Months Ended March 31, 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

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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

15

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

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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 and goodwill 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.

16

### 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. 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 March 31, 2007 and December 31, 2006 and 2005. Per share data has been adjusted to reflect the effects of a March 31, 2006 2-for-1 stock split.

	March 31, 2007	December 31, 2006	D
Return on average assets	1.46%	1.50%	
Return on average equity	12.90%	13.41%	
Net interest margin (1)	3.96%	4.13%	
Noninterest margin (2)	1.46%	1.54%	
Basic net earnings per share	\$0.45	\$1.80	

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

Fully diluted net earnings per share \$0.45 \$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 quarter 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.

The net interest margin declined by 17 basis points. This decrease was due to rising interest rates. Interest expense has continued to grow at a faster pace than interest income.

Growth

The following table shows NBI's key growth indicators:

	March 31, 2007	December 31, 2006	December 31, 2005
Securities	\$288,005	\$285,489	\$272,541
Loans, net	498,129	495,486	487,162
Deposits	774,264	764,692	745,649
Total assets	881,915	868,203	841,498

At March 31, 2007 total assets were \$881,915, an increase of \$13,712 or 1.6%. If annualized, the growth rate would be approximately 6.4%. The level of asset growth during the first quarter of 2007 reflects the effects of a competitive loan market. Deposits grew by 1.3% in the first quarter of 2007.

Asset Quality

Key asset quality indicators are shown below:

	March 31, 2007	December 31, 2006	Dec
Nonperforming loans	\$ 1,132	\$ ---	
Loans past due over 90 days	327	681	
Other real estate owned	251	390	

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

Allowance for loan losses to loans	1.00%	1.03%
-----	-----	-----
Net charge-off ratio	0.09%	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 a few credits. There has been no specific allocation to the allowance for loan losses for the additional nonperforming loans, as management believes that these credits are 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 period ending March 31, 2007 was \$7,114, a decline of \$231 when compared to the same period in 2006.

Until the third quarter of 2006 interest rate levels were continuously rising. During the period of rising interest rates the Company's interest-bearing liabilities rose at a faster pace than interest earning assets resulting in the compression in the interest rate spread. The Company continues to experience this compression, a portion of which is attributable to the increase in time deposits that was generated in 2006 by two special promotions at the Company's bank subsidiary. If interest rates remain stable, the compression of rates should improve as these time deposits mature.

The following chart shows trends in asset yields and cost of liabilities.

	March 31, 2007	For the period ended December 31, 2006	Decem
	-----	-----	-----
Loans	7.35%	7.11%	
Taxable securities	4.95%	4.89%	
Non-taxable securities	6.36%	6.25%	
Interest-bearing deposits	5.47%	5.08%	
	-----	-----	
Total interest-bearing deposits	6.68%	6.51%	
	=====	=====	
Interest-bearing liabilities	2.00%	1.87%	
Saving deposits	0.50%	0.50%	
Time deposits	4.47%	3.94%	
Other borrowings	5.56%	6.19%	
	-----	-----	
Total interest-bearing liabilities	3.33%	2.94%	
	=====	=====	
Interest rate spread	3.35%	3.57%	
	=====	=====	

From December 31, 2005 to March 31, 2007, the yield on loans has increased by 57 basis points. During the same period, the yield on taxable securities has gone up by 15 basis points, with nontaxable securities increasing a nominal 3 basis points. Among the asset categories interest-bearing deposits, which reprice daily, experienced the highest level of increase.

Among the categories of liabilities, interest-bearing demand deposit rates increased by 69 basis points from December 31, 2005 to March 31, 2007. Time deposit rates increased by 124 basis points. This is significant, not only

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

because of the level of rate increases, but also because of the volume of deposits in the category. Saving deposit rates have been essentially flat throughout the period. Rate increases have occurred in the other borrowings

18

category, however because the dollar volume is not substantial, there is little impact on the net interest spread.

There are three significant factors concerning net interest income. First, overall interest rates have stabilized. If rates remain stable, the net interest spread will improve. Second, the yield on nontaxable securities, which declined in 2006, has rebounded. At present, management is uncertain how this will affect portfolio yields. Third, during 2006 two time deposit promotions with special higher interest rates were offered. Higher-rate deposits from the first promotion began to mature in the first quarter of 2007. Deposits obtained in the second promotion will begin to mature in September of 2007. This should have the effect of decreasing the cost of time deposit costs, assuming that overall interest rates remain stable and competitive factors allow these deposits to reprice downward.

### Provision and Allowance for Loan Losses

The provision for loan losses (net recovery) for the three-month period ended March 31, 2007 was \$(3). The ratio of the allowance for loan losses to total loans at the end of the first three months of 2007 was 1.00%, which compares to 1.03% at December 31, 2006. The net charge-off ratio at March 31, 2007 was .09%, and it was .07% at March 31, 2006.

The Company regularly reviews asset quality and re-evaluates the allowance for loan losses. Reviews are conducted and an appropriate provision and allowance for loan losses is established depending upon factors that are unique to the subsidiary bank and the quality of its loan portfolio.

At present, management does not anticipate any significant additions to the Provision for Loan Losses. Management's opinion of current asset quality, evaluated in the context of historical experience, forms the basis of this position, despite the reported increase in nonperforming loans. (See "Allowance for Loan Losses" under "Critical Accounting Policies".)

### Noninterest Income

	March 31, 2007	March 31, 2006	March 31, 2005
Service charges on deposits	\$810	\$815	\$675
Other service charges and fees	83	109	87
Credit card fees	598	524	494
Trust fees	373	380	408
Other income	264	267	137
Realized securities gains (losses)	51	(36)	(33)

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

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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:

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

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

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

Service charges on deposits were \$810 at March 31, 2007, a decrease of \$5.

19

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

- o Fees for the issuance of official checks
- o Safe deposit box rent
- o Income from the sale of customer checks
- o 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 March 31, 2007 were \$83, as compared with \$109 for the same period the prior year. As indicated above, this category, because of its nature varies from time to time.

Credit card fees consist of three types of revenues.

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

In all three cases volume is critical to growth in 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 \$74 or 14.1% when March 31, 2007 and March 31, 2006 are compared. The increase was attributable to volume.

Trust income is somewhat dependent upon market conditions and the number of estate accounts being handled at any given point in 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 three months of 2007

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

was \$373, a decrease of \$7 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:

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

Given the nature of the items included in this category, trends or patterns are not identifiable. Other income decreased \$3 when March 31, 2007 and March 31, 2006 are compared.

Realized net gains and (losses) on securities include equity adjustments in certain investments in limited liability companies (LLC's) 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 March 31, 2007. The majority of this gain was attributable to equity adjustments in investments in limited liability companies (LLC's).

20

### Noninterest Expense

	March 31, 2007	March 31, 2006	March
Salaries and employee benefits	\$2,841	\$2,911	\$2,
Occupancy and furniture and fixtures	485	533	
Data processing and ATM	258	301	
Credit card processing	447	413	
Intangibles and goodwill amortization	284	284	
Net costs of other real estate owned	58	14	
Other operating expenses	884	1,043	1,

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:

- o Health insurance
- o Employee life insurance
- o Dental insurance
- o Executive compensation plans (1)
- o Qualified Pension plans (1)

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

- o Supplemental retirement plan (salary continuation agreements)
  - o Employer FICA
  - o 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 for the period ending March 31, 2007 were \$2,841 a decline of \$70 when compared to the same period in 2006. At March 31, 2007 the Company had 250 full time equivalent employees compared to 283 at March 31, 2006. The decline in salary expense came about from a drop in the number of employees which was the result of attrition following the May 2006 merger of the Company's two bank subsidiaries and the subsequent consolidation of several support functions.

Occupancy expense for the first three months of 2007 was \$485, down \$48 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 primarily due 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.

Data processing and ATM expense at March 31, 2007 decreased by \$43 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 increased by \$34, as compared with March 31, 2007.

21

Comparing the first three months of 2007 with the same period in 2006, net cost of other real estate owned increased by \$44. Losses on the sale of OREO property were \$30, and \$7 in write-downs was taken on properties in the first quarter of 2007. Other foreclosure expense was \$21.

Other operating expenses include all other types of expense not classified elsewhere in the Company's statement of income.

Because of management's ongoing cost containment measures, other operating expenses declined by \$157 from March 31, 2006 to March 31, 2007.

### Balance Sheet

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

Assets	March 31, 2007	December 31, 2006
Interest-bearing deposits	\$ 20,319	\$ 13,457
Securities available for sale	167,419	164,421
Securities held to maturity	117,370	106,645
Mortgage loans held for sale	583	543
Real estate construction loans	37,090	29,308
Real estate mortgage loans	127,787	121,912
Commercial and industrial loans	213,091	232,758
Loans to individuals	123,072	110,967
Total Assets	\$ 867,945	\$ 840,080

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

Liabilities and stockholders equity		
Noninterest-bearing demand deposits	\$ 102,982	\$108,977
Interest-bearing demand deposits	227,740	221,927
Savings deposits	47,554	51,745
Time deposits	384,541	358,422
Other borrowings	73	420
Shareholders' equity	\$97,927	\$94,194

### Liquidity and Capital Resources

Net cash provided by operating activities was \$3,849 for the period ended March 31, 2007, which compares to \$3,611 for the same period the previous year.

Net cash used in investing activities was \$15,021 for the period ended March 31, 2007, and \$8,541 used for the period ended March 31, 2006. Net cash provided by financing activities was \$9,515 for the period ending March 31, 2007.

Management is unaware of any commitment that would have a material and adverse effect on liquidity at March 31, 2007.

Total shareholders' equity grew by \$3,068 from December 31, 2006 to March 31, 2007. Earnings and the changes in unrealized gains and losses for securities available for sale accounted for the net increase. During the first three months of 2007, the Company repurchased 4,800 shares of its own stock for approximately \$115 at an average price of \$24.20 (including broker commission). The Tier I and Tier II risk-based capital ratios at March 31, 2007 were 14.56% and 15.41%, respectively. The Company's leverage capital ratio was 10.21%

### 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 three months of 2007, there have been no significant or unusual changes in this area.

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

### 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 March 31, 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 three months ended March 31, 2007.

23

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 first 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	Approximate Number of Shares Th Purchase Plans or
---------------	-------------------------------------	------------------------------------	---	---

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

			Plans or Programs (2)
January	---	\$---	---
February	3,900	24.21	3,900
March	900	24.15	900

- 1) Average price per share includes commissions.  
 2) On May 9, 2006 the Board approved the repurchase of up to 100,000 shares of common stock in the period from June 1, 2006 through May 31, 2007.

- Item 3. Defaults upon Senior Securities  
 None for the three months ended March 31, 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: May 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	(incorporated herein by

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

	National Bankshares, Inc.	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)
*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, 2003)

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

*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 th 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 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 Bank of Tazewell County and Marilyn B. Buhyoff.	(incorporated herein by reference to Exhibit 10(iii) (A) of Form 8-K filed on February 8, 2006)
31(i)	Section 302 Certification of Chief Executive Officer	Page 27
31(ii)	Section 302 Certification of Chief Financial Officer	Page 28
32(i)	18 U.S.C. Section 1350 Certification of Chief Executive Officer	Page 29
32(ii)	18 U.S.C. Section 1350 Certification of Chief Financial Officer	Page 29

\* 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

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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: May 9, 2007

/s/ JAMES G. RAKES

-----  
James G. Rakes  
Chairman President and Chief Executive Officer  
(Principal Executive Officer)

## Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

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: May 9, 2007

/s/ J. ROBERT BUCHANAN

-----  
J. Robert Buchanan  
Treasurer  
(Principal Financial Officer)

28

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 March 31, 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 March 31, 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 March 31, 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 March 31, 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 March 31, 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 March 31, 2007, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

Edgar Filing: NATIONAL BANKSHARES INC - Form 10-Q

/s/ J. ROBERT BUCHANAN

-----

J. Robert Buchanan  
Treasurer  
(Principal Financial Officer)