NATIONAL BANKSHARES INC
Form 10-Q
August 09, 2006

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 June 30, 2006.

|_| 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 |_|

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 |X| 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 |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 July 31, 2006
Common Stock, $1.25 Par Value	6,996,284

(This report contains 34 pages)

10 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 and per share data)	(Unaudited) June 30, 2006
Assets:	
Cash and due from banks	$19,037
Interest-bearing deposits	13,966
Securities available for sale, at fair value	162,813
Securities held to maturity (fair value approximates $102,747 at June 30, 2006 and $109,513 at December 31, 2005)	104,864
Mortgage loans held for sale	222
Loans:	
Real estate construction loans	30,177
Real estate mortgage loans	123,688
Commercial and industrial loans	209,667
Loans to individuals	132,944
Total loans	496,476
Less unearned income and deferred fees	(976)
Loans, net of unearned income and deferred fees	495,500
Less: allowance for loan losses	(5,340)
Loans, net	490,160
Bank premises and equipment, net	12,777
Accrued interest receivable	5,301
Other real estate owned, net	390
Intangible assets and goodwill, net	16,544
Other assets	17,333
Total assets	$843,407
Liabilities and Stockholders' Equity:	
Noninterest-bearing demand deposits	$108,252
Interest-bearing demand deposits	241,664
Savings deposits	53,518
Time deposits	343,147
Total deposits	746,581

Other borrowed funds	78
Accrued interest payable	688
Other liabilities	2,887
Total liabilities	750,234

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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 6,999,284 shares in 2006 and 7,019,874 in 2005	8,749
Retained earnings	87,723
Accumulated other comprehensive income (loss), net	(3,299)
Total stockholders' equity	93,173
Total liabilities and stockholders' equity	$843,407

See accompanying notes to the consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income
Three Months Ended June 30, 2006 and 2005
(Unaudited)

($ In thousands, except share and per share data)	June 30, 2006
Interest income:	
Interest and fees on loans	$8,637
Interest on interest-bearing deposits	102
Interest on Federal funds sold	---
Interest on securities - taxable	1,893
Interest on securities - nontaxable	1,217
Total interest income	11,849
Interest expense:	
Interest on time deposits $100,000 or more	1,103
Interest on other deposits	3,259
Interest on borrowed funds	12

Total interest expense	4,374
Net interest income	7,475
Provision for loan losses	7
Net interest income after provision for loan losses	7,468
Noninterest income:	
Service charges on deposit accounts	855
Other service charges and fees	104
Credit card fees	636
Trust income	365
Other income	250
Realized securities gains, net	2
Total noninterest income	2,212
Noninterest expense:	
Salaries and employee benefits	2,929
Occupancy, furniture and fixtures	472
Data processing and ATM	327
Credit card processing	469
Intangibles amortization	285
Net costs of other real estate owned	---
Other operating expenses	919
Total noninterest expense	5,401
Income before income tax expense	4,279
Income tax expense	1,052
Net income	$3,227

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Net income per share - basic	$0.46
- diluted	$0.46
Weighted average number of common shares outstanding - basic	7,011,581
- diluted	7,033,626
Dividends declared per share	$0.36

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Income
Six Months Ended June 30, 2006 and 2005
(Unaudited)

($ In thousands, except share and per share data)	June 30, 2006
Interest income:	
Interest and fees on loans	$16,998
Interest on interest-bearing deposits	260
Interest on Federal funds sold	---
Interest on securities - taxable	3,696
Interest on securities - nontaxable	2,478
Total interest income	23,432
Interest expense:	
Interest on time deposits $100,000 or more	2,191
Interest on other deposits	6,407
Interest on borrowed funds	14
Total interest expense	8,612
Net interest income	14,820
Provision for loan losses	24
Net interest income after provision for loan losses	14,796
Noninterest income:	
Service charges on deposit accounts	1,670
Other service charges and fees	213
Credit card fees	1,160
Trust income	745
Other income	517
Realized securities (losses), net	(34)
Total noninterest income	4,271
Noninterest expense:	
Salaries and employee benefits	5,840
Occupancy, furniture and fixtures	1,005
Data processing and ATM	628
Credit card processing	882
Intangibles amortization	569
Net costs of other real estate owned	14
Other operating expenses	1,962
Total noninterest expense	10,900
Income before income tax expense	8,167
Income tax expense	1,937
Net income	$6,230

Net income per share - basic	$0.89
- diluted	$0.89
Weighted average number of common shares outstanding - basic	7,013,311
- diluted	7,039,303
Dividends declared per share	$0.36

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
Six Months Ended June 30, 2006 and 2005
(Unaudited)

($ In thousands)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensiv Income
Balances, December 31, 2004	$8,797	$77,735	$556	
Net income	---	6,145	---	$6,1
Dividends ($0.35 per share)		(2,464)		
Other comprehensive loss, net of tax:				
Unrealized loss on securities available for sale, net of income tax $(185)	---	---	---	(3
Reclass adjustment, net of tax $(64)	---	---	---	(1
Other comprehensive loss	---	---	(462)	(4
Comprehensive income	---	---	---	$5,6
Exercise of stock options	5	42	---	-
Stock repurchased	(29)	(504)		
Balances, June 30, 2005	$8,773	$80,954	$94	-

Balances, December 31, 2005	$8,775	$84,610	$(1,446)	
Net income	---	6,230	---	$6,2
Dividends ($0.36 per share)		(2,524)		
Other comprehensive loss, net of tax:				
Unrealized loss on securities available for sale, net of income tax $(1,011)	---	---	---	(1,8
Reclass adjustment, net of tax $13	---	---	---	
Other comprehensive loss	---	---	(1,853)	(1,8
Comprehensive income	---	---	---	4,3
Exercise of stock options	13	108	---	-
Stock repurchased	(39)	(701)		
Balances, June 30, 2006	$8,749	$87,723	$(3,299)	

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Six Months Ended June 30, 2006 and 2005
(Unaudited)

($In thousands)	June 30, 2006
Cash flows from operating activities:	
Net income	$6,230
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	24
Depreciation of bank premises and equipment	506
Amortization of intangibles	569
Amortization of premiums and accretion of discount, net	124
(Gains) on disposal of fixed assets	(2)
(Gains)losses on sales and calls of securities available for sale, net	40
(Gains)losses on calls of securities held to maturity	(3)
Losses and writedowns on other real estate owned	10
Increase(decrease) in:	
Mortgage loans held for sale	(222)

Accrued interest receivable	(156)
Other assets	(376)
Increase in:	
Accrued interest payable	(37)
Other liabilities	59
Net cash provided by operating activities	$6,766
Cash flows from investing activities	
Net (increase) in federal funds sold	$---
Net (increase) decrease in interest-bearing deposits	(3,687)
Proceeds from calls, principal payments, sales and maturities of securities available for sale	7,847
Proceeds from calls, principal payments and maturities of securities held to maturity	6,261
Proceeds from the sale of securities held to maturity	---
Purchases of securities available for sale	(10,798)
Purchases of securities held to maturity	(1,458)
Purchases of loan participations	(2,232)
Collections of loan participations	4,084
Net (increase) in loans to customers	(4,974)
Acquisitions, net of cash received	---
Proceeds from disposal of other real estate owned	---
Recoveries on loans charged off	76
Purchase of bank premises and equipment	(475)
Proceeds from disposal of bank premises and equipment	2
Net cash provided by(used in) investing activities	$(5,354)

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Cash flows from financing activities	
Net increase (decrease) in other deposits	$10,873
Net increase (decrease) in time deposits	(9,941)
Net increase (decrease) in other borrowed funds	(279)
Stock options exercised	121
Cash dividends	(2,524)
Stock repurchased	(740)
Net cash used in financing activities	$(2,490)
Net increase (decrease) in cash and due from banks	(1,078)
Cash and due from banks at beginning of period	20,115
Cash and due from banks at end of period	$19,037
Supplemental disclosure of cash flow information:	
Cash paid for interest	$8,649

Cash paid for income taxes	$1,741
Loans charged to the allowance for loan losses	$209
Loans transferred to other real estate owned	$24
Unrealized (losses) on securities available for sale	$(2,851)
Transactions related to acquisition of branches:	
Increase in assets and liabilities:	
Investments	$---
Loans	$---
Deposits	$---
Fixed assets	$---

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2006
(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 six months ended June 30, 2006 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 2005 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 250,000 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. On December 29, 2005, the Company's Board of Directors passed a resolution stating that all 142,000 previously granted, but unvested, stock options be immediately vested. The vesting was made subject to the provision that any shares of NBI common stock obtained by an option grantee by exercise of an option subject to accelerated vesting may not be sold or otherwise transferred prior to the expiration of the option's original vesting period. This action was taken to reduce the impact of the "Statement of Financial Accounting Standards No. 123R, Share-Based Payment" on the Company's earnings over the remaining vesting period of the stock options. 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 June 30, 2006, 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, 2005 for assumptions used. There have been no grants of stock options in 2006.

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Options	Shares(1)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2006	172,500	$19.90		
Granted	---			
Exercised	(10,710)	$11.24		
Forfeited or expired	---			

Outstanding at June 30, 2006	161,790	$20.48	7.5	$442
	=======	======	===	====
Exercisable at June 30, 2006	161,790	$20.48	7.5	$442
	=======	======	===	====

1. Outstanding shares at January 1, 2006 have been adjusted to reflect a 2-for-1 stock split effective March 31, 2006.

Because no options were granted in 2006, there is no expense included in net income.

	Six months ended June 30,	Three months ended June 30,
($ In thousands, except per share data)	2005	2005

Net income, as reported	$6,145	$3,152
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(73)	(37)
Pro forma net income	$6,072	$3,115
Earnings per share:		
Basic - as reported	$0.88	$0.45
Basic - pro forma	$0.87	$0.45
Diluted - as reported	$0.87	$0.45
Diluted - pro forma	$0.86	$0.45

During the six months ended June 30, 2006, there were no stock options granted and 10,710 stock options were exercised with an intrinsic value of $128,000. For the six months ended June 30, 2005 there were no stock options granted and 1,250 options were forfeited.

For and 2004, 36,000 shares and 16,500 shares were excluded.

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

	For the periods ended		
	June 30,		December 31,
	2006	2005	2005
($ In thousands, except % data)			
Balance at beginning of period	$5,449	$5,729	$5,729
Provision for loan losses	24	388	567
Loans charged off	(209)	(585)	(1,101)
Recoveries	76	100	254
Balance at the end of period	$5,340	$5,632	$5,449
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	1.08%	1.13%	1.11%
Ratio of net charge-offs to average loans, net of unearned income and deferred fees(1.)	0.05%	0.21%	0.17%
Ratio of allowance for loan losses to nonperforming loans(2.)	---	2,234.92%	3,061.24%

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.

($ In thousands, except % data)	June 30, 2006	June 30, 2005	December 31, 2005
Nonperforming Assets:			
Nonaccrual loans	$---	$252	$178
Restructured loans	---	---	---
Total nonperforming loans	---	252	178
Foreclosed property	390	483	376
Total nonperforming assets	$390	$735	$554
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	0.08%	0.15%	0.11%

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	June 30, 2006	June 30, 2005	December 31, 2005
Loans Past due 90 days or more and still accruing	$362	$526	$546
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	0.07%	0.11%	0.11%
Impaired loans:			
Total impaired loans	$---	$252	$174
Impaired loans with a valuation allowance	---	---	---
Valuation allowance	---	---	---
Impaired loans, net of allowance	---	---	---
Impaired loans with no valuation allowance	$---	$252	$174
Average recorded investment in impaired loans	$232	$316	$274

Income recognized on impaired loans	$---	---	---
Amount of income recognized on a cash basis	$---	---	$11

Nonaccrual loans excluded from impaired loan disclosure under FASB 114 at June 30, 2006 were $0.

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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 June 30, 2006 are as follows:

	June 30, 2006		
($ In thousands)	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses
Available for sale:			
U.S. Treasury	$3,035	---	$216
U.S. Government Agencies and Corporations	28,784	---	685
State and political subdivisions	70,641	591	1,163
Mortgage-backed securities	28,962	51	919
Corporate debt securities	32,052	15	1,945
Federal Reserve Bank stock-restricted	91	---	---
Federal Home Loan Bank stock-restricted	1,732	---	---
Other securities	1,640	147	---
Total securities available for sale	$166,937	$804	$4,928

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities held to maturity by major security type as of June 30, 2006 are as follows:

	June 30, 2006		
($ In thousands)	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses

Held to Maturity:

U.S. Government Agencies and Corporations	$28,609	---	$1,235
State and political subdivisions	53,483	433	558
Mortgage-backed securities	3,577	18	88
Corporate securities	19,195	130	817
Total securities held to maturity	$104,864	$581	$2,698

Information pertaining to securities with gross unrealized losses at June 30, 2006 and December 31, 2005, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

June 30, 2006

	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealiz
U.S. Government agencies and corporations	$39,480	$1,055	$18,812	$1,
State and political subdivisions	36,444	751	19,239	
Mortgage-backed securities	18,608	544	10,546	
Corporate debt securities	12,447	489	26,840	2,
Total temporarily impaired securities	$106,979	$2,839	$75,437	$4,

December 31, 2005

	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealiz
U.S. Government agencies and corporations	$38,913	541	$11,698	
State and political subdivisions	28,660	429	15,625	
Mortgage-backed securities	22,169	333	3,132	
Corporate debt securities	12,052	200	25,881	1,
Total temporarily impaired securities	$101,794	$1,503	$56,336	$2,

The Company had 304 securities with a fair value of $182,416 which were temporarily impaired at June 30, 2006. The total unrealized loss on these securities was $7,626. Losses are attributed to interest rate movements. Credit quality of the securities portfolio is continuously monitored by management, and there is no present concern with that quality. The Company has the ability and intent to hold these securities until maturity. Therefore, the losses associated with these securities are considered temporary at June 30, 2006. All securities shown are above investment grade.

Note (5) Recent Accounting Pronouncements

In March 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets an amendment of FASB Statement 140" (Statement 156). Statement 156 amends Statement 140 with respect to separately recognized servicing assets and liabilities. Statement 156 requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract and requires all servicing assets and liabilities to be initially measured at fair value, if practicable. Statement 156 also permits entities to subsequently measure servicing assets and liabilities using an amortization method or fair value measurement method. Under the amortization method, servicing assets and liabilities are amortized in proportion to and over the estimated period of servicing. Under the fair value measurement method, servicing assets are measured at fair value at each reporting date and changes in fair value are reported in net income for the period the change occurs.

Adoption of Statement 156 is required as of the beginning of fiscal years beginning subsequent to September 15, 2006. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements.

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The Company does not expect the adoption of Statement 156 at the beginning of 2007 to have a material impact.

Note (6) Defined Benefit Plan

Components of Net Periodic Benefit Cost

	Pension Benefits	
	Six Months Ended June 30,	
($ in Thousands)	2006	2005
Service cost	$ 286	$ 280
Interest cost	322	306
Expected return on plan assets	(286)	(290)
Amortization of prior service cost	(6)	4
Recognized net actuarial loss	106	92
Amortization of transition cost	4	(6)
Net periodic benefit cost	$ 426	$ 386

Employer Contributions

Bankshares expects to contribute a total of $698, paid in quarterly installments, to the pension plan for 2006. Contributions through June 30, 2006 totaled $349, and Bankshares anticipates making all required contributions prior to the end of 2006.

Note (7) Stock Split

Bankshares' Board of Directors approved a 2-for-1 stock split of Bankshares' common stock effective March 31, 2006. All per share information for prior periods presented has been restated to reflect the stock split.

National Bankshares, Inc. and Subsidiaries
(In thousands, except per share data)

Item 2. Management's Discussion and Analysis of Financial Condition

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 2005 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

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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 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.

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Overview

National Bankshares, Inc. (NBI) is a financial holding company located in Southwest Virginia. Until May 26, 2006, it conducted operations primarily through two full-service banking affiliates, the National Bank of Blacksburg and Bank of Tazewell County. On May 26, Bank of Tazewell County was merged with and into the National Bank of Blacksburg, which does business as National Bank. It also has one 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 June 30, 2006 and 2005 and December 31, 2005. Per share data has been adjusted to reflect the effects of the March 31, 2006 2-for-1 stock split.

	June 30, 2006	June 30, 2005	D
Return on average assets	1.50%	1.53%	
Return on average equity	13.69%	13.90%	
Net interest margin (1)	4.22%	4.65%	
Noninterest margin (2)	1.59%	1.89%	
Basic net earnings per share	$0.89	$0.88	
Fully diluted net earnings per share	$0.89	$0.87	

(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 half of 2006 was 1.50%, down slightly from the 1.53% for the same period in the prior year and from the 1.52% at December 31, 2005. The return on average equity also experienced a decline.

The net interest margin declined by 43 basis points when compared with June 30, 2005, and it is down 23 basis points when compared to year-end 2005. 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:

	June 30, 2006	June 30, 2005	December 31, 2005
Securities	$267,677	$259,385	$272,541
Loans, net	490,160	491,882	487,162
Deposits	746,581	725,997	745,649
Total assets	843,407	819,574	841,498

At June 30, 2006, total assets were $843,407, an increase of $23,833, or 2.91%, when compared to June 31, 2005, and total assets increased $1,909, or 0.23%, when compared to December 31, 2005.

In order to reduce the compression of the net interest margin, management has exercised restraint when pricing large denomination time deposits. This approach has had positive influence on profitability; however, it has caused lower rates of deposit growth.

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Asset Quality

Key asset quality indicators are shown below:

	June 30, 2006	June 30,2005	Dec
Nonperforming loans	$ ---	$ 252	
Loans past due over 90 days	362	526	
Other real estate owned	390	483	
Allowance for loan losses to loans	1.08%	1.13%	
Net charge-off ratio	0.05%	0.20%	

This data indicates that the level of nonperforming loans has declined, and at quarter-end there were no nonperforming loans. The level of loans past due 90 days or more has also declined. Asset quality remains excellent.

Net Interest Income

Net interest income for the period ending June 30, 2006 was $14,820, a decrease of $1,214 or 7.57%, from June 30, 2005.

The principal cause of the decline is rising interest rates. Specifically, the Company's interest-bearing liabilities have repriced upward at a faster pace than interest-earning assets. The yield on earning assets rose by 14 basis points, while the cost of interest-bearing liabilities increased by 67 basis points when the six months ended June 30, 2006 and 2005 are compared.

Net Interest Income - Trends and Future Expectations

Starting in mid-2004 and continuing through 2006, the Federal Reserve Board initiated a series of interest rate increases. These increases were designed to restore interest rates to historically more typical levels and to prevent inflation. Rate increases have occurred at regular intervals, each at 25 basis points to date.

Rising energy costs coupled with high levels of government spending are viewed as inflationary. Government expenditures are expected to remain high as a result of natural disasters, conflict in the Middle East and new spending programs such as the prescription drug benefit for senior citizens. This may prompt future interest rate increases by the Federal Reserve Bank, unless the national economy slows sufficiently to keep inflationary pressure in check.

As long as interest rates continue to rise the Company will experience downward pressure on its net interest margin.

The general impact of a rising interest rate scenario on the Company's balance sheet is described on page 15 of the Company's 2005 Form 10K, which is incorporated by reference in this report.

Interest Expense

Interest expense for the six months ended June 30, 2006 was $8,612, an increase of $2,343, or 37.37%, from the same period the prior year. As previously discussed, rising interest rates have been the major contributor to this increase.

During periods of rising interest rates, interest-bearing demand deposits, and to a lesser degree savings deposits, migrate to higher rate, longer-term time deposits. Generally, as rates climb, more migration occurs. Given their re-pricing characteristics, interest-bearing demand deposits readily respond to any interest rate movement. In other words, increases or decreases in interest expense can occur quite quickly.

Provision and Allowance for Loan Losses

The provision for loan losses for the six-month period ended June 30, 2006 was $24, a $364 decrease from the same period ended June 30, 2005. The ratio of the allowance for loan losses to total loans at the end of the first six months of 2006 was 1.08%, which compares to 1.13% at the same period last year. The net charge-off ratio at June 30, 2006 was .05%, and it was .20% at June 30, 2005.

The Company regularly reviews asset quality and re-evaluates the allowance for loan losses. An appropriate provision and allowance for loan losses is established for the bank, depending upon the quality of its loan portfolio. Because of the continued excellent overall quality of the loan portfolio and somewhat slower loan growth, it is management's judgment that the decrease in the provision for loan losses is justified and the allowance is appropriate and adequate. (See "Allowance for Loan Losses" under "Critical Accounting Policies".)

Noninterest Income

	June 30, 2006	June 30, 2005
Service charges on deposits	$1,670	$1,476
Other service charges and fees	213	156
Credit card fees	1,160	1,072
Trust fees	745	736
Other income	517	259
Realized securities gains (losses)	(34)	(4)

Noninterest income is made up of several categories. Following is a description of each, 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:

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 $1,670 at June 30, 2006, an increase of $194 or 13.14%. Of that increase, approximately $188 was due to increases in fees for overdrafts and returned checks. In early 2005 the Company increased its charge for each overdrawn item, and the amount of daily maximum charges was increased.

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 June 30, 2006 were $213, as compared with $156 for the same period the prior year. Of the $57 increase, approximately $10 was due to increases in fees associated with cashing income tax refund checks. Another $19 came from increased fees for letters of credit. The remainder of the increase were in the safe deposit box, and credit life insurance categories.

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 $88 or 8.21% when June 30, 2006 and June 30, 2005 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 2006, the financial markets have experienced a degree of volatility. Income from estates is also unpredictable. Trust income for the first six months of 2006 was $745, an increase of $9 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 increased $258 when June 30, 2006 and June 30, 2005 are compared. Of the $258 change, approximately $273 was attributable to increases in cash value associated with bank owned life insurance policies, offset by declines in other areas.

Realized net gains and losses on securities include write-downs 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 gains and losses were ($34) for the period ended June 30, 2006. The majority of this loss was attributable to write-downs in investments in limited liability companies (LLC's).

Noninterest Expense

	June 30, 2006	June 30, 2005
Salaries and employee benefits	$5,840	$5,712
Occupancy and furniture and fixtures	1,005	959

Data processing and ATM	628	902
Credit card processing	882	839
Intangibles and goodwill amortization	569	549
Net costs of other real estate owned	14	181
Other operating expenses	1,962	2,138

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)
o Supplemental retirement plan (salary continuation agreements)
o Employer FICA
o Unemployment taxes

(1) See the 2005 Form 10-K and the Proxy Statement for the 2006 Annual

Meeting of Stockholders for further information.

Salaries and employee benefits expense was $5,840 at June 30, 2006, an increase of $128 or 2.24% when compared with the same period in 2005. Included in the increase is an $180 expense associated with a supplemental retirement plan that provides for salary continuation agreements with selected officers of the Company and its affiliates. This expense was offset by income from bank owned life insurance on the plan participants. (See the discussion of "Other Income".) The Company employed 250.5 fulltime equivalent employees at June 30, 2006 and 275.5 at June 30, 2005.

Occupancy costs include such items as depreciation expense, maintenance of the properties, repairs and real estate taxes. At June 30, 2006, occupancy and furniture and fixture expense was $1,005, an increase of $46 or 4.80% over the end of the first half of last year. The increase was due to fluctuation in various accounts, none of which represent a material change.

Data processing and ATM expense decreased by $274 when compared to June 30, 2005. A decline in maintenance cost of approximately $116 and a decrease in conversion expenses of $152 account for most of the decrease.

Credit card processing includes costs associated with the processing of credit cards, debit cards and merchant transactions. These expenses are related to credit card income previously discussed in "Noninterest Income", and the comments in that section are applicable. Credit card processing expense was $882 for the six months ended June 30, 2006, an increase of $43 from the same period in 2005. Volume accounted for the increase.

Intangible expense is influenced by acquisitions, amortization schedules and impairment testing depending on the nature of the intangible. Core deposit intangibles are amortized while goodwill is subject to testing for impairment. Both generally increase with acquisitions. Intangibles amortization expense at June 30, 2006 was $569, an increase of $20 over the same period the previous year. The increase was associated with the acquisition of two branches acquired in February 2005.

Net cost of other real estate owned consists of losses on disposal, repairs, write-downs and other foreclosure costs. Net costs of other real estate owned was down $167 when compared to the first half of last year. This category can fluctuate substantially depending on the number of properties on hand, the gains or losses on sale and the amount of write-downs.

Other operating expenses include all other forms of expense not classified elsewhere in the Company's statement of income. Included in this category are such items as stationery and supplies, franchise taxes, contributions, telephone, postage and other operating costs. Other operating expenses for the first half of 2006, at $1,962, were down $176 from the same period in the prior year, largely due to cost containment measures.

Balance Sheet

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

Assets	June 30, 2006	December 31, 2005
Federal funds sold	$ 220	$ ---

Interest-bearing deposits	11,464	14,819
Securities available for sale	164,689	151,431
Securities held to maturity	107,462	110,312
Mortgage loans held for sale	337	609
Real estate construction loans	27,501	26,926
Real estate mortgage loans	118,113	117,855
Commercial and industrial loans	200,818	200,799
Loans to individuals	146,473	148,088
Total Assets	$ 837,315	$ 819,341
Liabilities and stockholders equity		
Noninterest-bearing demand deposits	$ 113,188	$114,186
Interest-bearing demand deposits	224,410	204,522
Savings deposits	53,930	57,836
Time deposits	348,770	347,471
Other borrowings	772	705
Shareholders' equity	$91,754	$90,470

Loans

Total loans net of unearned income at June 30, 2006 were $495,500, an increase of $2,889 or approximately .59% from December 31, 2005. This equates to an annualized growth rate of approximately 1.18%.

Deposits

Total deposits at June 30, 2006 increased by $932 from December 31, 2005. Noninterest-bearing demand deposits decreased by $4,193 when June 30, 2006 is compared to December 31, 2005. During the same period, interest-bearing demand deposits increased by $16,053, and time deposits decreased by $9,941. Saving deposits during the period declined by $987.

Liquidity and Capital Resources

Net cash provided by operating activities was $6,776 for the period ended June 30, 2006, which compares to $6,075 for the same period the previous year.

Net cash used in investing activities was $5,354 for the period ended June 30, 2006, and $1,129 was provided for the period ended June 30, 2005. Net cash used by financing activities was $2,490 for the period ending June 30, 2006.

Management is unaware of any commitment that would have a material and adverse effect on liquidity at June 30, 2006.

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Total shareholders' equity grew by $1,234 from December 31, 2005 to June 30, 2006. Earnings, the changes in unrealized gains and losses for securities available for sale and a dividend of $2,524 accounted for the net increase. During the first half of 2006, the Company repurchased 31,300 shares of its own stock for approximately $740 at an average price of $23.67 (including broker commission). The Tier I and Tier II risk-based capital ratios at June 30, 2006 were 13.35% and 14.25%, respectively. The Company's leverage capital ratio was 9.76%

Interest Rate Sensitivity

Following is a table showing repricing and maturity data for the Company's interest-earning assets and interest-bearing liabilities:

	June 30, 2006		
Assets	<1 Year	1-5 Years	> 5 Years
Federal funds sold	---	---	---
Interest-bearing deposits	13,966	---	---
Securities available for sale	25,422	86,862	50,529
Securities held to maturity	10,374	56,459	38,031
Mortgage loans held for sale	222	---	---
Loans, net of unearned income and deferred fees	173,630	259,668	62,202
Total assets repricing/maturing	223,614	402,989	150,762=
Liabilities			
Interest-bearing demand deposits	241,664	---	---
Savings deposits	53,518	---	---
Time deposits	177,815	147,749	17,583
Other borrowings	78	---	---
Total liabilities/maturing	473,075	147,749	17,583
Gap	(249,461)	255,240	133,179
Cumulative repricing gap	(249,461)	5,779	138,958
Cumulative gap ratio	0.47	1.01	1.22

As shown in the above table, the Company is liability sensitive. In other words, the Company's interest-bearing liabilities reprice and/or mature at a faster rate than its interest-earning assets. During periods of rising interest rates, such as we have recently experienced, this causes the Company's net interest margin to decrease. This in turn has a negative impact on overall profitability.

Management's Discussion and Analysis of the Financial Condition and Results of Operations for the Three Months ended June 30, 2006

Net income for the three months ended June 30, 2006 was $3,227, up $75 when compared to the same period the prior year. Basic earnings per share for the second quarter of 2006 were $0.46 compared to $0.45 in the second quarter of 2005.

Earnings

Interest rates have been steadily rising throughout 2005 and 2006. Because the Company is liability sensitive, the rising rates have had an adverse impact on net interest income. As shown in the statement of profit and loss, interest income increased by $581, while interest expense during the same period increased by $1,148. This produced a decline in net interest income of $567, when the second quarter of 2006 and 2005 are compared.

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The provision for loan losses increased by $7 in the second quarter of 2006, a decrease from the $198 in the second quarter of 2005. Asset quality remains excellent. Therefore, based upon current information, the Company does not anticipate substantial additions to the allowance for loan losses.

Noninterest income increased by $285 when the second quarter of 2006 and 2005 are compared. With the exception of realized gains and losses on securities, which declined by $27, all other categories improved. Comments made in the year-to-date discussion apply. Other income was up significantly because of income from bank-owned life insurance contracts.

Noninterest expense was $5,401 for the quarter ended June 30, 2006. This represents a decrease of $190 from the same period last year. Comments made in the year-to-date discussion apply. Data processing expense declined when compared to 2005 because of acquisition-related computer conversion costs in 2005. The cost of other real estate owned has dropped substantially as foreclosed properties have been liquidated.

In summary, the Company has experienced a decline in net interest income due to rising interest rates. To date, increases in the noninterest income areas, coupled with decreases in noninterest expense, have more than offset the decline in net interest income. The extent to which noninterest income and expense will continue to offset the decline in interest income is not currently known. If interest rates continue to rise and the interest margin erodes further, it would not be unreasonable to expect that net income could be negatively impacted. However, if interest rates stabilize, the Company's interest income could improve.

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, swaps and options. 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 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 half of 2006, there have been no significant or unusual changes in these types of off balance sheet contractual obligations.

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 provides 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, 2005. (See "Interest Rate Sensitivity".)

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 June 30, 2006. 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 quarter ending June 30, 2006.

Item 1A. Risk Factors

No material changes from risk factors as previously disclosed in the Company's 2005 Annual Report on Form 10-K.

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

The following table provides information about our purchases during the second quarter of 2006 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	Approxi Value o Shares Th Purchase Plans or
April 1-30	4,100	$24.62	4,100	
May 1-31	6,000	$24.07	6,000	

June 1-30	10,500	$22.91	10,500	

1) Average price per share includes commissions.
2) On May 12, 2005 the Board approved the repurchase of up to $1 million of common stock in the period from June 1, 2005 through May 31, 2006. On May 9, 2006 the Board approved repurchase of up to 100,000 shares of common stock in the period from June 1, 2006 through May 31, 2007.

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3) Beginning in June of 2006 the units remaining to be repurchased are e xpressed in shares.

Item 3. Defaults upon Senior Securities

None for the three months ended June 30, 2006.

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

Three Class 1 Directors of the Company were elected for a term of three years each by a vote of the security holders.

(a) This matter was submitted to a vote at the Company's Annual Meeting of Stockholders held on April 11, 2006.

(b) The name of each director elected at the meeting follows:

Lawrence J. Ball
Mary G. Miller
Glenn P. Reynolds

The name of each director whose term of office continued after the meeting is listed:

Jack H. Harry
Jack M. Lewis
William A. Peery
James G. Rakes
James M. Shuler
Jeffrey R. Stewart

(c) The number of votes cast for or against each nominee is provided below. There were no abstentions and no broker non-votes.

Election of Directors

Director	Votes For	Votes Against
Lawrence J. Ball	3,113,421	13,074
Mary G. Miller	3,111,955	14,540
Glenn P. Reynolds	3,114,655	11,840

Item 5. Other Information

None

Item 6. Exhibits

See Index of Exhibits.

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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: August 9, 2006

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) 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) the Annual Report on Form 10-K for the fiscal y ended December 31, 2003)
3(i)	Amended and Restated Articles of Incorporation of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3.1 o 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) the Annual Report on Form for fiscal year ended December 31, 1993)
4(i)	Article Four of the Articles of Incorporation of	(incorporated herein by

	National Bankshares, Inc. included in Exhibit No. 3(a)	reference to Exhibit 4(b) the Annual Report on orm 1 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) the Annual Report on Form 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 o the Form S-8, filed as Registration No. 333-79979 with the Commission on Jun 1999)
*10(iii)(A)	Employment Agreement dated January 2002 between National Bankshares, Inc. and James G. Rakes	(incorporated herein by reference to Exhibit 10(ii of Form 10-Q for the perio ended June 30, 2002)
*10(iii)(A)	Employment Lease Agreement dated August 14, 2002 between National Bankshares, Inc., The National Bank of Blacksburg and James G. Rakes	(incorporated herein by reference to Exhibit 10(iii)(A) of Form 10-Q fo the period ended June 30,
*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 ii of Form 10-K for the period ended December 31,
*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 ii of Form 10-K for the period ended December 31,
*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(ii 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(ii of Form 8-K filed on Febru 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(ii of Form 8-K filed on Febru 2006)
31(i)	Section 302 Certification of Chief Executive Officer	Page 32

* Indicates a management contract or compensatory plan required to be filed herein.

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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: August 9, 2006

/s/ JAMES G. RAKES

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

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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: August 9, 2006

/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 June 30, 2006, 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 June 30, 2006, 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 June 30, 2006, 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 June 30, 2006, 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 June 30, 2006, 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 June 30, 2006, 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)