

October 16, 2008

National Bankshares Inc. (NKSH-NASDAQ-US\$19.74)
NKSH: Initiating Coverage with a Buy

RATING: Buy **SECTOR:** Financials
TARGET PRICE: US\$22.00 **SECTOR RECOMMENDATION:** Market-weight
BASIS OF TARGET: Approximately 1.6x TBV or 11.0x our 2009 EPS Estimate

Attractive Risk/Reward Scenario. We believe that NKSH offers an attractive investment opportunity at current levels given its currently depressed valuation; therefore, we are initiating coverage of NKSH with a Buy rating. Our \$22.00 price target is based on approximately 1.6x TBV or 11.0x our 2009 EPS estimate of \$2.00, representing approximately 15% total return upside from current levels. In addition, we are comfortable with NKSH's capital position, balance sheet composition and relatively strong asset quality metrics. NKSH shares are currently trading at 1.4 times tangible book value (PTBV) compared to its average PTBV multiple of 1.9x over the past eight years. Over this time period, NKSH shares have traded at a PTBV peak of 2.72x and a trough of 0.94x, presenting what we feel is an attractive risk/reward scenario.

Attractive Deposit Base and Market Share. National has either a number one or number two market share position in each of its top four markets, which in total represent approximately 76% of National's total deposits. In each of these markets, NKSH has at least 20% deposit market share. However, these markets lag both the state of Virginia and the entire country in terms of expected population growth and household income levels.

Top-Tier Returns. National has historically posted very strong returns relative to its peers, which we feel supports its premium valuation on a price to book value basis. In 2007, NKSH's ROAE (12.60%) exceeded its peer group average by 259 basis points and over the past seven years has exceeded its peer group average by an average of 122 basis points. We believe that NKSH's strong core deposit base should enable the bank to continue to generate above average returns going forward.

Modest Earnings Growth Expected in 2009. Our 2008 and 2009 EPS estimates are \$1.96 and \$2.00, respectively, representing modest low-single digit earnings growth. We are currently expecting NKSH's net interest margin to decline from current levels (4.34% in Q3 back to the 4.00-4.10% range in Q4 and 2009) and average earning assets to grow at an annualized rate of 4.0% in the fourth quarter of 2008 and 3.0% in 2009. Our loan loss provision estimate for 2009 of \$1.3 million could prove conservative depending on economic conditions. Lastly, NKSH has benefited from the fallout created by the larger institutions' issues in the form of additional loan opportunities. At period end, NKSH's loan to deposit ratio was below 70%, which should enable the bank to capitalize on such opportunities.

Ample Capital Levels. NKSH's capital position has strengthened over the past several years due to its modest balance sheet growth and strong profitability. At the end of the third quarter, National's tangible equity to assets ratio was a healthy 10.75%. On the asset quality front, total non-performing assets were \$3.0 million, or 0.34% of total assets, at the end of the third quarter, which compares favorably to most of its peers. In addition, net charge-offs remain very manageable at 0.08% of loans. While we expect non-performers to increase over the next couple of quarters as a result of the weak economy, we expect NKSH's strict underwriting standards to keep NPAs at manageable levels.

Disclosure Code: I2

Important disclosures and analyst certifications are in the Disclosure Section.

Valuation Data (source: StockVal)

FYE Dec	2007A	2008E	2009E
Projected P/E:	10.8x	10.1x	9.9x

Projected				
EPS:	Q1	Q2	Q3	Q4
	\$0.45	\$0.45	\$0.46	\$0.48
	\$0.46	\$0.50	\$0.52	\$0.48
	\$0.46	\$0.48	\$0.48	\$0.48
Total	\$1.82	\$1.96	\$2.00	\$2.00

Trading & Operating Data

52-Wk Range:	\$15.00-\$21.98
Dividend Indicated FY1:	\$0.78
Dividend Yield Indicated:	4.0%
Volume 60-Day Avg (Th):	3.00
Avg. Shares O/S- LQ:	6.9
Market Value (\$M):	\$136
Fiscal Year End:	12.00
Book Value PS LQtr:	\$15.80
Price/BV:	1.2x
ROE LTM:	12.6%
ROA LTM:	1.52%

Company Profile

National Bankshares is the holding company of The National Bank of Blacksburg. NKSH provides a full line of banking, trust, and investment products and services throughout the southwestern region of Virginia. National operates 26 branches and had over \$892 million in assets as of the end of the third quarter 2008.

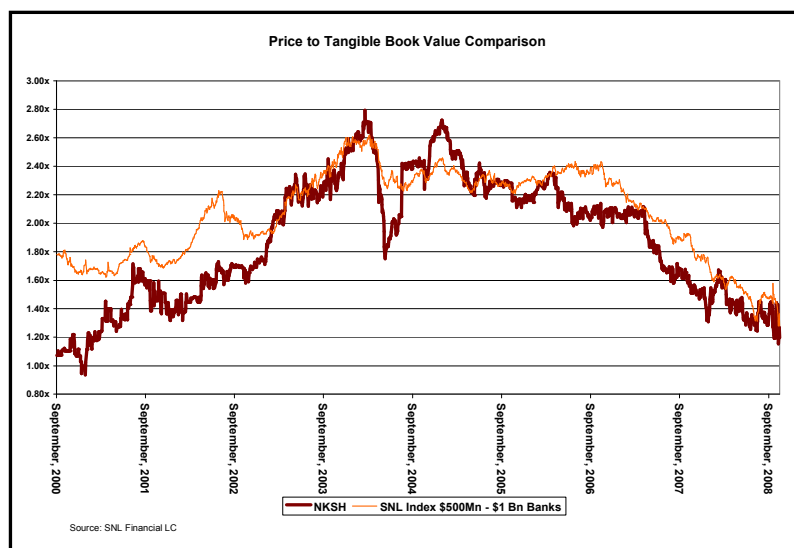
RISK PROFILE: Average

RISK CONSIDERATIONS: general economic risks, interest rate sensitivity, stock liquidity, asset quality trends

Investment Thesis and Current Valuation

We believe that National Bankshares offers an attractive investment opportunity at current levels given its currently depressed valuation. In addition, we are comfortable with NKSH's capital position, balance sheet composition and relatively strong asset quality metrics. NKSH shares are currently trading at 1.4 times tangible book value (PTBV) compared to its average PTBV multiple of 1.9x over the past eight years. Over this time period, NKSH shares have traded at a PTBV peak of 2.72x and a trough of 0.94x, presenting what we feel is an attractive risk/reward scenario. Compared to its peers, NKSH shares are currently trading at a premium to the group on a PTBV basis (1.4x versus 1.1x median for the peer group), which we feel is warranted given its superior performance. On a price to earnings basis, NKSH shares are trading at approximately 9.9 times our 2009 EPS estimate of \$2.00, compared to the peer group median of 10.0x. On a trailing twelve month EPS basis, NKSH shares are trading at 10.2x, compared to its eight year average multiple of 12.1x and the SNL Bank \$500 million to \$1 Billion Index average multiple of 16.3x over the same time period.

Any way you look at it, we feel that NKSH shares offer the potential for solid returns over the next several years, supplemented by its above average dividend (current dividend yield of 4.0%). The bank's strong capital levels and market share should enable NKSH to move its way through the current cycle in relatively good fashion, positioning investors for above average returns once the sector rebounds.



Investment Positives

- History of Strong Returns.** National has historically posted very strong returns relative to its peers, which we feel supports its premium valuation on a price to book value basis. In 2007, NKSH's ROAE (12.60%) exceeded its peer group average by 259 basis points and over the past seven years has exceeded its peer group average by an average of 122 basis points. We believe that NKSH's strong core deposit base should enable the bank to continue to generate above average returns going forward.

NKSH Performance Ratio Trends							
	2002	2003	2004	2005	2006	2007	Q3 2008
ROAA	1.53%	1.64%	1.62%	1.52%	1.50%	1.46%	1.61%
ROAE	14.33%	14.77%	14.48%	13.73%	13.41%	12.60%	13.20%
NIM	4.74%	4.82%	4.69%	4.45%	4.14%	3.98%	4.34%
Efficiency ratio	46.78%	46.22%	47.59%	48.69%	49.96%	48.20%	49.18%

Source: Company Reports

- Excellent Market Share in Stable Markets.** National has either a number one or number two market share position in its top four markets, which represent approximately 76% of National's total deposits. In each of these markets, NKSH has at least 20% deposit market share. However, these markets lag both the state of Virginia and the entire country in terms of expected population growth and household income levels. The presence of two universities, Virginia Tech and Radford, helps to support the local economy. **See Exhibit 2.**
- Above Average Dividend.** National's current dividend yield of 4.0% exceeds its peer group average dividend yield of 3.3%. National pays a semi-annual dividend and, with the exception of 2001, has increased its dividend every year since 1995. We believe that NKSH's dividend is well-covered given its strong capital position, above average returns, and fairly modest payout ratio (forecasted to be 39.9% in 2008).
- Ample Capital Position.** One of the primary concerns for many banks currently is capital adequacy; however, this is not a major concern for NKSH. If asset quality holds up, we believe that National should be able to comfortably move through this cycle without a need for additional capital. Given the bank's strong returns and modest balance sheet growth, on top of the already strong capital position, we feel that National's capital levels should enable the bank to take advantage of the opportunity created by the current market turmoil to enhance its market share. See Capital Position section below.

Investment Concerns

- Asset Quality Trends.** At quarter-end, NKSH's asset quality remained strong relative to most others in the industry. Non-performing assets (NPAs) as a percentage of total assets was 0.34% and third quarter annualized charge-offs were only 0.08% of average loans. While these ratios are low compared to peers, we expect asset quality will likely deteriorate over the next few quarters as economic conditions remain weak. That said, NKSH's markets, by and large, did not participate in the large run up in real estate values and speculative building has been fairly muted compared to other regions. In sum, while we expect asset quality to weaken further, it appears that NKSH is positioned to weather the economic storm better than most.
- General Banking Environment.** The general banking environment remains tough as asset quality deteriorates across the board. Additionally, deposit competition remains high, pressuring margins, and access to attractive capital is non-existent. While we feel that NKSH is well positioned to emerge from the current cycle in good shape, the current market conditions do not lend themselves to a favorable banking environment. Again, while Virginia has not experienced the magnitude of decline in real estate values that has occurred in other states, the risk is still apparent. The weak economy will also likely weigh on loan growth rates over the next several quarters, as well.

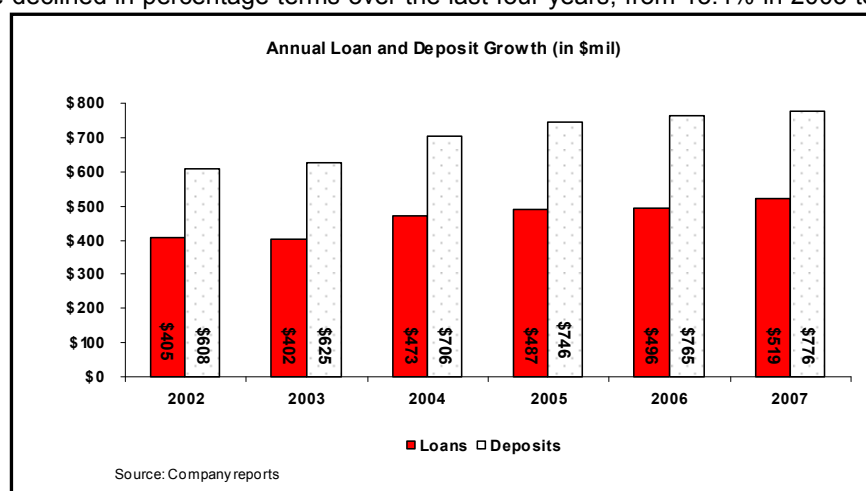
Recent Results

National Bankshares recently reported third quarter earnings of \$0.52 per share, which was up from last year's third quarter earnings of \$0.46. The bank continues to maintain tight underwriting standards during these tough economic times, which drove a sequential decline in average earning assets in the quarter (down 5.6% annualized). As we mentioned earlier, we believe the company is benefitting from the fallout created by the larger institutions' issues and, therefore, we expect the balance sheet to expand in the fourth quarter and in 2009. The third quarter net interest margin of 4.34% was materially higher than the second quarter NIM (up 29 basis points) due to the timing of certain assets and liabilities repricing. The company mentioned that at September 30th, the NIM had reverted back to 4.11% and we are modeling for Q4 NIM of 4.10%. The third quarter loan loss provision was \$280 thousand, which was approximately double the second quarter provision. As expected, asset quality continued to deteriorate in the third quarter, although the company's non-performing assets and net charge-offs remain below peer group averages (See Asset Quality section). All in all, a good quarter for NKSH, especially when considering that many of its peers are struggling.

Balance Sheet

National's balance sheet has grown modestly over the past several years. From 2002 to 2007, NKSH's net loans grew at a 5.1% compounded rate, bolstered by the 2004 acquisition of Community National Bank (\$67.8 million in assets). We are forecasting fourth quarter 2008 average earning asset growth of 4.0% annualized with 3.0% growth in 2009. The relatively modest asset growth over the past few years provides a degree of comfort in the current environment, as it indicates that more aggressive or speculative credits were not chased, reducing the overall risk of the loan portfolio.

We are also comfortable with the overall composition of the loan portfolio, as construction loans make up only 10.0% of total loans. Construction loans have increased as a percentage of total loans over the past three and a half years, up from 5.2% in 2004. Residential 1-4 family loans have remained fairly steady at 25%-27% of loans over the past several years, as has commercial real estate exposure at 39%-42%. Consumer loans have declined in percentage terms over the last four years, from 13.4% in 2003 to 10.0% at quarter end. Again, given the modest loan growth and relatively low exposure to riskier credits, we are comfortable with NKSH's loan portfolio. At quarter end, total CDs were approximately 45.5% of total deposits, with jumbo (over \$100,000) CDs making up only 16.2% of total deposits. Transaction accounts have steadily grown as a percentage of total deposits since 2003, from 27.3% to 37.9% at quarter's end. NKSH's strong core deposit base enhances the bank's franchise value and should support margins going forward. Lastly, NKSH's investment portfolio carries, in our opinion, below average risk. In the available for sale securities portfolio, state and political debt made up nearly 53% of the total fair value at quarter-end. Also, National does not hold any of the GSE preferred securities in their investment portfolio.



Capital Position

NKSH's capital position has strengthened over the past several years due to its modest balance sheet growth and strong profitability. At quarter-end, National's tangible equity to assets ratio was a healthy 10.75%. National does have the majority of a 100 thousand share repurchase authorization available and we expect that management will likely deploy some of its excess capital into the repurchase program over the next few quarters. In addition, NKSH pays an attractive dividend, which currently yields 4.0%. All in all, NKSH's strong capital position should enable the bank to ramp earnings growth as we eventually exit this part of the cycle.

NKSH Capital Ratio Trends							
	2002	2003	2004	2005	2006	2007	Q3 2008
Tier 1 risk-based capital	12.73%	13.93%	12.36%	13.10%	14.16%	14.82%	15.23%*
Total risk-based capital	13.80%	15.01%	13.39%	14.10%	15.04%	15.67%	16.07%*
Leverage capital ratio	9.02%	9.95%	9.00%	9.35%	10.01%	10.63%	10.77%*
Tangible Equity to Assets	9.23%	10.12%	9.00%	9.08%	9.48%	10.31%	10.75%
*Period end Q2 2008 (Q3 2008 data not available)				Source: Company Reports			

Asset Quality

National has historically posted excellent asset quality metrics, although they are not immune from the current economic downturn. Total non-accrual loans at quarter-end were \$2.0 million, up from \$1.2 million at year-end, and loans 90 days past due were \$1.3 million, up slightly versus year-end levels. Total non-performing assets (excluding 90 days past due and still accruing) were \$3.0 million, or 0.34% of total assets, at quarter-end, which compares favorably to most of its peers. In addition, net charge-offs remain very manageable at 0.08% of loans. While we expect non-performers to increase over the next couple of quarters as a result of the weak economy, we expect NKSH's strict underwriting standards to keep NPAs at manageable levels. Lastly, NKSH's primary markets did not, by and large, participate in the tremendous run up in real estate values and excessive speculative construction that many markets experienced; therefore, we do not expect the downside to be as severe as other areas.

NKSH Asset Quality Trends							
	2002	2003	2004	2005	2006	2007	Q3 2008
Net C/Os to Avg. Loans	0.35%	0.34%	0.30%	0.17%	0.07%	0.07%	0.08%
NPAs to Assets	0.12%	0.28%	0.16%	0.07%	0.04%	0.16%	0.34%
LLR to Loans	1.24%	1.32%	1.20%	1.11%	1.03%	1.00%	0.99%
				Source: Company Reports			

Management

Mr. James (Jim) G. Rakes serves as NKSH's Chairman, President and CEO. Mr. Rakes has been President of the Bank since 1983 and also serves as Chairman and President of National Bankshares Financial Services. Mr. F. Brad Denardo serves as National's interim CFO and has been COO of the National Bank of Blacksburg since 2002. National's management team has been with the company for an extensive period of time, which has certainly helped in the bank's efforts to navigate the current tough banking conditions successfully.

Risks

- Interest rates. Income derived from interest-earning assets and interest paid on interest-bearing liabilities are sensitive to general economic conditions and changes in monetary policy. While NKSH attempts to manage this sensitivity, the business may be impacted either positively or negatively as yields and costs shift during times of fluctuating interest rates.
- The company offers loans secured by real estate, the value of which can fluctuate and adversely affect the company's ability to collect payment on the loans.
- Asset quality could deteriorate and hurt earnings from the need to increase loan loss provisions.
- Regulatory/Legal environment. National Bankshares is in a heavily regulated industry. The Bank is a national association and is subject to supervision and regulation by the Office of the Comptroller of Currency. The Bank is also subject to supervision and regulation by the FDIC and the Federal Reserve.
- NKSH is a very thinly traded stock. Orders should be placed with care.

Davenport & Company
Last updated: October 16, 2008

	National Bankshares Actual & Estimated Earnings																								
	2009		2008		Fourth Quarter-E		Third Quarter-A		Second Quarter-A		First Quarter-A		2007 Actual		Fourth Quarter-A		Third Quarter-A		Second Quarter-A		First Quarter-A		2006 Actual		
Income Statement:	Projected	Projected	Projected	Projected	7,724	8,214	7,657	7,305	7,305	7,205	7,305	7,305	29,024	7,334	7,251	7,325	7,114	29,337	2,881	2,881	2,881	2,881	2,881	2,881	
Net interest income (TE)	\$35,397	\$34,281	\$30,900	\$3,380	835	824	894	827	827	827	827	827	3,447	808	931	918	790	2,881	2,881	2,881	2,881	2,881	2,881	2,881	
Tax equivalent adjustment	3,500	3,380	3,090	3,380	7,724	8,214	7,657	7,305	7,305	7,305	7,305	7,305	29,024	7,334	7,251	7,325	7,114	29,337	2,881	2,881	2,881	2,881	2,881	2,881	
Net interest income	31,897	30,900	27,810	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Provision for loan losses	1,300	1,300	1,300	0	300	280	280	280	280	280	280	280	423	294	119	13	(3)	49	49	49	49	49	49	49	
Net interest income after provision	30,597	30,085	26,510	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Trust income	1,300	1,254	1,254	0	325	307	319	303	303	303	303	303	1,333	314	286	360	373	29,288	1,528	1,528	1,528	1,528	1,528	1,528	
Other	8,450	7,860	7,860	0	2,040	1,901	1,926	1,993	1,993	1,993	1,993	1,993	7,376	1,893	1,839	1,899	1,806	7,244	7,244	7,244	7,244	7,244	7,244	7,244	
Core non-interest income	9,450	9,114	9,114	0	2,365	2,208	2,245	2,296	2,296	2,296	2,296	2,296	8,709	2,197	2,125	2,259	2,179	8,772	8,772	8,772	8,772	8,772	8,772	8,772	
Gain on security transactions	0	(18)	(18)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	30	30	30	30	30	30	30	
Gain on sales of loans	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Other	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Total non-interest income	9,450	9,096	9,096	0	2,365	2,208	2,227	2,296	2,296	2,227	2,296	2,296	8,709	2,197	2,125	2,259	2,179	8,802	8,802	8,802	8,802	8,802	8,802	8,802	
Salaries and benefits	11,400	11,195	11,195	0	2,800	2,792	2,746	2,857	2,857	2,746	2,857	2,857	10,773	2,533	2,621	2,778	2,841	11,466	11,466	11,466	11,466	11,466	11,466	11,466	
Occupancy expenses	1,975	1,773	1,773	0	445	437	435	456	456	435	456	456	1,743	427	419	412	485	1,957	1,957	1,957	1,957	1,957	1,957	1,957	
Amortization of intangibles	1,100	1,121	1,121	0	279	279	279	284	284	279	284	284	1,138	285	284	285	284	1,137	1,137	1,137	1,137	1,137	1,137	1,137	
Other operating expenses	7,900	7,780	7,780	0	2,050	2,023	1,846	1,861	1,861	1,846	1,861	1,861	7,302	1,850	1,776	2,029	1,847	7,074	7,074	7,074	7,074	7,074	7,074	7,074	
Core non-interest expenses	22,375	21,869	21,869	0	5,574	5,531	5,306	5,458	5,458	5,306	5,458	5,458	20,956	5,095	5,100	5,504	5,257	21,634	21,634	21,634	21,634	21,634	21,634	21,634	
Non-recurring expenses	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	36	36	36	36	36	36	36	
Total non-interest expenses	22,375	21,869	21,869	0	5,574	5,531	5,306	5,458	5,458	5,306	5,458	5,458	20,956	5,095	5,100	5,504	5,257	21,670	21,670	21,670	21,670	21,670	21,670	21,670	
Pre-tax income	17,672	17,312	17,312	0	4,215	4,611	4,443	4,043	4,043	4,443	4,043	4,043	16,404	4,142	4,157	4,067	4,039	16,420	16,420	16,420	16,420	16,420	16,420	16,420	
Provision for taxes	3,888	3,759	3,759	0	927	966	974	892	892	974	892	892	3,729	919	961	927	923	3,788	3,788	3,788	3,788	3,788	3,788	3,788	
Net income	\$13,784	\$13,553	\$13,553	0	\$3,288	\$3,615	\$3,469	\$3,181	\$3,181	\$3,469	\$3,181	\$3,181	\$12,675	\$3,223	\$3,196	\$3,140	\$3,116	\$12,632	\$12,632	\$12,632	\$12,632	\$12,632	\$12,632	\$12,632	
Cumulative effect of accounting change	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Available for common	\$13,784	\$13,553	\$13,553	0	\$3,288	\$3,615	\$3,469	\$3,181	\$3,181	\$3,469	\$3,181	\$3,181	\$12,675	\$3,223	\$3,196	\$3,140	\$3,116	\$12,632	\$12,632	\$12,632	\$12,632	\$12,632	\$12,632	\$12,632	
Average diluted shares	6,890	6,932	6,929	6,931	6,920	6,929	6,931	6,947	6,947	6,931	6,947	6,947	6,985	6,966	6,978	6,996	7,001	7,025	7,025	7,025	7,025	7,025	7,025	7,025	
Net income	13,784	13,553	13,553	13,553	3,288	3,615	3,469	3,181	3,181	3,469	3,181	3,181	12,675	3,223	3,196	3,140	3,116	12,632	12,632	12,632	12,632	12,632	12,632	12,632	
Non-recurring items	0	(11)	(11)	(11)	0	0	0	0	0	0	0	0	0	0	0	0	0	4	4	4	4	4	4	4	
Pro forma net income	13,784	13,542	13,542	13,542	3,288	3,615	3,469	3,181	3,181	3,469	3,181	3,181	12,675	3,223	3,196	3,140	3,116	12,636	12,636	12,636	12,636	12,636	12,636	12,636	
Earnings per share - diluted	\$2.00	\$1.96	\$1.96	\$1.96	\$0.48	\$0.52	\$0.50	\$0.46	\$0.46	\$0.50	\$0.46	\$0.46	\$1.82	\$0.46	\$0.46	\$0.45	\$0.45	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80
Pro forma earnings per share	\$2.00	\$1.96	\$1.96	\$1.96	\$0.48	\$0.52	\$0.50	\$0.46	\$0.46	\$0.50	\$0.46	\$0.46	\$1.82	\$0.46	\$0.46	\$0.45	\$0.45	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80

Source: Company Reports and Davenport & Company estimates

Assumptions:	2009	2008	Fourth Quarter-E	Third Quarter-A	Second Quarter-A	First Quarter-A	2007 Actual	Fourth Quarter-A	Third Quarter-A	Second Quarter-A	First Quarter-A	2006 Actual
Average earning assets	\$663,342	\$838,196	\$635,072	\$832,990	\$844,591	\$840,131	\$814,426	\$816,169	\$806,020	\$811,851	\$806,731	\$785,901
Growth - earning assets	3.0%	2.9%	4.10%	-1.4%	4.05%	2.9%	3.6%	1.3%	-0.7%	4.0%	1.7%	1.5%
Net interest margin	4.10%	4.11%	4.10%	4.34%	4.05%	3.93%	3.96%	3.95%	3.98%	4.03%	3.95%	4.1%
Avg earning assets/avg assets	94.00%	93.52%	93.00%	93.00%	93.60%	94.49%	93.93%	93.34%	93.75%	93.65%	92.92%	93.55%
Avg equity/avg assets	12.50%	12.17%	12.07%	12.21%	12.07%	12.04%	11.60%	11.86%	11.69%	11.66%	11.28%	11.21%
Effective tax rate	22.00%	21.72%	22.00%	21.60%	21.92%	21.32%	22.73%	22.19%	23.12%	22.79%	22.85%	23.07%
Projected:												
Average assets	\$918,449	\$896,253	\$897,927	\$892,260	\$902,368	\$889,104	\$867,061	\$874,400	\$859,736	\$866,915	\$867,945	\$840,080
Average equity	\$114,806	\$109,050	\$110,894	\$108,974	\$108,891	\$107,036	\$100,597	\$103,677	\$100,527	\$101,105	\$97,927	\$94,194
Return on average assets	1.50%	1.46%	1.46%	1.61%	1.55%	1.44%	1.46%	1.47%	1.49%	1.45%	1.46%	1.50%
Return on average equity	12.01%	12.43%	11.88%	13.20%	12.81%	11.95%	12.60%	12.43%	12.72%	12.46%	12.90%	13.41%
Efficiency ratio	49.89%	50.40%	51.02%	49.18%	50.79%	50.85%	48.20%	46.43%	46.63%	49.67%	48.99%	49.96%

National Bankshares Demographic Data - Exhibit 2

County	Market Rank	Number of Branches	Company Deposits in Market (\$'000)	Deposit Market Share (%)	Percent of State Franchise (%)	Percent of National Franchise (%)	Total Population 2008 (Actual)	Population Change 2000-2008 (%)	Projected Population Change 2008-2013 (%)	Median HH Income 2008 (\$)	HH Income Change 2000-2008 (%)	Projected HH Income Change 2008-2013 (%)
Montgomery	2	7	264,630	19.9	33.9	33.9	88,945	6.36	2.91	41,266	26.57	16.18
Tazewell	2	8	224,954	23.7	28.8	28.8	44,987	0.87	0.70	33,830	22.57	12.32
Pulaski	1	3	107,995	27.0	13.8	13.8	35,151	0.07	(0.19)	42,968	26.56	18.39
Giles	2	3	93,065	36.7	11.9	11.9	17,333	4.06	3.71	43,678	25.09	18.54
Wythe	5	1	41,989	8.8	5.4	5.4	28,763	4.22	2.85	39,180	21.47	11.17
Radford	7	1	17,778	6.4	2.3	2.3	15,210	(4.09)	(2.04)	32,300	31.11	15.48
Washington	11	1	13,454	1.4	1.7	1.7	53,479	4.65	2.96	41,035	24.20	15.19
Galax	6	1	9,564	2.8	1.2	1.2	6,867	0.44	0.57	35,228	25.25	13.91
Smyth	7	1	7,769	1.6	1.0	1.0	32,631	(1.36)	(1.05)	36,699	22.00	12.35
VA Totals		26	781,198		100.0	100.0	323,366					
Weighted Average: Virginia Franchise							3,10	11.59	1.76	39,208	24.96	15.29
Aggregate: Entire State of Virginia							7,899,205	7.36	6.30	61,817	32.29	16.39
Aggregate: National							309,299,265	9.91	6.30	54,749	29.85	16.97

Weighted Average is calculated as the sum of (Percent of State/National Franchise * demographic item) within each market. Banks, Thrifts, and Savings Banks included (Retail Branches Only)

Note: National Franchise does not include deposits held in U.S. Territories and other non-states, excluding District of Columbia.

Demographic data is provided by ESRI based primarily on US Census data. For non-census year data, ESRI uses samples and projections to estimate the demographic data.

SNL performs calculations on the underlying data provided by ESRI for some of the data presented on this page.

Source: SNL Financial LC

National Bankshares Inc.

**Disclosure Section**

As of 10/01/08, Davenport's ratings of covered companies were distributed as follows: 52.1% Buy, 43.1% Neutral, 4.8% Sell
 As of 10/01/08, Davenport's percentages of covered companies that were investment banking clients within the past 12 months by rating were: 5.7% Buy, 8.3% Neutral, 0.0% Sell

Companies Mentioned in this Report and Associated Disclosures

National Bankshares Inc. (NKSH - NASDAQ):I2

Description of Rating System

- Strong Buy** These shares are viewed as compelling short and long-term investment opportunities. We expect these shares to materially outperform the market over the next 12 months. Aggressive purchase is recommended at current prices.
- Buy** These shares offer attractive long-term appreciation potential from current prices. We would expect these shares to outperform the market over a longer-term horizon and long-term investors can buy at current prices.
- Neutral** These shares should perform roughly in-line with the current market. We neither encourage the purchase nor the sale of these securities at current prices.
- Reduce/Sell** These shares have more downside risk than upside potential at current prices. We expect these shares to underperform the market at current prices.

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This risk classification has been determined primarily from considering the level and predictability of earnings, the volatility of the stock relative to the market, applicable debt ratings, the composition and level of the company's capital structure, the dependence on key customers, and other relevant risk considerations.

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