SKYLINE CORP
Form DEF 14A
July 30, 2003

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant o
Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

Skyline Corporation

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.
o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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1) Amount Previously Paid:

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4) Date Filed:

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SKYLINE CORPORATION

2520 By-Pass Road
P.O. Box 743
Elkhart, Indiana 46515

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

September 22, 2003

NOTICE IS HEREBY GIVEN that the Annual Meeting of the Shareholders of Skyline Corporation (Skyline) will be held at the Emerald Room, in the Ramada Inn, 3011 Belvedere Road, Elkhart, Indiana, on Monday, September 22, 2003, at 9:00 a.m., Eastern Standard Time, for the following purposes:

1. To elect a Board of Directors for the ensuing year, or until their successors are elected and qualify.

2. To transact such other business as may properly come before the meeting, or any adjournment thereof.

The Board of Directors has fixed the close of business on July 17, 2003, as the record date for the determination of shareholders entitled to notice of, and to vote at, said meeting.

By Order of the Board of Directors

Samuel S. Thompson

General Counsel and
Secretary

July 30, 2003

IF YOU DO NOT EXPECT TO ATTEND THE MEETING IN PERSON, PLEASE SIGN, DATE AND PROMPTLY RETURN THE ENCLOSED PROXY IN THE ACCOMPANYING ENVELOPE, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES.

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SKYLINE CORPORATION

2520 By-Pass Road, P.O. Box 743
Elkhart, Indiana 46515
July 30, 2003

PROXY STATEMENT

The enclosed proxy is solicited by the Board of Directors of Skyline Corporation (Skyline) for use at the Annual Meeting of Shareholders to be held September 22, 2003. The shares represented by properly executed proxies received prior to the meeting will be voted. If the shareholder directs in the proxy how the shares are to be voted, they will be voted accordingly. When no direction has been given by the shareholder, it is the intention of the proxies named in the proxy to vote the same in accordance with their best judgment. Any proxy given may be revoked by the shareholder at any time prior to the voting of the proxy. The approximate date on which this proxy statement and the form of proxy are first sent or given to security holders is July 30, 2003.

VOTING SECURITIES

Only shareholders of record as of the close of business on July 17, 2003, or their proxies are entitled to vote at the meeting. As of that date, Skyline had outstanding 8,391,244 shares of Common Stock having one vote per share.

ELECTION OF DIRECTORS

Each share of Common Stock is entitled to one vote, which means that the holders of more than 50% of the shares voting for the election of Directors can elect all of the Directors and approve any other matter as may properly come before the meeting if they choose to do so.

It is proposed that seven Directors be elected at the meeting, each to serve until the next Annual Meeting of Shareholders and until his successor is elected and qualifies.

It is intended that the votes authorized by the enclosed proxy will be cast for the election of the seven nominees for Directors whose names are set forth below. In the event that one or more of the nominees shall unexpectedly become unavailable for election, the votes will be cast, pursuant to authority granted by the enclosed proxy, for such person or persons as may be designated by the present Board of Directors or the Board may be reduced accordingly. All of the nominees for whom the proxies intend to vote have agreed to serve as Directors if elected.

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Information about the nominees for election as Directors and the beneficial ownership of Skyline Common Stock by directors as a group is as follows:

Name, Title, Address and Principal Occupation	Age	Skyline Director Since	Shares of Skyline Common Stock Beneficially Owned at July 1, 2003 Directly or Indirectly	Percent of Class(2)
ARTHUR J. DECIO Chairman of the Board, serving in a non-executive officer and consulting capacity. Skyline Corporation 2520 By-Pass Road Elkhart, Indiana 46514 Mr. Decio is also a Director and member of the Compensation Committee of Ni Source Inc., Merrillville, Indiana (Mr. Decio was an executive officer until September 24, 2001 and Chief Executive Officer of Skyline until December 16, 1998.)	72	1959	1,477,784(1)	17.6%
THOMAS G. DERANEK Vice Chairman and Chief Executive Officer Skyline Corporation 2520 By-Pass Road Elkhart, Indiana 46514 Mr. Deranek was elected Vice Chairman and Chief Executive Officer and a Director on September 24, 2001. He served as Chief of Staff from 1991 to 2001	67	2001	0	
JERRY HAMMES 2015 West Western Avenue South Bend, Indiana 46629 President of Romy Hammes, Inc., a bank holding company and real estate investment company, South Bend, Indiana, and Chairman of Peoples Bank of Kankakee County, a bank, Bourbonnais, Illinois. Mr. Hammes is also a Director Emeritus of St. Joseph Capital Corporation, Mishawaka, Indiana	71	1986	13,000	
RONALD F. KLOSKA 1329 East Woodside South Bend, Indiana 46614 Mr. Kloska currently serves Skyline in a consulting capacity. Mr. Kloska was Vice-Chairman and Chief Executive Officer of Skyline Corporation until September 24, 2001 and Mr. Kloska was Deputy Chief Executive Officer of Skyline until December 16, 1998	69	1965	28,600	

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Name, Title, Address and Principal Occupation	Age	Skyline Director Since	Shares of Skyline Common Stock Beneficially Owned at July 1, 2003 Directly or Indirectly	Percent of Class(2)
WILLIAM H. LAWSON One Sarasota Tower, Suite 408 Sarasota, Florida 34236 Retired March 31, 2003 as Chairman of the Board, Chief Executive Officer and a Director of Franklin Electric Company, Inc., a manufacturer of electric motors, Bluffton, Indiana. Mr. Lawson is a Director of JSJ Corporation and Sentry Insurance, a Mutual Company.	66	1975	3,000	
DAVID T. LINK Dean Emeritus, Notre Dame Law School, University of Notre Dame, Notre Dame, Indiana 46556 President, International Centre for Healing and the Law 9292 W. KL Avenue Kalamazoo, Michigan 49009	66	1994	600	
ANDREW J. McKENNA 8338 North Austin Avenue Morton Grove, Illinois 60053 Chairman and CEO of Schwarz, a national printer, converter and distributor of packaging and promotional materials, Morton Grove, Illinois. Mr. McKenna is also a director of Click Commerce, Aon Corporation and McDonalds Corporation.	73	1971	12,300	
ALL NOMINEES AND OFFICERS AS A GROUP			1,572,464	18.7%

(1) Includes 83,500 shares in The Arthur J. Decio Foundation, a charitable foundation, of which Mr. Decio is a trustee. Mr. Decio disclaims any beneficial interest with respect to these shares.

(2) Less than one percent unless otherwise indicated.

Information about Board and Committee meetings is as follows:

The Audit Committee consisted of Messrs. Hammes, McKenna, Lawson, and Link. It met nine times during the fiscal year ended May 31, 2003. The Committee meets with the accounting firm which conducts the annual audit of Skyline s books, reviews auditors recommendations, reviews the independence of Skyline s auditors and considers the range of audit and non-audit fees. It also meets with the internal audit staff and Chief Financial Officer, reviews the scope and adequacy of Skyline s internal auditing program and reports its findings to the Board with any recommendations it considers appropriate. Skyline s Board of Directors has adopted a written charter for the Audit Committee. The members of Skyline s Audit Committee are all independent as defined in the applicable

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Listing Standards. Messrs. Hammes, McKenna, Lawson, and Link are all Audit Committee Financial Experts .

The Governance and Compensation Committee consisted of Messrs. McKenna, Hammes, Lawson and Link. It met one time during the last fiscal year. The Committee established compensation for the Chairman of the Board and consulted with the Chairman of the Board concerning compensation for other elected officers of the Company. The Committee also recommended to the Board the selection of nominees for election as directors, and considered the performance of incumbent directors in determining whether to nominate them for re-election.

The Governance and Compensation Committee has been replaced by two new committees, designated The Nominating and Governance Committee and the Compensation Committee, and the former functions and responsibilities of the Governance and Compensation Committee will be addressed by the two new committees. Since these are newly formed committees whose functions were to commence in the new fiscal year, they did not meet during the last fiscal year.

The Nominating and Governance Committee consists of Messrs. McKenna, Hammes, Lawson and Link. The Committee recommends to the Board the selection of nominees for election as directors, and considers the performance of incumbent directors in determining whether to nominate them for reelection. The Committee also develops and recommends to the Board a set of corporate governance principles applicable to the Corporation and performs other related tasks such as studying the size, committee structure or meeting frequency of the Board, making studies or recommendations regarding management succession, or similar tasks. Nominees recommended by shareholders will be considered upon their submission in writing by the shareholders to Skyline prior to the end of the fiscal year immediately preceding the next regular annual shareholders meeting.

The Compensation Committee consists of Messrs. McKenna, Hammes, Lawson and Link. The functions of the Compensation Committee shall be to discharge the Board s responsibilities relating to compensation of the Corporation s executives and produce an annual report on executive compensation for inclusion in the Corporation s proxy statement, review and approve corporate goals and objectives relevant to the Chief Executive Officer compensation, evaluate Chief Executive Officer performance in light of these goals and objectives and set the Chief Executive Officer s compensation level based on this evaluation and to make recommendations to the Board regarding incentive compensation plans, equity based plans and to undertake any similar functions.

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The Executive Committee of the Board of Directors consists of Messrs. Arthur J. Decio, McKenna, Hammes, Lawson and Link, and met eight times during the last fiscal year. This Committee exercises the powers of the Board of Directors in the management of the business affairs of Skyline, subject to the approval of the full Board of Directors at the next regular or special meeting.

The Board of Directors met or took action six times during the last fiscal year. Every Board member was present at all Board meetings and meetings of all committees of which he was a member, except that three Board members each missed one Board meeting, and one Board member missed three committee meetings and another Board member missed one committee meeting.

Report of the Audit Committee

The Audit Committee of Skyline s Board of Directors has reviewed and discussed Skyline s audited financial statements with management; has discussed with Skyline s independent auditors PricewaterhouseCoopers LLP the matters required to be discussed by Codification of Statements on Auditing Standards, AV §380, Statement on Auditing Standards No. 61; has received from the auditors disclosures regarding the auditors independence as required by Independence Standards Board Standard No. 1 and has discussed with the auditors the auditors independence; and has, based on the review and discussions noted above, recommended to Skyline s Board of Directors that the audited financial statements be included in Skyline s Annual Report on Form 10-K for the fiscal year ended May 31, 2003 for filing with the Securities and Exchange Commission. Skyline s Board of Directors has adopted a formal charter for the Audit Committee setting forth its responsibilities. A copy of the Audit Committee Charter is included as Exhibit A to this proxy statement.

Jerry Hammes
Andrew J. McKenna
William H. Lawson
David T. Link

Audit Fees

The aggregate fees billed for professional services rendered for the audit of Skyline s annual financial statements for the last two fiscal years ending May 31, 2002 and May 31, 2003 and the reviews of the financial statements included in Skyline s Forms 10-Q and all services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years were $117,000 for the year ended May 31, 2002 and were $145,000 for the year ended May 31, 2003.

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Audit-Related Fees

The aggregate fees billed for professional services during the last two fiscal years for assurance and related services by PricewaterhouseCoopers LLP that are reasonably related to the performance of the audit or review of Skyline s financial statements, other than those reported as Audit Fees, were $15,000 for the fiscal year ended May 31, 2002 and were $15,000 for the fiscal year ended May 31, 2003.

Tax Fees

The aggregate fees billed in each of the last two fiscal years for professional services rendered by PricewaterhouseCoopers LLP for tax compliance, tax advise, and tax planning were $10,000 for fiscal year ended May 31, 2002 and were $10,000 for fiscal year ended May 31, 2003. The services were the review, assistance and preparation and signing of the Corporation s consolidated Federal tax return.

All Other Fees

The aggregate fees billed Skyline for services by PricewaterhouseCoopers LLP, other than for services addressed under the captions Audit Fees , Audit-Related Fees and Tax Fees for each of the last two fiscal years were $0 for the fiscal year ended May 31, 2002 and were $0 for the fiscal year ended May 31, 2003.

The Audit Committee s preapproval policies and procedures pursuant to 17 CFR 210.2-01(c)(7)(i) requires any and all engagements must receive explicit approval by the committee after the committee has received an adequate description of the proposed engagement.

The percentage of the services addressed under the captions Audit-Related Fees , Tax Fees and All Other Fees that were preapproved by the Audit Committee pursuant to 17 CFR 210.2-01(c)(7)(i) is 100%. The number of hours spent by persons other than full-time permanent employees of PricewaterhouseCoopers LLP on auditing Skyline s financial statements for the most recent fiscal years was less than 50% of the total number of hours.

CERTAIN OTHER BENEFICIAL OWNERS

The following person, entities or group as indicated are known to Skyline to own beneficially at least five percent (5%) of Skyline s common stock or are members of management identified in the summary compensation table but who are not on Skyline s Board. The beneficial ownership of Skyline common stock

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by the members of its Board and its nominees for directors is shown in the table under Election of Directors above.

Name and Address of Beneficial Owner	Shares of Skyline Common Stock Beneficially Owned at July 1, 2003	Percent of Class(1)
Private Capital Management, Inc. 3003 Tamiami Trail North, 3rd Floor Naples, Florida 34103	1,464,416	17.5%
T. Rowe Price Associates Inc.(2) 100 East Pratt Street Baltimore, Maryland 21202	829,300	9.88%
Royce & Associates, LLC 1414 Avenue of the Americas New York, New York 10019	552,900	6.59%
Dimensional Fund Advisors 1299 Ocean Avenue, 11th Floor Santa Monica, California 90401	521,000	6.21%
Terrence M. Decio Senior Executive Vice President 2520 Bypass Road Elkhart, Indiana 46514	30,080	
William H. Murschel President and Chief Operations Officer 2520 Bypass Road Elkhart, Indiana 46514	4,000	
Christopher R. Leader Vice President, Operations 2520 Bypass Road Elkhart, Indiana 46514	1,000	
James R. Weigand Vice President, Finance and Treasurer and Chief Financial Officer 2520 Bypass Road Elkhart, Indiana 46514	800	

(1) Less than one percent (1%) if not specified.

(2) T. Rowe Price Associates, Inc. (Price Associates) has informed Skyline that these securities are owned by various individual and institutional investors which Price Associates serves as investment adviser with power to direct investment and/or sole power to vote the securities and that for purposes of the reporting requirements of the Securities Exchange Act of 1934, Price Associates is deemed to be a beneficial owner of such securities; however, Price Associates expressly disclaims that it is, in fact, the beneficial owner of such securities.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely on a review of forms provided to Skyline and on certain written representations, Skyline is unaware of any failure to file on a timely basis reports required by Section 16(a) of the Exchange Act by any director, officer or beneficial owner of more than ten percent of Skyline s common stock.

EXECUTIVE COMPENSATION

The following table sets forth all cash compensation paid during the fiscal year ended May 31, 2003 for each of the highest paid executive officers of Skyline, including the Chief Executive Officer. The table also shows for each such officer, the amounts set aside during the last fiscal year under Skyline s Profit Sharing Plan.

	Annual Compensation			All Other Compensation
Name and Principal Position	**Year**	**Salary($)**	**Bonus($)**	**(Vested Profit Sharing)**
Thomas G. Deranek	2003	298,000	70,000	9,000
Vice Chairman and Chief Executive Officer;	2002	236,500	158,400	9,000
Chief of Staff until September 24, 2001	2001	155,000	45,000	9,000
William H. Murschel	2003	360,000	70,000	9,000
President and Chief Operations Officer	2002	351,500	158,400	9,000
	2001	330,000	125,400	9,000
Terrence M. Decio	2003	288,800	60,000	9,000
Senior Executive Vice-President	2002	275,000	121,000	9,000
	2001	275,000	104,500	9,000
James R. Weigand	2003	209,200	50,000	9,000
Vice President, Finance and Treasurer	2002	192,500	88,000	9,000
and Chief Financial Officer	2001	175,000	39,400	9,000
Christopher R. Leader	2003	200,000	50,000	9,000
Vice-President, Operations	2002	197,500	88,000	9,000
	2001	190,000	54,200	9,000

Compensation of Directors

Directors who are not employees of Skyline receive an annual fee of $16,000 payable in quarterly installments and receive $500 for each Board or Committee meeting attended. Chairmen of Board Committees who are not employees of Skyline receive an additional $2,000 annually and Committee members who are not employees of Skyline receive an additional $1,500 annually payable in quarterly installments.

Termination of Employment Arrangements

The Skyline Corporation and Affiliates Employees Profit Sharing Plan provides benefits on death, disability or retirement for substantially all employees. Employees become eligible as of the June 1 or December 1 immediately following completion of six months of employment. The amount of contribution under the Plan is at the discretion of Skyline each year. The maximum contribution for any participant shall not exceed 12% of a participant s basic compensation. Upon retirement, death or permanent total disability, a participant is entitled to all of the funds credited to his account. In case of termination of employment by resignation or discharge, the participant is entitled to a percentage of the amount credited to his account, ranging from 0% after one year of employment to 100% after seven years. Forfeitures resulting from any employee s termination of employment prior to full vesting will be used to reduce employer contributions. Net investment earnings or net losses for each fiscal year are allocated to the account of each participant in the same ratio as the participant s account balance bears to the total account balances of all participants. Skyline reserves the right to modify, amend or terminate the Plan. In the event of termination of the plan, the entire amount theretofore contributed under the Plan must be paid to participants or their beneficiaries and under no circumstances reverts to Skyline.

Under an insurance plan, payments would be made to the below named executive officers and two former executive officers, and executive officers as a group, for a period of 10 years upon retirement from Skyline at age 60, 62 or later, in the following annual amounts: Thomas G. Deranek, $75,000; William H. Murschel, $75,000; Terrence M. Decio, $75,000; James R. Weigand, $60,000; Christopher R. Leader, $60,000; Arthur J. Decio, $100,000; and Ronald F. Kloska, $100,000; and all current and former executive officers as a group, consisting of 9 individuals, $645,000. Under the same insurance plan, in the event of the death of any of these individuals while employed by Skyline, payments would be made for a period of 10 years in the annual amounts hereinafter specified to the beneficiaries of the following individuals and group: Thomas G. Deranek, $75,000; William H. Murschel, $75,000; Terrence M. Decio, $75,000; James R. Weigand, $40,000; Christopher R. Leader, $40,000; Arthur J. Decio, $100,000; and Ronald F. Kloska, $100,000 and 2 other executive officers,

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totaling 9 individuals, $575,000. Skyline is the owner and beneficiary of policies insuring the lives of all these individuals in the total amount of $5,012,000.

In addition, in the event of the death of Arthur J. Decio, whether before or after his retirement from Skyline, Skyline has agreed to pay his survivor(s) the sum of $2,700,000, which at the present income tax rates, would result in after tax cost to Skyline of approximately $1,620,000. Skyline is the owner and beneficiary of policies insuring Arthur J. Decio s life in the amount of $1,700,000.

The appreciation in cash surrender value of all of the above-described insurance policies is such that there is no current cost to Skyline for their maintenance.

Compensation Committee Interlocks and Insider Participation

The following persons served as members of the Governance and Compensation Committee (the Compensation Committee) of Skyline s Board of Directors during the fiscal year ended May 31, 2003: Andrew J. McKenna, Jerry Hammes, William H. Lawson and David T. Link. Arthur J. Decio is the Chairman of the Board of Skyline, and is a member of the Board of Directors of Schwarz. Andrew J. McKenna is an executive officer of Schwarz.

Report of the Governance and Compensation

Committee (the Compensation Committee) on Executive Compensation

The compensation of Skyline s executive officers is determined by the Compensation Committee of the Board of Directors. Each member of the Compensation Committee is a director who is not an employee of Skyline or any of its affiliates. The following report with respect to compensation paid to Skyline s executive officers for the fiscal year ended May 31, 2003 is furnished by the Compensation Committee.

General Policies. Skyline s compensation programs are intended to enable Skyline to attract, motivate, reward and retain the executive management talent required to achieve corporate objectives. It is Skyline s policy to reward exceptional performance and contributions to the development of Skyline s business. To attain these objectives, Skyline s executive compensation program includes a competitive base salary coupled with the opportunity to participate in a bonus pool which is created based on the performance of Skyline s business. The Governance and Compensation Committee (the Compensation Committee) establishes the base salaries and discretionary bonuses which will be paid to Skyline s executive officers for each fiscal year. In setting salaries and bonuses,

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the Compensation Committee takes into account several factors, including compensation paid by competitors and other industries compensation data as well as qualitative factors bearing on an individual s experience, responsibilities, management and job performance. The Compensation Committee evaluates the contributions to Skyline s overall performance during the last fiscal year, leadership, effectiveness and commitment of all executive officers, including the Chief Executive Officer. For the fiscal year ended May 31, 2003, each of the executive officers received a bonus, in the amounts set forth above in the executive compensation table.

Salaries. Salary levels for executive officer positions are set so as to reflect the duties and level of responsibilities inherent in the position and current economic conditions relating to Skyline s business. Comparative salaries paid by other companies in the industries in which Skyline does business are considered in establishing the salary level for a given position. The Compensation Committee does not, however, target a specific percentile range within the comparative group in setting salaries of Skyline s executive officers. The particular qualifications and level of experience of the individual holding the position are also considered in establishing a salary level when the individual is first appointed to a given position.

Bonus. Skyline provides executive officers the opportunity to earn an annual incentive bonus based on an evaluation of the executive s individual performance and Skyline s performance. No executive officer is automatically entitled to a bonus or a bonus in any particular amount. In considering bonuses for executives other than Arthur J. Decio, the Compensation Committee consults with the Chairman of the Board.

Other. In addition, the executive officers participate in a profit sharing program and insurance and other plans described above providing payments on death or retirement.

Compensation of Chief Executive Officer (CEO). In setting the base salary and bonus for Skyline s CEO, for the fiscal year ended May 31, 2003, the Compensation Committee considered the same factors as with other executive officers of Skyline. The Compensation Committee believes the CEO s compensation was fully supported by those standards.

Andrew J. McKenna, Chairman
Jerry Hammes
William H. Lawson
David T. Link

Being all the members of Skyline s
Governance and Compensation Committee
(the Compensation Committee)

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PERFORMANCE GRAPH

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN* AMONG SKYLINE CORPORATION, S & P 500 INDEX AND PEER GROUP**

* Notes:

Assumes initial investment of $100 on May 31, 1998 and compares the return on that investment through May 31, 2003.

For comparison purposes, Total Return assumes reinvestment of dividends, although Skyline has no dividend reinvestment plan.

Total Return is based on market capitalization.

** This self constructed peer group consists of the following companies:

Champion Enterprises, Inc.
Coachmen Industries, Inc.
Fleetwood Enterprises, Inc.
Liberty Homes, Inc.
Thor Industries, Inc.

The returns for each member of this peer group have been weighted according to that company s respective stock market capitalization.

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INDEPENDENT PUBLIC AUDITORS

Skyline s independent public accounting firm is PricewaterhouseCoopers LLP. It is expected that representatives of PricewaterhouseCoopers LLP will be present at the meeting of shareholders, will have the opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

SHAREHOLDER PROPOSALS

Any proposal submitted for inclusion in Skyline s Proxy Statement and form of proxy for the 2004 Annual Meeting of Shareholders must be received at the address shown above on or before April 3, 2004.

MISCELLANEOUS

As of the date of this Proxy Statement, the Board of Directors knows of no other business which will be presented for consideration at the annual meeting. However, if other proper matters are presented at the meeting, it is the intention of the proxies named in the enclosed proxy to take such action as shall be in accordance with their best judgment.

The expense of this solicitation, including the cost of preparing and mailing this Proxy Statement and accompanying material, will be paid by Skyline. Skyline expects to pay approximately $6,500 to Georgeson Shareholder Communications, Inc. as compensation for the solicitation of proxies, and may reimburse brokers and others for their expense for sending proxy material to principals for the purpose of obtaining signed proxies. In addition, solicitation may be by mail, telephone, telefax and personal interview by regularly engaged officers of Skyline who will not be additionally compensated therefor.

Shareholders are respectfully requested to date, sign and return promptly the enclosed proxy in the enclosed envelope. No postage is required if mailed in the United States.

By Order of the

Board of Directors

Samuel S. Thompson

General Counsel and
Secretary

Exhibit A

CHARTER OF THE AUDIT COMMITTEE

OF
THE BOARD OF DIRECTORS
OF
SKYLINE CORPORATION

The Audit Committee shall consist of at least three (3) directors, all of whom are independent (as defined in Section 17 of the Code of Federal Regulations) of management of the Corporation and any of its subsidiaries and free from any relationship that, in the judgment of the Board of Directors, would interfere with the exercise of independent judgment respecting the matters over which the Committee is given authority.

The members of the Audit Committee shall be elected annually by the Board of Directors in connection with the annual meeting of the board. Members shall be elected by the Board of Directors with due regard to such member s training in, or experience with, accounting and financial reporting issues. Members of the Committee may be removed, and vacancies on the Committee may be filled by the Board of Directors in accordance with the Code of By-laws of the Corporation. The Chairman of the Audit Committee may be designated by the Board of Directors and, in the absence of such designation, may be elected by the Audit Committee from among their members.

The Audit Committee shall assist the Board of Directors to oversee the Corporation s financial reporting processes, its internal financial control structures and its internal and external financial audit processes. The Audit Committee shall facilitate communication on Financial Matters (defined below) among the Board of Directors, management, the Corporation s internal audit department and the Corporation s independent auditors.

The Audit Committee has oversight authority over the following matters (collectively referred to herein as Financial Matters):

The quality, accuracy and integrity of the Corporation s annual financial statements, including footnotes and related disclosures.

The quality, scope and procedures of the independent auditors audits of the Corporation s financial statements.

The quality, appropriateness and implementation of the Corporation s significant accounting policies.

Audit conclusions respecting significant estimates and adjustments.

The disclosure, treatment or resolution of any material weakness in financial reporting or controls or reportable conditions identified by management, the internal audit department or the independent auditors.

The quality, adequacy and appropriateness of the Corporation s internal financial control structures, including any circumstances in which such controls may be overridden or compromised.

The quality, adequacy and appropriateness of the Corporation s internal auditing processes.

Disagreements among management, the internal audit department or the independent auditors.

The assessment of material risks or contingencies that may affect the Corporation s financial reporting including the risk of liability associated with litigation or noncompliance with law.

The Corporation s compliance with legal and regulatory requirements.

The preparation of such reports as may be required by SEC rules.

Such other matters affecting the quality, integrity or accuracy of the Corporation s financial reporting as the Committee deems relevant to any of the forgoing matters.

Authority Respecting Independent Auditors

The Audit Committee has the following specific authority and direct responsibility respecting the independent auditors:

(a) The engagement or dismissal of the independent auditors. The Corporation shall not engage or dismiss its independent auditors without the action of the Audit Committee or the Board of Directors.

(b) To direct the independent auditors to meet with the Audit Committee from time to time, separately or in the presence of management or others, to discuss Financial Matters or to prepare and submit reports to the Committee respecting Financial Matters.

(c) To require the independent auditors to report to the Audit Committee on matters that may be deemed to affect the independence of the independent auditors, including any management consulting services provided, or proposed to be provided, by the independent auditors for the Corporation or its affiliates and the fees paid or proposed to be paid for such services; to assess the effect of the forgoing on the independence of the independent auditors and the appearance of propriety of the forgoing and to direct management to take action in respect of such matters.

(d) To take action to resolve any disagreement respecting accounting principles, the implementation or application of such principles or Financial Matters between management and the independent auditors. The auditors will report directly to the Audit Committee.

Authority Respecting The Internal Audit Department

The Audit Committee has the following specific authority respecting the internal audit department:

(a) To elect or remove the director of internal audit or to refer the election or removal of the director of internal audit for action by the Board of Directors, with or without an affirmative or negative recommendation.

(b) To assess the quality, adequacy and appropriateness of the plan for the Corporation s internal auditing processes, and, in the Committee s discretion, from time to time or upon request, to approve or disapprove such plan or to approve or disapprove any changes therein.

(c) To direct the director of internal audit to meet with the Audit Committee or the Board of Directors from time to time, separately or in the presence of the independent auditors, management or others, to discuss Financial Matters or to prepare and submit reports to the Committee respecting Financial Matters.

(d) To direct management, the director of internal audit, the Corporation or the independent auditors to take such action as the Committee may deem necessary or appropriate to address any issues identified by any of such parties regarding significant internal audit findings, difficulties encountered in carrying out internal audit procedures, or any management override of internal control mechanisms.

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Authority Over Management Activities

Relating To Financial Matters

The Audit Committee has the following specific authority over the activities of management in Financial Matters.

(a) To direct the chief financial officer or other members of management to meet with the Audit Committee or the Board of Directors from time to time, separately or in the presence of the independent auditors, the director of internal audit or others, to discuss Financial Matters or to prepare and submit reports to the Committee respecting Financial Matters.

(b) To assess the quality, adequacy and appropriateness of the accounting principles and policies implemented and applied by the Corporation and the quality, integrity and accuracy of the Corporation s financial reporting, and, in the Committee s discretion, from time to time or upon request, to approve or disapprove such principles or policies or to approve, disapprove or mandate any changes therein.

Investigations Procedure for Handling Complaints and Obtaining Advice

The Audit Committee has authority to require investigations and to obtain advice respecting the Corporation s Financial Matters and the Committee s exercise of its authority, as the Committee deems necessary or appropriate. Without limiting the forgoing, the Committee has authority to direct management, including the Corporation s counsel, the independent auditors and the director of internal audit to investigate any Financial Matters and related issues and to provide reports to the Committee respecting such investigation. The Committee has authority to meet with the Corporation s counsel, to obtain advice respecting the exercise of the Committee s authority and to direct such counsel to investigate such legal issues relating to Financial Matters and to report to the Committee regarding same, as the Committee deems necessary or appropriate. The Committee has authority to engage independent advisors whom the Committee may designate to provide advice and guidance to the Committee respecting the exercise of its authority and issues relating to Financial Matters as the Committee deems necessary or appropriate, including, without limitation, independent legal counsel, and independent financial advisors which may include investment banking firms or accounting firms, other than the independent auditors. The

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Committee has authority to meet separately with, and to receive private and, where appropriate, privileged, written or oral communications from any of such advisors. The Committee shall establish procedures for receiving and handling complaints received by the Corporation regarding internal accounting controls or audit matters and procedures for anonymous submission of complaints by employees regarding questionable accounting or audit matters.

Procedural Matters

The Audit Committee shall meet from time to time at the call of its Chairman or at the direction of the Board of Directors. The Committee shall meet at least four (4) times per year. The Chairman of the Audit Committee shall call a meeting of the Committee upon the request of any member of the Committee or the Chairman of the Board of Directors. The provisions of the Code of By-laws of the Corporation respecting notice of meetings and for action to be taken by the Board of Directors shall apply to meetings and actions of the Audit Committee.

The Chairman of the Audit Committee shall report on the activities of the Committee to the Board of Directors from time to time upon request of the Chairman of the Board of Directors or of the Board of Directors.

ADOPTED BY THE BOARD OF DIRECTORS this 26th day of March, 2003.

Noninterest expense

Salaries and employee benefits

2,831

2,857

Occupancy, furniture and fixtures

469

456

Data processing and ATM

322

349

Credit card processing

463

460

Intangibles amortization

278

284

Net costs of other real estate owned

60

14

Other operating expenses

1,207

1,037

Total noninterest expense

5,630

5,457

Income before income tax expense

4,273

4,043

Income tax expense

886

862

Net income

$

3,387

$

3,181

continued

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Net income per share - basic	**$ 0.49**	$ 0.46
- diluted	**$ 0.49**	$ 0.46
Weighted average number of common		
shares outstanding - basic	**6,929,474**	6,937,933
- diluted	**6,934,846**	6,947,278
Dividends declared per share	**$ ---**	$ ---

See accompanying notes to consolidated financial statements.

National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity

Three Months Ended March 31, 2009 and 2008

(Unaudited)

$ in thousands, except per share data	**Common Stock**	**Retained Earnings**	**Accumulated Other Comprehensive (Loss)**	**Comprehensive Income**	**Total**
Balances at December 31, 2007	$ 8,690	$ 97,810	$ (1,700)		$ 104,800
Net income	---	3,181	---	$ 3,181	3,181
Other comprehensive income, net of tax:					
Unrealized gain on securities available for sale, net of income tax $886	---	---	---	1,645	---
Reclass adjustment, net of tax $(92)	---	---	---	(170)	---
Other comprehensive income, net of tax $794	---	---	1,475	1,475	1,475
Comprehensive income	---	---	---	$ 4,656	---
Effect of changing pension plan measurement date pursuant to SFAS No. 158	---	(45)	3	---	(42)
Stock repurchase	(29)	(428)	---	---	(457)
Balances at March 31, 2008	$ 8,661	$ 100,518	$ (222)		$ 108,957
Balances at December 31, 2008	$ 8,662	$ 105,356	$ (3,910)		$ 110,108
Net income	---	3,387	---	$ 3,387	3,387
Other comprehensive income, net of tax:					
Unrealized gains on securities available for sale, net of income tax $61	---	---	---	113	---
Reclass adjustment, net of tax $(28)	---	---	---	(52)	---
Other comprehensive income, net of tax $33	---	---	61	61	61
Comprehensive income	---	---	---	$ 3,448	---
Balances at March 31, 2009	**$ 8,662**	**$ 108,743**	**$ (3,849)**		**$ 113,556**

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Three Months Ended March 31, 2009 and 2008

(Unaudited)

$ in thousands	March 31, 2009	March 31, 2008
Cash Flows from Operating Activities		
Net income	**$ 3,387**	$ 3,181
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**370**	100
Depreciation of bank premises and equipment	**235**	249
Amortization of intangibles	**278**	284
Amortization of premiums and accretion of discounts, net	**85**	63
(Gains) on sales and calls of securities available for sale, net	**(75)**	(262)
(Gains) on calls of securities held to maturity, net	**(5)**	(21)
Losses on other real estate owned	**49**	---
Net change in:		
Mortgage loans held for sale	**(650)**	(249)
Accrued interest receivable	**(449)**	8
Other assets	**131**	(394)
Accrued interest payable	**(5)**	8
Other liabilities	**992**	1,103
Net cash provided by operating activities	**4,343**	4,070
Cash Flows from Investing Activities		
Net change interest-bearing deposits	**(12,273)**	(14,189)
Proceeds from calls, principal payments, sales and maturities of securities available for sale	**7,978**	10,150
Proceeds from calls, principal payments and maturities of securities held to maturity	**14,541**	17,031
Purchases of securities available for sale	**(26,648)**	(10,370)
Purchases of securities held to maturity	**(31,277)**	(18,471)
Purchases of loan participations	**---**	(117)
Collections of loan participations	**68**	61
Loan originations and principal collections, net	**648**	(4,028)
Proceeds from disposal of other real estate owned	**17**	8
Recoveries on loans charged off	**13**	61
Purchase of bank premises and equipment	**(101)**	(74)
Net cash used in investing activities	**(47,034)**	(19,938)
Cash Flows from Financing Activities		
Net change in other deposits	**35,494**	15,493
Net change in time deposits	**4,487**	3,253

Net change in other borrowed funds		**(3)**		(3)
Common stock repurchased		**---**		(457)
Net cash provided by financing activities		**39,978**		18,286
Net change in cash and due from banks		**(2,713)**		2,418
Cash and due from banks at beginning of period		**16,316**		16,324
Cash and due from banks at end of period	**$**	**13,603**	$	18,742

continued

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Supplemental Disclosures of Cash Flow Information		
Interest paid on deposits and borrowed funds	**$ 4,417**	$ 5,399
Income taxes paid	**$ ---**	$ 105
Supplemental Disclosure of Noncash Activities		
Loans charged against the allowance for loan losses	**$ 123**	$ 152
Loans transferred to other real estate owned	**$ ---**	$ 15
Unrealized gains on securities available for sale	**$ 94**	$ 2,269
Capital reduction due to change in pension measurement date	**$ ---**	$ 63

See accompanying notes to consolidated financial statements.

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National Bankshares, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

March 31, 2009

(Unaudited)

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

Note (1) General

The consolidated financial statements of National Bankshares, Inc. (NBI) and its wholly-owned subsidiaries, The National Bank of Blacksburg (NBB) and National Bankshares Financial Services, Inc. (NBFS) (collectively, the Company), conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the three months ended March 31, 2009 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 2008 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 NBI and its subsidiaries an opportunity to acquire shares of NBI common stock. The Plan terminated on March 9, 2009. The purpose of the 1999 Stock Option Plan was to promote the success of NBI and its subsidiaries by providing an incentive to key employees that enhanced the identification of their personal interest with the long term financial success of the Company and with growth in stockholder value. Under the 1999 Stock Option Plan, up to 500,000 shares of NBI common stock could be granted. The 1999 Stock Option Plan limited the maximum term of any option granted to ten years, stated that options could be granted at not less than fair market value on the date of the grant and contained certain other limitations on the exercisability of incentive stock options. The options generally vested 25% after one year, 50% after two years, 75% after three years and 100% after four years. There were no nonvested options outstanding at March 31, 2009.

Compensation expense is calculated using the Black-Scholes model and is amortized over the requisite service period using the straight-line method. There have been no grants of stock options in 2009.

Options	**Shares**	**Weighted-Average Exercise Price**	**Weighted Average Remaining Contractual Term**	**Aggregate Intrinsic Value ($000)**

Outstanding at January 1, 2009	113,500	$ 21.84		
Granted	---	---		
Exercised	---	---		
Forfeited or expired	---	---		
Outstanding at March 31, 2009	113,500	$ 21.84	5.86	$ ---
Exercisable at March 31, 2009	113,500	$ 21.84	5.86	$ ---

Because no options have been granted in 2009 and all options were fully vested at December 31, 2008, there is no expense included in net income.

During the three months ended March 31, 2009 and 2008, there were no stock options granted and no options were exercised.

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

	Three Months ended March 31,		Year ended December 31,
$ in thousands, except % data	**2009**	**2008**	**2008**
Balance at beginning of period	**$ 5,858**	$ 5,219	$ 5,219
Provision for loan losses	**370**	100	1,119
Loans charged off	**(123)**	(152)	(611)
Recoveries	**13**	61	131
Balance at the end of period	**$ 6,118**	$ 5,228	$ 5,858
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees	**1.06 %**	0.99 %	1.02 %
Ratio of net charge-offs to average loans, net of unearned income and deferred fees[1.]	**0.08 %**	0.07 %	0.09 %
Ratio of allowance for loan losses to nonperforming loans[2.]	**457.59 %**	396.36 %	439.46 %

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.

	March 31,		**December 31,**
$ in thousands, except % data	**2009**	**2008**	**2008**
Nonperforming assets:			
Nonaccrual loans	**$ 1,337**	$ 1,319	$ 1,333
Restructured loans	**---**	---	---
Total nonperforming loans	**1,337**	1,319	1,333
Foreclosed property	**1,918**	270	1,984
Total nonperforming assets	**$ 3,255**	$ 1,589	$ 3,317
Ratio of nonperforming assets to loans, net of unearned income and deferred fees, plus other real estate owned	**0.56 %**	0.30 %	0.57 %

	March 31,		**December 31,**
$ in thousands, except % data	**2009**	**2008**	**2008**
Loans past due 90 days or more and still accruing	**$ 1,607**	$ 1,392	$ 1,127
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees	**0.28 %**	0.26 %	0.20 %
Impaired loans			
Total impaired loans	**$ 3,208**	$ 1,319	$ 3,576
Impaired loans with a valuation allowance	**$ 2,176**	$ ---	$ 2,548
Valuation allowance	**(893)**	---	(679)
Impaired loans, net of allowance	**$ 1,283**	$ ---	$ 1,869
Impaired loans with no valuation allowance	**$ 1,032**	$ 1,319	$ 1,028
Average recorded investment in impaired loans	**$ 3,223**	$ 1,235	$ 3,790
Income recognized on impaired loans	**$ 44**	$ ---	$ 140

Amount of income recognized on a cash basis	**$ ---**	$---	$ ---

There were no nonaccrual loans excluded from impaired loan disclosure under SFAS 114 at March 31, 2009.

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Note (4) Securities

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities available for sale by major security type as of March 31, 2009 are as follows:

	March 31, 2009			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Fair
$ in thousands	**Costs**	**Gains**	**Losses**	**Values**
Available for sale:				
U.S. Treasury	**$ 2,023**	**$ 218**	**$ ---**	**$ 2,241**
U.S. Government agencies and corporations	**33,226**	**524**	**338**	**33,412**
State and political subdivisions	**82,981**	**1,875**	**865**	**83,991**
Mortgage-backed securities	**21,538**	**680**	**---**	**22,218**
Corporate debt securities	**23,984**	**92**	**4,293**	**19,783**
Federal Reserve Bank stock-restricted	**92**	**---**	**---**	**92**
Federal Home Loan Bank stock-restricted	**1,677**	**---**	**---**	**1,677**
Other securities	**2,768**	**---**	**175**	**2,593**
Total securities available for sale	**$ 168,289**	**$ 3,389**	**$ 5,671**	**$ 166,007**

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities held to maturity by major security type as of March 31, 2009 are as follows:

	March 31, 2009			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Fair
$ in thousands	**Costs**	**Gains**	**Losses**	**Values**
Held to maturity:				
U.S. Government agencies and corporations	**$ 38,816**	**$ 493**	**$ 210**	**$ 39,099**
State and political subdivisions	**85,276**	**1,388**	**1,968**	**84,696**
Mortgage-backed securities	**1,720**	**66**	**---**	**1,786**
Corporate debt securities	**8,672**	**22**	**1,098**	**7,596**
Total securities held to maturity	**$ 134,484**	**$ 1,969**	**$ 3,276**	**$ 133,177**

Information pertaining to securities with gross unrealized losses at March 31, 2009 and December 31, 2008, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	March 31, 2009			
	Less Than 12 Months		12 Months or More	
	Fair	Unrealized	Fair	Unrealized
$ in thousands	Value	Loss	Value	Loss
U.S. Government agencies and corporations	$ 31,483	$ 548	$ ---	$ ---
State and political subdivisions	44,671	2,393	5,631	440
Mortgage-backed securities	51	---	1	---
Corporate debt securities	7,204	995	13,397	4,396
Other securities	---	---	495	175
Total temporarily impaired securities	$ 83,409	$ 3,936	$ 19,524	$ 5,011

	December 31, 2008			
	Less Than 12 Months		12 Months or More	
	Fair	Unrealized	Fair	Unrealized
$ in thousands	**Value**	**Loss**	**Value**	**Loss**
U.S. Government agencies and corporations	$ 995	$ 4	$---	$ ---
State and political subdivisions	54,480	2,533	1,000	2
Mortgage-backed securities	1,309	9	635	3
Corporate debt securities	13,786	851	12,046	3,255
Other securities	---	---	492	96
Total temporarily impaired securities	$ 70,570	$ 3,397	$ 14,173	$ 3,356

The Company had 153 securities with a fair value of $102,933 which were temporarily impaired at March 31, 2009. The total unrealized loss on these securities was $8,947. Of the temporarily impaired total, 32 securities with a fair value of $19,524 and an unrealized loss of $5,011, have been in a continuous loss position for 12 months or more.

Significant volatility and increased risk in the financial markets has been associated with the recent economic downturn. The increase in financial market credit risk affects the Company in the same way as it affects other institutional and individual investors. The Company's investment portfolio includes corporate bonds. If, because of economic hardships, the issuing firms were to default, there could be a delay in the payment of interest or bond principal, or there could be a loss of principal. To date, there have been no defaults in any of the corporate bonds held in the investment portfolio. The Company also holds a large number of municipal bonds. A prolonged and deep recession could negatively impact the ability of states and municipalities to make scheduled principal and interest payments on their outstanding indebtedness. If tax income and other sources of income decline, states and municipalities could default on their bonds. Again, this risk is hypothetical, since there have been no defaults among the municipal bonds in the Company's portfolio.

Management regularly monitors the credit quality of the investment portfolio. Changes in ratings are noted and follow-up research on the issuer is undertaken when warranted. Management intends to carefully follow any changes in bond quality, particularly through these challenging times for our nation's economy. The Company has the ability and intent to hold any securities in an unrealized loss position until maturity or until the cost is recovered.

Note (5) Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather, provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. The Companyadopted SFAS 157 on January 1, 2008. The FASB approved a one-year deferral for the implementation of the Statement for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company adopted the provisions of SFAS 157 for nonfinancial assets and liabilities as of January 1, 2009 without a material impact on the consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), "Business Combinations" (SFAS 141(R)). The Standard significantly changed the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree;

recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisition dates on or after the beginning of an entity's first year that begins after December 15, 2008. The Company does not expect the implementation of SFAS 141(R) to have a material impact on its consolidated financial statements, at this time.

In April 2009, the FASB issued FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies." FSP FAS 141(R)-1 amends and clarifies SFAS 141(R) to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company does not expect the adoption of FSP FAS 141(R)-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. Earlier adoption is permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 157-4 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments." FSP FAS 107-1 and APB 28-1 amends SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, the FSP amends APB Opinion No. 28, "Interim Financial Reporting," to require those disclosures in summarized financial information at interim reporting periods. The FSP is effective for interim periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-1 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." FSP FAS 115-1 and FAS 124-2 amends other-than-temporary impairment guidance for debt securities to make guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-1 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 115-1 and FAS 124-2 to have a material impact on its consolidated financial statements.

In April 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 111 (SAB 111). SAB 111 amends and replaces SAB Topic 5.M. in the SAB Series entitled "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities." SAB 111 maintains the SEC Staff's previous views related to equity securities and amends Topic 5.M. to exclude debt securities from its scope. The Company does not expect the implementation of SAB 111 to have a material impact on its consolidated financial statements.

Note (6) Defined Benefit Plan

Components of Net Periodic Benefit Cost

	Pension Benefits	
	Three Months ended March 31,	
$ in thousands	**2009**	**2008**
Service cost	**$ 89**	$ 107
Interest cost	**165**	154
Expected return on plan assets	**(133)**	(167)
Amortization of prior service cost	**(25)**	(25)
Amortization of net obligation at transition	**(3)**	(3)
Recognized net actuarial loss	**84**	39
Net periodic benefit cost	**$ 177**	$ 105

Employer Contributions

NBI's estimated required minimum pension plan contribution for 2009 is $600. The 2009 plan year valuation has not yet been completed. The contribution is being paid in quarterly installments.

Note (7) Fair Value Measurements

Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157), defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

<u>Securities available for sale</u>

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, securities are classified within Level 2 of the valuation hierarchy and fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Currently, all of the Company's securities available for sale are considered to be Level 2 securities.

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2009.

		Fair Value Measurements at March 31, 2009 Using		
Description	**Balance as of March 31, 2009**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets:				
Available-for-sale securities	$ 164,238	$ ---	$ 164,238	$ ---

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

<u>Loans held for sale</u>

Loans held for sale are required to be measured at the lower of cost or fair value. Under SFAS 157, market value is to represent fair value. Management obtains quotes or bids on all or part of these loans directly from the purchasing financial institutions. Premiums received or to be received on the quotes or bids are indicative of the fact that cost is lower than fair value. At March 31, 2009, the entire balance of loans held for sale was recorded at its cost.

Impaired loans

SFAS 157 applies to loans measured for impairment using the practical expedients permitted by Statement of Financial Accounting Standards No. 114, “Accounting by Creditors for Impairment of a Loan”, including impaired loans measured at an observable market price (if available), or at the fair value of the loan’s collateral (if the loan is collateral dependent). Fair value of the loan’s collateral, when the loan is dependent on collateral, is determined by appraisal or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

The following table summarizes the Company’s impaired loans that were measured at fair value on a nonrecurring basis during the period.

Description	Balance as of March 31, 2009	Carrying Value at March 31, 2009 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans net of valuation allowance	$ 1,283	$ ---	$ ---	$ 1,283

Other Real Estate Owned

Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. We believe that the fair value component in its valuation follows the provisions of SFAS 157.

The following table summarizes the Company's other real estate owned that were measured at fair value on a nonrecurring basis during the period.

Description	Balance as of March 31, 2009	Carrying Value at March 31, 2009 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Other real estate owned net of valuation allowance	$ 955	$ ---	$ ---	$ 955

National Bankshares, Inc. and Subsidiaries

(In thousands, except per share data)

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

The purpose of this discussion and analysis 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 2008 Annual Report on Form 10-K for an understanding of the following discussion and analysis.

Cautionary Statement Regarding Forward-Looking Statements

We make forward-looking statements in this Form 10-Q that are subject to significant risks and uncertainties. These forward-looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals, and are based upon our management's views and assumptions as of the date of this report. The words "believes," "expects," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends," or other similar words or terms are intended to identify forward-l statements.

These forward-looking statements are based upon or are affected by factors that could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. These factors include, but are not limited to, changes in:

- interest rates,
- general economic conditions,
- the legislative/regulatory climate,
- monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury, the Office of the Comptroller of the Currency and the Federal Reserve Board, and the impact of any policies or programs implemented pursuant to the Emergency Economic Stabilization Act of 2008 (EESA),
- the quality or composition of the loan and/or investment portfolios,
- demand for loan products,

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- deposit flows,
- competition,
- demand for financial services in the Company’s trade area,
- the real estate market in the Company’s trade area,
- the Company’s technology initiatives, and
- applicable accounting principles, policies and guidelines.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained in this report. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report.

This discussion and analysis should be read in conjunction with the description of our “Risk Factors” in Item 1A of our 2008 Annual Report on Form 10-K and in this Form 10-Q.

There have been historic disruptions in the financial system in the United States during the past year. While the Company has not been significantly negatively impacted during the recent economic crisis, continuation of turbulence in large portions of the global financial markets, particularly if it worsens or is prolonged, could impact the Company’s performance. The impact could be direct, by affecting revenues and the value of the Company’s assets and liabilities, or it could be indirect, by affecting the economy generally. Although the Company’s markets have not been dramatically affected, large declines in housing values in other geographic areas of the country have resulted in significant write-downs of asset values by some financial institutions in the United States. Concerns about the stability of the U.S. financial markets generally have reduced the availability of funding to some financial institutions, leading to a tightening of credit, reduction of business activity and increased market volatility. It is not yet clear what the ultimate impact of liquidity and funding initiatives of the Treasury and other bank regulatory agencies that have been announced or other programs that may be initiated in the future will be on financial markets and the financial services industry. An extended U. S. or global recession could have an adverse effect on all financial institutions, including the Company.

Critical Accounting Policies

General

The discussion and analysis of the Company’s financial condition and results of operations is based in large part upon its consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). These accounting principles are complex and require management to apply significant judgment to various accounting, reporting, and disclosure matters. Management must use assumptions, judgments and estimates when applying these principles where precise measurements are not possible or practical. These policies are critical because they are highly dependent upon subjective or complex judgments, assumptions and estimates. Changes in such judgments, assumptions or estimates may have a significant impact on the consolidated financial statements. Actual results, in fact, could differ from initial estimates.

The accounting policies with the greatest uncertainty and that require our most difficult, subjective or complex judgments and the greatest likelihood that materially different amounts would be reported under different conditions, or using different assumptions, are our allowance for loan losses and our accounting for core deposit intangibles, both of which are described below.

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 are 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 the actual events occur. The formula allowance uses a historical loss view 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. Historical loss information, 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 and to industry or geographic sectors whose impact on the portfolio have occurred but have yet to be recognized either in the formula or in the specific allowance.

Core Deposit Intangibles

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). 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, SFAS 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 SFAS 142 and therefore any intangible asset arising from such transactions remained subject to amortization over its estimated useful life.

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

Overview

National Bankshares, Inc. (NBI) is a financial holding company incorporated under the laws of Virginia. Located in southwest Virginia, NBI has two wholly-owned subsidiaries, The National Bank of Blacksburg (NBB) and National Bankshares Financial Services, Inc. (NBFS). The National Bank of Blacksburg, which does business as National Bank from twenty-six office locations, is a community bank. NBB is the source of nearly all of the Company's revenue. National Bankshares Financial Services, Inc. does business as National Bankshares Investment Services and National Bankshares Insurance Services. Income from NBFS is not significant at this time, nor is it expected to be so in the near future.

Performance Summary

The following table shows NBI's key performance ratios for the three months ended March 31, 2009 and year ended December 31, 2008.

	March 31, 2009			December 31, 2008		
Return on average assets		1.43	%		1.51	%
Return on average equity		12.14	%		12.52	%
Net interest margin (1)		4.08	%		4.12	%
Noninterest margin (2)		1.52	%		1.46	%
Basic net earnings per share	$	0.49		$	1.96	

Fully diluted net earnings per share	$	0.49	$	1.96

(1) Net interest margin: Year-to-date tax-equivalent net interest income divided by year-to-date average earning assets.

(2) Noninterest margin: Noninterest income (excluding securities gains and losses) less noninterest expense (excluding the provision for bad debts and income taxes) divided by average year-to-date assets.

The return on average assets for the three months ended March 31, 2009 was 1.43%, a decline of 8 basis points from 1.51% for the year ended December 31, 2008, as internally generated asset growth increased at a faster rate than earnings. The return on average equity declined from 12.52% for the year ended December 31, 2008 to 12.14% for the three months ended March 31, 2009. Return on average equity declined because the Company's equity, mostly from retained earnings, grew at a faster rate than first quarter earnings. Although the net interest margin, at 4.08%, was 4 basis points lower than the 4.12% at year-end, it remained at a healthy level for the first quarter of 2009.

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Growth

The following table shows the Company's key growth indicators:

	March 31, 2009	December 31, 2008	Percent Change
Securities	$ 300,491	$ 264,999	13.39 %
Loans, net	568,600	569,699	(0.19)%
Deposits	857,829	817,848	4.89 %
Total assets	979,787	935,374	4.75 %

Securities, deposits and total assets all grew in the first three months of 2009. Net loans remained essentially the same as at December 31, 2008. Growth in deposits came from municipalities and also from individual customers as they sought safety of principal while the value of other investment vehicles declined in volatile markets.

Asset Quality

Key asset quality indicators are shown below:

	March 31, 2009	December 31,2008
Nonperforming loans	$ 1,337	$ 1,333
Loans past due over 90 days	1,607	1,127
Other real estate owned	1,918	1,984
Allowance for loan losses to loans	1.06 %	1.02 %
Net charge-off ratio	0.08 %	0.09 %

Nonperforming loans at March 31, 2009, all of which were nonaccrual loans, were $1,337, or 0.23% of total loans. Nonperforming loans increased by $4 over the $1,333 reported on December 31, 2008. Loans past due 90 days or more at the end of the first quarter of 2009 were $1,607, up $480 from the total at year-end. Although there were modest increases in loans past due 90 days or more from year-end, the ratio of loans 90 days or more past due to total loans remains low when compared with peers and is consistent with the Company's conservative underwriting policies.

The Company has increased the allowance for loan losses to account for the higher potential risk in the loan portfolio that accompanies a recessionary environment. The ratio of the allowance for loan losses to loans increased from 1.02% at December 31, 2008 to 1.06% at March 31, 2009.

Net Interest Income

Net interest income for the first three months of 2009 was $8,166, an increase of $862, or 11.80%, when compared with the same period in 2008. This net increase is attributable to a decrease of $995 in interest expense, offset by a decrease in interest income of $133. The substantial decrease in interest expense was primarily caused by a decline in interest rates. In addition, management has focused on deposit pricing to maximize profitability.

The amount of net interest income earned is affected by various factors. These include changes in market interest rates due to the Federal Reserve Board's monetary policy, as well as the level and composition of the earning assets and interest-bearing liabilities. The Company has some ability to respond to interest rate movements and reduce volatility in the net interest margin. However, the frequency and magnitude of changes in market interest rates are difficult to predict, and these changes may have a greater impact on net interest income than any adjustments by management.

Interest rates are at historic lows, and low and stable interest rates benefit the Company. Offsetting the effect of low interest rates is the fact that some higher yielding securities in the Company's investment portfolio may be called when rates are low and are replaced with securities yielding at the lower market rate.

The primary source of funds used to support the Company's interest-earning assets is deposits. Deposits are obtained in the Company's trade area through traditional marketing techniques. Other funding sources, such as the Federal Home Loan Bank, while available, are only occasionally used. The cost of funds is dependent on interest rate levels and competitive factors. This limits the ability of the Company to react to interest rate movements.

If interest rates remain low and stable, management anticipates that there will be less pressure on the net interest margin as management is able to price loans and deposits rationally. If interest rates were to rise quickly, the net interest margin would narrow, because deposit rates would increase at a faster rate than loan rates. If interest rates rise more slowly, the negative effect on the net interest margin would be less pronounced.

Provision and Allowance for Loan Losses

The provision for loan losses for the three-month period ended March 31, 2009 was $370. The ratio of the allowance for loan losses to total loans at the end of the first three months of 2009 was 1.06%, which compares to 1.02% at December 31, 2008. The net charge-off ratio was 0.08% at March 31, 2009 and 0.09% at December 31, 2008.

During the first quarter of 2009, management added to the provision for loan losses in an amount management believes is sufficiently prudent given current economic conditions. Refer to the “Critical Accounting Policies” section of this report for more information related to the methodologies used to establish the Allowance for Loan Losses. The nonperforming loans total is made up of two loans, which management considers well-collateralized. Especially in this uncertain economic environment, loan quality indicators are closely monitored, and management regularly evaluates the sufficiency of the allowance for loan losses.

Noninterest Income

	Three Months ended		
	March 31, 2009	**March 31, 2008**	**Percent Change**
Service charges on deposit accounts	$ 804	$ 768	4.69 %
Other service charges and fees	73	84	(13.10) %
Credit card fees	625	637	(1.88) %
Trust fees	276	303	(8.91) %
Other income	249	221	12.67 %
Realized securities gains	80	283	(71.73) %

Service charges on deposit accounts totaled $804 for the three months ended March 31, 2009. This is an increase of $36, or 4.69%, from the same period of 2008. This category is affected by the number of deposit accounts, the level of service charge fees and the number of checking account overdrafts. The growth resulted from an increase in the level of service charge fees.

Other service charges and fees includes charges for official checks, income from the sale of checks to customers, safe deposit rent, fees for letters of credit and the income earned from commission on the sale of credit life, accident and health insurance. These fees were $73 for the three months ended March 31, 2009 and $84 for the three months ended March 31, 2008.

A slightly lower volume of credit card accounts, transactions and merchant transactions resulted in credit card fees of $625 for the three months ended March 31, 2009. This was a decrease of $12, or 1.88%, when compared with the $637 total reported for the same period last year.

Trust fees, at $276, were down by $27, or 8.91%, from the $303 earned in the first quarter of 2008. Trust income varies depending on the number of Trust accounts, the types of accounts under management and financial market conditions. The decline in Trust fees is attributable to a combination of all three factors. The financial markets have declined significantly during 2008 and 2009, negatively affecting income. In addition, there are fewer accounts under management. The mix of account types also affected Trust fees during the quarter.

Other income is income that cannot be classified in another category. Some examples include net gains from the sales of fixed assets, rent from foreclosed properties, income from the increase in the cash value of life insurance and revenue from investment and insurance sales. Other income for the three months ended March 31, 2009 was $249. This represents an increase of $28, or 12.67%, when compared with the three months ended March 31, 2008.

During the first quarter of 2008, the Company recognized $290 in a one-time gain from the initial public offering of Visa, Inc. When the credit card processor went public, the Company was required to sell a portion of its Class B shares. This gain, offset by losses in called investment securities, was the source of the relative high level of realized securities gains for the three months ended March 31, 2008. Realized securities gains for the three months ended March 31, 2009 were $80, as compared with $283 for the same period in 2008.

Noninterest Expense

	Three Months ended March 31, 2009	March 31, 2008	Percent Change
Salaries and employee benefits	$ 2,831	$ 2,857	(0.91) %
Occupancy, furniture and fixtures	469	456	2.85 %
Data processing and ATM	322	349	(7.74) %
Credit card processing	463	460	0.65 %

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Intangibles amortization	278	284	(2.11	) %
Net costs of other real estate owned	60	14	328.57	%
Other operating expenses	1,207	1,037	16.39	%

Salary and benefits expense decreased 0.91%, from $2,857 for the three months ended March 31, 2008 to $2,831 for the three months ended March 31, 2009. The Company has made a concerted effort to control these costs.

Occupancy, furniture and fixtures expense was $469 for the three months ended March 31, 2009, an increase of $13, or 2.85%, from the same period last year. The small increase reflects the Company's emphasis on containing controllable expenses.

Data processing and ATM expense was $322 for the three months ended March 31, 2009, a decrease of $27, or 7.74% from the three months ended March 31, 2008. In the first quarter of 2008, the Company had higher data processing costs associated with branch capture and merchant capture projects.

Credit card processing expense was $463 for the three months ended March 31, 2009, a slight increase of $3 from the total for the three months ended March 31, 2008. This expense is driven by volume and other factors such as merchant discount rates and is subject to a degree of variability.

The expense for intangibles and goodwill amortization is related to acquisitions. There were no acquisitions in the past year, and certain expenses have been fully amortized. This accounts for the decline from $284 for the three months ended March 31, 2008 to $278 for the three months ended March 31, 2009.

Net costs of other real estate owned have increased from $14 for the three months ended March 31, 2008 to $60 for the three months ended March 31, 2009. This expense category varies with the number of other real estate owned properties and the expenses associated with each, and it has increased in 2009 as the total of other real estate owned has grown.

The category of other operating expenses includes noninterest expense items such as franchise taxes, professional services, stationery and supplies, telephone costs, postage and charitable donations. Other operating expenses for the three months ended March 31, 2009 were $1,207. This reflects an increase of $170, or 16.39%, when compared with the same period in 2008.

The majority of the growth in other operating expenses is attributable to an increase of $100 in Federal Deposit Insurance Corporation Deposit Insurance Fund premiums. As the impact of the financial crisis on the banking industry worsens, this expense will increase in the future. FDIC has announced an emergency special assessment on insured banks, payable on June 30. However, this amount and terms of the assessment are still being discussed and have not yet been finalized.

Balance Sheet

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

Assets		**March 31, 2009**		**December 31, 2008**	**Percent Change**	
Interest-bearing deposits	$	41,121	$	21,440	91.80	%
Securities available for sale		160,767		157,291	2.21	%
Securities held to maturity		125,712		124,076	1.32	%

Mortgage loans held for sale	1,091	386	182.64	%
Real estate construction loans	61,145	56,063	9.06	%
Real estate mortgage loans	163,518	148,816	9.88	%
Commercial and industrial loans	245,170	225,806	8.58	%
Loans to individuals	104,412	108,908	(4.13	) %
Total Assets	960,824	899,462	6.82	%
Liabilities and stockholders equity				
Noninterest-bearing demand deposits	$ 108,918	$ 112,608	(3.28	) %
Interest-bearing demand deposits	274,840	243,409	12.91	%
Savings deposits	46,617	45,796	1.79	%
Time deposits	409,453	381,961	7.20	%
Other borrowings	53	297	(82.15	) %
Stockholders’ equity	113,111	108,585	4.17	%

Securities

The total amortized cost of securities available for sale and securities held to maturity at March 31, 2009 was $302,773 and total fair value was $299,184. At March 31, 2009 the Company held individual securities with a total fair value of $102,933 that had a total unrealized loss of $8,947. Of this total, securities with a fair value of $19,524 and unrealized loss of $5,011 have been in a continuous loss position for 12 months or more. Management considers the decline in fair value in the securities portfolio to be a temporary impairment. Management's evaluation is based largely on the following considerations:

- Each of the investment securities with an unrealized loss remains rated as investment grade by independent rating agencies.
- Upheaval and uncertainty in financial markets have negatively impacted the value of investment securities, particularly those issued by firms with ties to the financial sector, which constitute a majority of temporarily impaired securities in the Company's investment portfolio. The future prospects of issuers have changed quickly because of government rescue plans, mergers and buyouts and corporate-to-bank charter conversions.
- The Company has the intent and ability to hold its investments to maturity or until costs are recovered. Several temporarily impaired securities will mature in the short to intermediate term.

Management regularly monitors the quality of the securities portfolio, and management closely follows the uncertainty in the economy and the volatility in financial markets. The value of individual securities will be written down if the decline in fair value is considered to be other than temporary based upon the totality of circumstances.

Loans

		March 31, 2009		December 31, 2008	Percent Change	
Real estate construction	$	58,645	$	60,798	(3.54	) %
Real estate mortgage		164,684		162,757	1.18	%
Commercial and industrial		249,925		246,218	1.51	%
Loans to individuals		102,533		106,907	(4.09	) %
Total loans	$	575,787	$	576,680	(0.15	) %

The Company's total loans declined slightly from $576,680 at year-end 2008 to $575,787 at March 31, 2009. The $893, or 0.15%, decrease, is the result of a decline in the commercial and industrial and loans to individuals categories, partially offset by growth in the real estate mortgage and real estate construction categories.

Among the four loan categories, real estate construction loans have experienced the greatest percentage of growth. At December 31, 2008 there was $246,218 in real estate construction loans, and at March 31, 2009 the total increased 1.51% to $249,925. Real estate mortgage loans were at $164,684 at March 31, 2009 and $162,757 at December 31, 2008, an increase of $1,927, or 1.18%. Because of the nature of real estate construction loans, a portion of the increase in that category is seasonal. It is NBB's policy to require a commitment for permanent mortgage financing from a secondary market mortgage lender prior to approving a residential construction loan. NBB converts most commercial real estate construction loans to permanent commercial and industrial loans.

The commercial and industrial loans category has declined from $60,798 at December 31, 2008 to $58,645 at the end of the first quarter of 2009. This decline is the result of lower loan demand in a slower economy.

The 4.09% decline in loans to individuals continues a trend that has been evident over the past several years. The availability of low cost dealer auto loans and other products, such as home equity lines of credit, make traditional consumer installment loans less attractive to customers.

Deposits

		March 31, 2009		December 31, 2008	Percent Change	
Noninterest-bearing demand deposits	$	112,473	$	109,630	2.59	%
Interest-bearing demand deposits		285,218		256,416	11.23	%
Saving deposits		49,178		45,329	8.49	%
Time deposits		410,960		406,473	1.10	%
Total deposits	$	857,829	$	817,848	4.89	%

Total deposits have increased by 4.89%, from $817,848 at December 31, 2008 to $857,829 at March 31, 2009. The growth was internally generated and was not the result of acquisitions. Each of the deposit categories has grown since year-end, with interest-bearing demand deposits increasing at the highest rate, up by 11.23%, from $256,416 at December 31, 2008 to $285,218. A portion of the increase in total deposits is attributable to a higher level of municipal deposits. Many customers are also seeking the safety of insured deposits when other forms of investments are uncertain and volatile.

Liquidity

Liquidity measures the Company's ability to provide sufficient cash flow to meet its financial commitments, to fund additional loan demand and to handle withdrawals of existing deposits. Sources of liquidity include deposits, loan principal and interest repayments, sales, calls and maturities of securities and short-term borrowing. The Company has other available sources of liquidity. They include lines of credit with a correspondent bank, advances from the Federal Home Loan Bank, and Federal Reserve Bank discount window borrowings.

Net cash provided by operating activities for the three months ended March 31, 2009 was $4,343, which compares to $4,070 for the three months ended March 31, 2008.

Net cash used in investing activities in the three months ended March 31, 2009 was $47,034, compared to $19,938 for the three months ended March 31, 2008.

Net cash provided by financing activities for the three months ended March 31, 2009 was $39,978, compared to $18,286 provided by financing activities in the same period last year.

NBB has been able to readily attract deposits at reasonable rates, particularly from local governments in its market area. NBB has long had an internal policy targeting the loan to deposit ratio in the 65% to 75% range. At March 31, 2009 it was 67.0%. In addition, management maintains a reasonable percentage of the laddered investment portfolio in investments that are categorized as available for sale. These factors, together with those cited above, contribute to the Company's sound levels of liquidity.

At March 31, 2009, management is unaware of any commitment or trend that would have a material effect on liquidity.

Capital Resources

Total stockholders' equity at March 31, 2009 was $113,556, an increase of $3,448 from December 31, 2008. The Tier I and Tier II risk-based capital ratios at March 31, 2009 were 15.78% and 16.71%, respectively. Capital levels remain significantly above the regulatory minimum capital requirements of 4.0% for Tier I and 8.0% for Tier II capital.

Off-Balance Sheet Arrangements

In the normal course of business, NBB extends lines of credit to its customers. 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 NBB's customers. There are two types of standby letters of credit. The first is a guarantee of payment to facilitate customer purchases. The second type is a performance letter of credit that guarantees a payment if the customer fails to perform a specific obligation. While it would be possible for customers to draw in full on approved lines of credit and letters of credit, historically this has not occurred. In the event of a sudden and substantial draw on these lines, the Company has its own lines of credit on which it can draw funds. A sale of loans would also be an option.

NBB sells mortgages on the secondary market for which there are recourse agreements should the borrower default.

There were no material changes in these off-balance sheet arrangements during the first three months of 2009, except for regular and normal seasonal fluctuations in loan commitment totals.

Contractual Obligations

The Company had no capital lease or purchase obligations at March 31, 2009. Operating lease obligations and long-term debt were not material at the end of the first quarter of 2009 and have not changed materially from that which was disclosed in the Company's 2008 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company considers interest rate risk to be a significant market risk and has systems in place to measure the exposure of net interest income to adverse movement in interest rates. Interest rate shock analyses provide management with an indication of potential economic loss due to future rate changes. There have not been any changes which would significantly alter the results disclosed as of December 31, 2008 in the Company's 2008 Form 10-K.

Item 4. Controls and Procedures

The Company's management evaluated, with the participation of the Company's principal executive officer and principal financial officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the

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Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based on that evaluation, the Company’s principal executive officer and principal financial officer concluded that the Company’s disclosure controls and procedures are effective as of March 31, 2009 to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including the Company’s principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in the Company’s internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the quarter ended March 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Corporation’s internal control over financial reporting.

Because of the inherent limitations in all control systems, the Company believes that no system of controls, no matter how well designed and operated, can provide absolute assurance that all control issues have been detected.

Part II

Other Information

Item 1. Legal Proceedings

There are no pending or threatened legal proceedings to which the Company or any of its subsidiaries is a party or to which the property of the Company or any of its subsidiaries is subject that, in the opinion of management, may materially impact the financial condition of the Company.

Item 1A. Risk Factors

Please refer to the “Risk Factors” previously disclosed in Item 1A of our 2008 Annual Report on Form 10-K and the factors discussed under “Cautionary Statement Regarding Forward-Looking Statements” in Item 2 of this Form 10-Q.

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

The Company did not repurchase stock during the first quarter of 2009.

Item 3. Defaults Upon Senior Securities

None for the three months ended March 31, 2009.

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

None

Item 5. Other Information

None

Item 6. Exhibits

See Index of Exhibits.

Signatures

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

	NATIONAL BANKSHARES, INC.
DATE: May 6, 2009	/s/ JAMES G. RAKES James G. Rakes President and Chief Executive Officer (Authorized Officer)
DATE: May 6, 2009	/s/ DAVID K. SKEENS David K. Skeens Treasurer and Chief Financial Officer (Principal Financial Officer)

Index of Exhibits

Exhibit No.	**Description**	**Page No. in Sequential System**
3(i)	Amended and Restated Articles of Incorporation of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3.1 of the Form 8K for filed on March 16, 2006)
3(ii)	Amended By-laws of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3(ii) of the Annual Report on Form 10K for fiscal year ended December 31, 2007)
4(i)	Specimen copy of certificate for National Bankshares, Inc. common stock	(incorporated herein by reference to Exhibit 4(a) of the Annual Report on Form 10K for fiscal year ended December 31, 1993)
*10(iii)(A)	National Bankshares, Inc. 1999 Stock Option Plan	(incorporated herein by reference to Exhibit 4.3 of the Form S-8, filed as Registration No. 333-79979 with the Commission on June 4, 1999)
*10(iii)(A)		

	Executive Employment Agreement dated December 17, 2008, between National Bankshares, Inc. and James G. Rakes	(incorporated herein by reference to Exhibit 10(iii)(A) of the Annual Report on Form 10K for the fiscal year ended December 31, 2008)
*10(iii)(A)	Employee Lease Agreement dated August 14, 2002, between National Bankshares, Inc. and The National Bank of Blacksburg	(incorporated herein by reference to Exhibit 10 (iii) (A) of Form 10Q for the period ended September 30, 2002)
*10(iii)(A)	Executive Employment Agreement dated December 17, 2008, between National Bankshares, Inc. and F. Brad Denardo	(incorporated herein by reference to Exhibit 10(iii)(A) of the Annual Report on Form 10K for the fiscal year ended December 31, 2008)
*10(iii)(A)	Executive Employment Agreement dated December 17, 2008, between National Bankshares, Inc. and Marilyn B. Buhyoff	(incorporated herein by reference to Exhibit 10(iii)(A) of the Annual Report on Form 10K for the fiscal year ended December 31, 2008)
*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 the Form 8K filed on February 8, 2006)
*10(iii)(A)	Salary Continuation Agreement dated February 8, 2006, between The National Bank of Blacksburg and F. Brad Denardo	(incorporated herein by reference to Exhibit 10(iii)(A) of the Form 8K filed on February 8, 2006)
*10(iii)(A)	Salary Continuation Agreement dated February 8, 2006, between National Bankshares, Inc. and Marilyn B. Buhyoff	(incorporated herein by reference to Exhibit 10(iii)(A) of the Form 8K filed on February 8, 2006)

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*10(iii)(A)	First Amendment, dated December 19, 2007, to The National Bank of Blacksburg Salary Continuation Agreement for James G. Rakes	(incorporated herein by reference to Exhibit 10(iii)(A) of the Form 8K filed on December 19, 2007)
*10(iii)(A)	First Amendment, dated December 19, 2007, to The National Bank of Blacksburg Salary Continuation Agreement for F. Brad Denardo	(incorporated herein by reference to Exhibit 10(iii)(A) of the Form 8K filed on December 19, 2007)
*10(iii)(A)	First Amendment, dated December 19, 2007, to National Bankshares, Inc. Salary Continuation Agreement for Marilyn B. Buhyoff	(incorporated herein by reference to Exhibit 10(iii)(A) of the Form 8K filed on December 19, 2007)
*10(viii)(A)	Second Amendment, dated June 12, 2008, to The National Bank of Blacksburg Salary Continuation Agreement for F. Brad Denardo	(incorporated herein by reference to Exhibit 10(iii)(A) of the Form 8K filed on June 12, 2008)

*10(viii)(A)	Second Amendment, dated December 17, 2008, to The National Bank of Blacksburg Salary Continuation Agreement for James G. Rakes	(incorporated herein by reference to Exhibit 10(iii)(A) of the Annual Report on Form 10K for the fiscal year ended December 31, 2008)
*10(viii)(A)	Second Amendment, dated December 17, 2008, to The National Bank of Blacksburg Salary Continuation Agreement for Marilyn B. Buhyoff	(incorporated herein by reference to Exhibit 10(iii)(A) of the Annual Report on Form 10K for the fiscal year ended December 31, 2008)
*10(viii)(A)	Third Amendment, dated December 17, 2008, to The National Bank of Blacksburg Salary Continuation Agreement for F. Brad Denardo	(incorporated herein by reference to Exhibit 10(iii)(A) of the Annual Report on Form 10K for the fiscal year ended December 31, 2008)
31(i)	Section 906 Certification of Chief Executive Officer	(included herewith)
31(ii)	Section 906 Certification of Chief Financial Officer	(included herewith)
32(i)	18 U.S.C. Section 1350 Certification of Chief Executive Officer	(included herewith)
32(ii)	18 U.S.C. Section 1350 Certification of Chief Financial Officer	(included herewith)

* Indicates a management contract or compensatory plan.

Exhibit 31(i)

CERTIFICATIONS

I, James G. Rakes, 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 evaluation; and

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

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

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

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

Date: May 6, 2009

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

Exhibit 31(ii)

CERTIFICATIONS

I, David K. Skeens, 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 evaluation; and

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

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

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

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

Date: May 6, 2009

/s/ DAVID K. SKEENS
David K. Skeens
Treasurer and

Chief Financial Officer

(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 March 31, 2009, I, James G. Rakes, President and Chief Executive Officer (Principal Executive Officer) of National Bankshares, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended March 31, 2009, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended March 31, 2009, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

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

May 6, 2009

Exhibit 32 (ii)

CERTIFICATION OF CHIEF FINANCIAL OFFICER

PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Form 10-Q of National Bankshares, Inc. for the quarter ended March 31, 2009, I, David K. Skeens, Treasurer and Chief Financial Officer (Principal Financial Officer) of National Bankshares, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended March 31, 2009, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended March 31, 2009, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

/s/ DAVID K. SKEENS
David K. Skeens
Treasurer and

Chief Financial Officer

(Principal Financial Officer)

May 6, 2009