FORM 10KSB

Annual and transition reports of small business issuers [Section 13 or 15(d), not S-B Item 405]

Filing Date: **1999-03-26** | Period of Report: **1998-12-31**
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FILER

CARDINAL BANKSHARES CORP
CIK:**1022759**| IRS No.: **541804471** | State of Incorp.:**VA**
Type: **10KSB** | Act: **34** | File No.: **000-28780** | Film No.: **99574816**
SIC: **6022** State commercial banks

Business Address
P O BOX 215
FLOYD VA 24091
5407454191

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

(Mark One)

X Annual Report under Section 13 or 15(d) of the Securities Exchange Act 1934 (Fee required). For the fiscal year ended December 31, 1998.

or

_____ Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934 (No fee required)

For the transition period from _____ to _____

Commission file No. _0-28780_

Cardinal Bankshares Corporation
(Name of small business issuer in its charter)

Virginia	54-1804471
(State or other jurisdiction of incorporation or organization	(IRS Employer Identification No.)

101 Jacksonville Circle, Floyd, Virginia 24091
(Address of principal executive offices)

(540) 745-4191
Issuer's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $10.00 per share
Title of Class

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for past 90 days.
Yes X No_____

Check if there is no disclosure of delinquent filers in response to Item 405 of regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-KSB or any amendment to this Form 10-KSB. [X]

The issuer's revenues for its most recent fiscal year were $11,758,000

The aggregate market value of the voting stock as of March 15, 1998, held by non-affiliates of the registrant computed by reference to the price at which the stock was sold, or the average bid and asked prices of such stock, as of a specified date within the last 60 days was $22,465,000.

511,911 shares of the Issuer's common stock were issued and outstanding as of March 15, 1999.

Transitional Small Business Disclosure Format. (Check one):
Yes_____ No X

DOCUMENTS INCORPORATED BY REFERENCE

The annual report to security holders for fiscal year ended December 31, 1998 is incorporated by reference into Form 10-KSB Part II, Items 7 and 8, and Part III, Item 13. The issuer's Proxy Statement dated March 24, 1999 is incorporated by reference into Form 10-KSB Part III, Items 9, 10, 11, and 12.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

(A) BUSINESS DEVELOPMENT

Cardinal Bankshares Corporation (the Company) was incorporated as a Virginia corporation on March 12, 1996 to acquire the stock of The Bank of Floyd (the Bank). The Bank was acquired by the Company on June 30, 1996.

The Bank was organized as a state chartered bank on February 24, 1951 through the consummation of a plan of consolidation between two state chartered community banks then operating in Floyd County, Virginia.

The Bank and its wholly-owned subsidiary, FBC, Inc., are incorporated and operate under the laws of the Commonwealth of Virginia. As a state chartered Federal Reserve member, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions and the Federal Reserve. FBC, Inc.'s assets and operations consist primarily of a minority interest in a title insurance company.

(B) DESCRIPTION OF THE BUSINESS

The principal business of the Company and Bank is to provide comprehensive individual and corporate banking services through its main office in Floyd, Virginia, and its branch in Hillsville, Roanoke and Willis, Virginia. Effective April 6, 1994, the Bank acquired a 7-1/2% interest in Virginia Title Center, LLC (a title insurance company) through its acquisition by FBC, Inc. (a wholly owned subsidiary of the Bank). FBC, Inc. has no significant assets or operations other than its interest in Virginia Title Center, LLC.

(1) SERVICES

The Bank is a full service retail commercial bank offering a wide range of services, including demand and time deposits as well as installment, mortgage and other consumer lending services. The Bank makes seasonal and term commercial loans, both alone and in conjunction with other banks or governmental agencies.

(2) COMPETITIVE CONDITIONS

The banking business is highly competitive. The Company competes as a financial intermediary with other commercial banks, savings and loan associations, credit unions and money market mutual funds operating in its trade area and elsewhere. As of December 31, 1998, there were two commercial banks (one of which is the Bank) operating a total of three offices in Floyd County, Virginia. The competing institution is not locally owned.

Floyd County generates approximately 70% of the Bank's total deposits. In the other parts of the Bank's trade area (the Virginia Counties of Roanoke and Montgomery and the City of Roanoke, Virginia), there are a number of locally owned community banks, statewide banking organizations, and affiliate banks of southeast regional bank holding companies in operation.

(3) MATERIAL CUSTOMERS

Deposits are derived from a broad base of customers in its trade area. No material portion of deposits have been obtained from a single person or a few persons (including Federal, State, and local governments and agencies thereunder), the loss of which would have a materially adverse effect on the business of the Bank.

The majority of loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Company's market area. The majority of such customers are depositors. The Company generally does not extend credit to any single borrower or group of related borrowers in excess of approximately $1,750,000. Although the Company has a reasonably diversified loan portfolio, it has a loan concentration relating to customers who are motel and bed-and-breakfast owners and operators. Total loans and loan commitments to this industrial group amounted to approximately $8,900,000 and $6,400,000 at December 31, 1998 and 1997, respectively.

(B) DESCRIPTION OF BUSINESS, CONTINUED

(4) RIGHTS

No patents, trademarks, licenses, franchises or concessions held are of material significance to the Company.

(5) NEW SERVICES

The Company has expended no material dollars on research activities relating to new lines of business in the last two years and has not announced any new line of business which will require an investment of material assets.

(6) ENVIRONMENTAL LAWS

Compliance with Federal, State, or Local provisions regulating the discharge of materials into the environment has not had, nor is it expected to have in the future, a material effect upon the Company's capital expenditures, earnings or competitive position.

(7) EMPLOYEES

The Bank had 20 officers, 32 full-time employees and seven part-time employees as of December 31, 1998. Employee relations have been good.

ITEM 2. DESCRIPTION OF PROPERTY

The present headquarters of the Company consists of a three-story brick building, with approximately 21,200 square feet of floor space located at 101 Jacksonville Circle, Floyd, Virginia. The Bank also operates branch offices in Hillsville and Roanoke, Virginia. All facilities are owned by the Bank and each has drive-up facilities. The Bank's Willis, Virginia office operates from a leased facility.

The Bank also owns a three-story brick building adjacent to its main office which serves primarily as community meeting rooms and off-site data backup storage.

ITEM 3. LEGAL PROCEEDINGS

Neither the Company nor the Bank or its subsidiary are a party to, nor is any of their property the subject of, any material pending legal proceedings incidental to the business of the Company or the Bank or its subsidiary.

ITEM 4. SUBMISSION OF MATTER TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(A) Beginning in 1997, the Company's stock was listed on the NASDAQ Bulletin Board under the symbol CDBK. Prior to 1997, no active public market existed for the common stock of the Bank. Transfers of the common stock occurred from time to time, but management had no direct access to the prices realized in those trades. Based on information available to the Bank concerning such trading, the following table shows the trading ranges of the Common Stock for the previous five years. The table has been adjusted for the effects of a four for one stock split in 1995 and a 10% stock dividend in 1997.

Year	High	Low
1998	$57.00	$48.25
1997	$47.00	$44.00
1996	$44.00	$35.45
1995	$35.45	$21.59
1994	$21.59	$20.45

(B) The approximate number of holders of the Bank's 511,911 Common Stock Securities as of December 31, 1998, is 721.

(C) Dividends paid for 1998 were $1.06 and 1997 were $1.00 per share (adjusted for the effects of a four for one stock split in 1995 and a 10% stock dividend in 1997) owned. The Company's ability to declare and pay dividends in the future will be dependent upon its consolidated income and fiscal condition, tax considerations, and general business condition. Subject to these considerations, dividends may be declared only in the discretion of the Board of Directors. The Company presently expects that dividends will continue to be paid in the future.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS

The information required under this item is incorporated by reference to the Company's Annual Report to Stockholders, Exhibit 13.1, pages 24-42 and inside front cover.

ITEM 7. FINANCIAL STATEMENTS

The following consolidated financial statements of the registrant and the independent Auditor's Report set forth on pages 2 through 23 of the Company's 1998 Annual Report to Stockholders are incorporated herein by reference:

(1) Independent Auditor's Report

(2) Consolidated Balance Sheets as of December 31, 1998 and 1997

(3) Consolidated Statements of Income for the years ended December 31, 1998, 1997, and 1996

(4) Consolidated Statements of Stockholders' Equity for the years ended December 31, 1998, 1997, and 1996

(5) Consolidated Statements of Cash Flows for the years ended December 31, 1998, 1997, and 1996

(6) Notes to Consolidated Financial Statements

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

NONE

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS: COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

The Executive Officer of the Company as of December 31, 1998 is listed on page 3 of the Company's Proxy statement dated March 24, 1999 and is incorporated herein by reference. Information with respect to the directors of the Company is set out under the caption "Election of Directors" on page 2 of The Company's Proxy statement dated March 24, 1999, which information is incorporated herein by reference.

The disclosure required by item 405 of regulation S-K is set out under the caption "Beneficial Ownership Reporting Compliance" section 16(a) on page 5 of the Company's Proxy Statement dated March 24, 1999, which information is incorporated by reference.

ITEM 10. EXECUTIVE COMPENSATION

The information set forth under "Executive Compensation" and "Directors Meetings, Committees and Fees" on page 4 of the Company's Proxy Statement dated March 24, 1999 is incorporated herein by reference.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information set forth under "Ownership of Common Stock" on pages 3, 4 and 5 of the Company's Proxy Statement dated March 24, 1999 is incorporated herein by reference.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information contained under "Certain Transactions" on page 5 of the Company's Proxy Statement dated March 24, 1999 is incorporated herein by reference.

PART IV

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of the report:

	1998 Annual Report To Stockholders Pages(s)*
1. Financial Statements:	
Independent Auditors' Report	2
Consolidated Balance Sheets December 31, 1998 and 1997	3
Consolidated Statements of Income Years ended December 31, 1998, 1997, and 1996	4
Consolidated Statements of Stock-	

* Incorporated by reference from the indicated pages of the 1998 Annual Report to Stockholders

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K, CONTINUED

2. Financial Statement Schedules:

All schedules are omitted as the required information is inapplicable or the information is presented in the Consolidated Financial Statements or related notes.

3. Exhibits

The exhibits filed as part of this report and exhibits incorporated herein by reference to other documents are listed in the Index to Exhibits to this Annual Report on Form 10-KSB.

REPORTS ON FORM 8-K

None.

EXHIBITS

See Item 13(a)3 above.

FINANCIAL STATEMENT SCHEDULES

See Item 13(a)2 above.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CARDINAL BANKSHARES CORPORATION

Date: March 22, 1999

By: /s/ Ronald Leon Moore

Ronald Leon Moore
President and CEO

In accordance with the Exchange Act, this report has to be signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Ronald Leon Moore Ronald Leon Moore	Director, President and Chief Executive Officer (principal financial and accounting officer).	3/22/99
/s/ K. Venson Bolt K. Venson Bolt	Director	3/22/99
/s/ J. H. Conduff J. H. Conduff	Director	3/22/99
/s/ W. R. Gardner, W. R. Gardner, Jr.	Director	3/22/99
/s/ C. W. Harman	Director	3/22/99

C. W. Harman

/s/ Kevin D. Mitchell Kevin D. Mitchell	Director	3/22/99
/s/ Dorsey H. Thompson Dorsey H. Thompson	Director	3/22/99

INDEX TO EXHIBITS

EXHIBIT NO.	DESCRIPTION	PAGE NO. IN SEQUENTIAL SYSTEM
13.1	1998 Annual Report to Stockholders (Such Report, except to the extent incorporated herein by reference, is being furnished for the information of the Commission only and is not deemed to be filed as part of this Report on Form 10-KSB).	---
3.1	Cardinal Bankshares Corporation, Articles of Incorporation	Incorporated by reference to the Company's Registration on Form 8-A, filed August 16, 1996
3.2	Cardinal Bankshares Corporation by-laws	Incorporated by reference to the Company's 1996 Annual Report filed on Form 10-KSB on March 26, 1997
21.1	Subsidiaries of Cardinal Bankshares Corporation	---
27.1	Financial Data Schedule	---

Sec.8-Reference herein to directors, officers, employees or agents shall include former directors, officers, employees and agents and their respective heirs, executors and administrators.

1998 ANNUAL REPORT

TABLE OF CONTENTS

FINANCIAL HIGHLIGHTS SUMMARY(1)

	1998	1997	1996	1995	1994
SUMMARY OF OPERATIONS(2)					
Interest income	$ 11,269	$ 11,078	$ 10,289	$ 10,003	$ 8,724
Interest expense	5,797	5,681	5,307	5,060	3,887
Net interest income	5,472	5,397	4,982	4,943	4,837
Provision for loan losses	175	500	325	136	255
Other income	489	543	343	225	233
Other expense	3,066	2,934	2,823	3,088	2,811
Income taxes	781	652	594	548	564
Net income	$ 1,939	$ 1,854	$ 1,583	$ 1,396	$ 1,440
PER SHARE DATA(3)					
Basic earnings per share	$ 3.79	$ 3.62	$ 3.09	$ 2.73	$ 2.81
Cash dividends declared	1.06	1.00	.94	.88	.86
Book value	33.84	31.22	28.38	26.62	23.59
YEAR-END BALANCE SHEET SUMMARY					
Loans, net	$ 85,810	$ 85,305	$ 85,372	$ 78,630	$ 79,635
Securities	41,329	45,094	43,722	43,998	31,449
Total assets	153,410	145,072	136,422	130,901	122,097
Deposits	135,211	128,189	118,424	116,537	109,299
Stockholders' equity	17,321	15,984	14,535	13,631	12,081
Interest earning assets	$147,666	$140,397	$130,458	$125,121	$115,872
Interest bearing liabilities	119,657	115,960	108,639	105,669	98,394
SELECTED RATIOS					
Return on average assets	1.3%	1.3%	1.2%	1.1%	1.2%
Return on average equity	11.5%	12.0%	11.6%	10.7%	12.7%
Dividends declared as percent of net income	28.0%	27.7%	30.3%	32.4%	29.3%

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(1) In thousands of dollars, except per share data.

(2) Reflects Bank of Floyd operations prior to formation of Cardinal Bankshares Corporation on March 12, 1996.

(3) Adjusted for the effects of a four for one stock split in 1995 and 10% stock dividend in 1997.

Dear Shareholders:

We are pleased to present the annual report of Cardinal Bankshares Corporation. Our financial statements are audited by Larrowe & Company, PLC, Certified Public Accountants.

Cardinal Bankshares Corporation experienced another year of hard work, expansion, community involvement, and financial growth.

We become an active participant in the America's Promise Program, endorsed by General Colin Powell and the American Bankers Association. Working with America's youth has much to offer the future of America and our financial industry.

We opened our Hillsville office in June 1998. The growth in our new office has surpassed our expectations. Our presence in the Carroll County market has been well received.

Our financial growth continued to be good in 1998. We again experienced record earnings while placing added funds in reserve for potential losses and paying a record $781,368.00 in federal income taxes. Net earnings of $1,938,852.00 and ending assets of $153,409.703.00 compare very favorably with peer banks.

Earnings per share increased to $3.79 for 1998 from $3.62 in 1997. We paid shareholders a cash dividend of $1.06 per share, the seventh year of increased dividends. The market value of our stock continued to perform well in 1998. Stock quotes for Cardinal can be found under the bulletin board symbol CDBK.

A significant new issue addressed in 1998 was Year 2000 or Y2K. In 1998 we made a major investment in hardware and software to assure our readiness for Year 2000 and beyond. As of the writing of this report all our mission critical systems have been tested and Y2K certified. We will continue to monitor all systems in 1999. We want to begin the new millennium on a strong and positive note, and build on our success of the past.

We thank our Board of Directors, our staff, and you our shareholders, for a very good 1998 and we look forward to a prosperous 1999.

Sincerely,

Leon Moore
President and Chief Executive Officer

J. H. Conduff
Chairman of the Board

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
Cardinal Bankshares Corporation
Floyd, Virginia

We have audited the consolidated balance sheets of Cardinal Bankshares Corporation and subsidiaries as of December 31, 1998 and 1997 and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cardinal Bankshares Corporation and subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/ Larrowe & Company, plc
Galax, Virginia
January 8, 1999

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 1998 AND 1997

	1998	1997
ASSETS		
Cash and due from banks	$ 2,985,331	$ 1,941,494
Interest-bearing deposits with banks	7,100,000	5,000,000
Federal funds sold	11,825,000	3,825,000
Investment securities available for sale	25,981,443	31,663,068
Investment securities held to maturity	15,347,979	13,430,624
Loans, net of allowance for loan losses $1,668,201 in 1998 and $1,452,126 in 1997	85,809,506	85,304,739
Property and equipment, net	2,173,693	1,687,859
Accrued income	984,457	1,093,063
Other assets	1,202,294	1,126,470
	$153,409,703	$145,072,317
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Demand deposits	$ 15,553,868	$ 12,229,167
NOW deposits	9,991,178	8,923,777
Savings deposits	18,476,177	17,507,178
Large denomination time deposits	15,666,927	15,120,658
Other time deposits	75,522,910	74,407,946
Total deposits	135,211,060	128,188,726
Accrued interest payable	240,709	269,032
Other liabilities	636,809	630,408
	136,088,578	129,088,166
Commitments and contingencies		
STOCKHOLDERS' EQUITY		
Common stock, $10 par value; 5,000,000 shares authorized; 511,911 shares issued in 1998 and 1997	5,119,110	5,119,110
Surplus	2,925,150	2,925,150
Retained earnings	9,123,733	7,727,506
Unrealized appreciation on investment securities available for sale, net of income taxes	153,132	212,385
	17,321,125	15,984,151
	$153,409,703	$145,072,317

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
INTEREST INCOME			
Loans and fees on loans	$ 8,034,738	$ 8,074,494	$ 7,472,380
Federal funds sold and securities purchased under agreements to resell	476,913	315,065	169,334
Investment securities:			
Taxable	1,843,843	2,159,381	2,177,067
Exempt from federal income tax	625,769	491,074	469,751
Deposits with banks	288,227	38,009	--
	11,269,490	11,078,023	10,288,532
INTEREST EXPENSE			
Deposits	5,797,887	5,538,989	5,288,779
Borrowings	--	142,467	17,812
	5,797,887	5,681,456	5,306,591
Net interest income	5,471,603	5,396,567	4,981,941
PROVISION FOR LOAN LOSSES	175,000	500,000	325,000
Net interest income after provision for loan losses	5,296,603	4,896,567	4,656,941
NONINTEREST INCOME			
Service charges on deposit accounts	152,001	143,794	114,280
Other service charges and fees	37,977	36,128	27,411
Net realized gains on sales of securities	27,315	7,018	5,856
Gain on sale of other real estate owned	89,637	232,732	--
Other income	182,435	123,313	195,741
	489,365	542,985	343,288
NONINTEREST EXPENSE			
Salaries and employee benefits	1,871,271	1,760,878	1,754,020
Occupancy expense	136,641	115,612	122,006
Equipment expense	274,861	273,026	230,367
Other expense	782,975	783,882	717,169
	3,065,748	2,933,398	2,823,562
Income before income taxes	2,720,220	2,506,154	2,176,667
INCOME TAX EXPENSE	781,368	652,470	593,747
Net income	$ 1,938,852	$ 1,853,684	$ 1,582,920
BASIC EARNINGS PER SHARE	$ 3.79	$ 3.62	$ 3.09
WEIGHTED AVERAGE SHARES OUTSTANDING	511,904	512,090	512,090

</TABLE>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>
<CAPTION>

	COMMON STOCK	SURPLUS	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL
<S>	<C>	<C>	<C>	<C>	<C>
BALANCE, DECEMBER 31, 1995	$ 4,655,360	$ 1,200,000	$ 7,481,589	$ 294,529	$ 13,631,478
COMPREHENSIVE INCOME					
Net income	--	--	1,582,920	--	1,582,920

Net change in unrealized appreciation on investment securities available for sale, net of taxes of $(103,019)	--	--	--	(194,121)	(194,121)
Reclassification adjustment	--	--	--	(5,856)	(5,856)
TOTAL COMPREHENSIVE INCOME					1,382,943
Dividends paid ($1.03 per share)	--	--	(479,502)	--	(479,502)
BALANCE, DECEMBER 31, 1996	4,655,360	1,200,000	8,585,007	94,552	14,534,919
COMPREHENSIVE INCOME					
Net income	--	--	1,853,684	--	1,853,684
Net change in unrealized appreciation on investment securities available for sale, net of taxes of $61,118	--	--	--	124,851	124,851
Reclassification adjustment	--	--	--	(7,018)	(7,018)
TOTAL COMPREHENSIVE INCOME					1,971,517
Dividends paid ($.51 per share)	--	--	(237,423)	--	(237,423)
10% stock dividend	465,540	1,731,790	(2,197,330)	--	--
Redemption of fractional shares	(1,790)	(6,640)	--	--	(8,430)
Dividends paid ($.54 per share)	--	--	(276,432)	--	(276,432)
BALANCE, DECEMBER 31, 1997	5,119,110	2,925,150	7,727,506	212,385	15,984,151
COMPREHENSIVE INCOME					
Net income	--	--	1,938,852	--	1,938,852
Net change in unrealized appreciation on investment securities available for sale, net of taxes of $(30,525)	--	--	--	(31,938)	(31,938)
Reclassification adjustment	--	--	--	(27,315)	(27,315)
TOTAL COMPREHENSIVE INCOME					1,879,599
Dividends paid ($1.06 per share)	--	--	(542,625)	--	(542,625)
Common stock purchased	(2,500)	--	(11,000)	--	(13,500)
Common stock reissued	2,500	--	11,000	--	13,500
BALANCE, DECEMBER 31, 1998	$ 5,119,110	$ 2,925,150	$ 9,123,733	$ 153,132	$ 17,321,125

</TABLE>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 1,938,852	$ 1,853,684	$ 1,582,920
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and amortization	176,587	190,065	166,307
Accretion of discount on securities, net of amortization of premiums	68,587	176	(73,699)
Provision for loan losses	175,000	500,000	325,000
Deferred income taxes	(82,635)	(213,850)	168,713
Net realized (gains) losses on securities	(27,315)	(7,018)	(5,857)
Deferred compensation and pension expense	65,599	70,748	38,989
Changes in assets and liabilities:			
Accrued income	108,606	(39,487)	15,908
Other assets	37,336	494,783	529,779
Accrued interest payable	(28,323)	22,032	(5,957)
Other liabilities	(59,198)	144,305	(103,546)

Net cash provided by operating activities	2,373,096	3,015,438	2,638,557
CASH FLOWS FROM INVESTING ACTIVITIES			
Net increase in interest-bearing deposits	(2,100,000)	(5,000,000)	--
Net (increase) decrease in federal funds sold	(8,000,000)	(3,325,000)	1,250,000
Purchases of investment securities	(19,326,465)	(15,236,219)	(19,551,812)
Sales of available for sale securities	12,125	2,075,317	3,466,994
Maturities of investment securities	22,947,560	11,974,853	16,137,232
Net (increase) decrease in loans	(679,767)	(437,099)	(7,106,355)
Purchases of property and equipment	(922,050)	(317,342)	(200,586)
Sales of property and equipment	259,629	--	--
Net cash used in investing activities	(7,808,968)	(10,265,490)	(6,004,527)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase (decrease) in demand, NOW, and savings deposits	5,361,101	(404,102)	1,318,505
Net increase in time deposits	1,661,233	10,168,381	569,304
Net increase (decrease) in short-term debt	--	(400,000)	400,000
Net increase (decrease) in long-term debt	--	(2,400,000)	2,400,000
Redemption of fractional shares	--	(8,430)	--
Dividends paid	(542,625)	(513,855)	(479,502)
Common stock purchased	(13,500)	--	--
Common stock reissued	13,500	--	--
Net cash provided by financing activities	6,479,709	6,441,994	4,208,307
Net increase (decrease) in cash and cash equivalents	1,043,837	(808,058)	842,337
CASH AND CASH EQUIVALENTS, BEGINNING	1,941,494	2,749,552	1,907,215
CASH AND CASH EQUIVALENTS, ENDING	$ 2,985,331	$ 1,941,494	$ 2,749,552
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Interest paid	$ 5,826,210	$ 5,659,424	$ 5,312,548
Income taxes paid	$ 874,869	$ 750,470	$ 357,964
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES			
Other real estate acquired in settlement of loans	$ --	$ 4,819	$ 39,194

</TABLE>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Cardinal Bankshares Corporation (the Company) was incorporated as a Virginia corporation on March 12, 1996 to acquire the stock of The Bank of Floyd (the Bank). The Bank was acquired by the Company on June 30, 1996.

The Bank of Floyd and its wholly-owned subsidiary, FBC, Inc., are incorporated and operate under the laws of the Commonwealth of Virginia. As a state chartered Federal Reserve member, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions and the Federal Reserve. The Bank serves the counties of Floyd, Carroll, and Roanoke, Virginia and the City of Roanoke, Virginia, through four banking offices. FBC, Inc.'s assets and operations consist primarily of annuity sales and a minority interest in a title insurance company.

The accounting and reporting policies of the Company, the Bank and FBC, Inc. follow generally accepted accounting principles and general practices within the financial services industry. Following is a summary of the more significant policies.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company, the Bank and FBC, Inc.. All material intercompany accounts and transactions are eliminated in consolidation.

BUSINESS SEGMENTS

The Company reports its activities as a single business segment. In determining the appropriateness of segment definition, the Company considers components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period.
Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for loan and foreclosed real estate losses, management obtains independent appraisals for significant properties.

The majority of the Company's loan portfolio consists of loans in Southwest Virginia. Accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio and the recovery of a substantial portion of the carrying amount of foreclosed real estate are susceptible to changes in local market conditions. The regional economy is diverse, but is influenced by the agricultural, textile and governmental segments.

While management uses available information to recognize loan and foreclosed real estate losses, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as a part of their routine examination process, periodically review the Company's allowances for loan and foreclosed real estate losses. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowances for loan and foreclosed real estate losses may change materially in the near term.

CASH AND CASH EQUIVALENTS

For purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "cash and due from banks."

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

TRADING SECURITIES

The Company does not hold securities for short-term resale and therefore does not maintain a trading securities portfolio.

SECURITIES HELD TO MATURITY

Bonds, notes, and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity or to call dates.

SECURITIES AVAILABLE FOR SALE

Available-for-sale securities are reported at fair value and consist of bonds, notes, debentures, and certain equity securities not classified as trading securities or as held-to-maturity securities.

Unrealized holding gains and losses, net of tax, on available-for-sale securities are reported as a net amount in a separate component of stockholders' equity. Realized gains and losses on the sale of available-for-sale securities are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity or to call dates.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below cost that are other than temporary are reflected as write-downs of the individual securities to fair value. Related write-downs are included in earnings as realized losses.

LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal amount adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Discounts and premiums on any purchased residential real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Discounts and premiums on any purchased consumer loans are recognized over the expected lives of the loans using methods that approximate the interest method.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received.

The allowance for loan losses is increased by charges to income and decreased by charge-offs, net of recoveries. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions.

PROPERTY AND EQUIPMENT

Land is carried at cost. Bank premises, furniture and equipment are carried at cost, less accumulated depreciation and amortization computed principally by the straight-line method over the following estimate useful lives:

	Years
Buildings and improvements	20-40
Furniture and equipment	5-20

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

FORECLOSED PROPERTIES

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in loss on foreclosed real estate. The historical average holding period for such properties is in excess of 36 months.

PENSION PLAN

The Bank maintains a noncontributory defined benefit pension plan covering all employees who meet eligibility requirements. To be eligible, an employee must be 21 years of age and have completed one year of service. Plan benefits are based on final average compensation and years of service. The funding policy is to contribute the maximum deductible for Federal income tax purposes.

INCOME TAXES

Provision for income taxes is based on amounts reported in the statements of income (after exclusion of non-taxable income such as interest on state and municipal securities) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred taxes assets and liabilities are adjusted through the provision for income taxes.

Deferred income tax liability relating to unrealized appreciation (or the deferred tax asset in the case of unrealized depreciation) on investment securities available for sale is recorded in other liabilities (assets). Such unrealized appreciation or depreciation is recorded as an adjustment to equity in the financial statements and not included in income determination until realized. Accordingly, the resulting deferred income tax liability or asset is also recorded as an adjustment to equity.

BASIC EARNINGS PER SHARE

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock splits and dividends.

DILUTED EARNING PER SHARE

The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares. For the years presented, the Company has no potentially dilutive securities outstanding.

COMPREHENSIVE INCOME

Annual comprehensive income reflects the change in the Company's equity during the year arising from transactions and events other than investments by and distributions to stockholders. It consists of net income plus certain other changes in assets and liabilities that are reported as separate components of stockholders' equity rather than as income or expense.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

FINANCIAL INSTRUMENTS

All derivative financial instruments held or issued by the Company are held or issued for purposes other than trading.

In the ordinary course of business the Company has entered into off-balance-sheet financial instruments consisting of commitments to extend credit and commercial and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

The Bank does not utilize interest-rate exchange agreements or interest-rate futures contracts.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, Disclosures about Fair Value of Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Statement No. 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

CASH AND CASH EQUIVALENTS: The carrying amounts reported in the balance sheet for cash and cash equivalents approximate their fair values.

INTEREST-BEARING DEPOSITS WITH BANKS: Fair values for time deposits are estimated using a discounted cash flow analysis that applies interest rates currently offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

AVAILABLE-FOR-SALE AND HELD-TO-MATURITY SECURITIES: Fair values for securities, excluding restricted equity securities, are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying values of restricted equity securities approximate fair values.

LOANS RECEIVABLE: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable. The carrying amount of accrued interest receivable approximates its fair value.

DEPOSIT LIABILITIES: The fair values disclosed for demand and savings deposits are, by definition, equal to the amount payable on demand at the reporting date. The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits. The carrying amount of accrued interest payable approximates fair value.

SHORT-TERM AND LONG-TERM DEBT: The carrying amounts of short-term debt approximate their fair values. The fair values for long-term debt are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

FAIR VALUE OF FINANCIAL INSTRUMENTS, CONTINUED

OTHER LIABILITIES: For fixed-rate loan commitments, fair value considers the difference between current levels of interest rates and the committed rates. The carrying amounts of other liabilities approximates fair value.

IMPACTS OF NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES. This Statement (effective for fiscal quarters beginning after June 15, 1999) establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. While the Company has not completed its analysis of all impacts of Statement No. 133, Management does not believe that implementation of the Statement will be material to the financial statements.

RECLASSIFICATION

Certain reclassifications have been made to the prior years' financial statements to place them on a comparable basis with the current year. Net income and stockholders' equity previously reported were not affected by these reclassifications.

NOTE 2. RESTRICTIONS ON CASH AND DUE FROM BANKS

To comply with banking regulations, the Company is required to maintain certain average cash reserve balances. The daily average cash reserve requirement was approximately $686,000 and $576,000 for the two week periods including December 31, 1998 and 1997, respectively.

NOTE 3. SECURITIES

Debt and equity securities have been classified in the consolidated balance sheets according to management's intent. The carrying amount of securities and their approximate fair values at December 31 follow:

1998	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
AVAILABLE FOR SALE				
U.S. Government agency securities	$ 7,897,742	$ 34,315	$ 1,070	$ 7,930,987
State and municipal securities	560,796	20,319	--	581,115

Mortgage-backed securities	15,793,265	151,472	30,238	15,914,499
Other securities	1,497,207	57,635	--	1,554,842
	$25,749,010	$ 263,741	$ 31,308	$25,981,443
HELD TO MATURITY				
State and municipal securities	$14,025,427	$ 398,185	$ 5,388	$14,418,224
Mortgaged-backed securities	684,527	2,355	2,093	684,789
Other securities	638,025	--	--	638,025
	$15,347,979	$ 400,540	$ 7,481	$15,741,038

</TABLE>

NOTE 3. SECURITIES, CONTINUED

<TABLE>
<CAPTION>

1997	AMORTIZED COST	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
AVAILABLE FOR SALE				
U.S. Government agency securities	$15,613,575	$ 40,349	$ 5,320	$15,648,604
State and municipal securities	561,886	5,106	--	566,992
Mortgage-backed securities	13,676,416	233,482	36,217	13,873,681
Other securities	1,488,980	84,811	--	1,573,791
	$31,340,857	$ 363,748	$ 41,537	$31,663,068
HELD TO MATURITY				
U.S. Government agencies securities	$ 498,191	$ 1,809	$ --	$ 500,000
State and municipal securities	11,165,507	183,311	--	11,348,818
Mortgaged-backed securities	1,156,601	5,762	7,018	1,155,345
Other securities	610,325	--	--	610,325
	$13,430,624	$ 190,882	$ 7,018	$13,614,488

</TABLE>

Investment securities with amortized cost of approximately $4,400,562 and $4,337,036 at December 31, 1998 and 1997, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

Gross realized gains and losses for the years ended December 31, 1998, 1997 and 1996 are as follows:

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Realized gains, available for sale securities	$ 27,358	$ 8,855	$ 7,000
Realized losses, available for sale securities	(43)	(1,837)	(1,144)
	$ 27,315	$ 7,018	$ 5,856

</TABLE>

The scheduled maturities of securities available for sale and held to maturity at December 31, 1998, were as follows:

<TABLE>
<CAPTION>

	AVAILABLE FOR SALE		HELD TO MATURITY	
	AMORTIZED COST	FAIR VALUE	AMORTIZED COST	FAIR VALUE
<S>	<C>	<C>	<C>	<C>
Due in one year or less	$11,196,104	$11,255,749	$ 1,342,613	$ 1,348,344
Due after one year through five years	8,181,464	8,262,834	6,573,488	6,738,523
Due after five years through ten years	5,231,515	5,306,102	6,611,939	6,833,089
Due after ten years	1,139,927	1,156,758	181,914	183,057
Restricted equity securities	--	--	638,025	638,025
	$25,749,010	$25,981,443	$15,347,979	$15,741,038

</TABLE>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS RECEIVABLE

The major components of loans in the consolidated balance sheets at December 31, 1998 and 1997 are as follows (in thousands):

<TABLE>
<CAPTION>

	1998	1997
Commercial	$ 5,630	$ 6,208
Real estate:		
Construction and land development	4,028	4,888
Residential, 1-4 families	24,545	25,629
Residential, 5 or more families	2,219	1,785
Farmland	4,134	3,905
Nonfarm, nonresidential	32,794	30,795
Agricultural	1,140	1,815
Consumer	7,244	7,689
Other	6,057	4,383
	87,791	87,097
Unearned discount	(7)	(44)
Unearned net loan origination costs, net of fees	(306)	(296)
	87,478	86,757
Allowance for loan losses	(1,668)	(1,452)
	$ 85,810	$ 85,305

<CAPTION>
Nonperforming assets at December 31, 1998 and 1997 are detailed as follows:

	1998	1997
Nonaccrual loans	$ 66,251	$ 278,782
Restructured loans	--	--
Loans past due 90 days or more	343,225	312,332
Total nonperforming loans	409,476	591,114
Foreclosed, repossessed and idled properties	101,756	210,709
Total nonperforming assets	$ 511,232	$ 801,823

</TABLE>

Gross interest income that would have been recognized for each year if the nonaccrual loans and restructured loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination, if held part of the period, is detailed below. Applicable interest income that was actually collected and included in net income for each year is also summarized below:

<TABLE>
<CAPTION>

	1998	1997	1996
NONACCRUAL LOANS:			
Interest income, original terms	$ 4,433	$ 27,239	$13,033
Interest income recognized	$ 1,140	$ 20,840	$ 3,212
RESTRUCTURED LOANS:			
Interest income, original terms	$ --	$ --	$ --
Interest income recognized	$ --	$ --	$ --

</TABLE>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS RECEIVABLE, CONTINUED

An allowance determined in accordance with SFAS No. 114 and No. 118 is provided for all impaired loans. The total recorded investment in impaired loans and the related allowance for loan losses at December 31, the average annual recorded investment in impaired loans, and interest income recognized on impaired loans for the year (all approximate) are summarized below.

	1998	1997	1996
Recorded investment at December 31	$1,103,551	$1,467,636	$2,205,464
Allowance for loan losses	$ 286,250	$ 594,105	$ 271,538
Average recorded investment for the year	$ 847,271	$ 453,875	$1,674,412
Interest income recognized for the year	$ 103,056	$ 133,973	$ 147,742

The Company is not committed to lend additional funds to debtors whose loans have been modified.

NOTE 5. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses are as follows:

	1998	1997
BALANCE, BEGINNING	$ 1,452,126	$ 1,002,455
Provision charged to expense	175,000	500,000
Recoveries of amounts charged off	117,917	17,920
Amounts charged off	(76,842)	(68,249)
BALANCE, ENDING	$ 1,668,201	$ 1,452,126

NOTE 6. PROPERTY AND EQUIPMENT

Components of property and equipment and total accumulated depreciation at December 31, 1998 and 1997, are as follows:

	1998	1997
Land	$ 377,612	$ 407,245
Bank premises	2,301,028	1,719,754
Furniture and equipment	1,867,069	1,593,952
Construction in progress	--	162,337
	4,545,709	3,883,288
Less accumulated depreciation	(2,372,016)	(2,195,429)
	$ 2,173,693	$ 1,687,859

NOTE 7. DEBT

SHORT-TERM DEBT

Short-term debt consists of short-term borrowings from Federal Home Loan Bank of Atlanta. Additional information for the years ended December 31, 1998 and 1997 is summarized below:

	1998	1997
Outstanding balance at December 31	$ --	$ --
Year-end weighted average rate	--	--
Daily average outstanding during the year	$ --	$ 63,561
Average rate for the year	--	6.89%
Maximum outstanding at any month-end during the year	$ --	$400,000

NOTE 7. DEBT, CONTINUED

SHORT-TERM DEBT, CONTINUED

The Bank has established various credit facilities to provide additional liquidity if and as needed. These include unsecured lines of credit with correspondent banks totaling $6,500,000 and a secured line of credit with the Federal Home Loan Bank of Atlanta of approximately $17,000,000. Additional amounts are available from the Federal Home Loan Bank, with additional collateral.

LONG-TERM DEBT

The Company had no long-term indebtedness at December 31, 1998 or 1997.

NOTE 8. EMPLOYEE BENEFIT PLAN

The Bank has a qualified noncontributory, defined benefit pension plan which covers substantially all of its employees. The benefits are primarily based on years of service and earnings. The following is a summary of the plan's funded status as of December 31, 1998 and 1997.

	1998	1997
CHANGE IN BENEFIT OBLIGATION		
Benefit obligation at beginning of year	$ 1,167,829	$ 984,721
Service cost	88,222	86,171
Interest cost	87,570	73,837
Plan participants' contributions	--	--
Amendments	--	--
Actuarial (gain) loss	76,439	31,599
Acquisition	--	--
Benefits paid	(139,738)	(8,499)
Benefit obligation at end of year	$ 1,280,322	$ 1,167,829
CHANGE IN PLAN ASSETS		
Fair value of plan assets at beginning of year	$ 1,156,480	$ 970,764
Actual return on plan assets	5,294	194,215
Acquisition	--	--
Employer contribution	--	--
Plan participants' contributions	--	--
Benefits paid	(139,738)	(8,499)
Fair value of plan assets at end of year	$ 1,022,036	$ 1,156,480
CHANGE IN PREPAID (ACCRUED) BENEFIT COST		
Prepaid (accrued) benefit cost, beginning	$ (266,984)	$ (196,284)
Contributions	--	--
Pension cost	(65,384)	(70,700)
Prepaid (accrued) benefit cost, ending	$ (332,368)	$ (266,984)

Funded status	$ (258,286)	$ (11,349)
Unrecognized transitional net assets	(44,313)	(48,341)
Unrecognized prior service cost	77,729	83,708
Unrecognized net actuarial (gain) loss	(107,498)	(291,002)
Prepaid (accrued) benefit cost	$ (332,368)	$ (266,984)
WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31		
Discount rate	7.5%	7.5%
Expected return on plan assets	9.0%	9.0%
Rate of compensation increase	5.0%	5.0%

</TABLE>

NOTE 8. EMPLOYEE BENEFIT PLAN, CONTINUED

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
COMPONENTS OF NET PERIODIC BENEFIT COST			
Service cost	$ 88,222	$ 86,171	$ 79,707
Interest cost	87,570	73,837	71,032
Return on plan assets	(5,294)	(194,215)	(105,080)
Originating unrecognized asset gain (loss)	(98,769)	109,015	21,974
Amortization	(6,345)	(4,108)	(5,532)
Net periodic benefit cost	$ 65,384	$ 70,700	$ 62,101

</TABLE>

NOTE 9. DEFERRED COMPENSATION AND LIFE INSURANCE

Deferred compensation plans have been adopted for certain members of the Board of Directors for future compensation upon retirement. Under plan provisions aggregate annual payments ranging from $1,568 to $8,482 are payable for ten years certain, generally beginning at age 65. Liability accrued for compensation deferred under the plan amounts to $117,625 and $117,410 at December 31, 1998 and 1997, respectively.

Charges to income are based on present value of future cash payments, discounted at 8%, and amounted to $9,408, $9,404 and $9,310 for 1998, 1997 and 1996, respectively.

The Bank is owner and beneficiary of life insurance policies on these directors. Policy cash values, net of policy loans, totaled $26,785 and $21,530 at December 31, 1998 and 1997, respectively.

NOTE 10. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of the Company's financial instruments are as follows (dollars in thousands):

<TABLE>
<CAPTION>

	DECEMBER 31, 1998		DECEMBER 31, 1997	
<S>	CARRYING AMOUNT <C>	FAIR VALUE <C>	CARRYING AMOUNT <C>	FAIR VALUE <C>
FINANCIAL ASSETS				
Cash and cash equivalents	$ 2,985	$ 2,985	$ 1,941	$ 1,941
Interest-bearing deposits with banks	7,100	7,100	5,000	5,000
Federal funds sold	11,825	11,825	3,825	3,825
Securities, available-for-sale	25,981	25,981	31,663	31,663
Securities, held to maturity	15,348	15,741	13,431	13,614
Loans, net of allowance for loan losses	85,810	89,213	85,305	87,934
FINANCIAL LIABILITIES				
Deposits	135,211	136,993	128,189	128,845
OFF-BALANCE-SHEET ASSETS (LIABILITIES)				
Commitments to extend credit and standby letters of credit	--	--	--	--
Commercial letters of credit	--	--	--	--

</TABLE>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. INCOME TAXES

CURRENT AND DEFERRED INCOME TAX COMPONENTS

The components of income tax expense (substantially all Federal) are as follows:

	1998	1997	1996
Current	$ 864,003	$ 866,320	$ 425,034
Deferred	(82,635)	(213,850)	168,713
	$ 781,368	$ 652,470	$ 593,747

RATE RECONCILIATION

A reconciliation of the expected income tax expense computed at 34% to income tax expense included in the statements of income is as follows:

	1998	1997	1996
Expected tax expense	$ 924,875	$ 852,092	$ 740,067
Tax exempt interest	(233,669)	(186,555)	(178,641)
Other	90,162	(13,067)	32,321
	$ 781,368	$ 652,470	$ 593,747

DEFERRED TAX ANALYSIS

The components of net deferred tax assets (substantially all Federal) at December 31, 1998 and 1997 are summarized as follows:

	1998	1997
Deferred tax assets	$ 731,041	$ 653,399
Deferred tax liabilities	(149,997)	(185,515)
	$ 581,044	$ 467,884

The tax effects of each significant item creating deferred taxes are summarized below:

	1998	1997
Net unrealized appreciation on securities available for sale	$ (79,301)	$(109,826)
Allowance for loan losses	383,999	324,499
Other valuation reserves	85,520	89,370
Deferred compensation and accrued pension costs	152,998	130,694
Depreciation	(47,774)	(37,718)
Accretion of discount on investment securities	(22,922)	(37,971)
Deferred loan fees	108,524	108,836
	$ 581,044	$ 467,884

NOTE 12. COMMITMENTS AND CONTINGENCIES

LITIGATION

In the normal course of business, the Company is involved in various legal proceedings. After consultation with legal counsel, management believes that any liability resulting from such proceedings will not be material to the consolidated financial statements.

NOTE 12. COMMITMENTS AND CONTINGENCIES, CONTINUED

FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to loan loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance-sheet instruments. A summary of the Bank's commitments at December 31, 1998 and 1997, is as follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>
Commitments to extend credit	$7,097,000	$7,348,000
Standby letters of credit	132,000	307,000
	$7,229,000	$7,655,000

</TABLE>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, crops, livestock, inventory, property and equipment, residential real estate and income producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

CONCENTRATIONS OF CREDIT RISK

The majority of the Company's loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Company's market area. The majority of such customers are depositors of the Bank. Investments in state and municipal securities involve governmental entities within and outside the Company's market area. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit are granted primarily to commercial borrowers. The Company, as a matter of policy, does not extend credit to any single borrower or group of related borrowers in excess of approximately $1,750,000. Although the Bank has a reasonably diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon economic conditions in and around Floyd, Carroll, and Roanoke Counties and the City of Roanoke, Virginia. A significant amount of the real estate loans set forth in Note 4 are secured by commercial real estate. In addition, the Company has a loan concentration relating to customers who are motel and bed-and-breakfast owners and operators. Total loans and loan commitments to this industrial group amounted to approximately $8,894,020 and $6,439,303 at December 31, 1998 and 1997, respectively.

The Company has cash and cash equivalents on deposit with financial institutions which exceed federally-insured limits.

NOTE 12. COMMITMENTS AND CONTINGENCIES, CONTINUED

YEAR 2000

Like most financial service providers, the Company and its operations could be significantly affected by the Y2K issue due to its dependence on technology and date-sensitive data. Computer software and hardware and other equipment, both within and outside the Company's direct control, and third parties with whom the Company electronically or operationally interfaces (including without limitation its customers and third party vendors) could be affected. If computer systems are not modified in order to be able to identify the year 2000, many computer applications could fail or create erroneous results. Likewise, under certain circumstances, a failure to adequately address the Y2K issue could adversely affect the viability of the Company's suppliers and creditors and the creditworthiness of its borrowers. Thus, if not adequately addressed, the Y2K issue could result in a significant adverse impact on the Company's operations and, in turn, its financial condition and results of operations.

The Company has formulated its plan to address the Y2K issue. Following are the primary phases of the Company's Y2K plan:

1. Awareness phase
2. Assessment phase
3. Renovation phase
4. Validation or testing phase
5. Implementation phase

The Company is expensing a majority of the costs associated with required system changes as those costs are incurred, and such costs are being funded through operating cash flows.

During the awareness phase, Company management and the Board of Directors became aware of the Y2K issue and potential risks. During the assessment phase, Company management identified all hardware, software, and environmental systems such as security systems, elevators, vaults and customer/vendor interdependencies affected by the Y2K date change. These items and systems were prioritized by assigning a significance rating of mission critical, mission necessary, mission desirable, or mission unrelated. During the renovation phase management performed necessary computer hardware and software upgrades and other system replacements. During June 1998, management upgraded the mainframe computer. By the end of the third quarter of 1999, management anticipates implementing a wide area network which will enhance productivity and customer service.

During the validation and implementation phase, Company management tested all mission critical applications falling into the categories of its core-banking software, the Federal Reserve Fedline System, and new account and loan processing systems. The Company has received warranties from vendors to the effect of the core-banking software, the Federal Reserve Fedline System, and new account and loan processing systems. In addition to the vendor warranties, Company management has tested the mission critical systems and certified them as Y2K compliant as of January 18, 1999.

With respect to each third party with whom the Company interfaces electronically or from whom it obtains significant services or supplies, the Company has requested information regarding that party's preparations and state of preparedness with respect to Y2K issues. Interruptions in the services provided by such third parties have been taken into account in the Company's contingency plans (which, for example, provide for increased inventories of business forms and supplies, increased levels of cash on hand, the use of a back-up site for the Company's main computer system and operation functions, manual processing of branch transactions, clearing of checks through a correspondent bank rather than the Federal Reserve and, if necessary, a change to a different third party supplier).

LEASES

During 1997 the bank leased a building used as a branch location under an operating lease. Rental expense in 1998 and 1997 was $3,720 and $1,125, respectively. Future minimum lease payments are $1,500 in 1999 and $375 in 2000.

NOTE 13. REGULATORY RESTRICTIONS

DIVIDENDS

The Company's dividend payments are made from dividends received from the Bank. The Bank, as a Virginia banking corporation, may pay dividends only out of its retained earnings. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such a limitation is in the public interest and is necessary to ensure financial soundness of the Bank.

INTERCOMPANY TRANSACTIONS

The Bank's legal lending limit on loans to the Company are governed by Federal Reserve Act 23A, and differ from legal lending limits on loans to external customers. Generally, a bank may lend up to 10% of its capital and surplus to its Parent, if the loan is secured. If collateral is in the form of stocks, bonds, debentures or similar obligations, it must have a market value when the loan is made of at least 20% more than the amount of the loan, and if obligations of a state or political subdivision or agency thereof, it must have a market value of at least 10% more than the amount of the loan. If such loans are secured by obligations of the United States or agencies thereof, or by notes, drafts, bills of exchange or bankers' acceptances eligible for rediscount or purchase by a Federal Reserve Bank, requirements for collateral in excess of the loan amount do not apply. Under this definition, the legal lending limit for the Bank on loans to the Company was approximately $1,252,900 at December 31, 1998. No 23A transactions were deemed to exist between the Company and the Bank at December 31, 1998.

CAPITAL REQUIREMENTS

The Company is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets, as all those terms are defined in the regulations. Management believes, as of December 31, 1998, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 1998, the most recent notification from the Federal Reserve categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

NOTE 13. REGULATORY RESTRICTIONS, CONTINUED

CAPITAL REQUIREMENTS, CONTINUED

The Bank's actual capital amounts and ratios are also presented in the table (in thousands).

<TABLE>
<CAPTION>

	ACTUAL		REQUIRED FOR CAPITAL ADEQUACY PURPOSES		TO BE WELL CAPITALIZED UNDER PROMPT CORRECTIVE ACTION PROVISIONS	
	AMOUNT	RATIO	AMOUNT	RATIO	AMOUNT	RATIO
<S>	<C>	<C>	<C>	<C>	<C>	<C>
DECEMBER 31, 1998:						
Total Capital						
(to Risk-Weighted Assets)	$ 13,501	15.1%	>$7,159	>8.0%	>$8,948	>10.0%

Tier I Capital (to Risk-Weighted Assets)	$ 12,376	13.8%	>$3,579	>4.0%	>$5,369	> 6.0%
Tier I Capital (to Average Assets)	$ 12,376	8.2%	>$6,066	>4.0%	>$7,582	> 5.0%
DECEMBER 31, 1997:						
Total Capital (to Risk-Weighted Assets)	$ 13,084	14.3%	>$7,315	>8.0%	>$9,144	>10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 11,938	13.0%	>$3,658	>4.0%	>$5,487	> 6.0%
Tier I Capital (to Average Assets)	$ 11,938	8.2%	>$5,777	>4.0%	>$7,221	> 5.0%

</TABLE>

NOTE 14. TRANSACTIONS WITH RELATED PARTIES

The Bank has entered into transactions with its directors, significant shareholders and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

Aggregate 1998 and 1997 loan transactions with related parties were as follows:

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>
BALANCE, BEGINNING	$ 926,805	$ 900,464
New loans	590,946	575,194
Repayments	(693,999)	(548,853)
Relationship changes	(51,399)	--
BALANCE, ENDING	$ 772,353	$ 926,805

</TABLE>

NOTE 15. PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information of Cardinal Bankshares Corporation is presented as follows:

BALANCE SHEETS
DECEMBER 31, 1998 AND 1997

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>
ASSETS		
Cash due from banks	$ 3,011,801	$ 1,996,076
Loans, net of allowance for loan losses of $25,000 in 1998 and 1997	1,722,064	1,797,087
Investment in affiliate bank at equity	12,528,906	12,150,482
Other assets	58,568	48,174
	$17,321,339	$15,991,819
LIABILITIES		
Accounts payable and other liabilities	$ 214	$ 7,668
SHAREHOLDERS' EQUITY		
Common stock	5,119,110	5,119,110

Surplus	2,925,150	2,925,150
Retained earnings	9,123,733	7,727,506
Unrealized appreciation on affiliate's investment securities available for sale, net of income taxes	153,132	212,385
	17,321,125	15,984,151
	$17,321,339	$15,991,819

</TABLE>

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997
AND THE SIX MONTHS ENDED DECEMBER 31, 1996

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
INCOME:			
Dividends from affiliate bank	$ 1,500,000	$ 1,100,000	$ 3,750,000
Interest on taxable securities	160,679	207,432	17,512
Other income	1,429	--	--
	1,662,108	1,307,432	3,767,512
EXPENSES:			
Salaries	88,078	27,166	--
Management and professional fees	37,692	132,588	30,794
Other expenses	34,443	25,791	30,452
	160,213	185,545	61,246
Income before tax benefit and equity in undistributed income of affiliate	1,501,895	1,121,887	3,706,266
INCOME TAX (EXPENSE) BENEFIT	(720)	(8,308)	15,611
Income before equity in undistributed income of affiliate	1,501,175	1,113,579	3,721,877
EQUITY IN UNDISTRIBUTED INCOME OF AFFILIATE	437,677	740,105	(2,914,620)
Net income	$ 1,938,852	$ 1,853,684	$ 807,257

</TABLE>

NOTE 15. PARENT COMPANY FINANCIAL INFORMATION, CONTINUED

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997
AND THE SIX MONTHS ENDED DECEMBER 31, 1996

<TABLE>
<CAPTION>

<S>	1998 <C>	1997 <C>	1996 <C>
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 1,938,852	$ 1,853,684	$ 807,257
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization	5,929	5,929	2,564
Provision for loan losses	--	--	25,000
Increase (decrease) in equity in undistributed income of affiliate	(437,677)	(740,105)	2,914,620
Deferred income taxes	--	--	(8,500)
Net change in other assets	(16,323)	2,096	(50,263)
Net change in other liabilities	(7,454)	6,024	1,644
Net cash provided by operating activities	1,483,327	1,127,628	3,692,322
CASH FLOWS FROM INVESTING ACTIVITIES, NET (INCREASE) DECREASE IN LOANS	75,023	570,424	(2,392,511)

CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends paid	(542,625)	(513,855)	(479,502)
Redemption of fractional shares	--	(8,430)	--
Common stock purchased	(13,500)	--	--
Common stock reissued	13,500	--	--
Net cash used by financing activities	(542,625)	(522,285)	(479,502)
Net increase in cash and cash equivalents	1,015,725	1,175,767	820,309
CASH AND CASH EQUIVALENTS, BEGINNING	1,996,076	820,309	--
CASH AND CASH EQUIVALENTS, ENDING	$ 3,011,801	$ 1,996,076	$ 820,309

</TABLE>

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS

OVERVIEW

Management's Discussion and Analysis is provided to assist in the understanding and evaluation of Cardinal Bankshares Corporation's financial condition and its results of operations. The following discussion should be read in conjunction with the Corporation's consolidated financial statements.

Cardinal Bankshares Corporation, the parent company of The Bank of Floyd, currently operates four offices in Floyd, Roanoke and Carroll Counties of Virginia. The main office is in Floyd with a limited service office in Willis. The Roanoke office is in the Cave Spring area of Roanoke County. The Hillsville office is located in Carroll County on Route 52 in Hillsville, Virginia.

The individual market conditions of each county vary from rural to urban with Floyd County being the most rural and Roanoke the most urban. Each have their own growth patterns which vary in intensity. The closing of the Cross Creek Apparel manufacturing plant and Skyline Manufacturing have had an impact on the Floyd economy and will continue to impact the economy during 1999. The Bank of Floyd and bank personnel work with local government and leaders in an effort to attract industry to Floyd County.

The earnings position of the Bank continues to improve. Cardinal Bankshares Corporation experienced record net earnings for 1998, $1,938,852 compared to $1,853,684 for 1997 and $1,582,920 in 1996. Return on average assets was 1.3% for 1998 and 1997 compared to 1.2% for 1996. During 1998 revenues from the Bank of Floyd represent 98.6% of Cardinal Bankshares Corporation's total revenues. Revenues from the Bank of Floyd represented 98.2% of Cardinal Bankshares Corporation's total 1997 revenues and 99.8% of 1996 total revenues.

Average equity to average assets shows the Bank with a strong capital position with a ratio of 11.4%.

The total assets of Cardinal Bankshares Corporation grew to $153,409,703 from $145,072,317, a 5.75% increase, continuing our strategy to grow the Company. Foreclosed properties were reduced by 51.7% to a balance of $101,756 at year end.

Management continues to look at increasing market share by expanding to contiguous markets as it becomes feasible, with capital generated through normal earnings supporting growth of the Company. Management of Cardinal Bankshares Corporation has no plans to raise new capital from external sources to finance expansion activities in the foreseeable future.

TABLE 1. NET INTEREST INCOME AND AVERAGE BALANCES (THOUSANDS)

<TABLE>
<CAPTION>

	1998			1997			1996		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income Expense	yield/ Cost
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Interest earning assets:									
Deposit in other banks	$ 5,278	$ 288	5.46%	$ 652	$ 38	5.83%	$ -	$ -	- %
Taxable investment securities	28,845	1,844	6.39%	31,364	2,159	6.88%	32,540	2,177	6.69%
Nontaxable investment securities	13,331	626	4.70%	10,183	491	4.82%	8,660	470	5.43%
Federal funds sold	9,040	477	5.28%	5,743	315	5.48%	3,187	169	5.30%
Loans, net	83,611	8,035	9.61%	86,528	8,075	9.33%	80,721	7,473	9.26%
Total interest-earning assets	140,105	11,270		134,470	11,078		125,108	10,289	
Yield on average interest-earning assets			8.04%			8.24%			8.22%
Noninterest-earning assets:									
Cash and due from banks	2,150			1,942			1,912		
Premises and equipment	2,020			1,593			1,572		
Interest receivable and other	4,473			3,524			2,668		
Total noninterest-earning assets	8,643			7,059			6,152		
Total assets	$148,748			$141,529			$131,260		
Interest-bearing liabilities:									
Demand deposits	$ 8,892	$ 250	2.81%	$ 8,766	$ 253	2.89%	$ 8,263	$ 208	2.52%
Savings deposits	18,055	582	3.22%	18,096	582	3.22%	18,530	588	3.17%
Time deposits	88,100	4,966	5.64%	83,002	4,703	5.67%	78,630	4,493	5.71%
Other borrowings	-	-	- %	2,485	143	5.75%	306	18	5.88%
Total interest-bearing liabilities	115,047	5,798		112,349	5,681		105,729	5,307	
Cost on average interest-bearing liabilities			5.04%			5.06%			5.02%
Noninterest-bearing liabilities									
Demand deposits	15,537			12,863			11,043		
Interest payable and other	1,272			908			831		
Total noninterest-bearing liabilities	16,809			13,771			11,874		
Total liabilities	131,856			126,120			117,603		
Stockholders' equity	16,892			15,409			13,657		
Total liabilities and stockholders' equity	$148,748			$141,529			$131,260		
Net interest income		$ 5,472			$ 5,397			$ 4,982	
Net yield on interest-earning assets			3.91%			4.01%			3.98%

</TABLE>

TABLE 2. RATE/VOLUME VARIANCE ANALYSIS (THOUSANDS)

<TABLE>
<CAPTION>

	1998 COMPARED TO 1997			1997 COMPARED TO 1996		
	Interest Income/ Expense Variance	Variance Attributable To		Interest Income/ Expense Variance	Variance Attributable To	
		Rate	Volume		Rate	Volume
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Interest-earning assets:						
Deposits in other banks	$ 250	$ (20)	$ 270	$ 38	$ --	$ 38
Taxable investment securities	(315)	(142)	(173)	(18)	60	(78)
Nontaxable investment securities	135	(17)	152	21	(63)	84
Federal funds sold	162	(19)	181	146	11	135
Loans	(40)	232	(272)	602	68	534
Total	192	34	158	789	76	713
Interest-bearing liabilities:						
Demand deposits	(3)	(7)	4	45	32	13
Savings deposits	--	1	(1)	(6)	8	(14)
Time deposits	263	(26)	289	210	(33)	243
Other borrowings	(143)	--	(143)	125	--	125
Total	117	(32)	149	374	7	367
Net interest income	$ 75	$ 66	$ 9	$ 415	$ 69	$ 346

</TABLE>

NET INTEREST INCOME

Net interest income, the principal source of bank earnings, is the amount of income generated by earning assets (primarily loans and investment securities) less the interest expense incurred on interest-bearing liabilities (primarily deposits used to fund earning assets). Table 1 summarizes the major components of net interest income for the past three years and also provides yields and average balances.

Net interest income in 1998 increased by 1.30% to $5.47 million from $5.40 million in 1997 and $4.98 million in 1996. The increase in net interest income realized in 1998 was the result of a $5.64 million increase in the volume of average interest earning assets. Competition for deposits and loans continue to be a major factor in net margins. Predatory pricing and competition from unregulated organizations have also been a factor in the declining net interest margin. The net interest margin for 1998 was 3.91% compared to 4.01% for 1997 and 3.98% for 1996. Net interest income in 1997 increased by $415,000, or 8.33%, over 1996. The increase in net interest income realized in 1997 was the result of an increase in the volume of net average earning assets and a 3 basis point increase in net interest margin. The effects of changes in volumes and rates on net interest income in 1998 compared to 1997, and 1997 compared to 1996 are shown in Table 2.

Interest income for 1998 increased $200,000 to $11.3 million from $11.1 million in 1997. Interest income in 1996 totaled $10.3 million. The increase in interest income from 1997 to 1998 was the result of an increase in the volume of deposits in other banks, federal funds sold and nontaxable investment securities along with a 28 basis point increase in the yield on net average loans. The increase in interest income from 1996 to 1997 was the result of an increase in the volume of average earning assets and a 2 basis point increase in yield.

Interest expense increased by $117,000 in 1998 to $5.8 million from $5.7 million in 1997 and $5.3 million in 1996. The increase from 1997 to 1998 was due primarily to a $5.1 million or 6.1% increase in the volume of time deposits. Interest expense increased by $374,000 from 1996 to 1997. The increase was due to the average interest bearing liabilities increasing by $6.6 million while the average rate paid on interest bearing liabilities increased by 4 basis points. Interest paid on time deposits, which make up the largest portion of interest-bearing deposits, increased $263,000, or 5.59% from 1997 to 1998. This increase is due primarily to a $5.1 million increase in the volume of time deposits. The average rate paid on time deposits decreased 3 basis points to 5.64% in 1997 from 5.67% in 1997 and 5.71% in 1996.

PROVISION FOR LOAN LOSSES

The allowance for loan losses is established to provide for potential losses in the Bank's loan portfolio. Loan losses and recoveries are charged or credited directly to the allowance. Management determines the provision for loan losses required to maintain an allowance adequate to provide for any potential losses. The factors considered in making this decision are the collectibility of past due loans, volume of new loans, composition of the loan portfolio, and general economic outlook.

In 1998, management decreased the provision for loan loss reserve from $500,000 in 1997 to $175,000 in 1998. The provision for loan losses was $325,000 in 1996. The Bank's allowance for loan losses as a percentage of total loans at the end of 1998 was 1.91% as compared to 1.67% in 1997 and 1.16% in 1996. When compared to the most recent available peer bank information as of September 30, 1998 the allowance for loan losses as percentage of total loans at the end of 1998 was in the top 10% of all peer banks.

Additional information is contained in Tables 12, 13 and 14, and is discussed in Nonperforming and Problem Assets.

OTHER INCOME

Noninterest income consists of revenues generated from a broad range of financial services and activities. The majority of noninterest income is a result of service charges on deposit accounts including charges for insufficient funds checks and fees charged for nondeposit services. Noninterest income totaled $489,000 in 1998, a decrease of 9.9% from the $543,000 recorded in 1997. Noninterest income in 1996 totaled $343,000. The majority of the decrease in noninterest income from 1997 to 1998 is explained by a lower amount of gains on the sale of other real estate owned. The $8,000 increase in insurance commissions is due to an increase in dividends from title insurance sales and annuity sales by the Bank of Floyd's subsidiary. The primary sources of noninterest income for the past three years are summarized in Table 3.

TABLE 3. SOURCES OF NONINTEREST INCOME (THOUSANDS)

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Service charges on deposit accounts	$152	$144	$114
Other service charges and fees	38	36	27
Insurance commissions	54	4	12
Gain on the sale of securities	27	7	6
Gain on sale of other real estate owned	90	233	--
Other income	128	77	184
Total noninterest income	$489	$543	$343

</TABLE>

Other noninterest income was up $51,000 in 1998 to $128,000 from $77,000 in 1997 and $184,000 in 1996. Noninterest income includes fees charged for various bank services such as safe deposit box rental fees, letters of credit fees, and gains realized on the sale of fixed assets.

OTHER EXPENSE

Noninterest expense for 1998 increased by $133,000 or 4.5% to $3.1 million. Noninterest expense in 1997 was $2.9 million and it was $2.8 million in 1996 (see Table 4). The overhead ratio of noninterest expense to adjusted total revenues (net interest income plus noninterest income excluding securities transactions) was 52.6% in 1998, 50.8% in 1997 and 53.1% in 1996.

Occupancy expense increased $21,000 or 18.1% to $137,000 in 1998 from $116,000 in 1997. This increase is due to an increased building depreciation expense of $7,871, a utilities expense increase of $4,345, other occupancy expense increase of $3,682, real estate tax increase of $1,258 and leasehold improvement depreciation expense increase of $943. These increases are due primarily to the addition of the Hillsville branch during June. In addition, leasehold improvement depreciation expenses relating to the Willis branch were realized for a full year versus approximately six months in 1997.

TABLE 4. SOURCES OF NONINTEREST EXPENSE (THOUSANDS)

	1998	1997	1996
Salaries & wages	$1,386	$1,298	$1,242
Employee benefits	485	463	512
Total personnel expense	1,871	1,761	1,754
Occupancy expense	137	116	122
Furniture & equipment	275	273	230
Printing & supplies	55	44	54
FDIC deposit insurance	15	14	2
Professional services	119	120	177
Postage	76	72	69
Telephone	49	40	33
Courier fees	29	21	21
Education & seminars	17	20	13
Travel expense	17	21	27
Director fees and expense	48	38	40
Advertising and public relations	33	31	38
Insurance expense	33	36	37
Capital Stock Tax	97	77	98
Outside services	28	26	--
Other real estate expense, net	4	46	35
Real estate loan servicing fee	16	12	16
Other operating expense	147	165	58
Total noninterest expense	$3,066	$2,933	$2,824

Other real estate expense decreased $42,000 or 91.3% to $4,000 in 1998 from $46,000 in 1997. This decrease is the result of the disposal of a number of properties reducing the net other real estate owned balance by $108,953 or 51.7% from $210,709 as of December 31, 1997 to $101,756 as of December 31, 1998. The sale of these properties reduces the amount of nonperforming assets and also increases the amount of earning assets available to the bank.

Printing and supplies expense increased $11,000 or 25.0% from $44,000 in 1997 to $55,000 in 1998. The primary reason for this increase was a $16,098 increase in office supply printing attributed to the Hillsville branch and Year 2000 disclosures.

The increase occurring during 1998 in the remaining categories of noninterest expense was primarily attributable to the higher level of activity associated with the growth in deposits. Table 4 provides a further breakdown of noninterest expense for the past three years.

INCOME TAXES

Income tax expense is based on amounts reported in the statements of income (after adjustments for non-taxable income and non-deductible expenses) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. The deferred tax assets and liabilities represent the future Federal income tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled.

Income tax expense (substantially all Federal) was $781,368 in 1998, $652,470 in 1997 and $593,747 for 1996 representing 28.7%, 26.0% and 27.3% of income before income taxes, respectively. The tax expense increased $128,898 or 19.8% from 1997 to 1998.

The Bank's deferred income tax benefits and liabilities result primarily from temporary differences (discussed above) in provisions for credit losses, valuation reserves, depreciation, deferred compensation, deferred income, pension expense, and investment security discount accretion.

Net deferred income tax benefits of $581,000, $468,000 and $315,000 at December 31, 1998, 1997, and 1996, respectively, are included in other assets. At December 31, 1998, $79,301 of the total deferred tax liability is applicable to unrealized appreciation on investment securities available for sale. Accordingly, this amount was not charged to income but recorded directly to the related stockholders' equity account.

YEAR 2000 (Y2K) ISSUES

Y2K refers to the potential disruption to computers lacking the ability to recognize years beyond 1999. During September 1997, management of the Bank formed a Y2K committee to identify, monitor, and control the potential risks associated with the Y2K computer problem. These risks include the inability to process loan and deposit transactions such as payments and computation of interest due to a computer failure. Another risk is a possible disruption to bank operations due to the failure of equipment that relies on embedded technology such as microprocessors. Other risks include disruptions in operations of the bank's service vendors and large loan and deposit customers.

Total estimated expenses to assess and control Y2K risks are $180,000 for the time period from September 1997 to March 2000. These expenses include the following: (1) management time involved during risk assessment and testing, (2) expenses for Y2K training conferences attended by management, (3) expenses for seminars held by The Bank of Floyd for bank customers, (4) expenses for hardware and software upgrades, (5) and potential increases in legal expenses. Total expenditures through December 31, 1998 are $138,184 or 77% of the total estimated expenses.

Bank management has established a Y2K plan with the following five phases: awareness, assessment, renovation, validation and implementation. During the awareness phase, management and the board of directions became aware of the Y2K issue and potential risks. During the assessment phase, management identified all hardware, software, and environmental systems such as security systems, elevators, vaults and customer/vendor interdependencies affected by the Y2K date change. These items and systems were prioritized by assigning a significance rating of mission critical, mission necessary, mission desirable, or mission unrelated. During the renovation phase management performed necessary computer hardware and software upgrades and other system replacements. During June 1998, management upgraded the mainframe computer. By the end of the third quarter of 1999, management anticipates implementing a wide area network which will enhance productivity and customer service.

During the validation and implementation phase management tested all mission critical applications. All mission critical systems were certified as Y2K compliant as of January 18th, 1999. These mission critical systems include the following items: mainframe hardware, software and interfaces with other bank computer systems; the Federal Reserve Fedline system; and new account and loan processing systems.

The Y2K risks involved in a worst case scenario involve malfunctions with mission critical or mission desirable applications and systems. For example, if certain systems such as the mainframe computer were to malfunction it would be almost impossible to operate the bank without a backup system. If certain loan and deposit processing software were to malfunction it would be difficult to extend loans and open deposit accounts without an alternate process. Other disruptions beyond management control would include loss of electrical and telephone service.

To deal with the worst case possibilities, bank management has established a Y2K contingency plan. This contingency plan includes identifying and using other vendors who are fully Y2K compliant for critical functions, and maintaining supplies necessary to perform functions manually. To plan for a mainframe computer malfunction, management has back up arrangements in place with a third party to use a comparable mainframe. Management has in place manual, paper based processes in the event of the failure of loan and deposit processing software. Bank management has maintained constant communication with electric and telephone companies to evaluate their Y2K efforts and allow the Bank of Floyd to develop needed plans. The Federal Reserve bank will have the ability to ship extra currency to various locations to cover any potential increased demand for currency.

EARNING ASSETS

Average earning assets increased 4.2% over the past twelve months. Total earning assets represented 94.2% of total average assets in 1998 compared to 95.0% in 1997. The mix of average earning assets changed in 1998 with an increase in the mix of federal funds sold and interest bearing bank balances and a decrease in the mix of loans. Average federal funds sold accounted for 6.1% of total average assets compared to 4.1% in 1997. Average interest bearing bank balances accounted for 3.6% of total average assets compared to 0.5% in 1997. Average loans accounted for 56.2% of total average assets in 1998 compared to 61.1% in 1997. For 1996, average net loans represented 61.5% of average assets. A summary of average assets for the past three years is shown in Table 5.

TABLE 5. AVERAGE ASSET MIX (THOUSANDS)

<TABLE>
<CAPTION>

	1998		1997		1996	
	Average Balance	%	Average Balance	%	Average Balance	%
<S>	<C>	<C>	<C>	<C>	<C>	<C>
EARNING ASSETS:						
Loans, net	$ 83,611	56.21	$ 86,528	61.14	$ 80,721	61.50
Investment securities	42,176	28.35	41,547	29.36	41,200	31.39
Federal funds sold	9,040	6.08	5,743	4.06	3,187	2.42
Interest-bearing bank balances	5,278	3.55	652	0.45	--	0.00
Total earning assets	140,105	94.19	134,470	95.01	125,108	95.31
NONEARNING ASSETS:						
Cash and due from banks	2,150	1.44	1,942	1.37	1,912	1.46
Premises and equipment	2,020	1.36	1,593	1.13	1,572	1.20
Other assets	4,473	3.01	3,524	2.49	2,668	2.03
Total nonearning assets	8,643	5.81	7,059	4.99	6,152	4.69
Total assets	$148,748	100.00	$141,529	100.00	$131,260	100.00

</TABLE>

LOANS

Average net loans totaled $83.6 million during 1998, a decrease of $2.9 million or 3.4% less than 1997. A significant portion of the loan portfolio, $67.7 million or 77.1%, is made up of loans secured by various types of real estate. Total loans secured by 1-4 family residential properties represented 28% of total loans at the end of 1998. The loans represented in the other loan classification in Table 6 increased by 38.2% during 1998 to a total of $6.1 million, or 6.9% of total loans outstanding compared to a total of $4.4 million at the end of 1997. The growth in the other loan classification is primarily the result of an increase in commercial loans to leasing companies.

The Bank makes both consumer and commercial loans to all neighborhoods within its market area, including the low- and moderate-income areas. The market area is generally defined to be all or portions of the Floyd, Roanoke, Montgomery and Carroll Counties of Virginia and the Cities of Roanoke and Radford, Virginia. The Bank places emphasis on consumer based installment loans and commercial loans to small and medium sized businesses. The local Floyd economy experienced the closure of the Cross Creek Apparel manufacturing plant in 1998. Predatory pricing and competition from unregulated organizations have also been a factor when generating new loans. The amounts of loans outstanding by type at year-end 1998 and 1997, and the maturity distribution of variable and fixed rate loans as of year-end 1998 are presented in Table 6 and Table 7, respectively.

TABLE 6. LOAN PORTFOLIO SUMMARY (THOUSANDS)

<TABLE>
<CAPTION>

	DECEMBER 31, 1998		DECEMBER 31, 1997	
	Amount	%	Amount	%
<S>	<C>	<C>	<C>	<C>
Construction and development	$ 4,028	4.59	$ 4,888	5.61
Farmland	4,134	4.71	3,905	4.48
1-4 family residential	24,545	27.96	25,629	29.43
Multifamily residential	2,219	2.53	1,785	2.05
Nonfarm, nonresidential	32,794	37.35	30,795	35.66
Total real estate	67,720	77.14	67,002	76.93
Agricultural	1,140	1.30	1,815	2.08
Commercial & industrial	5,630	6.41	6,208	7.13
Consumer	7,244	8.25	7,689	8.83
Other	6,057	6.90	4,383	5.03
Total	$87,791	100.00	$87,097	100.00

</TABLE>

Interest rates charged on loans vary with the degree of risk, maturity and amount of the loan. Competitive pressures, money market rates, availability of funds, and government regulation also influence interest rates. On average, loans yielded 9.61% in 1998 compared to an average yield of 9.33% in 1997.

TABLE 7. MATURITY SCHEDULE OF LOANS (THOUSANDS)

<TABLE>
<CAPTION>

	COMMERCIAL FINANCIAL AND AGRICULTURE	CONSTRUCTION AND DEVELOPMENT	OTHERS	TOTAL AMOUNT	TOTAL %
<S>	<C>	<C>	<C>	<C>	<C>

FIXED RATE LOANS:					
Three months or less	$ 469	$ --	$ 897	$ 1,366	1.56
Over three months to twelve months	581	--	1,507	2,088	2.38
Over twelve months to three years	3,236	--	6,972	10,208	11.63
Over three years to five years	2,331	--	7,435	9,766	11.12
Over five years to fifteen years	5,365	10	3,775	9,150	10.42
Over fifteen years	257	--	2,301	2,558	2.91
Total fixed rate loans	$12,239	$ 10	$22,887	$35,136	40.02
VARIABLE RATE LOANS:					
Three months or less	$ 7,286	$ 2,547	$ 3,425	$13,258	15.10
Over three months to twelve months	9,389	--	5,554	14,943	17.02
Over twelve months to three years	9,321	--	7,781	17,102	19.49
Over three years to five years	4,343	529	1,538	6,410	7.30
Over five years to fifteen years	--	942	--	942	1.07
Over fifteen years	--	--	--	--	0.00
Total variable rate loans	$30,339	$ 4,018	$18,298	$52,655	59.98
TOTAL LOANS:					
Three months or less	$ 7,755	$ 2,547	$ 4,322	$14,624	16.66
Over three months to twelve months	9,970	--	7,061	17,031	19.40
Over twelve months to three years	12,557	--	14,753	27,310	31.11
Over three years to five years	6,674	529	8,973	16,176	18.43
Over five years to fifteen years	5,365	952	3,775	10,092	11.50
Over fifteen years	257	--	2,301	2,558	2.91
Total loans	$42,578	$ 4,028	$41,185	$87,791	100.00

</TABLE>

INVESTMENT SECURITIES

The Bank uses its investment portfolio to provide liquidity for unexpected deposit decreases or loan generation, to meet the Bank's interest rate sensitivity goals, and to generate income.

Management of the investment portfolio has always been conservative with virtually all investments taking the form of purchases of U.S. Treasury, U.S. Government agencies, Mortgage Backed Securities and State and local bond issues. Management views the investment portfolio as a source of income, and purchases securities with the intent of retaining them until maturity. However, adjustments are necessary in the portfolio to provide an adequate source of liquidity which can be used to meet funding requirements for loan demand and deposit fluctuations and to control interest rate risk. Therefore, from time to time, management may sell certain securities prior to their maturity. Table 8 presents the investment portfolio at the end of 1998 by major types of investments and maturity ranges. Maturities may differ from scheduled maturities in mortgage-backed securities because the mortgages underlying the securities may be called or repaid prior to

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the scheduled maturity date. Maturities on all other securities are based on the earlier of the contractual maturity or the call date, if any.

The interest rate environment in 1998 caused the average yield of the investment portfolio to decrease to 5.89% from 6.30% in 1997. At December 31, 1998, the market value of the investment portfolio was $41.7 million, representing a $625,000 appreciation over amortized cost. This compared to a market value of $45.3 million and a $507,000 appreciation over amortized cost a year earlier.

TABLE 8. INVESTMENT SECURITIES (THOUSANDS)

<TABLE>
<CAPTION>
DECEMBER 31, 1998

AMORTIZED COST DUE

	IN ONE YEAR OR LESS	AFTER ONE THROUGH FIVE YRS.	AFTER FIVE THROUGH TEN YRS.	AFTER TEN YEARS	RESTRICTED EQUITY SECURITIES	TOTAL	MARKET VALUE
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
INVESTMENT SECURITIES:							
U.S. Government agencies							
and Mortgage Backed Securities	$ 10,703	$ 7,574	$ 4,777	$ 1,322	--	$24,376	$24,530
State and political subs	840	6,679	7,067	--	--	14,586	14,999
Other	995	502	--	--	--	1,497	1,555
Restricted Equity Securities	--	--	--	--	638	638	638
Total	$ 12,538	$ 14,755	$ 11,844	$ 1,322	$ 638	$41,097	$41,722
WEIGHTED AVERAGE YIELDS:							
U.S. Government agencies							
and Mortgage Backed Securities	6.18%	6.43%	6.50%	6.96%	--	--	--
States and political subs	4.72%	4.68%	4.64%	--	--	--	--
Other	10.63%	7.72%	--	--	--	--	--
Restricted Equity Securities	--	--	--	--	6.89%	--	--
Consolidated	6.44%	5.68%	5.39%	6.96%	6.89%	5.89%	--

</TABLE>

<TABLE>
<CAPTION>

DECEMBER 31, 1997	BOOK VALUE	MARKET VALUE
<S>	<C>	<C>
INVESTMENT SECURITIES:		
U.S. Government agencies and Mortgage Backed Securities	$30,945	$31,178
States and political subdivisions	11,727	11,916
Other	1,489	1,574
Restricted Equity Securities	610	610
Total	$44,771	$45,278

</TABLE>

DEPOSITS

The Bank relies on deposits generated in its market area to provide the majority of funds needed to support lending activities and for investments in liquid assets. More specifically, core deposits (total deposits less certificates of deposits in denominations of $100,000 or more) are the primary funding source. The Bank's balance sheet growth is largely determined by the availability of deposits in its markets, the cost of attracting the deposits, and the prospects of profitably utilizing the available deposits by increasing the loan or investment portfolios. Market conditions have resulted in depositors shopping for deposit rates more than in the past. An increased customer awareness of interest rates adds to the importance of rate management. The Bank's management must continuously monitor market pricing, competitor's rates, and internal interest rate spreads to maintain the Bank's growth and profitability. The Bank attempts to structure rates so as to promote deposit and asset growth while at the same time increasing overall profitability of the Bank.

Average total deposits for the year ended December 31, 1998 amounted to $130.6 million which was an increase of $7.9 million, or 6.4% over 1997. Average core deposits totaled $116.2 million in 1998 representing a 5.1% increase over the $110.6 million in 1997. The percentage of the Bank's average deposits that are interest-bearing decreased to 88.1% in 1998 from 89.5% in 1997. Average demand deposits which earn no interest increased to $15.5 million in 1998 from $12.9 million in 1997 and $11.0 million in 1996.
Average deposits for the past three years are summarized in Table 9.

TABLE 9. DEPOSIT MIX (THOUSANDS)

<TABLE>
<CAPTION>

	1998		1997		1996	
	AVERAGE BALANCE	%	AVERAGE BALANCE	%	AVERAGE BALANCE	%
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Interest-bearing deposits:						
NOW accounts	$ 8,892	6.81	$ 8,766	7.14	$ 8,263	7.10
Money Market	3,365	2.58	3,228	2.63	3,417	2.93
Savings	14,690	11.25	14,868	12.12	15,113	12.98
Small denomination certificates	73,755	56.48	70,924	57.79	68,943	59.20
Large denomination certificates	14,345	10.98	12,078	9.84	9,687	8.32
Total interest-bearing deposits	115,047	88.10	109,864	89.52	105,423	90.53
Noninteresting-bearing deposits	15,537	11.90	12,863	10.48	11,043	9.47
Total deposits	$130,584	100.00	$122,727	100.00	$116,466	100.00

</TABLE>

The average balance of certificates of deposit issued in denominations of $100,000 or more increased by $2.3 million or 18.8%, in 1998. Much of the increase in large certificates of deposit is from local government funds. The strategy of management has been to support loan and investment growth with core deposits and not to aggressively solicit the more volatile, large denomination certificates of deposit. Table 10 provides maturity information relating to Certificate of Deposits of $100,000 or more at December 31, 1998.

TABLE 10. LARGE TIME DEPOSIT MATURITIES (THOUSANDS)

ANALYSIS OF TIME DEPOSITS OF $100,000 OR MORE AT DECEMBER 31, 1998:

Remaining maturity of three months or less	$ 1,757
Remaining maturity over three through twelve months	8,646
Remaining maturity over twelve months	5,264
Total time deposits of $100,000 or more	$15,667

CAPITAL ADEQUACY

Shareholder's equity amounted to $17.3 million at December 31, 1998, a 8.1% increase over the 1997 year-end total of $16.0 million. The increase was primarily a result of earnings increase. Average shareholders' equity as a percentage of average total assets amounted to 11.5% in 1998 and 10.9% in 1997.

Regulatory guidelines relating to capital adequacy provide minimum risk-based ratios which assess capital adequacy while encompassing all credit risks, including those related to off-balance sheet activities. Capital ratios under these guidelines are computed by weighing the relative risk of each asset category to derive risk-adjusted assets. The risk-based capital guidelines require minimum ratios of core (Tier 1) capital (common shareholders' equity) to risk-weighted assets of 4.0% and total regulatory capital (core capital plus allowance for loan losses up to 1.25% of risk-weighted assets) to risk-weighted assets of 8%. As of December 31, 1998 the Bank has a ratio of Tier 1 capital to risk-weighted assets of 13.8% and a ratio of total capital to risk-weighted assets of 15.1%.

TABLE 11. YEAR-END RISK-BASED CAPITAL (THOUSANDS)

	1998	1997
Tier I capital	$12,376	$11,938
Qualifying allowance for loan losses (limited to 1.25% of risk-weighted assets)	1,125	1,146
Total regulatory capital	$13,501	$13,084
Total risk-weighted assets	$90,000	$91,680
Tier I as a percent of risk-weighted assets	13.8%	13.0%
Total regulatory capital as a percent of risk-weighted assets	15.1%	14.3%
Leverage Ratio*	8.1%	8.2%

* Tier I capital divided by average total assets for the quarter ended December 31, 1998.

In addition, a minimum leverage ratio of Tier I capital to average total assets for the previous quarter is required by federal bank regulators, ranging from 3% to 5%, subject to the regulator's evaluation of the Bank's overall safety and soundness. As of December 31, 1998, the Bank had a ratio of year-end Tier I capital to average total assets for the fourth quarter of 1998 of 8.1%. Table 11 sets forth summary information with respect to the Bank's capital ratios at December 31, 1998. All capital ratio levels indicate that the Bank is well capitalized.

At December 31, 1998 the Company had 511,911 shares of common stock outstanding which were held by approximately 620 shareholders of record.

NONPERFORMING AND PROBLEM ASSETS

Certain credit risks are inherent in making loans, particularly commercial and consumer loans. Management prudently assesses these risks and attempts to manage them effectively. The Bank attempts to use shorter-term loans and, although a portion of the loans have been made based upon the value of collateral, it tries to rely primarily on the cash flow of the borrower as the source of repayment rather than the value of the collateral.

The Bank also attempts to reduce repayment risks by adhering to internal credit policies and procedures. These policies and procedures include officer and customer limits, periodic loan documentation review and follow up on exceptions to credit policies.

Nonperforming Assets at December 31, 1998 and 1997 are analyzed in Table 12.

TABLE 12. NONPERFORMING ASSETS

	1998	1997

Non-Accrual Loans	$ 66,251	$278,782
Restructured	--	--
Foreclosed and In-Substance Foreclosed Properties	101,756	210,709
	$168,007	$489,491

Nonperforming assets at year-end 1998 were 0.2% of loans outstanding and 0.6% at year-end 1997. In addition to the nonperforming assets, loans which were 90 days and over past due amounted to $343,225 at December 31, 1998 and $312,332 at December 31, 1997.

The allowance for loan losses is maintained at a level adequate to absorb potential losses. Some of the factors which management considers in determining the appropriate level of the allowance for loan losses are: past loss experience, an evaluation of the current loan portfolio, identified loan problems, the loan volume outstanding, the present and expected economic conditions in general, and in particular, how such conditions relate to the market areas that the Bank serves. Bank regulators also periodically review the Bank's loans and other assets to assess their quality. Credits deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance. The accrual of interest on loans is discontinued on a loan when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due.

The provision for loan losses, net charge-offs and the activity in the allowance for loan losses is detailed in Table 13.

TABLE 13. LOAN LOSSES

<TABLE>
<CAPTION>

	1998	1997	1996
<S>	<C>	<C>	<C>
Allowance for loan losses, beginning	$ 1,452,126	$ 1,002,455	$ 1,134,182
Provision for loan losses, added	175,000	500,000	325,000
Loans charged off	(76,842)	(68,249)	(495,201)
Recoveries of loans previously charged off	117,917	17,920	38,474
Net charge-offs	41,075	(50,329)	(456,727)
Allowance for loan losses, ending	$ 1,668,201	$ 1,452,126	$ 1,002,455

</TABLE>

Net loan recoveries as a percentage of average loans were 0.14% in 1998. Net loan charge-offs as a percentage of average loans were 0.06% and 0.57% in 1997 and 1996, respectively. Gross charge offs during 1998 totaled $76,842 and consisted of $73,309 in installment loans and $3,533 in real estate loans. Recoveries during 1998 totaled $117,917 and consisted of $97,745 in installment loans and $20,172 in real estate loans.

The loan portfolio also included loans to various borrowers (watch loans) at year-end for which management had concerns about the ability of the borrowers to continue to comply with present loan repayment terms, and which could result in some or all of these loans being uncollectible. Management monitors these loans carefully and has provided for these loans in the allowance for loan losses.

The allowance for loan losses was approximately $1.7 million, or 1.91% of gross loans outstanding at December 31, 1998, an increase of $216,075 above the 1.67% reserve at December 31, 1997. Management realizes that general economic trends greatly affect loan losses and no assurances can be made about future losses. Management does, however, consider the allowance for loan losses to be adequate at December 31, 1998.

The allocation of the reserve for loan losses is detailed in Table 14 below:

TABLE 14. ALLOCATION OF THE RESERVE FOR LOAN LOSSES

<TABLE>
<CAPTION>

	1998		1997		1996	
Balance at end of period applicable to	AMOUNT	PERCENT(1)	AMOUNT	PERCENT(1)	AMOUNT	PERCENT(1)
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Commercial, financial and agricultural	$ 502	7.71	$ 194	9.21	$ 93	9.24
Real estate, construction	--	4.59	60	5.61	65	6.49
Real estate, mortgage	657	72.55	1,089	71.32	723	72.19
Installment loans to individuals, other	509	15.15	109	13.86	121	12.08
Total	$1,668	100.00	$1,452	100.00	$1,002	100.00

</TABLE>

LIQUIDITY AND INTEREST RATE SENSITIVITY

The principal goals of the Bank's asset and liability management strategy are the maintenance of adequate liquidity and the management of interest rate risk. Liquidity is the ability to convert assets to cash to fund depositors' withdrawals or borrowers' loans without significant loss. Interest rate risk management balances the effects of interest rate changes on assets that earn interest or liabilities on which interest is paid, to protect the Bank from wide fluctuations in its net interest income which could result from interest rates changes.

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(1) Percent of loans in each category to total loans.

Management must insure that adequate funds are available at all times to meet the needs of its customers. On the asset side of the balance sheet, maturing investments, loan payments, maturing loans, federal funds sold, and unpledged investment securities are principal sources of liquidity. On the liability side of the balance sheet, liquidity sources include core deposits, the ability to increase large denomination certificates, federal funds lines from correspondent banks, borrowings from the Federal Reserve Bank and the Federal Home Loan Bank, as well as the ability to generate funds through the issuance of long-term debt and equity.

The liquidity ratio (the level of liquid assets divided by total deposits plus short-term liabilities) was 20.2% at December 31, 1998 compared to 18.9% at December 31, 1997. These ratios are considered to be adequate by management.

TABLE 15. INTEREST RATE SENSITIVITY (THOUSANDS)

<TABLE>
<CAPTION>

	DECEMBER 31, 1998 MATURITIES/REPRICING				
	1-3 MONTHS	4-12 MONTHS	13-60 MONTHS	OVER 60 MONTHS	TOTAL
<S> `	<C>	<C>	<C>	<C>	<C>
EARNINGS ASSETS:					
Loans	$13,215	$26,541	$40,420	$ 7,615	$ 87,791
Investments	5,228	7,310	14,755	13,804	41,097
Interest-bearing deposits with other banks	7,100	-	-	-	7,100

Federal Funds Sold	11,825	-	-	-	11,825
Total	$37,368	$33,851	$55,175	$21,419	$147,813
INTEREST-BEARING DEPOSITS:					
NOW accounts	9,991	-	-	-	9,991
Money market	3,327	-	-	-	3,327
Savings	15,149	-	-	-	15,149
Certificates of Deposit	15,665	43,762	31,763	-	91,190
Other borrowing	-	-	-	-	-
Total	$44,132	$43,762	$31,763	-	$119,657
Interest sensitivity gap	$(6,764)	$(9,911)	$23,412	$21,419	$ -
Cumulative interest sensitivity gap	$(6,764)	$(16,675)	$ 6,737	$28,156	$ 28,156
Ratio of sensitivity gap to total earning assets	(4.6)%	(6.7)%	15.8%	14.5%	-
Cumulative ratio of sensitivity gap to total earning assets	(4.6)%	(11.3)%	4.6%	19.0%	19.0%

</TABLE>

Interest rate risk is the effect that changes in interest rates would have on interest income and interest expense as interest-sensitive assets and interest-sensitive liabilities either reprice or mature. Management attempts to maintain the portfolios of earning assets and interest-bearing liabilities with maturities or repricing opportunities at levels that will afford protection from erosion of net interest margin, to the extent practical, from changes in interest rates. Table 15 shows the sensitivity of the Bank's balance sheet on December 31, 1998. This table reflects the sensitivity of the balance sheet as of that specific date and is not necessarily indicative of the position on other dates. At December 31, 1998, the Bank appeared to be cumulatively asset-sensitive (earning assets subject to interest rate changes exceeding interest-bearing liabilities subject to changes in interest rates). Included in the interest-bearing liabilities subject to interest rate changes within

three months are NOW accounts and savings accounts totaling $25,140,000 which historically have not been as interest-sensitive as other types of interest-bearing deposits. Therefore, the Bank is asset sensitive in the three month or less time period; liability sensitive in the four to twelve months time period and asset-sensitive in the thirteen to sixty months time period and over sixty months time period.

Matching sensitive positions alone does not ensure that the Bank has no interest rate risk. The repricing characteristics of assets are different from the repricing characteristics of funding sources. Thus, net interest income can be impacted by changes in interest rates even if the repricing opportunities of assets and liabilities are perfectly matched.

TABLE 16. KEY FINANCIAL RATIOS

	1998	1997	1996
Return on average assets	1.3%	1.3%	1.2%
Return on average equity	11.5%	12.0%	11.6%
Average equity to average assets	11.4%	10.9%	10.4%

STAFF

MAIN OFFICE

<TABLE>
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CUSTOMER SERVICE	LOAN OPERATIONS	SECRETARIES
<S>	<C>	<C>
Diane Bishop	Renee Akers	Beulah Correll
Sherrie Janney	Debra Funkhouser	Yara Middleton
Betty Moran	Gail Phillips, Supervisor	Lisa Thomas
Sharon Zeman	Jan Rorrer	
		DATA PROCESSING CENTER
	Karen Sowers, Supervisor	
		Ruth Anders
PAYING AND RECEIVING TELLERS	Wendy Taylor	
		Jill Caldwell
Jessica Bower	COLLECTIONS	
		Gail Goad
Karen Bowman	Ralph Edwards	
		Gay Grim
Regina Compton		
	CREDIT CARDS	Leslie Moran
Regina Gibson		
	Shelia DeHart	Patricia Whitlock
Helen Roberson		
	ACCOUNTING	
Tammy Rutrough		CUSTODIANS
	Deborah Reed	
Patsy Wallace		Roger Dickerson
	LENDING	
		Lucy Harris
	Ola Lee Driskell	
	Dennis McDaniel	

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CAVE SPRING OFFICE	WILLIS OFFICE	HILLSVILLE OFFICE
<S>	<C>	<C>
CUSTOMER SERVICE		CUSTOMER SERVICE
	HEAD TELLER	
Margaret Caldwell		Frances Sharpe
	Karen Sutphin	
PAYING AND RECEIVING		PAYING AND RECEIVING
Kevin Harvey, Head Teller		Rebecca Adams
Paula McDaniel		Karen Arnold
		Louise Goad, Head Teller

</TABLE>

BOARD OF DIRECTORS OF CARDINAL BANKSHARES AND THE BANK OF FLOYD

K. VENSON BOLT	C. W. HARMAN	LEON MOORE
J. H. CONDUFF	KEVIN D. MITCHELL	DORSEY H. THOMPSON
WILLIAM R. GARDNER, JR.		

<TABLE>

<S>	<C>
OFFICERS OF CARDINAL BANKSHARES	
J. H. CONDUFF	CHAIRMAN OF THE BOARD
LEON MOORE	PRESIDENT AND CHIEF EXECUTIVE OFFICER
CHRISTOPHER B. SNODGRASS	ASSISTANT VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
WANDA M. GARDNER	ASSISTANT VICE PRESIDENT AND INTERNAL AUDITOR

ANNETTE V. BATTLE	SECRETARY

OFFICERS OF THE BANK OF FLOYD

EXECUTIVE	
J. H. CONDUFF	CHAIRMAN OF THE BOARD
K. VENSON BOLT	VICE CHAIRMAN OF THE BOARD
LEON MOORE	PRESIDENT AND CHIEF EXECUTIVE OFFICER
LAWRENCE M. RENFROE	EXECUTIVE VICE PRESIDENT
CHRISTOPHER B. SNODGRASS	ASSISTANT VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
C. W. HARMAN	SECRETARY
SUNNY K. CORNWELL	ASSISTANT VICE PRESIDENT AND CREDIT REVIEW
MAIN OFFICE	
LOIS A. BOND	ASSISTANT VICE PRESIDENT
PATRICIA K. HARRIS	ASSISTANT CASHIER
CAROLYN W. REED	ASSISTANT CASHIER
CAVE SPRING OFFICE	
PATRICIA A. BOWER	ASSISTANT CASHIER
KIT C. EDWARDS	BRANCH OPERATIONS OFFICER
HILLSVILLE OFFICE	
EUGENE G. SHOCKLEY	ASSISTANT VICE PRESIDENT AND BRANCH MANAGER
ADMINISTRATIVE	
MARIE V. THOMAS	VICE PRESIDENT AND HUMAN RESOURCES
MARY ANN AYERS	ASSISTANT VICE PRESIDENT, FINANCIAL PRODUCTS AND MARKETING
ANNETTE V. BATTLE	ASSISTANT SECRETARY TO THE BOARD AND RECORDING SECRETARY
PATRICIA B. SPANGLER	ADMINISTRATIVE ASSISTANT
SHELBY L. RUTHERFORD	ADMINISTRATIVE ASSISTANT
LENDING	
DIANNE H. HAMM	ASSISTANT VICE PRESIDENT AND COMPLIANCE OFFICER
OPERATIONS	
BETTY A. WHITLOCK	ASSISTANT CASHIER AND MANAGER OF DATA PROCESSING
AUDIT	
WANDA M. GARDNER	ASSISTANT VICE PRESIDENT AND INTERNAL AUDITOR

</TABLE>

STOCKHOLDER INFORMATION

ANNUAL MEETING

The annual meeting of shareholders will be held Wednesday, April 28, 1999, at 2:00 p.m. in the community room at The Bank of Floyd, 101 Jacksonville Circle, Floyd, Virginia.

REQUESTS FOR INFORMATION

Requests for information should be directed to Mrs. Annette Battle, Recording Secretary, at The Bank of Floyd, Post Office Box 215, Floyd, Virginia, 24091; telephone (540) 745-4191. A copy of the Company's Form 10-KSB for 1998 will be furnished, without charge, after March 31, 1999 upon written request.

INDEPENDENT AUDITORS	STOCK TRANSFER AGENT
Larrowe & Company, PLC	The Bank of Floyd
Certified Public Accountants	Post Office Box 215
Post Office Box 760	Floyd, Virginia 24091
Galax, Virginia 24333	

FEDERAL DEPOSIT INSURANCE CORPORATION

The Bank is a member of the FDIC. This statement has not been reviewed, or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

Member of Federal Reserve Bank of Richmond.

Member of Federal Home Loan Bank of Atlanta.

BANKING OFFICES

FLOYD OFFICE	ROANOKE OFFICE
101 Jacksonville Circle	4094 Postal Drive
Floyd, Virginia 24091	Roanoke, Virginia 24018
(540) 745-4191	(540) 774-1111
ATM location	ATM location
WILLIS OFFICE	HILLSVILLE OFFICE
Floyd Highway South	185 South Main Street
Willis, Virginia 24380	Hillsville, Virginia 24343
(540) 745-4191	(540) 728-2341
	ATM location

MANAGEMENT'S DISCUSSION OF FINANCIAL CONDITION
AND
RESULTS OF OPERATION

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CARDINAL BANKSHARES AND SUBSIDIARIES CONSOLIDATED BALANCE SHEET AT DECEMBER 30, 1998 AND THE CONSOLIDATED STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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