

NATIONAL BANKSHARES INC
Form DEF 14A
March 12, 2014
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

SCHEDULE 14A

(RULE 14a-101)

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to Section 240.14a-12

National Bankshares

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

Title of each class of securities to which transaction applies:

(1)

Aggregate number of securities to which transaction applies:

(2)

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

Proposed maximum aggregate value of transaction:

(4)

(5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

Amount Previously Paid:

(1)

Form, Schedule or Registration Statement No.:

(2)

Filing Party:

(3)

Date Filed:

(4)

March 12, 2014

Dear Fellow Stockholder:

We invite you to join us for the Annual Meeting of Stockholders of National Bankshares, Inc. on Tuesday, April 8, 2014, at 3:00 p.m. The Annual Meeting will be held at the Custom Catering Center at 902 Patrick Henry Drive, at the intersection of North Main Street in Blacksburg, Virginia. A map and directions to Custom Catering are on the reverse of this letter.

The attached Notice of Annual Meeting and Proxy Statement describe the formal business to be transacted at the meeting. We will be electing your directors, and we will report on the operations of Bankshares.

YOUR VOTE IS IMPORTANT, REGARDLESS OF THE NUMBER OF SHARES YOU OWN. On behalf of the Board of Directors, I urge you to please sign, date and return the Proxy in the enclosed postage-paid envelope. Please return the Proxy as soon as possible, even if you now plan to attend the Annual Meeting. This will not prevent you from voting in person, but it will insure that your vote is counted if you are unable to attend the meeting.

Thank you for your interest and investment in National Bankshares, Inc.

Sincerely,

James G. Rakes
Chairman
President and
Chief Executive Officer

DIRECTIONS TO CUSTOM CATERING CENTER

FROM THE NORTH:

Exit left from US Route 460 at first Blacksburg exit to Business Route 460 (North Main Street). Proceed south on North Main Street to traffic light just past Food Lion Plaza. Turn right at traffic light onto Patrick Henry Drive, and turn at first right into Custom Catering Center.

FROM THE SOUTH:

Exit right from US Route 460 Bypass at first Prices Fork Road exit (Downtown). Follow Prices Fork Road to its end at the intersection with North Main Street. Proceed — around the new traffic circle and turn right onto North Main Street. Proceed north to second traffic light, at the intersection of Patrick Henry Drive. Turn left at Patrick Henry Drive, and turn at first right into Custom Catering Center.

NOTICE OF 2014 ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders of National Bankshares, Inc.:

This is your notice that the 2014 Annual Meeting of Stockholders of National Bankshares, Inc. will be held at the Custom Catering Center at 902 Patrick Henry Drive, at the intersection of North Main Street in Blacksburg, Virginia, on Tuesday, April 8, 2014, at 3:00 p.m. The meeting is for the purpose of considering and acting upon the following items of business:

1. To elect three Class 3 directors to serve a term of three years each.
2. To approve a non-binding resolution to approve the compensation of the named executive officers disclosed in this proxy statement.
3. To ratify the Board of Directors' appointment of Yount, Hyde & Barbour, P.C. as the Company's independent registered public accounting firm for the year ending December 31, 2014.

NOTE: The Board of Directors is not aware of any other business to come before the meeting.

Only stockholders of record at the close of business on February 21, 2014 are entitled to receive notice of and to vote at the meeting, or at any adjournments of the meeting.

Your attention is directed to the proxy statement accompanying this notice for a more complete statement of the matters proposed to be acted upon at the meeting.

To assure that your shares are represented at the meeting, please complete, date, sign and mail promptly the enclosed proxy, for which a return envelope is provided. The proxy will not be used if you attend and vote in person at the meeting. You may revoke your proxy prior to actual voting of the proxy.

BY ORDER OF THE BOARD OF DIRECTORS

Bryson J. Hunter
Secretary and Counsel
Blacksburg, Virginia

March 12, 2014

PROXY STATEMENT

OF

NATIONAL BANKSHARES, INC.

101 HUBBARD STREET

BLACKSBURG, VA 24060

P.O. BOX 90002

BLACKSBURG, VA 24062-9002

540/951-6300

www.nationalbankshares.com

www.nationalbanksharesproxy.com

ANNUAL MEETING OF STOCKHOLDERS

TUESDAY, APRIL 8, 2014

This proxy statement is furnished in connection with the solicitation of proxies by and on behalf of the Board of Directors (the "Board") of National Bankshares, Inc. ("NBI," "Bankshares" or the "Company") to be used at the 2014 Annual Meeting of Stockholders to be held at the Custom Catering Center at 902 Patrick Henry Drive, at the intersection of North Main Street, Blacksburg, Virginia, at 3:00 p.m., on Tuesday, April 8, 2014, and at any adjournments of the meeting. The approximate mailing date of the proxy statement, the notice of annual meeting and the accompanying proxy is March 12, 2014.

REVOCATION OF PROXIES

Stockholders who sign and send in their proxies retain the right to revoke them at any time prior to the actual voting of the proxies at the Stockholders Meeting. Proxies may be revoked by written notice received prior to the meeting, by attending the meeting and voting in person or by submitting a signed proxy with a later date. A written notice revoking a previously executed proxy should be sent to National Bankshares, Inc., P.O. Box 90002, Blacksburg, Virginia 24062-9002, Attention: James G. Rakes. Unless revoked, the shares represented by properly executed proxies will be voted at the meeting according to the instructions contained in the proxy. Where no instructions are given, proxies will be voted *for* the nominees for directors set forth in Proposal No. 1; *for* the non-binding resolution to

approve the compensation of the named executive officers described in Proposal No. 2; and *for* the ratification of the appointment of Yount, Hyde & Barbour, P.C. as the independent registered public accounting firm for the year ending December 31, 2014 described in Proposal No. 3.

An Annual Report to Stockholders, including the financial statements for the year ended December 31, 2013, is being mailed to you at the same time as this Proxy Statement, but should not be considered proxy solicitation material.

VOTING SECURITIES AND STOCK OWNERSHIP

As of March 12, 2014, Bankshares had 6,947,974 shares of common stock (\$1.25 par value) issued and outstanding. Each of the shares is entitled to one vote at the Annual Meeting. Only those stockholders of record at the close of business on February 21, 2014 will be entitled to vote at the meeting or at any adjournments.

A majority of votes entitled to be cast on matters to be considered at the Annual Meeting constitutes a quorum. If a share is represented for any purpose at the Annual Meeting, it will be considered to be present for purposes of establishing a quorum. Abstentions and shares held of record by a broker or its nominee (“broker shares”) which are voted on any matter are included in determining the number of votes present or represented at the Annual Meeting. Broker shares that are not voted on any matter will not be included in determining whether a quorum is present. If a quorum is established, directors will be elected by a plurality of votes cast by shares entitled to vote at the Annual Meeting. On all other matters, the vote of a majority of shares present in person or by proxy and entitled to vote is required. Broker shares may not be voted in an uncontested Board election such as this one unless the beneficial owner has provided voting instructions. Votes that are withheld and broker shares that are not voted on any matter will not be included in determining the number of votes cast.

STOCK OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

Shown below is information with respect to persons or groups that beneficially own more than 5% of National Bankshares, Inc. common stock. This information is derived from Schedules 13G filed by such persons or groups.

Name of Beneficial Owner	Shares of Common Stock Beneficially Owned as of December 31, 2013	Percentage Of Class
BlackRock, Inc.		
55 East 52 nd Street	414,053	(1)6.0 %
New York, NY 10055		

(1)Sole dispositive power for 414,053 shares and sole voting power for 398,304 have been reported.

STOCK OWNERSHIP OF DIRECTORS AND EXECUTIVE OFFICERS

The following table presents the beneficial ownership of National Bankshares, Inc. common stock as of February 21, 2014, by each director, each executive officer named in the Summary Compensation Table and all directors and executive officers as a group. Except as otherwise noted, the named individual has sole voting and investment power with respect to the stock.

Name of Beneficial Owner	Shares of Common Stock Beneficially Owned as of February 21, 2014	Percentage Of Class
Lawrence J. Ball	3,500	*
F. Brad Denardo	50,785	(1) *
John E. Dooley	450	*
Charles E. Green, III	40,138	(2) *
Bryson J. Hunter	---	*
Jack M. Lewis	6,056	*
Mary G. Miller	2,255	*
William A. Peery	33,910	(3) *
James G. Rakes	107,478	(4) 1.55 %
Glenn P. Reynolds	5,929	(5) *
James M. Shuler	28,227	(6) *
David K. Skeens	6,298	(7) *
	285,026	4.10 %

All Nominees, Current Directors and Executive Officers as a Group
(12 persons)

*Represents less than 1% of the Company's outstanding common stock.

- (1) Includes 4,534 shares owned jointly with spouse, 23,673 shares owned through National Bankshares, Inc. Employee Stock Ownership Plan and 16,000 shares in vested options which may be exercised as of February 21, 2014.
- (2) Includes 7,158 shares owned jointly with spouse and 11,880 shares held as custodian for children.
- (3) Includes 72 shares owned as custodian for son, 7,260 shares owned by a controlled corporation and 21,900 shares owned as Trustee.
- (4) Includes 9,380 shares owned jointly with spouse, 38,346 shares owned through National Bankshares, Inc. Employee Stock Ownership Plan and 30,000 shares in vested options which may be exercised as of February 21, 2014.
- (5) Includes 2,453 shares owned by spouse.
- (6) Includes 4,053 shares owned by spouse and 426 shares owned jointly with spouse.
- (7) Includes 6,236 shares owned through National Bankshares, Inc. Employee Stock Ownership Plan.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (“Exchange Act”) requires our directors and officers to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock and to furnish us with copies of all forms filed.

To our knowledge and based on the written representations of our directors and executive officers, during the past fiscal year (and in prior years, as noted below) our officers and directors complied with all applicable Section 16(a) filing requirements, except as noted below.

Mr. Peery inadvertently failed to file timely one required Form 4 to report the acquisition of the Company’s stock by inheritance in December 2013. A Form 4 was filed late.

Mr. Reynolds inadvertently failed to file timely one required Form 4 in December 2013 for him and his spouse. A Form 5 was filed reporting these four transactions. In addition, Mr. Reynolds inadvertently failed to file timely the required Form 4 for four purchases of the Company’s stock in 2012 and 2013 by his spouse which amounts to 87 shares. These four purchases of Company stock were made through a dividend reinvestment program sponsored by her broker-dealer. A “catch-up” Form 5 has been filed reporting these transactions.

PROPOSAL NO. 1 - ELECTION OF DIRECTORS

Bankshares’ articles of incorporation provide that the directors will be divided into three classes (1, 2 and 3) with each class as nearly equal in number as possible and the term of office of each class ending in successive years. The articles of incorporation currently also provide that the number of directors shall be set by the bylaws, but shall not be less than nine, or more than twenty-six. For the purpose of the election of directors at the Annual Meeting, the number of directors set forth in the bylaws is nine. The current term of office of the Class 3 directors expires at this 2014 Annual Meeting of Stockholders. The terms of Class 1 and Class 2 directors will expire in 2015 and 2016, respectively.

The Board of Directors has nominated three serving Class 3 directors, Charles E. Green, III, William A. Peery and James M. Shuler, to serve a three-year term to expire at the Annual Meeting of Stockholders in 2017.

It is the intention of the persons named as proxies, unless instructed otherwise, to vote for the election of the three nominees for Class 3 director. Each nominee has agreed to serve if elected. If any of the nominees is unexpectedly unable to serve, the shares represented by all valid proxies will be voted for the remaining nominees and any other person or persons who may be designated by the Board. At this time, the Board knows of no reason why any nominee might be unable to serve.

The following information is provided with respect to the three nominees to serve as Class 3 director and the six incumbent directors who will be continuing in office following the Annual Meeting. All information is provided as of February 21, 2014, and employment information is provided for the past five years. No director or nominee is related by blood, marriage or adoption to any other director, nominee or executive officer. No director or nominee currently serves or has served within the past five years, as a director of any company which has a class of securities registered

pursuant to Section 12 of the Securities Exchange Act of 1934, or is subject to the requirements of Section 15(d) of the Exchange Act, or of any company registered as an investment company under the Investment Company Act of 1940. Two directors, Mr. Rakes and Dr. Shuler, also currently serve as a director of one or both of the wholly owned subsidiaries of Bankshares, the National Bank of Blacksburg (“NBB”), and National Bankshares Financial Services, Inc. (“NBFS”). No other director has been employed by a subsidiary affiliate of the Company during the last five years. Each director and nominee, except for Mr. Rakes, has been determined to be independent by the Board of Directors, using the definition for independence of directors that is used for determining compliance with the applicable listing standards for the NASDAQ Stock Market, the national securities exchange on which Bankshares common stock is listed. (See also “Director Independence” and “Certain Transactions with Officers and Directors”).

Nominees

Class 3 Directors

(Serving until 2017 Annual Meeting)

Charles E. Green, III (Age 63): Mr. Green began a three year term of service on the Board of Directors in 2011. Previously, Mr. Green served as a member of the Board of Directors of NBB. He has nearly 26 years of experience as community bank director having been elected to the NBB Board in 2006 and to the board of a predecessor bank in 1986. Mr. Green has experience in small business management, as well as insurance and investment matters, all of which benefit the Company. He resides in, and was formerly the mayor of, Tazewell, Virginia, and Mr. Green possesses in-depth knowledge of that portion of the Company's market area.

William A. Peery (Age 62): As President of Cargo Oil Co., Inc. in Tazewell, Virginia, Mr. Peery has business management experience, including experience in financial management. Cargo Oil Co., Inc. operates convenience stores and sells petroleum products. The firm is headquartered in Tazewell, Virginia, where Mr. Peery also resides. Mr. Peery brings small business management experience to the Board. The Company considers small businesses to be a key component of its customer market. He was elected to the Company's Board of Directors in 2005.

James M. Shuler (Age 70): Dr. Shuler is a retired veterinarian who represented the 12th legislative district in the Virginia House of Delegates from 1994 until January 2012. Prior to his retirement, Dr. Shuler founded and ran a companion animal veterinary practice. Dr. Shuler brings small business management expertise, knowledge of Virginia's political environment and extensive contacts within the business and academic communities to his service on the Company's Board. He has served on the NBI Board since 2002 and is its Vice Chairman. Dr. Shuler is currently also a Director and Vice Chairman of NBB, where he has served on the Board since 1987.

Directors Continuing in Office

Class 1 Directors

(Serving until 2015 Annual Meeting)

Lawrence J. Ball (Age 59): Mr. Ball was elected to the National Bankshares, Inc. Board of Directors in 2006. He is the President of Moog Components Group, a part of Moog, Inc., which is an international corporation. Prior to being named President, Mr. Ball was the Vice President and General Manager of Moog Components Group. Moog Components Group is headquartered in Blacksburg, Virginia, and the company designs and manufactures products in motion, electronics and fiber optics. Mr. Ball has extensive experience in management and financial reporting. Mr. Ball's experience as a senior manager with a large corporation is considered valuable in adding to the Board of Directors' understanding of larger business operations.

Mary G. Miller (Age 63): Dr. Miller is the founder and President of IDD, Inc., a full-service Internet technology firm specializing in custom software solutions, education and training and online content management. The firm is located

in Blacksburg, Virginia. In addition to her experience in small business management, Dr. Miller brings in-depth knowledge of the region's developing technology sector to her service on the Board of Directors. Dr. Miller was first elected to the Board in 2003.

Glenn P. Reynolds (Age 61): Mr. Reynolds is the founder and President of Reynolds Architects Incorporated, an architecture firm located in Blacksburg, Virginia. He has been a member of the National Bankshares, Inc. Board of Directors since 2006. Mr. Reynolds' familiarity with the area's construction and development projects and his experience with local building firms are useful to the Company's Board. In addition, Mr. Reynolds has small business management experience and an extensive network of contacts in the local business and academic communities.

Class 2 Directors

(Serving until 2016 Annual Meeting)

John E. Dooley (Age 59): Dr. Dooley is Chief Executive Officer (CEO) of the Virginia Tech Foundation, Inc., where he oversees the leadership and management of Virginia Tech's private assets in support of university programs and initiatives which total assets exceed \$1.16 billion. Prior to becoming CEO of the Foundation in July 2012, Dr. Dooley served as Virginia Tech's Vice President for Outreach and International Affairs for ten years. Dr. Dooley is an active member of the Virginia Tech community through several committees and special projects. He also serves on the boards of several community and state organizations. He brings extensive financial knowledge and management capabilities to the Board as well as a significant network of contacts in the regional business and academic communities. Dr. Dooley was elected by the Board of Directors in November 2012 to fill the unexpired term of Jack W. Bowling. He was elected to a full three year term at the 2013 Annual Meeting.

Jack M. Lewis (Age 70): Dr. Lewis is the President of New River Community College in Dublin, Virginia. Before being elevated to the President's role, Dr. Lewis was Dean of the Community College and served as its chief financial officer. Dr. Lewis' experience with budgeting, financial reporting and organizational management is directly applicable to his Board service. In addition, he has been involved in local and regional economic development activities. Dr. Lewis was elected to the Board of Directors in 2004.

James G. Rakes (Age 69): Mr. Rakes is an original director of National Bankshares, Inc., having served on the Board since 1986. He has been President and Chief Executive Officer of the Company since its founding. Mr. Rakes has been the President and Chief Executive Officer of NBB since 1983 and the President and Treasurer of NBFS from 2001 until June 1, 2011. He has served as Chairman, President and CEO of NBFS since June 1, 2011. He is also the Chairman of the Board of Directors of NBB. He is active with, and has held leadership positions in, both state and national banking trade associations. These factors, together with Mr. Rakes' experience and expertise in financial services, qualify him to serve on the Board.

The Board of Directors recommends that the stockholders vote “FOR” all of the nominees for Class 3 director.

PROPOSAL NO. 2 – ADVISORY VOTE

ON THE APPROVAL OF COMPENSATION

OF THE NAMED EXECUTIVE OFFICERS

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) enables our stockholders to approve, on an advisory or nonbinding basis, the compensation of the Company’s named executive officers, as described in the disclosures and discussion regarding executive compensation in this proxy statement. Our performance-related compensation philosophy is the basis for all of our compensation decisions. Please refer to “Executive Compensation” for an overview of the compensation of the Company’s named executive officers, as required by Securities and Exchange Commission rules. At the 2011 Stockholder’s Meeting, stockholders approved a proposal on how frequently to hold this advisory nonbinding vote on compensation for named executive officers, which was to hold such vote annually.

We are asking for stockholder approval of our named executive officers’ compensation as described in this proxy. The vote is not intended to address any specific item of compensation, but rather the overall compensation of our named executive officers and the compensation policies and practices discussed in this proxy. Because the vote is advisory, it will not be binding on the Company or its Board of Directors. However, the Compensation Committee will take into account the outcome of the vote when considering future executive compensation arrangements.

The Board of Directors recommends that the stockholders vote “FOR” approval of the compensation of the named executive officers.

PROPOSAL NO. 3 – RATIFICATION OF

APPOINTMENT OF INDEPENDENT AUDITORS

For the year ending December 31, 2014, the Audit Committee of the Board of Directors has selected Yount, Hyde & Barbour, P.C., an independent registered public accounting firm, to perform the audit of the Company's financial statements and its internal controls over financial reporting. Yount, Hyde & Barbour has acted as the Company's independent registered public accounting firm for many years.

The selection of Yount, Hyde & Barbour as the Company's independent auditors is not required to be submitted to a vote of the stockholders for ratification. The Company is doing so because it believes that it is a matter of good corporate practice. If the stockholders fail to vote on an advisory basis in favor of the selection of Yount, Hyde & Barbour, the Audit Committee will reconsider whether to retain Yount, Hyde & Barbour, and may retain that firm or another firm without re-submitting the matter to the stockholders. Even if the stockholders ratify the appointment, the Audit Committee may, in its discretion, direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that a change would be in the Company's best interests.

A representative of Yount, Hyde & Barbour is expected to be at the Annual Meeting of Stockholders. That representative will have the opportunity to make a statement at the meeting and will be available to respond to appropriate questions.

The Board of Directors recommends that the stockholders vote "FOR" the ratification of the appointment of Yount, Hyde & Barbour, P.C. as the independent registered public accounting firm for the year ending December 31, 2014.

BOARD OF DIRECTORS MEETINGS, LEADERSHIP STRUCTURE,

COMMITTEES, COMPENSATION, DIRECTOR INDEPENDENCE, ATTENDANCE,

OVERSIGHT OF RISK AND COMMUNICATIONS WITH DIRECTORS

Board of Directors Meetings

The Board of Directors of Bankshares meets monthly. In 2013, there were 12 regular Board meetings and one special meeting.

Board Leadership Structure

National Bankshares, Inc. has chosen to combine the position of chairman of the board and principal executive officer. Mr. Rakes, who was serving as the Company's President and Chief Executive Officer, was elected as the Chairman of the Board of Directors in April of 1999. He has been re-elected annually. Mr. Rakes has the longest tenure of any current director of the Company, having served since the Company was founded in 1986. In addition Mr. Rakes is Chairman, President and CEO of the Company's primary subsidiary, the National Bank of Blacksburg, where nearly all of the Company's business operations take place. Mr. Rakes has spent his long career in banking and he has held leadership positions in both state and national banking trade organizations. The Board of Directors determined that Mr. Rakes' knowledge of NBB and the banking industry and his Board experience make him the logical and natural choice to serve as Chairman of the Board of National Bankshares, Inc. We believe the Board also benefits from the continuity provided by Mr. Rakes in chairing the Board.

The Board does not have a lead director designated as such. However, the Board of Directors believes that at times it is important for the independent directors to deliberate and act without having Company management present. To ensure that it has experienced leadership in these situations, the Board annually elects a Vice Chairman, who has the responsibility of chairing meetings when the Chairman is absent or when the Board wishes to meet without any representative of management being present. Dr. Shuler has served as Vice Chairman of the Board of Directors since April of 2007. We believe this structure provides the Board with independent leadership in situations where the Chairman is excused from acting as such due to his management position.

Board Committees

The Bankshares Board has standing Executive, Audit, Compensation and Nominating Committees. Mr. Rakes is the chairman of the Executive Committee, and Dr. Lewis and Dr. Shuler serve on the Committee. The Executive

Committee had one meeting in 2013. The Audit Committee, which is chaired by Dr. Lewis, is made up of Mr. Ball, Dr. Dooley and Mr. Green. The Audit Committee had five meetings in 2013. In 2013, the Compensation Committee was comprised of Mr. Ball, Dr. Dooley, Mr. Green, Dr. Lewis, Dr. Miller, Mr. Peery and Mr. Reynolds. Dr. Shuler serves as its chairman. The Compensation Committee met on February 13, 2013. Dr. Miller is the chairwoman of the Nominating Committee, and Mr. Peery, Mr. Reynolds and Dr. Shuler are its members. The Nominating Committee held its meeting on January 6, 2014 but did not meet in 2013 due to scheduling conflicts.

Board Compensation

In 2013, the members of the NBI Board of Directors received \$1,100 for each regular or special Board meeting they attended. They were paid \$600 for each committee meeting unless the committee meeting was held concurrently with the regular board meeting. Directors were also paid an annual retainer fee of \$16,000. The Chairmen of the Audit and Compensation Committees each received an additional \$1,500 annual retainer. NBI Directors receive no other forms of compensation, except as described in the table below.

Directors Compensation Table⁽¹⁾

	Fees Earned or Paid in Cash (\$)	Other (\$)	Total (\$)
Lawrence J. Ball	28,800	---	28,800
John E. Dooley	32,100	---	32,100
Charles E. Green, III	31,600	---	31,600
Jack M. Lewis	33,700	---	33,700
Mary G. Miller	29,800	---	29,800
William A. Peery	30,900	---	30,900
Glenn P. Reynolds	29,800	---	29,800
James M. Shuler	33,000	37,811	(2)70,811

(1)Directors fees paid to Mr. Rakes are disclosed in the Summary Compensation Table in “Executive Compensation.”

Represents \$26,900 in fees paid to Dr. Shuler for his service on the Board of Directors of NBB in 2013, and

(2)\$10,911 in payments from the Bank Directors Deferred Compensation Plan. Please see “Nonqualified Retirement Plans” below.

Director Independence and Certain Transactions with Officers and Directors

As has been mentioned, each director of Bankshares, except for Mr. Rakes, is independent, as defined by the listing standards for the NASDAQ Stock Market, the national securities exchange on which Bankshares common stock is listed. In determining that each director meets the NASDAQ Stock Market’s listing standards for independence, the Board of Directors recognized that NBB extends credit in the ordinary course of business to Bankshares’ directors and executive officers. Extensions of credit are also made to business organizations and persons with whom Bankshares’ directors and executive officers are associated or related. These extensions of credit are made at interest rates and with the same requirements as to collateral as is prevailing for comparable transactions with the general public at the time credit is extended. In the opinion of bank management, none of the outstanding transactions with directors and executive officers involve a greater than normal risk of collectability or present other unfavorable features. In making the determination that all of the directors are independent, except for Mr. Rakes, the Board of Directors considered that Mr. Green rents a small office space at an NBB branch location. He has a year-to-year lease with the Bank and pays market rate rent of \$4,200 each year, including in 2013. The Board also considered that Dr. Miller’s technology firm provided website services to Bankshares and NBB in 2013. Dr. Miller’s technology firm was paid \$3,600 for such services. Except for directors’ fees and the transactions listed in this paragraph, no director received direct or indirect

compensation from the Company in 2013.

Board Attendance

During 2013, each incumbent director attended 75% or more of the total number of meetings of the Board of Directors of Bankshares and of the Board committees on which he or she served. The Board does not have a formal policy regarding directors' attendance at the Annual Meeting of Stockholders.

Board Oversight of Risk

To fulfill its responsibility to oversee the Company's risk management processes, the full Board of Directors receives extensive and regular reports from management outlining the status of credit risk, interest rate risk, liquidity risk and major areas of operational risk. The Company's Treasurer and Chief Financial officer, who serves as the subsidiary bank's Senior Vice President/Operations & Risk Management, attends all meetings of the Board of Directors, is readily available to report and to answer the directors' questions and is responsible for raising any material risk management concerns with the Board. In addition to the regular reports received by the entire Board of Directors, the Audit Committee receives personal reports from the Corporate Auditor. The Corporate Auditor, who reports directly to the Board, supplies the Audit Committee with information about internal audits completed at both the parent company and subsidiary levels and about the status of the Company's regulatory compliance activities.

Communications with Directors

The Board of Directors provides a process for stockholders to send communications to it. Stockholders wishing to communicate with the Board of Directors or with specified individual directors should do so in writing mailed to National Bankshares, Inc., P. O. Box 90002, Blacksburg, Virginia 24062-9002, Attention: Board of Directors. All stockholder communications are forwarded to the Board or to the specified directors.

COMPENSATION DISCUSSION AND ANALYSIS

What are the objectives of the Company's compensation program for its named executive officers?

National Bankshares, Inc. has four goals for its compensation program for named executive officers. In 2013, these officers were Chairman, President & CEO James G. Rakes, Treasurer and CFO David K. Skeens, Executive Vice President F. Brad Denardo, Secretary and Counsel Bryson J. Hunter.

- To offer salaries and bonuses that fairly reward executive officers for their individual contributions in meeting short-term and long-term corporate strategic and financial goals.
- To offer retirement and post-retirement benefits which incent executive officers to remain in leadership roles and which recognize and reward long tenure with the Company.
- To offer total compensation that allows the Company to retain and recruit executive talent and which is competitive with peer financial institutions, but which fits within the Company's conservative approach to managing overhead expense.
- To offer a compensation program that does not increase, or have the potential to increase, material risk to the Company.

What is the program designed to reward?

The compensation program for the Chairman, President & CEO is designed to reward the profitable operation of the Company compared to its peers, particularly as measured by return on assets and return on equity. In addition, the program rewards the Chairman, President & CEO when the Company's short- and long-term strategic goals are met. Inherent in meeting strategic goals is the ability to recognize and manage risks to the Company. Named executive officers other than the Chairman, President & CEO are rewarded for the Company's success in meeting its performance goals and particularly for success in those areas for which they have individual management responsibility. One measure of the officers' success is their ability to recognize and manage risk in their areas of responsibility.

What is each element of compensation?

The elements of compensation are:

- Salary (all named executive officers)
- Cash bonus (Chairman, President & CEO)
- Capital Accumulation Plan (Chairman, President & CEO)
- Qualified retirement plans, including defined benefit, 401(k) and employee stock ownership plan (all named executive officers)
- Nonqualified officers salary continuation plan (all named executive officers)
- Board of Directors fees (Chairman, President & CEO and Executive Vice President)
- Perquisites and other personal benefits (Chairman, President & CEO and Executive Vice President)

Why does the Company choose to pay each element of compensation?

The Company uses salary as the cornerstone of its compensation program because it believes that the focus of executive officers, particularly of those below the level of the Chairman, President & CEO, should be on the Company's long-term growth and performance. Annual increases are awarded based upon individual performance in meeting stated goals for that review period. Because salary rather than some form of annual incentive is the major component of their compensation, executive officers have sufficient personal economic security to make and support management decisions that may trade immediate gain for greater long-term corporate success. In addition, limiting compensation primarily to salary inhibits the incentive to take unacceptable short-term risks at the expense of reaching long-term goals.

Since the Chairman, President & CEO is the individual who has the ultimate responsibility for the success of its operations, it has long been the Company's policy to pay him an annual incentive bonus that is based upon overall performance for the year in question. The ratio of incentive bonus to salary remains at a level which the Company believes does not increase its potential risk.

Each named executive officer, along with all other eligible Company employees, participates in three qualified retirement plans. NBI sponsors a defined benefit pension plan, the National Bankshares, Inc. Retirement Income Plan. The National Bankshares, Inc. Retirement Accumulation Plan is a 401(k) plan, and the Company also offers the National Bankshares, Inc. Employee Stock Ownership Plan. The Company believes that it is important to assist its long-term employees, including its executive officers, in assuring financial security in retirement for themselves and their families. National Bankshares, Inc. also believes that its Employee Stock Ownership Plan helps to align the interests of all employees, including executive officers, with the interests of its stockholders. More information is contained in “Qualified Retirement Plans.”

The Company established a nonqualified salary continuation plan that is designed to provide certain key Company officers, including all named executive officers, with supplemental retirement income. This plan was established to enhance the Company’s ability to retain key decision-makers and to supplement the retirement benefits of those more highly compensated executives who, because of legal limitations, are unable to participate fully in the qualified retirement plans. There is further discussion in “Nonqualified Retirement Plans.”

The Company elected to establish the National Bankshares, Inc. 1999 Stock Option Plan to promote the identification of the personal interest of participants with the long-term financial success of the Company and with growth in stockholder value. Incentive stock options were granted to Mr. Rakes and Mr. Denardo under this plan in each year from 1999 to 2005. The Plan terminated on March 9, 2009, although there are vested and unexercised stock-options remaining. See “Incentive Stock Options” for more information.

Mr. Rakes and Mr. Denardo serve as paid directors of the Company and/or of one of its subsidiaries. These individuals receive the same compensation as outside directors. The Company believes that this is an appropriate practice because these executive officers devote additional time to their Board of Directors’ responsibilities, and all directors, both internal and external, share the same fiduciary obligations and liability risk.

The perquisites and personal benefits that are provided for the Chairman, President & CEO are defined in his employment agreement. These items were agreed to for two reasons. First, they are typical benefits for individuals holding this position in peer banks and financial holding companies. As such, they are part of a total compensation package that is competitive in the Company’s operating environment. Second, certain perquisites that offer a degree of personal benefit are also directly related to job performance. The perquisites that are available to any of the other named executive officers are limited in nature and offer benefit to both the executive and the Company. See “Executive Compensation” and “Employment Agreements and Change in Control Agreements.”

How does the Company determine the amount for each element?

Salary: The salaries of National Bankshares’ named executive officers, except for that of the Chairman, President & CEO, are within the Company’s established salary ranges for each officer position. The ranges are developed after considering an annual salary survey published by the Virginia Bankers Association as well as publicly available salary information about comparable jobs in the locations in which Bankshares and its subsidiaries do business. The annual increase in base salary for these individuals is determined by the Chairman, President & CEO. In making the determination, Mr. Rakes considers the nature and responsibility of the position; the competitiveness of the market for the executive’s services; the expertise of the individual executive; and to what degree the executive has achieved annual performance goals. Individual annual performance goals support the Company’s business strategy, but are not tied to objective performance measures. The Chairman, President & CEO reports executive officer salaries to the Compensation Committee at least annually.

The base salary of the Chairman, President & CEO of at least \$225,500 was set in an employment agreement effective on January 1, 2002. The employment agreement was amended and restated in its entirety on December 17, 2008, effective December 31, 2008, and the base salary was increased to Mr. Rakes' 2008 salary of \$445,183. The base salary was determined after considering compensation for this position reported in the Virginia Bankers Association's annual salary survey and from the public documents of peer institutions that disclose salaries paid to other individuals holding similar positions. The Board of Directors Compensation Committee determines annual salary increases after assessing the CEO's contributions to the success of the Company. In measuring the Company's success, the Committee compares NBI's financial results to local and regional peers. Specifically, the Compensation Committee compares Bankshares' return on assets (ROA) and return on equity (ROE) with the average ROA and ROE of a group of at least five peer bank holding companies located in the Company's region. The composition of the peer group generally remains the same, but it is reviewed annually. For 2013, the peer group was made up of six bank holding companies including Union First Market Bankshares Corporation, American National Bankshares, Old Point Financial Corp., First Community Bankshares, First Century Bankshares and StellarOne Corporation. The fact that National Bankshares once again significantly outperformed its peers in 2013, particularly during a difficult operating environment for banks, is reflected in the amount of salary increase awarded by the Compensation Committee to the Chairman, President & CEO. The Committee also considered Mr. Rakes' long track record of success in profitably leading the Company and in managing risks to the Company encountered in a challenging economic environment. Although the Committee weighs the peer comparison heavily in determining Mr. Rakes' salary increase, it does not utilize an objective formula. The Committee considers the Company's progress in meeting budget goals for the year, but it does not utilize a quantitative assessment of budget goals in determining the amount of annual salary increase. Likewise, although there are no objective measures utilized, the Committee considers stock performance and the level of stockholder dividends in establishing salary. In assessing Bankshares' stock performance, the Compensation Committee looks at its price, the price to earnings ratio and dividend yield as compared with the stock of the Company's identified peers. The Committee validates salary increases by referring to the Virginia Bankers Association salary survey and to public documents from peer institutions.

Cash Bonus: The annual incentive bonus paid to the Chairman, President & CEO is determined with the same criteria that are used in establishing his annual salary increase.

Capital Accumulation Plan: The annual contribution to the Chairman, President & CEO's Capital Accumulation Plan ("CAP") is determined using a formula that is included in the employee agreement that was effective on January 1, 2002 and restated as of December 31, 2008. A description of the formula, which utilizes objective performance criteria based upon the ROA and ROE of Bankshares as compared with peers, and of the terms of the CAP is provided in "Grants of Plan-Based Awards." The CAP terminated on December 31, 2011 and the final grant was made on February 8, 2012 for fiscal year 2011.

Qualified Retirement Plans: The named executive officers participate with other eligible employees in the Company's three qualified retirement plans. Every participant's benefits are determined under the specific provisions of each of the plans. These plans are discussed in greater detail under "Qualified Retirement Plans."

Nonqualified Salary Continuation Plan: In early 2006, the Company's subsidiaries entered into salary continuation plan agreements, which may be amended from time to time, with a group of selected senior officers, including all of the named executive officers. Assuming retirement at normal retirement age (as defined in the Plan), contributions to the Salary Continuation Plan are sufficient to provide a minimum of fifteen annual supplemental retirement income payments of 30% of 2005 annual compensation (adjusted by a pre-retirement inflation factor of 4%) for the Chairman, President and CEO. Using the same assumption, contributions to the Salary Continuation Plan are sufficient to provide a minimum of fifteen annual supplemental retirement income payments of 25% of 2008 annual compensation (adjusted by a pre-retirement inflation factor of 4%) for Mr. Denardo, 25% of 2013 annual compensation (adjusted by a pre-retirement inflation factor of 4%) for Mr. Skeens, and 20% of 2013 annual compensation (adjusted by a pre-retirement inflation factor of 4%) for Mr. Hunter. Additional information is included under "Nonqualified Retirement Plans."

Incentive Stock Options: Until the termination of the 1999 Stock Option Plan on March 9, 2009, the Chairman, President & CEO could recommend annual grants of incentive stock options for the other named executive officers to the Board's Compensation Committee, which served as the Committee that administered the Plan. The Committee could make grants of stock options for Mr. Rakes and the other named executive officers. No grants of stock options have been made since 2005, because of the negative impact of these grants on the Company's earnings. See "Stock Options" for information concerning vested but unexercised stock options.

Board of Directors Fees: Mr. Rakes and Mr. Denardo receive the same compensation as outside directors for serving as directors of NBI and NBB. See also "Board of Director Meetings, Committees, Compensation, Attendance and Communications with Directors."

Perquisites and Other Personal Benefits: The Board Compensation Committee negotiated with the Chairman, President & CEO to develop a comprehensive and competitive total compensation package, including perquisites. This package was included in Mr. Rakes' January 1, 2002 employment agreement and was included in the amended and restated employment agreement effective on December 31, 2008. The Chairman, President & CEO determines perquisites available to the other named executive officers. These perquisites are limited to a Company-owned automobile for Mr. Denardo, which facilitate business travel, as well as sports tickets and club memberships, which assist Mr. Denardo with marketing and business development efforts. Mr. Rakes reports annually to the Committee on these items.

How do each element and the Company's decisions regarding that element fit into the Company's overall compensation objectives and affect the decisions regarding other elements?

As noted, each element supports retention, the achievement of annual and longer term corporate goals and provides reasonable financial security to the employee. Every year the Committee assesses the total compensation package for each named executive officer to determine that it is appropriate. The Committee also reviews each element of the compensation package and determines that each is satisfactory in relation to the other.

In determining Mr. Rakes' total annual compensation, the Committee has maintained the same proportionate relationship of salary to annual bonus in recent years. The Committee reviews Mr. Rakes' decisions regarding the compensation packages of the other executive officers. These packages remain focused heavily on salary. The executive officers participate in the qualified retirement plans available to all employees, as well as in the Officers Salary Continuation Plan. The allocation of all executive officers' compensation, including Mr. Rakes', among the various elements of compensation has not changed substantially in a number of years.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed this Compensation Discussion and Analysis with management. The Committee reviewed and fully discussed the Compensation Discussion and Analysis, and the report was recommended to the Board of Directors to be included in this proxy statement. Neither the Company nor the Compensation Committee engaged a consultant on compensation matters. The Compensation Committee of Bankshares is made up of all independent, non-employee directors. In 2013, Dr. Shuler was Committee Chairman, and Mr. Ball, Dr. Dooley, Mr. Green, Dr. Lewis, Dr. Miller, Mr. Peery and Mr. Reynolds were its members.

COMPENSATION COMMITTEE PROCEDURES

The Compensation Committee adopted a formal charter on January 8, 2014 which appears on the Company's website at www.nationalbankshares.com under "Corporate Governance." It is charged with annually evaluating the job performance of the Chairman, President & Chief Executive Officer and determining the appropriate compensation and benefits package for him. The Committee has delegated to Mr. Rakes the responsibility for evaluating the performance and setting the compensation of the other named executive officers, and he reports to the Committee at least annually about those matters.

In carrying out its responsibilities, the Compensation Committee meets at least once each year. There are no officers or employees present at the Compensation Committee's annual meeting to evaluate the performance of the Chairman, President & CEO and to determine his compensation. The Committee considers a package of data provided to it by the Executive Committee. The package includes the Company's financial performance data; information about the financial performance of peer institutions; and salary data from salary surveys and publicly available sources. The Committee also monitors the results of the annual advisory "say-on-pay" proposal and incorporates such results as one of many factors considered in connection with the discharge of its responsibilities, although no such factor is assigned a quantitative weighting. Because a substantial majority of our stockholders approved the compensation program described in the Company's proxy statement in 2013, the Committee did not implement changes to the Company's executive compensation program as a result of the stockholder advisory vote. At the conclusion of the Committee's meeting or at a separate meeting, the Chairman, President & CEO will provide the Committee with a report on the performance and compensation of the remaining named executive officers.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

None of the directors who serve on the Compensation Committee is now, or has been in the past, an officer or employee of Bankshares or of Bankshares' subsidiaries. This includes Chairman Shuler and Committee members: Mr. Ball, Dr. Dooley, Mr. Green, Dr. Lewis, Dr. Miller, Mr. Peery and Mr. Reynolds. Dr. Shuler serves on the Salary and Personnel Committee of NBB. No executive officer of Bankshares, NBB or NBFS served as a director of another entity which had an executive officer serving on the Bankshares Compensation Committee. No executive officer of

Bankshares, NBB or NBFS served as a member of the compensation committee of another entity which had an executive officer who served as a director of Bankshares. None of the members of the Bankshares Compensation Committee, or any business organizations or persons with whom they may be associated, has had any transactions with Bankshares or its subsidiaries, except as explained in “Director Independence and Certain Transactions with Officers and Directors.”

EXECUTIVE COMPENSATIONSummary Compensation Table

The following table sets forth information concerning total compensation earned or paid to the individuals who served as Bankshares' named executive officers during 2013.

Summary Compensation Table

Name and Principal Position	Year	Salary (\$)	Bonus (\$)
James G. Rakes	2013	706,800	300,440
Chairman, President & CEO – NBI	2012	706,800	286,133
(Principal Executive Officer)	2011	628,243	286,133
Chairman, President & CEO – NBB			
Chairman, President & CEO – NBFS			
David K. Skeens	2013	137,542	---
Treasurer & CFO – NBI	2012	125,625	---
(Principal Financial Officer)	2011	108,563	---
Senior Vice President/Operations & Risk Management & CFO – NBB			
F. Brad Denardo	2013	300,025	---
Executive Vice President – NBI	2012	300,000	---
Executive Vice President/ COO – NBB	2011	291,000	---
Treasurer – NBFS			
Bryson J. Hunter	2013	133,980	---
Senior Vice President, Secretary & Counsel – NBI	2012	130,250	---
Counsel – NBB	2011	85,728	---
Secretary & Counsel - NBFS			

Summary Compensation Table (continued)

Name	Year	Non-Equity Incentive Plan Compensation (\$)⁽¹⁾	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)⁽²⁾	All Other Compensation (\$)⁽³⁾	Total (\$)
James G. Rakes	2013	---	49,720	107,622	1,164,582
	2012	---	267,558	111,940	