



Local Bank. Personal Service.



National Bankshares

2014 ANNUAL REPORT

National Bankshares, Inc. is committed to providing the people of Southwest Virginia with truly personalized community banking. We always strive to provide friendly service and a combination of traditional and innovative banking products to meet our customers' diverse needs. We also believe in giving back to our community by supporting local people and organizations who make our hometowns a better place to live. Thank you for choosing us for your financial needs and for placing your trust in National Bankshares, Inc.

CONTENTS

Financial Highlights	1
Message to Shareholders	2
National Bankshares Board of Directors	3
Consolidated Balance Sheets	4
Consolidated Statements of Income	5
National Bank Board of Directors	6
Our Region	7
Corporate Information	8

ANNUAL MEETING

The National Bankshares, Inc. Annual Meeting of Stockholders will be held on Tuesday, May 12, 2015 at 3:00 p.m. at Custom Catering Center, 902 Patrick Henry Drive, Blacksburg, Virginia.

National Bankshares, Inc.

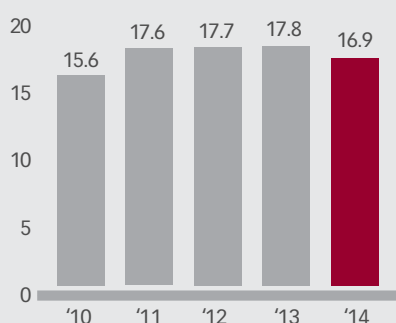
National Bankshares, Inc. is the Blacksburg, Virginia based holding company of the 124-year old National Bank. Founded in 1986 with the mission of providing a solid community banking investment that benefits our region, Bankshares is a nationally-recognized leader in community banking performance. In addition to National Bank, National Bankshares also operates a financial services subsidiary, National Bankshares Financial Services, Inc., that provides investment and insurance services in a community bank setting.

Financial Highlights (\$ in thousands, except ratios, share and per share data)

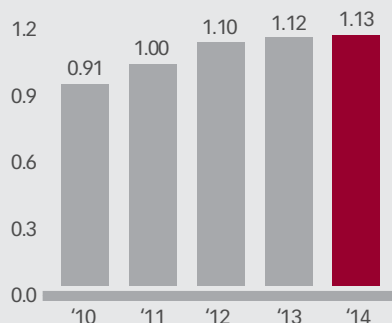
For the year	2014	2013	2012	2011	2010
Net income	\$ 16,914	\$ 17,790	\$ 17,747	\$ 17,638	\$ 15,569
Basic net income per share	2.43	2.56	2.56	2.54	2.25
Diluted net income per share	2.43	2.55	2.55	2.54	2.24
Cash dividends per share	1.13	1.12	1.10	1.00	0.91
Return on average assets	1.51%	1.63%	1.64%	1.71%	1.57%
Return on average equity	10.72%	11.90%	12.01%	12.89%	12.07%
Net interest margin	4.01%	4.24%	4.37%	4.59%	4.52%
Efficiency ratio	47.17%	45.99%	43.77%	44.00%	46.01%
Average equity to average assets	14.08%	13.71%	13.68%	13.26%	13.03%

At year-end	2014	2013	2012	2011	2010
Loans, net	597,203	587,463	583,813	580,402	568,779
Total securities	385,385	347,109	350,117	317,075	314,092
Total assets	1,154,731	1,110,630	1,104,361	1,067,102	1,022,238
Total deposits	982,428	960,036	946,766	919,333	884,583
Stockholders' equity	166,303	145,892	150,109	141,299	129,187
Book value per share	23.93	21.00	21.60	20.36	18.63

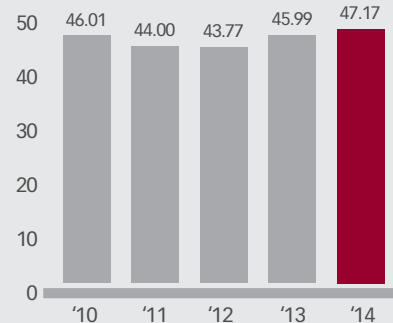
Net income (\$ millions)



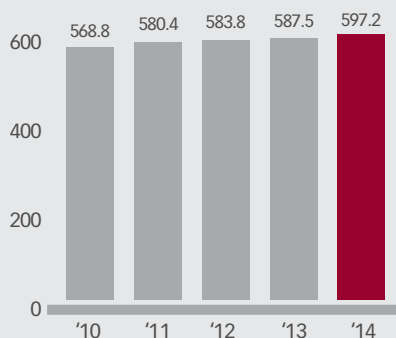
Cash dividends per share (\$)



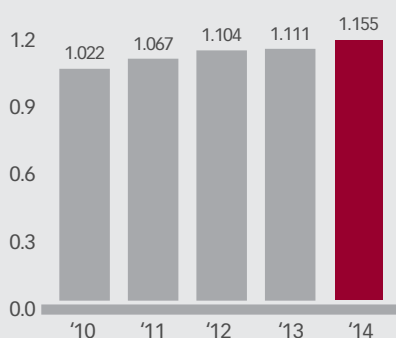
Efficiency ratio (%)



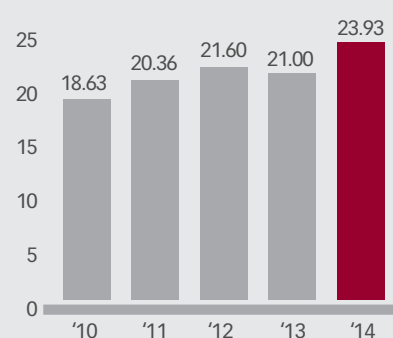
Loans, net (\$ millions)



Total assets (\$ billions)



Book value per share (\$)



To Our Shareholders

In 2014, we were reminded that banking is a cyclical business. It comes as no surprise that given the continued economic weakness in our marketplace that our year-end results are not consistent with our record high financial performance in recent years. As true community bankers, we are committed to working with our customers to assist them through tough times but we remain focused on monitoring and dealing with deteriorating credits, as well as taking measures necessary to improve earnings capability.

Net income after taxes for 2014 was \$16.91 million, a decrease from the \$17.79 million earned in 2013. Despite the fact that net income decreased as a result of the compression of margins and slow economic activity in our marketplace, your Company was able to report strong returns in some key areas. The 2014 return on average assets and return on average equity were 1.51% and 10.72%, respectively. The Company's basic earnings per share in 2014 were \$2.43. Stockholders' equity was \$166 million at year-end 2014, an increase of almost 14% from year-end 2013. Total assets at \$1.15 billion grew over \$44.10 million, or almost 4%, during 2014.

Growing the loan portfolio with quality assets is important for our continued success. Loan officers and credit administration staff have been very focused on maintaining a loan portfolio with strong credit quality. While modest, we were able to improve loan growth in 2014 by increasing the loan portfolio to \$597 million at December 31, 2014, a \$9.74 million increase from December 31, 2013. We continue to focus on increasing assets and liabilities through growth in quality loans and core deposits. Again, by staying committed to our community banking philosophy, this growth objective will be accomplished through further development of our current customer relationships and identifying new customer relationships. We believe that through this process, we enhance our ability to serve our customers and communities while enhancing stockholder value.

We continue to focus on increasing assets and liabilities through growth in quality loans and core deposits.

The full detail of our financial performance is discussed in the Management's Discussion and Analysis section found in the attached U.S. Securities and Exchange Commission Form 10-K. Please take the opportunity to read this information as it provides additional insights and discussion related to our 2014 financial performance.

It also is important to note that after ongoing reviews of the Company's earnings and capital position, your Board of Directors declared dividends in 2014 totaling \$1.13 compared to \$1.12 in 2013. This per share dividend payment amount resulted in an increase in the dividend payout ratio to 46.43% in 2014 compared to 43.74% in 2013.

In April 2014, Brad Denardo was elected President & CEO of the Company's subsidiary bank, The National Bank of Blacksburg. His election by the Bank's board reflected his major contribution to the growth and development of the Bank. As many of you know, Brad joined the Bank in 1983, and his knowledge, experience and relationships inside and outside of the Bank have played a significant part in achieving our growth and success.

In 2015, margin compression, potential credit weaknesses, competition for customers, and further regulatory burdens will all be at the forefront. Nonetheless, we continue to focus our efforts to have National Bankshares be a top performer responding to the needs of our customers, our stockholders, our employees, and our communities.

On behalf of the Directors of the Company and of National Bank, the management team and all our employees, we thank you for your investment and support.



James G. Rakes
Chairman, President and
Chief Executive Officer



National Bankshares, Inc. Board of Directors

Fulfilling our community banking mission requires input from a diverse group of leaders who represent the region we serve. We are thankful for the talents and time of our directors, whose experience, vision and accountability help guide our Company forward.



Standing, from left:

Glenn P. Reynolds
President
Reynolds Architects, Inc.

Lawrence J. Ball
President
Moog Components Group

William A. Peery
President
Cargo Oil Co., Inc.

John E. Dooley
Chief Executive Officer
Virginia Tech Foundation, Inc.

Seated, from left:

Charles E. Green, III
Financial Planner
AXA Advisors, L.L.C.

Dr. Mary G. Miller
President
Interactive Design and
Development, Inc.

Dr. James M. Shuler
Delegate, Retired
Virginia House of Delegates

Dr. Jack M. Lewis
President

New River Community College

James G. Rakes
*Chairman, President and Chief
Executive Officer*
National Bankshares, Inc.
Executive Chairman
National Bank
*Chairman, President and Chief
Executive Officer*
National Bankshares Financial
Services, Inc.

Consolidated Balance Sheets

\$ in thousands, except share and per share data

	December 31, 2014	December 31, 2013
Assets		
Cash and due from banks	\$ 12,894	\$ 13,283
Interest-bearing deposits	102,548	98,066
Securities available for sale, at fair value	222,844	181,712
Securities held to maturity (fair value approximates \$167,703 at December 31, 2014 and \$159,337 at December 31, 2013)	161,452	163,983
Restricted stock	1,089	1,414
Total securities	385,385	347,109
Mortgage loans held for sale	291	1,276
Loans:		
Real estate construction loans	45,562	45,925
Consumer real estate loans	147,039	145,499
Commercial real estate loans	310,762	311,266
Commercial non real estate loans	33,413	31,262
Public sector and IDA loans	41,361	34,220
Consumer non real estate loans	28,182	28,423
Total loans	606,319	596,595
Less unearned income and deferred fees	(853)	(905)
Loans, net of unearned income and deferred fees	605,466	595,690
Less allowance for loan losses	(8,263)	(8,227)
Loans, net	597,203	587,463
Premises and equipment, net	9,131	9,951
Accrued interest receivable	5,748	5,949
Other real estate owned, net	4,744	4,712
Intangible assets and goodwill	7,223	8,299
Bank-owned life insurance (BOLI)	21,797	21,181
Other assets	7,767	13,341
Total assets	\$ 1,154,731	\$ 1,110,630
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 150,744	\$ 142,645
Interest-bearing demand deposits	533,641	501,541
Savings deposits	81,297	74,141
Time deposits	216,746	241,709
Total deposits	982,428	960,036
Accrued interest payable	68	92
Other liabilities	5,932	4,610
Total liabilities	988,428	964,738
Commitments and contingencies	---	---
Stockholders' equity:		
Preferred stock, no par value, 5,000,000 shares authorized; none issued and outstanding	---	---
Common stock of \$1.25 par value. Authorized 10,000,000 shares; issued and outstanding, 6,950,474 shares in 2014 and 6,947,974 shares in 2013	8,688	8,685
Retained earnings	163,287	154,171
Accumulated other comprehensive (loss), net	(5,672)	(16,964)
Total stockholders' equity	166,303	145,892
Total liabilities and stockholders' equity	\$ 1,154,731	\$ 1,110,630

Consolidated Statements of Income

\$ in thousands, except share and per share data

	Years ended December 31,		
	2014	2013	2012
Interest Income			
Interest and fees on loans	\$ 31,217	\$ 32,819	\$ 35,354
Interest on interest-bearing deposits	262	213	240
Interest on securities – taxable	6,798	6,585	6,460
Interest on securities – nontaxable	5,826	6,388	6,463
Total interest income	44,103	46,005	48,517
Interest Expense			
Interest on time deposits of \$100 or more	570	865	1,491
Interest on other deposits	4,329	5,090	6,396
Total interest expense	4,899	5,955	7,887
Net interest income	39,204	40,050	40,630
Provision for loan losses	1,641	1,531	3,134
Net interest income after provision for loan losses	37,563	38,519	37,496
Noninterest Income			
Service charges on deposit accounts	2,434	2,563	2,594
Other service charges and fees	187	225	243
Credit card fees	3,631	3,330	3,278
Trust income	1,213	1,150	1,313
BOLI income	711	739	814
Other income	868	997	669
Realized securities gains (losses), net	2	(46)	60
Total noninterest income	9,046	8,958	8,971
Noninterest Expense			
Salaries and employee benefits	11,691	11,978	12,005
Occupancy and furniture and fixtures	1,722	1,616	1,589
Data processing and ATM	1,643	1,700	1,593
FDIC assessment	533	554	475
Credit card processing	2,593	2,546	2,442
Intangible assets amortization	1,075	1,078	1,083
Net costs of other real estate owned	369	296	208
Franchise taxes	1,182	1,083	901
Other operating expenses	3,709	3,519	3,179
Total noninterest expense	24,517	24,370	23,475
Income before income tax expense	22,092	23,107	22,992
Income tax expense	5,178	5,317	5,245
Net income	\$ 16,914	\$ 17,790	\$ 17,747
Basic net income per common share	\$ 2.43	\$ 2.56	\$ 2.56
Fully diluted net income per common share	\$ 2.43	\$ 2.55	\$ 2.55

National Bank Board of Directors



From left to right:

F. Brad Denardo

*Executive Vice President
National Bankshares, Inc.
President and Chief Executive
Officer
National Bank
Treasurer
National Bankshares Financial
Services, Inc.*

James C. Thompson

*Chairman
Thompson & Litton, Inc.*

James G. Rakes

*Chairman, President and Chief
Executive Officer
National Bankshares, Inc.
Executive Chairman
National Bank
Chairman, President and Chief
Executive Officer
National Bankshares Financial
Services, Inc.*

Dr. J. Lewis Webb, Jr.

Retired Dentist

Dr. James M. Shuler

*Delegate, Retired
Virginia House of Delegates*

Michael E. Dye

*Pharmacist/Owner
New Graham Pharmacy*

Mildred R. Johnson

*Associate Vice Provost for
Enrollment Management and
Director of Undergraduate
Admissions
Virginia Polytechnic Institute and
State University*

Norman V. Fitzwater

*President
A Cleaner World, Blacksburg*

National Bank Advisory Boards

Montgomery County: Dan A. Dodson, Kathryn S. Oddo, James J. Owen, Arlene A. Saari, James C. Stewart, Marc A. Verniel

Giles County: Dr. Terry E. Arbogast, Lisa W. Epperly, Dr. Robert C. McCracken

Galax: Thomas L. McChesney, Dr. James A. Williams, Jr., David F. Wilson

Christiansburg/Radford/Pulaski County: Charles R. Beller, III, William K. Cunningham, Dr. Kenneth E. Jones, Dr. Peter J. McDonald

Richlands: Thurmon T. Hackworth, Dr. Marvin D. Harman, Peter M. Mulkey, John M. Warner

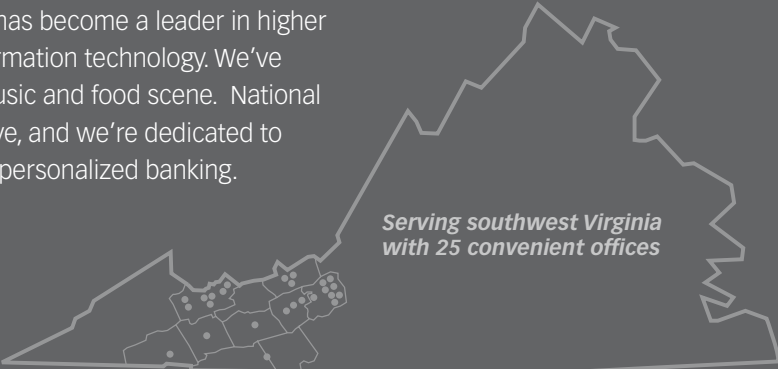


Welcome to Southwest Virginia



Proudly serving a dynamic region

The mountains and valleys of southwestern Virginia are well known for their scenic beauty. Look beyond the picture-postcard landscapes and you'll find a diversified 21st century economy made possible by the talented and hardworking people who call this area home. Rich in agricultural, mineral and forest resources, our region's economy has become a leader in higher education, research, medicine, high tech manufacturing and information technology. We've also embraced our cultural heritage by fostering a thriving art, music and food scene. National Bankshares, Inc. is proud to be a part of the communities we serve, and we're dedicated to meeting the financial needs of our unique region with truly local, personalized banking.



Serving southwest Virginia with 25 convenient offices

Corporate Information



National Bankshares, Inc. Executive Officers

James G. Rakes
Chairman, President and Chief Executive Officer

F. Brad Denardo
Executive Vice President

David K. Skeens
Treasurer and Chief Financial Officer

Annual Meeting

The Annual Meeting of Stockholders will be held on Tuesday, May 12, 2015 at 3:00 p.m. at Custom Catering Center, 902 Patrick Henry Drive, Blacksburg, Virginia.

Corporate Stock

National Bankshares, Inc. common stock trades on the NASDAQ Capital Market under the symbol "NKSH".

Financial Information

Investors and analysts seeking financial information about National Bankshares, Inc. should contact:

James G. Rakes
Chairman, President and Chief Executive Officer
(540) 951-6300 or (800) 552-4123
jrakes@nbbank.com

Written requests may be directed to:
National Bankshares, Inc.
P.O. Box 90002, Blacksburg, VA 24062-9002

Stockholder Services and Stock Transfer Agent

Stockholders seeking information about stock transfer requirements, lost certificates, dividends and other stockholder matters should contact:

Bryson J. Hunter
Secretary and Counsel
(540) 951-6300 or (800) 552-4123
bhunter@nbbank.com

or

Computershare, Inc.
P.O. Box 30170
College Station, TX 77842
800-368-5948
www.computershare.com

A copy of National Bankshares, Inc.'s annual report to the Securities and Exchange Commission on Form 10-K will be furnished without charge to any stockholder upon written request. The Form 10-K and other corporate publications are also available at www.nationalbankshares.com. Proxy materials for the Annual Meeting of Stockholders are available at www.nationalbanksharesproxy.com.

Corporate Office

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