

Banking Built on Values



National Bankshares

2017 Annual Report

National Bankshares, Inc. is a community bank holding company with headquarters in Blacksburg in Southwest Virginia. National Bankshares is the parent company of National Bank, a community bank with over 126 years of service in the area. National Bank currently operates 25 office locations and one loan production office throughout Southwest Virginia and offers a full range of financial products and services, including deposit accounts, commercial, consumer and mortgage loans, credit cards and trust services.

National Bankshares also operates an insurance and brokerage subsidiary, National Bankshares Financial Services, Inc., which does business as National Bankshares Insurance Services and National Bankshares Investment Services.



You are cordially invited to join us at the National Bankshares, Inc. Annual Meeting of Stockholders. The meeting will be held Tuesday, May 8th, 2018 at 3 p.m. at the Custom Catering Center, 902 Patrick Henry Drive, Blacksburg, Virginia 24060.



Banking Built on Values

National Bankshares, Inc. will strive to maximize earnings by practicing “Banking Built on Values” where our customers and shareholders can expect excellence in service based on honesty, integrity and accountability delivered by knowledgeable and valued employees who are committed to serving our communities as genuine professionals.

Corporate Values of National Bankshares

Positive Attitude

Accountability

Honesty and Integrity

Excellence in Service

Respect for Others

Open and Clear Communication

Knowledgeable

How do these values translate into our daily work? By fully investing in and immersing ourselves in these values, we will exhibit behaviors that show:

Team First

We value our coworkers as much as ourselves

Excellence in Service

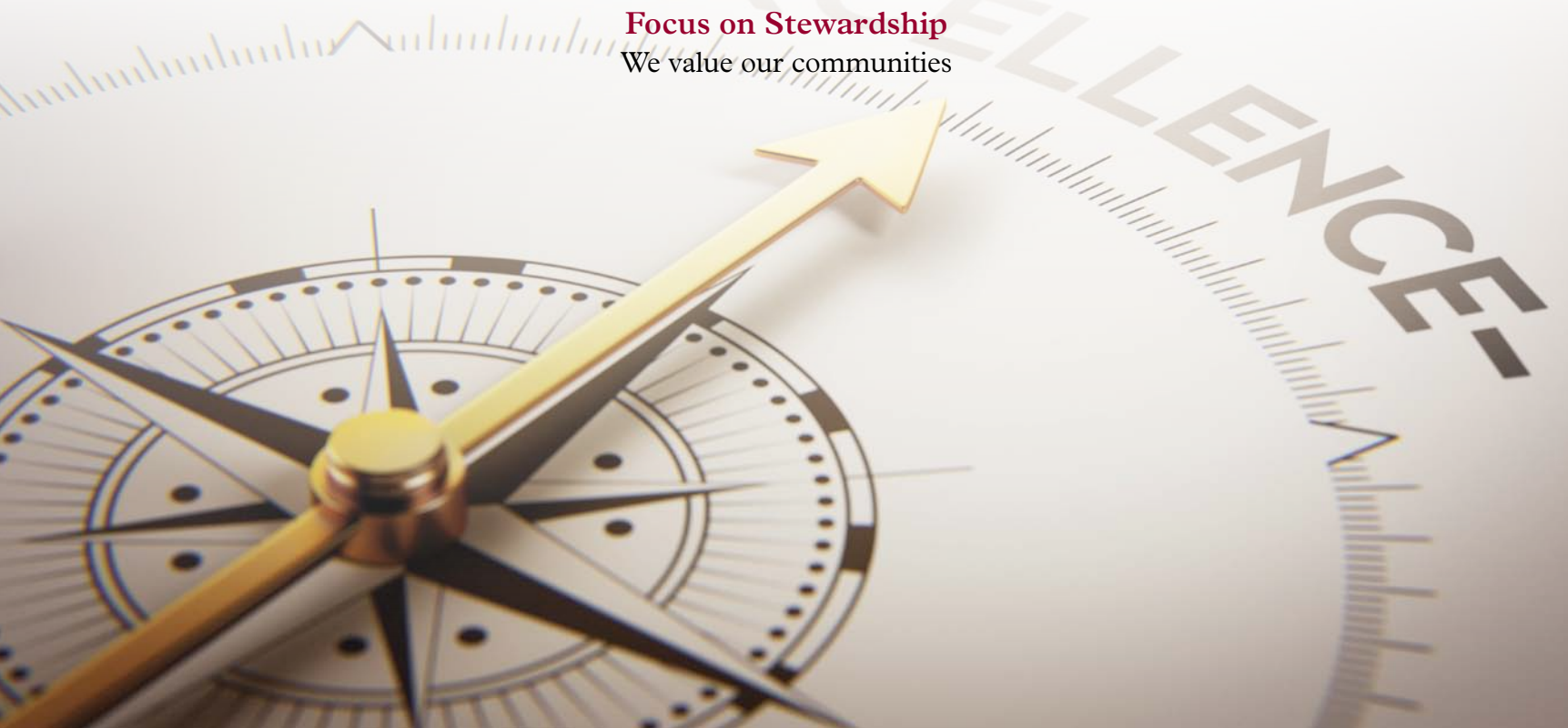
We value our customers

Focus on Profitability

We value our shareholders

Focus on Stewardship

We value our communities



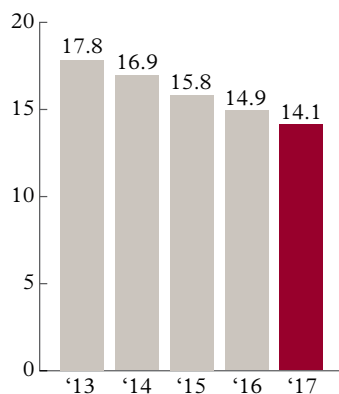


Financial Highlights 2013-2017

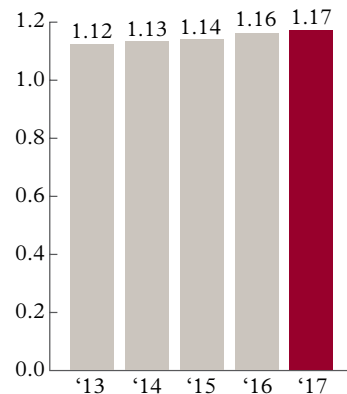
(\$ in thousands, except ratios, share and per share data)

FOR THE YEAR	2017	2016	2015	2014	2013
Net income	\$ 14,092	\$ 14,942	\$ 15,833	\$ 16,914	\$ 17,790
Basic net income per share	2.03	2.15	2.28	2.43	2.56
Diluted net income per share	2.03	2.15	2.28	2.43	2.55
Cash dividends per share	1.17	1.16	1.14	1.13	1.12
Return on average assets	1.14%	1.24%	1.37%	1.51%	1.63%
Return on average equity	7.64%	8.30%	9.22%	10.72%	11.90%
Net interest margin	3.45%	3.51%	3.86%	4.00%	4.21%
Average equity to average assets	14.93%	14.92%	14.86%	14.08%	13.71%
AT YEAR-END	2017	2016	2015	2014	2013
Loans, net	660,144	639,452	610,711	597,203	587,463
Total securities	459,751	440,409	389,288	385,385	347,109
Total assets	1,256,757	1,233,942	1,203,519	1,158,798	1,114,561
Allowance for loan losses to total loans	1.19%	1.28%	1.34%	1.36%	1.38%
Total deposits	1,059,734	1,043,442	1,018,859	982,428	960,036
Stockholders' equity	184,896	178,263	172,114	166,303	145,892
Book value per share	26.57	25.62	24.74	23.93	21.00

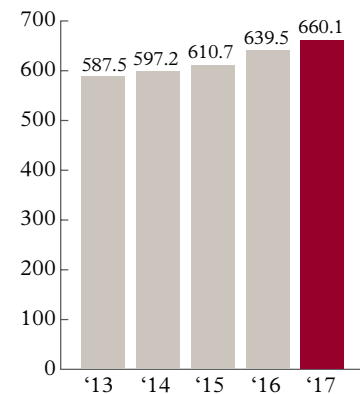
Net income (\$ millions)



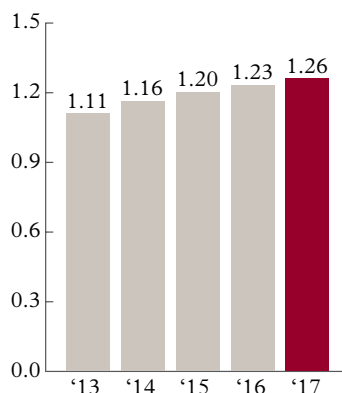
Cash dividends per share (\$)



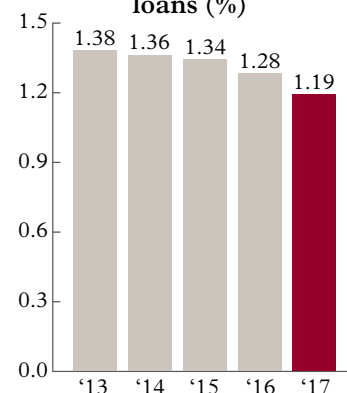
Loans, net (\$ millions)



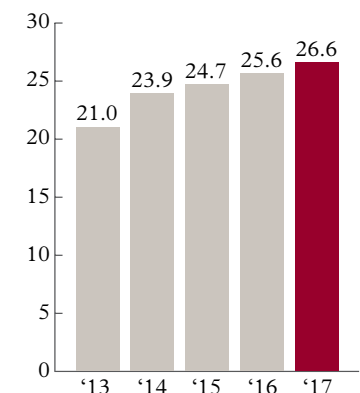
Total assets (\$ billions)



Allowance for loan losses to total loans (%)



Book value per share (\$)





To Our Shareholders

National Bankshares continues to be a sound and profitable community banking institution. We have stayed the course that brought us here by making good loans and providing the highest level of customer service, while rewarding our shareholders' investment and giving back to the communities we serve.

On September 1, 2017, I was honored to be named as President and Chief Executive Officer of National Bankshares upon the retirement of Jim Rakes. In his career of 35 years with National Bank and National Bankshares, Mr. Rakes provided our Company with strong leadership and a steady guiding hand. On behalf of myself as well as the Directors, employees and shareholders of the Company, we would like to thank Mr. Rakes for his decades of dedicated service and his peerless contribution to the financial success and remarkable longevity of the Company.

As you may have read in the Company's 2017 earnings announcement made on February 22, 2018, the Tax Cuts and Jobs Act of 2017 ("the Act") has had a major impact on our 2017 financial results. We anticipate that the Act will have a long-term positive effect on our earnings by reducing the Company's tax rate from 35% to 21%. However, due to the tax rate change, we were required to recognize a \$1.59 million revaluation adjustment on tax deferred assets in the fourth quarter of 2017.

Bankshares finished 2017 with earnings of \$14.09 million, or \$2.03 per common share. Excluding the unforeseen effect of the revaluation adjustment noted above, earnings for the year were \$15.68 million, which compares favorably to earnings of \$14.94 million in 2016. Our ongoing profitability, strong capital position and efforts to control costs resulted in a dividend payment of \$1.17 per share in 2017, up from \$1.16 in 2016.

Loans provide the core of our Company's earnings, and in 2017 we were pleased to see continued growth in this area. Net loans increased to \$660.14 million in 2017, up from \$639.45 million the year before. The Company has made a sustained effort to make our loan portfolio the best it can be by investing in additional loan personnel and technology while working to improve lending processes whenever possible. These efforts are paying off, and in 2017 we experienced substantial reductions in nonperforming assets as we continue to work with borrowers to restructure loans, when possible. As a result, we were able to reduce the allowance for loan losses in 2017 to \$7.93 million, down 4.5% from \$8.30 million in 2016.

At National Bankshares we diligently reinvest in the people, technology and projects that will position us strongly for the future. 2017 was no exception as we hired several experienced employees in critical areas, implemented technology updates, launched a new website and made physical improvements to our branch offices. These efforts will continue in 2018, and along with favorable changes in the broader economic sphere, should bode well for the future of our Company.

2017 marked National Bank's 126th year in business. Our long track record has been made possible by a commitment to "Banking Built on Values" – honesty, accountability, integrity and respect being foremost. At the beginning of 2018, we felt it was time to enshrine the values that we have always practiced by putting them into writing. These values give us direction, as reflected in the compass logo on the cover of our report, and a full statement of these values can be found on the first page. Our employees are dedicated to knowing and living these values so that our customers, shareholders and communities can continue to trust and rely on National Bankshares, Inc.

Thank you for your continued support. From the National Bankshares family, we wish you all the best in 2018.

F. Brad Denardo
President and
Chief Executive Officer





Consolidated Balance Sheets

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

	December 31, 2017	December 31, 2016
Assets		
Cash and due from banks	\$ 12,926	\$ 13,974
Interest-bearing deposits	51,233	80,268
Securities available for sale, at fair value	331,387	304,282
Securities held to maturity (fair value of \$130,113 at December 31, 2017 and \$137,692 at December 31, 2016)	127,164	134,957
Restricted stock	1,200	1,170
Total securities	459,751	440,409
Mortgage loans held for sale	260	478
Loans:		
Real estate construction loans	34,694	36,345
Consumer real estate loans	166,965	157,718
Commercial real estate loans	340,314	336,457
Commercial non real estate loans	40,518	39,024
Public sector and IDA loans	51,443	45,474
Consumer non real estate loans	34,648	33,528
Total loans	668,682	648,546
Less unearned income and deferred fees	(613)	(794)
Loans, net of unearned income and deferred fees	668,069	647,752
Less allowance for loan losses	(7,925)	(8,300)
Loans, net	660,144	639,452
Premises and equipment, net	8,221	8,853
Accrued interest receivable	5,297	5,260
Other real estate owned, net	2,817	3,156
Intangible assets and goodwill	5,898	5,966
Bank-owned life insurance (BOLI)	33,756	22,998
Other assets	16,454	13,128
Total assets	\$ 1,256,757	\$ 1,233,942
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 182,511	\$ 171,946
Interest-bearing demand deposits	622,189	604,093
Savings deposits	140,150	136,789
Time deposits	114,884	130,614
Total deposits	1,059,734	1,043,442
Accrued interest payable	62	55
Other liabilities	12,065	12,182
Total liabilities	1,071,861	1,055,679
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, 6,957,974 shares at December 31, 2017 and December 31, 2016	8,698	8,698
Retained earnings	185,893	178,224
Accumulated other comprehensive loss, net	(9,695)	(8,659)
Total stockholders' equity	184,896	178,263
Total liabilities and stockholders' equity	\$ 1,256,757	\$ 1,233,942



Consolidated Statements of Income

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

	Years ended December 31,		
	2017	2016	2015
Interest Income			
Interest and fees on loans	\$ 29,932	\$ 29,365	\$ 30,446
Interest on interest-bearing deposits	791	532	254
Interest on securities – taxable	5,711	5,910	6,776
Interest on securities – nontaxable	4,826	5,123	5,438
Total interest income	41,260	40,930	42,914
Interest Expense			
Interest on deposits	4,125	4,166	4,183
Total interest expense	4,125	4,166	4,183
Net interest income	37,135	36,764	38,731
Provision for loan losses	157	1,650	2,009
Net interest income after provision for loan losses	36,978	35,114	36,722
Noninterest Income			
Service charges on deposit accounts	2,776	2,458	2,250
Other service charges and fees	205	212	215
Credit card fees	3,948	3,798	3,861
Trust income	1,530	1,346	1,229
BOLI income	758	597	603
Other income	1,148	1,289	1,295
Realized securities gains, net	14	232	33
Total noninterest income	10,379	9,932	9,486
Noninterest Expense			
Salaries and employee benefits	13,746	12,792	12,522
Occupancy and furniture and fixtures	1,820	1,849	1,743
Data processing and ATM	2,275	2,186	1,657
FDIC assessment	364	476	546
Credit card processing	2,748	2,782	2,692
Intangible assets amortization	68	257	999
Net costs of other real estate owned	205	472	608
Franchise taxes	1,315	1,296	1,288
Other operating expenses	4,431	4,042	3,580
Total noninterest expense	26,972	26,152	25,635
Income before income tax expense	20,385	18,894	20,573
Income tax expense	6,293	3,952	4,740
Net income	\$ 14,092	\$ 14,942	\$ 15,833
Basic net income per common share	\$ 2.03	\$ 2.15	\$ 2.28
Fully diluted net income per common share	\$ 2.03	\$ 2.15	\$ 2.28



Boards of Directors

The Directors of National Bankshares and National Bank bring a diverse range of knowledge and experience to the leadership of the Company. The depth of their contributions play a fundamental role in the success of National Bankshares as a profitable community banking institution.



National Bankshares, Inc. Board of Directors, standing from left: **Michael E. Dye**, Pharmacist/Owner, New Graham Pharmacy; **Glenn P. Reynolds**, President, Reynolds Architects, Inc.; **Lawrence J. Ball**, President, Moog Components Group; **Dr. J. Lewis Webb, Jr.**, Retired Dentist; **William A. Peery**, President, Cargo Oil Co., Inc.; **Norman V. Fitzwater, III**, President, A Cleaner World, Blacksburg; **Dr. Mary G. Miller**, Director, Regional Acceleration and Mentoring Program; **James C. Thompson**, Chairman, Thompson & Litton, Inc.; **Dr. John E. Dooley**, CEO, Virginia Tech Foundation, Inc.

Seated, from left: **Mildred R. Johnson**, Dean of Admissions, Radford University; **Charles E. Green, III**, Financial Planner, AXA Advisors, L.L.C.; **Dr. Jack M. Lewis**, Past President, New River Community College; **F. Brad Denardo**, President and CEO, National Bankshares, Inc., Chairman, President and CEO, National Bank, Chairman, President & CEO, National Bankshares Financial Services, Inc.; **James G. Rakes**, Chairman, National Bankshares, Inc.



National Bank Board of Directors, standing from left: **Glenn P. Reynolds**, **William A. Peery**, **Mary G. Miller**, **J. Lewis Webb, Jr.**, **Lawrence J. Ball**, **Michael E. Dye**, **Norman V. Fitzwater, III**. Seated, from left: **James C. Thompson**, **Charles E. Green, III**, **Mildred R. Johnson**, **John E. Dooley**, **F. Brad Denardo**.



James G. Rakes: A Distinguished Career

On August 31st, 2017, James G. Rakes retired from his positions as President and Chief Executive Officer of National Bankshares, Inc., as Chairman of the Board of National Bank and as President and CEO of National Bankshares Financial Services.

Mr. Rakes joined National Bank in 1982 and succeeded William Billig as President and CEO in 1983. Under Mr. Rakes' leadership, the bank began a remarkable 35-year period of growth and financial success. In 1983, the bank had \$58.6 million in assets and by the end of 1989 had grown to \$162 million in assets. In 1986 Mr. Rakes led the formation of the bank's holding company, National Bankshares, Inc., positioning the Company for future growth and acquisitions. The bank enlarged its branch footprint in the 80's and early 90's, adding new offices in Blacksburg, Christiansburg, Pearisburg and Pembroke.

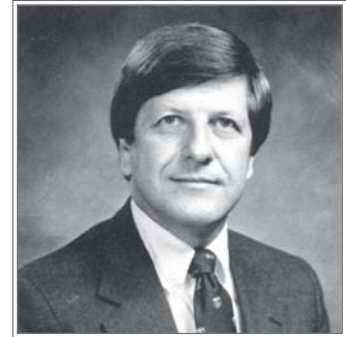
In 1996 the Company took a major leap forward when it acquired The Bank of Tazewell County (BTC). The merger of National Bank and BTC increased National Bankshares' asset size from slightly over \$200 million to \$388 million, and added new branch locations in Tazewell, Bluefield and Richlands. Bankshares ended the millennium with \$472 million in assets, \$292 million in loans and over 200 employees.

By the end of 2009 the Company had grown to \$982 million in assets and \$583 million in loans, and in 2011 reached assets of over \$1 billion. Today, with over \$1.2 billion in assets and 25 offices across Southwest Virginia, the Company's current size, financial strength and profitability serve as testament to Mr. Rakes' outstanding leadership.

Mr. Rakes' contributions reached well beyond the financial success of the Company and into the community at large. He contributed years of service and leadership on the boards of many local organizations, including the Blacksburg Museum and Cultural Foundation, The Blacksburg Partnership, the Free Clinic of the New River Valley, the Montgomery Regional Hospital, New River Community College and the Mental Health Association of the NRV, among others.

Mr. Rakes was also a tireless advocate for the community banking industry, serving on various committees and boards of the American Bankers Association and the Virginia Bankers Association. In 1999, Mr. Rakes helped found Bankers Insurance, which has since grown to 24 locations in Virginia and North Carolina and is the 5th largest insurance company in Virginia.

Mr. Rakes currently serves as Chairman of the National Bankshares Board and splits his time between Blacksburg and Florida where he enjoys spending time in retirement with his grandchildren.



Jim Rakes in 1984



Mr. Rakes with former Bankshares Director Paul Duncan (deceased).



Celebrating the Bank's 100th anniversary with Blacksburg's Mayor Roger Hedgepeth.



Signing the BTC merger with BTC President Ray Dodson (left) in 1996.



Receiving recognition for one of the Bank's many charitable donations.



Serving up ice cream for the Company's employees with Brad Denardo.



Corporate Information

National Bankshares, Inc. Executive Officers

F Brad Denardo
President and Chief Executive Officer
David K. Skeens
Treasurer and Chief Financial Officer

Annual Meeting

The Annual Meeting of Stockholders will be held on Tuesday, May 8, 2018 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:

F Brad Denardo
President and Chief Executive Officer
(540) 951-6300 or (800) 552-4123
bdenardo@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:

Joe Beury
Senior Vice President/Trust Officer
(540) 961-8500 or (800) 552-4123
jbeury@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.

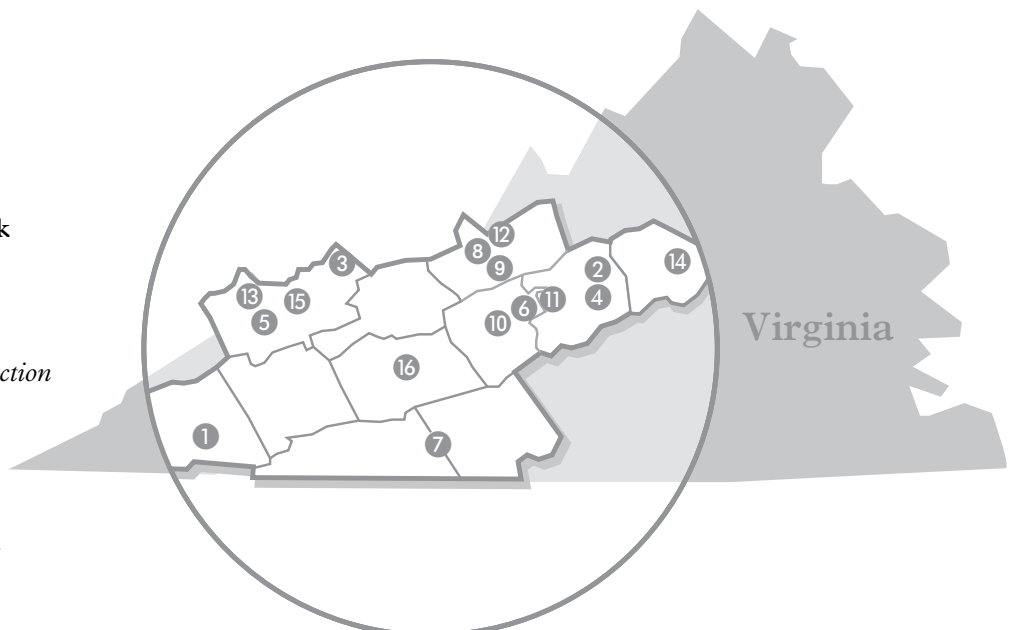
Corporate Office

National Bankshares, Inc.
101 Hubbard Street
Blacksburg, Virginia 24060
P.O. Box 90002
Blacksburg, Virginia 24062-9002
www.nationalbankshares.com
(540) 951-6300 or (800) 552-4123



National Bank Locations

- | | |
|-------------------------------|---|
| 1 Abingdon | 9 Pembroke |
| 2 Blacksburg
6 offices | 10 Pulaski
2 offices |
| 3 Bluefield, VA
2 offices | 11 Radford |
| 4 Christiansburg
2 offices | 12 Rich Creek |
| 5 Claypool Hill | 13 Richlands |
| 6 Dublin | 14 Roanoke
Loan Production
Office |
| 7 Galax | 15 Tazewell
3 offices |
| 8 Pearisburg | 16 Wytheville |





National Bankshares

101 Hubbard Street
Blacksburg, Virginia 24060