

2016 ANNUAL REPORT



Our Story

Continues



National Bankshares

*T*hese days, it's easy to think that banking is essentially a technological activity. There is no doubt that innovations in digital finance have revolutionized the ease with which we can perform everyday banking functions. But at National Bankshares, we believe that banking is defined by the personal relationships we have with our customers. Without the communication, trust and friendships we have with our customers, our Company would not exist. We know that there will be a place for our brand of relationship-based community banking for many years to come.

We know that our story continues.

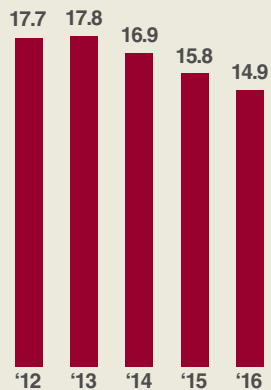
FINANCIAL HIGHLIGHTS 2012-2016

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

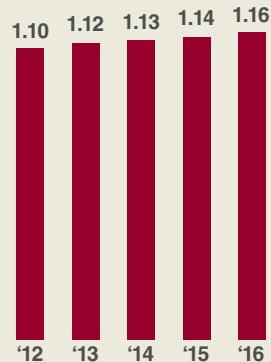
FOR THE YEAR	2016	2015	2014	2013	2012
Net income	\$ 14,942	\$ 15,833	\$ 16,914	\$ 17,790	\$ 17,747
Basic net income per share	2.15	2.28	2.43	2.56	2.56
Diluted net income per share	2.15	2.28	2.43	2.55	2.55
Cash dividends per share	1.16	1.14	1.13	1.12	1.10
Return on average assets	1.24%	1.37%	1.51%	1.63%	1.64%
Return on average equity	8.30%	9.22%	10.72%	11.90%	12.01%
Net interest margin	3.51%	3.86%	4.00%	4.21%	4.34%
Efficiency ratio	52.17%	49.41%	47.08%	45.99%	43.77%
Average equity to average assets	14.92%	14.86%	14.08%	13.71%	13.68%

AT YEAR-END	2016	2015	2014	2013	2012
Loans, net	639,452	610,711	597,203	587,463	583,813
Total securities	440,409	389,288	385,385	347,109	350,117
Total assets	1,233,942	1,203,519	1,158,798	1,114,561	1,107,964
Total deposits	1,043,442	1,018,859	982,428	960,036	946,766
Stockholders' equity	178,263	172,114	166,303	145,892	150,109
Book value per share	25.62	24.74	23.93	21.00	21.60

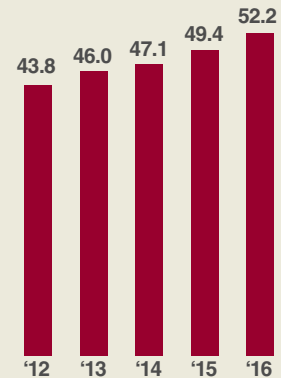
Net income (\$ millions)



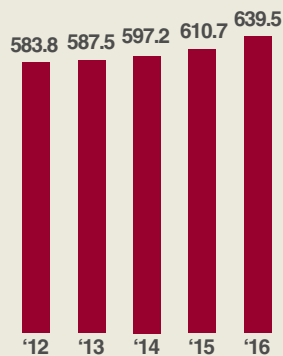
Cash dividends per share (\$)



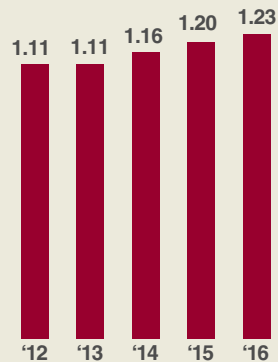
Efficiency ratio (%)



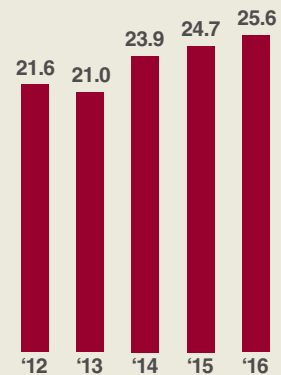
Loans, net (\$ millions)



Total assets (\$ billions)



Book value per share (\$)



To Our shareholders

2016 was another solid year for National Bankshares.

Loans and core deposits both grew steadily, while we maintained good asset quality. Noninterest income showed modest growth in key areas. Earnings were down from 2015, but we remain a very profitable company. Our profitability and strong capital position enabled us to pay a very good dividend once again this year.

Financial highlights of 2016 include:

- Net loans up 4.71%
- Total deposits up 2.41%
- Nonperforming assets down 16.93%
- Net charge-offs down 16.61%
- Per share dividend grew from \$1.14 to \$1.16
- Book value per share up 3.56%

2016 was also a special year for our Company. National Bank celebrated its 125th anniversary, and our story continues by staying true to our community banking roots. Commitment to customer service, prudent lending, capital strength and community service are still the foundation of our approach to banking.

There is no doubt that we faced challenges in 2016. Low interest rates governed by economic policy continued to reduce earnings on our loan and securities portfolios, driving down net income. An extremely competitive local loan market also reduced yields on loans. Regulatory compliance mandates required more time, money and staff than ever before.

In 2016 we met these challenges by focusing on what we can control. We worked hard to generate new loans and were rewarded with nice growth in our loan portfolio. The quality of our loans also improved, with substantial reductions in nonperforming assets and net charge-offs. We took successful measures to increase noninterest income, including an overhaul of our overdraft privilege program. As always, we found ways to control costs and maintain our efficiency.

Our Company also invested for the future in 2016. National Bank opened its first loan production office in downtown Roanoke, gaining access to an exciting new market. We hired talented, experienced professionals for several key positions and promoted others from within. We embarked on a project to review and improve our physical infrastructure, and we made ongoing investments in technology products that will make banking easier for our customers.

Bankshares' performance continues to be solid, and we look forward to a successful 2017 and beyond. As we move ahead, we will continue to execute a business plan that you can rely on. Strength, stability and superior customer service will always be at the heart of our community banking mission.

This year we would like to recognize Dr. James M. Shuler for his distinguished service on the National Bankshares and National Bank Boards of Directors. Dr. Shuler will retire from the Bankshares Board in May with 40 years of service to our organization. Through countless hours, his knowledge, experience and leadership have contributed greatly to the success of our Company. On behalf of all of our officers, employees and Directors, we thank Dr. Shuler for his dedicated service.

Looking back on our 125th year of business, we know that we would not be where we are today without our stockholders, customers and friends in the community. We thank you for your continued support. It is truly a privilege to serve you.



James G. Rakes
Chairman, President
and Chief Executive Officer



The full detail of our financial performance is discussed in the Management's Discussion and Analysis section found in the enclosed U.S. Securities and Exchange Commission Form 10-K.

National Bankshares, Inc. Board of Directors

Lawrence J. Ball is President of Moog Components Group, a Blacksburg-based division of Moog, Inc. Prior to being named President, Mr. Ball was Vice President and General Manager of the group, which designs and manufactures products in motion, electronics and fiber optics. Mr. Ball joined the Bankshares Board in 2006.

Dr. John E. Dooley is CEO and Secretary-Treasurer 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. Prior to becoming CEO of the Foundation, Dr. Dooley served as Virginia Tech's Vice President for Outreach and International Affairs. He joined the Bankshares Board in 2012.

Charles E. Green, III is a Financial Planner with AXA Advisors, L.L.C. Mr. Green has nearly 30 years of experience as a community bank director having been elected to the National Bank Board in 2006 and to the board of a predecessor bank in 1986. A resident and former mayor of Tazewell, Virginia, he has extensive experience in insurance and investment matters. Mr. Green has served on the Bankshares Board since 2011.

Dr. Mary G. Miller is the founder and President of Interactive Design and Development, Inc., a Blacksburg-based full-service Internet technology firm specializing in custom software solutions, education and online content management. Dr. Miller has an in-depth knowledge of information technology issues and the region's growing technology sector. She joined the Bankshares Board in 2003.

Dr. Jack M. Lewis is past 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. He has been involved in local and regional economic development

activities and serves on the boards of several nonprofit organizations. Dr. Lewis joined the Bankshares Board in 2004.

Glenn P. Reynolds is Founder and President of Reynolds Architects Incorporated, an architecture firm located in Blacksburg, Virginia. Mr. Reynolds has considerable experience with the area's construction and development projects and with local building firms. A member of several area boards and Virginia Tech organizations, he joined the Bankshares Board in 2006.

William A. Peery is President of Cargo Oil Co., Inc. The firm operates convenience stores and sells petroleum products out of its headquarters located in Tazewell, Virginia. Mr. Peery possesses extensive business and financial management experience as well as a close working knowledge of the western segments of Bankshares' market area. He joined the Bankshares Board in 2005.

James G. Rakes is Chairman, President and CEO of National Bankshares, Inc. Mr. Rakes is an original director of Bankshares and has served as President and CEO since its founding in 1986. Mr. Rakes was the President and CEO of National Bank from 1983 until 2014 and currently serves as Executive Chairman of the Bank. He also currently serves as Chairman, President and CEO of National Bankshares Financial Services, Inc.

Dr. James M. 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 veterinary practice in Blacksburg, Virginia. He has served on the Bankshares Board since 2002 and currently serves as Vice Chairman. Dr. Shuler retired from the National Bank Board at the end of 2016, where he had served since 1987.



Standing, from left: Dr. John E. Dooley, William A. Peery, Lawrence J. Ball, Glenn P. Reynolds
Seated from left: Charles E. Green, III, Dr. Mary G. Miller, Dr. Jack M. Lewis, Dr. James M. Shuler, James G. Rakes

CONSOLIDATED BALANCE SHEETS

\$ in thousands, except share and per share data	December 31, 2016	December 31, 2015
Assets		
Cash and due from banks	\$ 13,974	\$ 12,152
Interest-bearing deposits	80,268	130,811
Securities available for sale, at fair value	304,282	236,131
Securities held to maturity (fair value of \$137,692 at December 31, 2016 and \$158,032 at December 31, 2015)	134,957	152,028
Restricted stock	1,170	1,129
Total securities	440,409	389,288
Mortgage loans held for sale	478	634
Loans:		
Real estate construction loans	36,345	48,251
Consumer real estate loans	157,718	143,504
Commercial real estate loans	336,457	309,378
Commercial non real estate loans	39,024	37,571
Public sector and IDA loans	45,474	51,335
Consumer non real estate loans	33,528	29,845
Total loans	648,546	619,884
Less unearned income and deferred fees	(794)	(876)
Loans, net of unearned income and deferred fees	647,752	619,008
Less allowance for loan losses	(8,300)	(8,297)
Loans, net	639,452	610,711
Premises and equipment, net	8,853	9,020
Accrued interest receivable	5,260	5,769
Other real estate owned, net	3,156	4,165
Intangible assets and goodwill	5,966	6,224
Bank-owned life insurance (BOLI)	22,998	22,401
Other assets	13,128	12,344
Total assets	\$ 1,233,942	\$ 1,203,519
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	\$ 171,946	\$ 166,453
Interest-bearing demand deposits	605,226	569,787
Savings deposits	96,829	90,236
Time deposits	169,441	192,383
Total deposits	1,043,442	1,018,859
Accrued interest payable	55	56
Other liabilities	12,182	12,490
Total liabilities	1,055,679	1,031,405
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 in 2016 and 2015	8,698	8,698
Retained earnings	178,224	171,353
Accumulated other comprehensive loss, net	(8,659)	(7,937)
Total stockholders' equity	178,263	172,114
Total liabilities and stockholders' equity	\$ 1,233,942	\$ 1,203,519

CONSOLIDATED STATEMENTS OF INCOME

\$ in thousands, except share and per share data	Years ended December 31,		
	2016	2015	2014
Interest Income			
Interest and fees on loans	\$ 29,365	\$ 30,446	\$ 31,058
Interest on interest-bearing deposits	532	254	262
Interest on securities – taxable	5,910	6,776	6,798
Interest on securities – nontaxable	5,123	5,438	5,826
Total interest income	40,930	42,914	43,944
Interest Expense			
Interest on deposits	4,166	4,183	4,899
Total interest expense	4,166	4,183	4,899
Net interest income	36,764	38,731	39,045
Provision for loan losses	1,650	2,009	1,641
Net interest income after provision for loan losses	35,114	36,722	37,404
Noninterest Income			
Service charges on deposit accounts	2,458	2,250	2,434
Other service charges and fees	212	215	187
Credit card fees	3,798	3,861	3,631
Trust income	1,346	1,229	1,213
BOLI income	597	603	616
Other income	1,289	1,295	1,037
Realized securities gains, net	232	33	2
Total noninterest income	9,932	9,486	9,120
Noninterest Expense			
Salaries and employee benefits	12,792	12,522	11,606
Occupancy and furniture and fixtures	1,849	1,743	1,703
Data processing and ATM	2,186	1,657	1,650
FDIC assessment	476	546	533
Credit card processing	2,782	2,692	2,593
Intangible assets amortization	257	999	1,075
Net costs of other real estate owned	472	608	369
Franchise taxes	1,296	1,288	1,182
Other operating expenses	4,042	3,580	3,721
Total noninterest expense	26,152	25,635	24,432
Income before income tax expense	18,894	20,573	22,092
Income tax expense	3,952	4,740	5,178
Net income	\$ 14,942	\$ 15,833	\$ 16,914
Basic net income per common share	\$ 2.15	\$ 2.28	\$ 2.43
Fully diluted net income per common share	\$ 2.15	\$ 2.28	\$ 2.43

National Bank Board of Directors

F. Brad Denardo is President and Chief Executive Officer of National Bank (since 2014), Executive Vice President of National Bankshares Inc. and Treasurer and Board Member of National Bankshares Financial Services, Inc. Mr. Denardo joined the bank in 1983 and was promoted to Executive Vice President of Loans in 1989. In 2002 he was named Executive Vice President and COO and was elected to the bank's Board.

Michael E. Dye is a Pharmacist and owner of New Graham Pharmacy, Cornerstone Gifts, The Last Fountain and New Graham Knives, all located in Bluefield, Virginia. Mr. Dye possesses extensive knowledge of the business activity and community life of the important Bluefield market area. He joined the National Bank Board in 2006.

Norman V. Fitzwater, III is President of A Cleaner World dry cleaning business in Blacksburg, Virginia. Prior to opening the Blacksburg dry cleaning business in 1992, he was involved in the management and operation of several furniture manufacturing companies in Virginia and North Carolina. Mr. Fitzwater joined National Bank's Board in 2013.

Mildred R. Johnson is the Associate Vice Provost for Enrollment Management and Director of Undergraduate Admissions at Virginia Tech and has been at the university for 21 years. She is a recognized leader in higher education with a career which spans over 40 years, primarily in college admissions. Mrs. Johnson has served in leadership positions and on academic boards in both Virginia and nationally. She joined the National Bank Board in 2012.

James G. Rakes is Executive Chairman of National Bank. He served as President and Chief Executive Officer of National Bank from 1983 until 2014. Mr. Rakes has been Chairman, President and CEO of National Bankshares, Inc. since its founding in 1986. He also currently serves as Chairman, President and CEO of National Bankshares Financial Services, Inc.


Dr. James M. 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 veterinary practice in Blacksburg, Virginia. He joined the National Bank Board in 1987 and retired from the Bank Board at the end of 2016. Dr. Shuler joined the National Bankshares, Inc. Board in 2002 and currently serves as Vice-Chairman.

James C. Thompson is the Chairman of the Board of Directors of Thompson & Litton, Inc. and has been employed by the firm full-time since 1981. Thompson & Litton, Inc. is engaged in the business of engineering, architecture, and construction in seven Mid-Atlantic States. Mr. Thompson joined the National Bank Board of Directors in 2006.

Dr. J. Lewis Webb, Jr. is a retired dentist with 35 years of practice in Narrows, Virginia. Dr. Webb also has considerable experience as a board member with local school systems and colleges. He was elected to the National Bank Board of Directors in 1994 after serving on the bank's Giles County Advisory Board since 1988.



Standing, from left: Michael E. Dye, Dr. J. Lewis Webb, Jr., James C. Thompson, Norman V. Fitzwater, III
Seated, from left: Mildred R. Johnson, Dr. James M. Shuler, F. Brad Denardo, James G. Rakes

ational 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 125 years of service in the area. National Bank currently operates 26 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 9th, 2017 at 3 p.m. at Custom Catering Center, 902 Patrick Henry Drive, Blacksburg, Virginia 24060.

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 9, 2017 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
jakes@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 Buery
Senior Vice President/Trust Officer
(540) 961-8500 or (800) 552-4123
jbuery@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

② Blacksburg
6 offices

③ Bluefield, VA
2 offices

④ Christiansburg
2 offices

⑤ Claypool Hill

⑥ Dublin

⑦ Galax

⑧ Marion

⑨ Pearisburg

⑩ Pembroke

⑪ Pulaski
2 offices

⑫ Radford

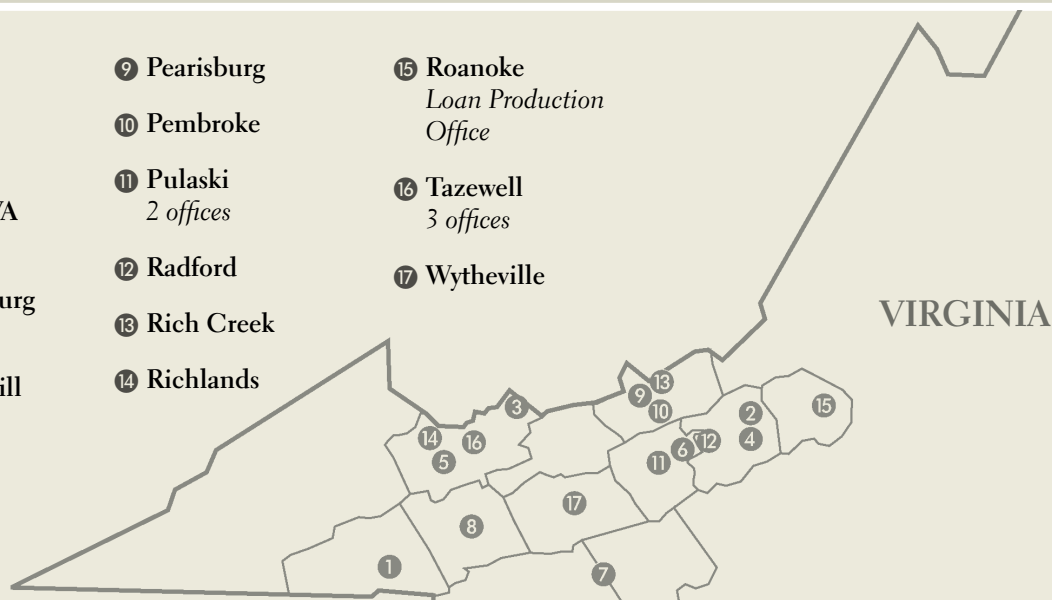
⑬ Rich Creek

⑭ Richlands

⑮ Roanoke
Loan Production
Office

⑯ Tazewell
3 offices

⑰ Wytheville





National Bankshares

101 Hubbard Street
Blacksburg, Virginia 24060