

NATIONAL BANKSHARES INC

Form DEF 14A

March 11, 2011

---

March 11, 2011

Dear Fellow Stockholder:

We invite you to join us for the Annual Meeting of Stockholders of National Bankshares, Inc. on Tuesday, April 12, 2011, 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. Turn left 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 2011 ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders of National Bankshares, Inc.:

This is your notice that the 2011 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 12, 2011, 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 determine whether the stockholder vote to approve the compensation of the named executive officers should occur every one, two or three years.
4. 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, 2011.

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 23, 2011 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

Marilyn B. Buhyoff  
Secretary and Counsel  
Blacksburg, Virginia  
March 11, 2011

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 12, 2011

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 2011 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 12, 2011, 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 11, 2011.

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; for conducting a vote to approve the compensation of the named executive officers every one year as set out in Proposal N. 3; 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, 2011 described in Proposal No. 4.

An Annual Report to Stockholders, including the financial statements for the year ended December 31, 2010, 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 11, 2011, Bankshares had 6,933,474 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 23, 2011 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. The outcome of Proposal No. 3, an advisory vote on the frequency of a stockholder vote on the

compensation of the Company's named executive officers, will be determined 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

As of February 23, 2011, Bankshares knows of no single person or group who is the beneficial owner of more than 5% of the outstanding common stock of the Company.

## STOCK OWNERSHIP OF DIRECTORS AND EXECUTIVE OFFICERS

The following table presents the beneficial ownership of National Bankshares, Inc. common stock as of February 23, 2011, 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 23, 2011 | Percentage Of Class |
|--|---|---------------------|
| Lawrence J. Ball   | 3,500   | *                   |
| Jack W. Bowling  | 4,100   | *                   |
| Marilyn B. Buhyoff   | 42,421.   | *                   |
| F. Brad Denardo  | 55,176.   | *                   |
| Charles E. Green, III  | 40,138.   | *                   |
| Jack H. Harry  | 106,410.  | 1.53%               |
| Jack M. Lewis  | 6,056   | *                   |
| Mary G. Miller   | 2,200   | *                   |
| William A. Peery   | 31,410.   | *                   |
| James G. Rakes   | 124,248.  | 1.79%               |
| Glenn P. Reynolds  | 5,819.  | *                   |
| James M. Shuler  | 26,801.   | *                   |
| David K. Skeens  | 5,167.  | *                   |
| All Nominees, Current Directors and Executive Officers as a Group (13 persons) | 453,446   | 6.54%               |

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

1. Includes 698 shares owned jointly with spouse, 12,223 shares owned through National Bankshares, Inc. Employee Stock Ownership Plan and 28,000 shares in vested options which may be exercised as of February 23, 2011.
2. Includes 4,534 shares owned jointly with spouse, 20,064 shares owned through National Bankshares, Inc. Employee Stock Ownership Plan and 24,000 shares in vested options which may be exercised as of February 23, 2011.
3. Includes 7,158 shares owned jointly with spouse and 11,880 shares held as custodian for children.
4. Includes 28,342 shares owned by spouse, 14,950 shares owned jointly with spouse, and 790 shares owned jointly with son.
5. Includes 72 shares owned as custodian for son, 7,260 shares owned by a controlled corporation and 21,900 shares owned as Trustee.
6. Includes 11,200 shares owned jointly with spouse, 33,296 shares owned through National Bankshares, Inc. Employee Stock Ownership Plan and 57,500 shares in vested options which may be exercised as of February 23, 2011.
7. Includes 2,343 shares owned by spouse.
8. Includes 4,053 shares owned by spouse and 426 shares owned jointly with spouse.
9. Includes 5,105 shares owned through National Bankshares, Inc. Employee Stock Ownership Plan.

## Section 16(a) Beneficial Ownership Reporting Compliance

Based upon the written representations of our directors and executive officers, we believe that all of our directors and executive officers complied with the reporting requirements of Section 16(a) of the Securities Act of 1934.

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 2011 Annual Meeting of Stockholders. The terms of Class 1 and Class 2 directors will expire in 2012 and 2013, respectively.



The Board of Directors has nominated two serving Class 3 directors, William A. Peery and James M. Shuler, to serve a three-year term to expire at the Annual Meeting of Stockholders in 2014. The remaining Class 3 director, Jack H. Harry, is retiring from the Board of Directors at the completion of his term, because he has reached mandatory retirement age as set out in Bankshares' bylaws. Therefore, Mr. Harry will not stand for re-election at the Annual Meeting. The Nominating Committee, consisting entirely of non-management independent directors, recommended Charles E. Green, III as the nominee for Class 3 director to fill the seat being vacated by Mr. Harry. The Board of Directors nominated Mr. Green to serve a three-year term expiring at the Annual Meeting in 2014.

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 23, 2011, 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"). 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. 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 2010. (See also "Director Independence" and "Certain Transactions with Officers and Directors").

Nominees  
Class 3 Directors  
(Serving until 2014 Annual Meeting)

Charles E. Green, III (Age 60): Mr. Green was recommended by the Nominating Committee and was nominated by the Board of Directors to serve a 3-year term to fill the vacancy created by Mr. Harry's retirement. If elected, this will be his first term on the Company's Board. Mr. Green currently serves as a member of the Board of Directors of NBB, and his plans are to resign from that Board upon election to the NBI Board. He brings nearly 25 years of experience as community bank director to his service on the Company's Board, 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 will 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 59): 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 National Bankshares, Inc. Board of Directors in 2005.

James M. Shuler (Age 67): Dr. Shuler is a retired veterinarian who currently represents the 12th legislative district in the Virginia House of Delegates. The 12th legislative district includes Blacksburg, where the headquarters of National Bankshares, Inc. is located. 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 National Bankshares, Inc. 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 2012 Annual Meeting)

Lawrence J. Ball (Age 56): 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 60): 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 58): 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 2013 Annual Meeting)

Jack W. Bowling (Age 64): Mr. Bowling is President of H. T. Bowling, Inc., a construction, grading, excavation and road building firm with offices in Fairlawn Virginia. He has been a Director of National Bankshares, Inc. since 2007. Mr. Bowling is a lifelong resident of the Company's market area and he has many years of small business management experience. These factors, in addition to his knowledge of building and construction activities in the market, are important to his service as a director.

Jack M. Lewis (Age 67): 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 66): 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 since it was organized in 2001. He is the Chairman of the Board of Directors of NBB and NBFS. 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.

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 – ADVISORY VOTE  
ON THE FREQUENCY OF A STOCKHOLDER VOTE  
ON THE COMPENSATION OF THE  
NAMED EXECUTIVE OFFICERS

The Dodd-Frank Act also enables stockholders, at least once every six years, to vote on the frequency of a stockholder vote on the compensation of the named executive officers. This proposal gives the Company’s stockholders the opportunity to advise the Board of Directors on how frequently they would like to vote on the compensation of executive officers: every one, two or three years. Stockholders may also abstain from voting on the frequency of a stockholder “say-on-pay” vote on executive compensation.

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 the frequency of a stockholder vote on executive compensation.

The Board of Directors has determined that having an annual vote on the compensation of the named executive officers is the best approach, because each year the Company’s Compensation Committee reviews the primary elements of Compensation, namely salary and the Chairman, President & CEO’s cash bonus.

The Board of Directors recommends that the stockholders vote to approve the compensation of the named executive officers every “ONE YEAR”.

Note: Stockholders are not voting to approve or disapprove this recommendation.

PROPOSAL NO. 4 – RATIFICATION OF  
APPOINTMENT OF INDEPENDENT AUDITORS

For the year ending December 31, 2011, 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, 2011.

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 2010, there were twelve regular Board meetings.

#### 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 met once in 2010. The Audit Committee, which is chaired by Dr. Lewis, is made up of Mr. Ball, Mr. Bowling and Mr. Harry. The Audit Committee had four meetings in 2010. In 2010 the Compensation Committee was comprised of Mr. Ball, Mr. Bowling, Mr. Harry, Dr. Lewis, Dr. Miller, Mr. Peery and Mr. Reynolds. Dr. Shuler serves as its chairman. The Compensation Committee met once in 2010. Dr. Miller is the chairman of the Nominating Committee, and Mr. Peery, Mr. Reynolds and Dr. Shuler are its members. The Nominating Committee met once in 2010.

#### Board Compensation

In 2010, the members of the NBI Board of Directors received \$1,000 for each regular or special Board meeting they attended. They were paid \$500 for each committee meeting. Directors were also paid an annual retainer fee of \$12,000. The Chairmen of the Audit and Compensation Committees each received an additional \$1,500 annual retainer. NBI Directors receive no other forms of compensation.

Directors Compensation Table(1)

|                   | Fees Earned<br>or Paid in |            | Total (\$) |
|-------------------|---------------------------|------------|------------|
|                   | Cash (\$)                 | Other (\$) |            |
| Lawrence J. Ball  | 25,000                    | ---        | 25,000     |
| Jack W. Bowling   | 25,500                    | ---        | 25,500     |
| Jack H. Harry     | 25,500                    | ---        | 25,500     |
| Jack M. Lewis     | 26,500                    | ---        | 26,500     |
| Mary G. Miller    | 24,500                    | ---        | 24,500     |
| William A. Peery  | 24,500                    | ---        | 24,500     |
| Glenn P. Reynolds | 24,500                    | ---        | 24,500     |
| James M. Shuler   | 26,000                    | 30,911 (2) | 56,911     |

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

(2) Represents \$20,000 in fees paid to Dr. Shuler for his service on the Board of Directors of NBB in 2010, and \$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 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 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. Except for directors' fees, no director received direct or indirect compensation from the Company in 2010.

#### Board Attendance

During 2010, 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. In 2010, all NBI directors attended the Annual Meeting, except for Mr. Ball, who was traveling on business on the date of the meeting.

#### 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, 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 and Compliance Officer. The Corporate Auditor and Compliance Officer, 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.

### COMPENSATION DISCUSSION AND ANALYSIS

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

National Bankshares, Inc. has five goals for its compensation program for named executive officers. In 2010, these officers were Chairman, President & CEO James G. Rakes, Treasurer David Skeens, Executive Vice President F. Brad Denardo and Secretary and Counsel Marilyn B. Buhyoff.

- 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)

