

INCARA PHARMACEUTICALS CORP
Form PRE 14A
January 22, 2003

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

SCHEDULE 14A

**Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934
(Amendment No. __)**

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

INCARA PHARMACEUTICALS CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

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

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

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

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

INCARA PHARMACEUTICALS CORPORATION

**P.O. Box 14287
79 T.W. Alexander Drive
4401 Research Commons, Suite 200
Research Triangle Park, North Carolina 27709**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD MARCH 13, 2003**

TO THE STOCKHOLDERS OF INCARA PHARMACEUTICALS CORPORATION:

The Annual Meeting of Stockholders of Incara Pharmaceuticals Corporation will be held at Incara's offices at 79 T.W. Alexander Drive, 4401 Research Commons, Suite 200, Research Triangle Park, North Carolina, on Thursday, March 13, 2003 at 9:00 a.m., for the following purposes:

1. To elect a board of five directors;
2. To approve an amendment to Incara's Amended and Restated Certificate of Incorporation to increase the authorized number of shares of common stock from 80,000,000 to 350,000,000 shares;
3. To ratify the appointment of PricewaterhouseCoopers LLP as the independent auditors of Incara for the fiscal year ending September 30, 2003; and
4. To act upon such other matters as may properly come before the meeting or any adjournment thereof.

These items are more fully described in the attached Proxy Statement.

The Board of Directors has fixed the close of business on January 14, 2003, as the record date for the determination of stockholders entitled to notice of and to vote at the Meeting or any adjournments thereof. A list of stockholders of Incara entitled to vote at the Meeting will be available for examination by a stockholder at Incara's office for the ten days prior to the Meeting during normal business hours. All such stockholders are cordially invited to attend the Meeting in person. However, to assure your representation at the Meeting, you are urged to vote your proxy as promptly as possible. Any stockholder attending the Meeting may vote in person, even if such stockholder returned a proxy.

Incara's Proxy Statement and proxy is enclosed along with Incara's Annual Report to Stockholders for the fiscal year ended September 30, 2002.

IMPORTANT YOUR PROXY IS ENCLOSED

WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE PROMPTLY VOTE YOUR PROXY ACCORDING TO THE INSTRUCTIONS ON THE PROXY CARD.

By Order of the Board of Directors,

RICHARD W. REICHOW
*Executive Vice President,
Chief Financial Officer,
Treasurer and Secretary*

Research Triangle Park,
North Carolina
February 3, 2003

INCARA PHARMACEUTICALS CORPORATION

**P.O. Box 14287
79 T.W. Alexander Drive
4401 Research Commons, Suite 200
Research Triangle Park, North Carolina 27709**

**PROXY STATEMENT
ANNUAL MEETING OF STOCKHOLDERS
MARCH 13, 2003**

INFORMATION CONCERNING SOLICITATION AND VOTING

Proxies are being solicited by the Board of Directors of Incara Pharmaceuticals Corporation, a Delaware corporation, for use at Incara's Annual Meeting of Stockholders to be held at Incara's offices at 79 T.W. Alexander Drive, 4401 Research Commons, Suite 200, Research Triangle Park, North Carolina, at 9:00 a.m. on Thursday, March 13, 2003, and any adjournments thereof. The cost of soliciting proxies will be borne by Incara. In addition to solicitation of proxies by mail, employees of Incara, without extra remuneration, might solicit proxies personally or by telephone. Incara will reimburse brokerage firms and other custodians, nominees and fiduciaries for their reasonable out-of-pocket expenses for forwarding proxy materials to beneficial owners and seeking instruction with respect thereto. The mailing address of the principal executive offices of Incara is P.O. Box 14287, Research Triangle Park, North Carolina 27709. Copies of this Proxy Statement and accompanying proxy card are being mailed to stockholders on or about February 3, 2003.

Revocability of Proxies

Any stockholder giving a proxy has the power to revoke it at any time before it is voted by giving a later proxy or written notice to Incara (Attention: Richard W. Reichow, Secretary), or by attending the Meeting and voting in person.

Voting

When the enclosed proxy is properly executed and returned (and not subsequently properly revoked), the shares it represents will be voted in accordance with the directions indicated thereon, or, if no direction is indicated thereon, it will be voted:

1. FOR the election of the five nominees for director identified below;
2. FOR the approval of an amendment to Incara's Amended and Restated Certificate of Incorporation to increase the authorized number of shares of common stock from 80,000,000 to 350,000,000 shares;
3. FOR ratification of the appointment of PricewaterhouseCoopers LLP, Raleigh, North Carolina, as independent auditors of Incara for the fiscal year ending September 30, 2003; and
4. In the discretion of the proxies with respect to any other matters properly brought before the stockholders at the Meeting.

Record Date

Only the holders of record of common stock at the close of business on the Record Date, January 14, 2003, are entitled to notice of and to vote at the Meeting. On the Record Date, 14,095,331 shares of common stock were outstanding. Stockholders will be entitled to one vote for each share of common stock held on the Record Date.

Vote Required

Votes withheld from any voting will be counted for purposes of determining the presence or absence of a quorum for the transaction of business, but will be excluded from the vote on any proposal. In Proposal 1, the five nominees for director receiving the highest number of affirmative votes of the shares present or represented and entitled to be voted at the Meeting shall be elected as directors of Incara. On Proposal 2, the affirmative vote of the holders of a majority of all shares of Incara's common stock outstanding on the Record Date is required for approval. On Proposal 3, the affirmative vote of the holders of a majority of the shares of Incara's common stock present or represented and voting on the proposal at the Meeting is required for approval.

While there is no definitive statutory or case law authority in Delaware as to the proper treatment of abstentions, Incara believes that abstentions should be counted for purposes of determining both whether a quorum is present at the Meeting and the total number of shares represented and voting on the proposals at the Meeting. Incara intends to treat abstentions in this manner, which means they will have the same effect as votes against the proposals. In a 1988 case, *Berlin v. Emerald Partners*, the Delaware Supreme Court held that, while broker non-votes may be counted for purposes of determining the presence or absence of a quorum of the transaction of business, broker non-votes should not be counted for purposes of determining the number of shares represented and voting with respect to the particular proposal on which the broker has expressly not voted. Broker non-votes with respect to any proposal will therefore not be considered represented and voting and, accordingly, will not affect the determination as to whether the requisite vote has been obtained to approve Proposals 1 and 3, but will have the same effect as votes against Proposal 2.

PROPOSAL NO. 1 ELECTION OF DIRECTORS

Nominees

Incara's By-Laws provide that the number of directors constituting the Board of Directors shall be no less than one nor greater than seven. The Board currently consists of six members. However, Director J. Misha Petkevich has requested not to be renominated because of his other business commitments. As a result, the Board has set the number of directors at five, effective immediately after the Meeting. The directors being elected are to serve for one year, each until the election and qualification of his successor, or until his death, removal or resignation. It is intended that proxies will be voted FOR all of the nominees named below. If any nominee is unable or declines to serve as a director at the time of the Meeting, the individuals named in the enclosed proxy may exercise their discretion to vote for any substitute proposed by the Board of Directors. Each nominee listed below has agreed to serve as a director if elected. None of the nominees is related by blood, marriage or adoption to any other nominee or any executive officer of Incara.

<u>Name of Nominee</u>	<u>Age</u>	<u>Director Since</u>
Clayton I. Duncan	53	1995
David B. Sharrock	66	1995
Edgar H. Schollmaier	69	1998
Stephen M. Prescott, M.D.	54	2000
Eugene J. McDonald.	70	2001

CLAYTON I. DUNCAN has been President, Chief Executive Officer and a director of Incara since January 1995. Mr. Duncan has been Chairman of the Board of Directors since April 2000. From 1989 until December 1993, Mr. Duncan was President and Chief Executive Officer of Sphinx Pharmaceuticals Corporation, a biopharmaceutical company which was acquired by Eli Lilly and Company in September 1994. From December 1993 until September 1994, he served as an independent consultant to Sphinx with regard to the sale of Sphinx to Lilly. From 1987 to 1989, Mr. Duncan was a General Partner of Intersouth Partners, a venture capital firm. From 1979 to 1987, he was an executive with Carolina Securities Corporation, a regional investment banking firm, serving as Executive Vice President and a director from 1984 to 1987. Mr. Duncan was founder and Chairman of the Board of CRX Medical, Inc., a medical products company that conducted research and development in

wound management, ophthalmic disorders and interventional radiology. Mr. Duncan is also a director of Aeolus Pharmaceuticals, Inc., Incara Development, Ltd., CPEC LLC and Incara Cell Technologies, Inc., all of which are subsidiaries of Incara. Mr. Duncan received an M.B.A. from the University of North Carolina at Chapel Hill. In addition, Mr. Duncan is a director of The Forest at Duke, a continuing care retirement community, and Chairman of the Board of Directors of the Carolina Ballet, a professional ballet company.

DAVID B. SHARROCK has been a director of Incara since October 1995. Mr. Sharrock was associated with Marion Merrell Dow, Inc., a multi-national pharmaceutical company, and its predecessor companies for over 35 years until his retirement in December 1993. Most recently, since December 1989, he served as Executive Vice President, Chief Operating Officer and a director and, in 1988, he was named President and Chief Operating Officer of Merrell Dow Pharmaceuticals Inc. Mr. Sharrock is also a director of four public companies, Interneuron Pharmaceuticals, Inc., Broadwing Inc., Praecis Pharmaceuticals, Incorporated and MGI Pharma, Inc.

EDGAR H. SCHOLLMAYER has been a director of Incara since May 1998. Mr. Schollmaier is the retired Chairman of Alcon Laboratories, Inc., a wholly owned subsidiary of Nestle SA. He served as President of Alcon from 1972 to 1997 and was Chief Executive Officer for the last 20 years of that term. He is a graduate of the University of Cincinnati and the Harvard Graduate School of Business Administration. Mr. Schollmaier is also a director of DENTSPLY International, Inc., a dental products company. In addition, he is a Trustee of Texas Christian University and a director of Cook Children's Hospital, Research to Prevent Blindness and the Foundation of the American Academy of Ophthalmology.

STEPHEN M. PRESCOTT, M.D. has been a director of Incara since April 2000. Dr. Prescott is the Executive Director of the Huntsman Cancer Institute at the University of Utah in Salt Lake City. Dr. Prescott received his M.D. degree from Baylor College of Medicine in 1973 and then completed training in Internal Medicine at the University of Utah. Dr. Prescott subsequently undertook advanced research training in biochemistry and molecular biology at Washington University School of Medicine. He joined the faculty at the University of Utah in 1982, and is currently a Professor of Internal Medicine at the University of Utah and holds the H.A. & Edna Benning Presidential Endowed Chair in Human Molecular Biology and Genetics. Dr. Prescott is also the Chief Executive Officer and a director of Huntsman Genomics Corporation. From 1998 until 1999, Dr. Prescott was Director of the Program in Human Molecular Biology & Genetics in the Eccles Institute at the University of Utah.

EUGENE J. MCDONALD was elected to the Board in March 2001. Mr. McDonald is Executive Vice President, Office of Investment Counsel at Duke University and has served at Duke University for more than two decades. Mr. McDonald founded and was the first president and CEO of Duke Management Company, the investment management affiliate of Duke University. He was Duke's Chief Financial/Administrative Officer from 1984 to 1990, and, prior to this, served as Vice President and University Counsel. He began his career as professor of law at Georgetown Law School, and as an attorney in the corporate/business practice of Brobeck, Phleger and Harrison in San Francisco. Mr. McDonald serves on the boards of directors of two public companies, Red Hat, Inc. and National Commerce Financial Corporation. He has also served on a number of advisory boards, including those of the New York Stock Exchange's PMAC Committee and T. Rowe Price Strategic Partners. Mr. McDonald received his undergraduate and law degrees from the University of San Francisco.

Information Concerning the Board of Directors and its Committees

The business of Incara is under the general management of the Board of Directors as provided by the laws of Delaware and the By-Laws of Incara. During the fiscal year ended September 30, 2002, the Board of Directors held five formal meetings, excluding actions by unanimous written consent. Each member of the Board attended at least 75% of the fiscal 2002 meetings of the Board of Directors and Board committees of which he was a member, with the exception of Dr. Prescott, who missed a Board meeting and a Compensation Committee meeting held on the same day.

The Board of Directors has established an Audit Committee and a Compensation Committee. The Board has no nominating committee. The Audit Committee currently consists of Mr. Schollmaier, Mr. Sharrock and Mr. McDonald. During fiscal 2002, the Audit Committee held two formal meetings and the Chairman of the Audit Committee met with Incara's independent public accountants prior to the release of financial results for the first three quarters of fiscal 2002. The Audit Committee reviews the results and scope of the audit and other services provided by Incara's independent public accountants. The Compensation Committee currently consists of Mr. Sharrock, Mr. Schollmaier and Dr. Prescott. During fiscal 2002, the Compensation Committee held two formal meetings. The Compensation Committee makes recommendations to the Board of Directors regarding salaries and incentive compensation for officers of Incara, and determines the amount and type of equity incentives granted to participants in Incara's 1994 Stock Option Plan and the 1999 Equity Incentive Plan.

The Board of Directors has approved and recommends that stockholders vote FOR the election of the five nominees listed above.

PROPOSAL NO. 2 APPROVAL TO INCREASE AUTHORIZED SHARES OF COMMON STOCK

The Board of Directors has approved and recommends that the stockholders adopt an amendment to Incara's Amended and Restated Certificate of Incorporation to increase the total authorized shares of common stock of the Company from 80,000,000 to 350,000,000 shares.

Of the 80,000,000 shares of common stock currently authorized, 14,095,331 shares are issued and outstanding, 6,000,000 shares have been reserved for issuance upon the conversion of the Series B and Series C preferred stock, 4,282,713 shares have been reserved for issuance upon the exercise of options granted, or that may be granted, under the Company's 1994 Stock Option Plan, 135,991 shares have been reserved for issuance under the Company's Employee Stock Purchase Plan, and 1,221,804 shares have been reserved for issuance upon the exercise of outstanding warrants. The increase is necessary to allow Incara to pursue additional financing to continue its operations through the sale and issuance of its common stock, or securities convertible into common stock. The Board believes that the number of shares currently available is inadequate for Incara's current and future capital needs.

The Board believes that the increased number of authorized shares of common stock also will provide several long-term advantages to Incara and its stockholders. Incara will be able to pursue acquisitions or enter into other transactions involving the issuance of stock that provide potential for future capital and growth. In addition, the additional authorized shares of common stock should allow Incara to fulfill future obligations to future holders of its preferred stock and obligations under Incara's 1994 Stock Option Plan, both of which the Board believes will be necessary to attract additional capital and to attract and retain qualified personnel. Finally, the availability of additional authorized shares of common stock would make any future transactions dependent on the issuance of additional shares of common stock less likely to be undermined by delays and uncertainties occasioned by the need to obtain stockholder approval prior to the consummation of such transactions. Incara currently does not have any definitive plans to issue additional shares of common stock, although it is pursuing financing alternatives that could include the issuance of common stock.

The Board of Directors has approved and recommends that stockholders vote FOR the amendment to the Amended and Restated Certificate of Incorporation to increase the number of authorized shares.

PROPOSAL NO. 3 RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS

The Board of Directors of Incara has appointed the firm of PricewaterhouseCoopers LLP, Raleigh, North Carolina to serve as the independent auditors of Incara for the fiscal year ending September 30, 2003, and recommends that the stockholders ratify such action. PricewaterhouseCoopers has audited the accounts of Incara and its subsidiaries since Incara's inception in March 1994 and has advised Incara that it does not have, and has not had, any direct or indirect financial interest in Incara or its subsidiaries in any capacity other than that of serving as independent auditors. Representatives of PricewaterhouseCoopers are expected to attend the Meeting. They will have an opportunity to make a statement, if they desire to do so, and will also be available to respond to appropriate questions.

Audit Fees

Fees for the audit of the Company's annual financial statements for fiscal year 2002 and for reviews of the financial statements included in the Company's quarterly reports on Form 10-Q for the first three quarters of fiscal 2002 are expected to be between \$55,000 and \$65,000, of which an aggregate amount of \$49,985 had been billed through December 31, 2002.

All Other Fees

PricewaterhouseCoopers billed Incara aggregate fees of \$42,300 for professional services rendered in fiscal 2002 other than audit services and review of quarterly reports. These fees resulted primarily from services rendered for the review of the Company's fiscal 2001 tax returns and other documents filed with the Securities and Exchange Commission during fiscal 2002 as part of the Company's reporting requirements. The Audit Committee of the Board of Directors considered these activities to be compatible with the maintenance of PricewaterhouseCoopers independence. Incara did not engage PricewaterhouseCoopers in fiscal 2002 to perform any services for financial information systems design or implementation.

If the appointment of PricewaterhouseCoopers is not ratified by the stockholders, the Board of Directors will reconsider its selection.

The Board of Directors has approved and recommends a vote FOR the ratification of the appointment of PricewaterhouseCoopers as independent auditors of Incara for the fiscal year ending September 30, 2003.

OTHER INFORMATION

Principal Stockholders

The following tables set forth certain information regarding the ownership of shares of our stock as of the Record Date by:

- each person known by us to beneficially own more than 5% of the outstanding shares of each class of stock,
- each director of Incara,
- each executive officer of Incara, and
- all directors and executive officers of Incara as a group.

Series B Convertible Preferred Stock

As of the Record Date, we had 503,544 shares of Series B convertible preferred stock and warrants for 22,191 shares of Series B preferred stock outstanding. The Series B preferred stock is non-voting except for matters relating to the rights of Series B preferred stock.

	Shares Beneficially Owned	Percentage of Class Owned
Elan Corporation, plc. Lincoln House Lincoln Place Dublin 2, Ireland	525,735 (1)	100.0%

(1) Includes 416,204 shares owned by Elan International Services, Ltd., 58,883 shares owned by Elan Pharma International Limited, 28,457 shares owned by Elan Pharmaceutical Investments III, Ltd. and 22,191 shares issuable upon exercise of warrants to purchase Series B preferred stock held by Elan Pharmaceutical Investments III, Ltd.

Series C Convertible Exchangeable Preferred Stock

As of the Record Date, we had 12,015 shares of Series C convertible exchangeable preferred stock outstanding. The Series C preferred stock is non-voting except for matters relating to the rights of Series C preferred stock.

	<u>Shares Beneficially Owned</u>	<u>Percentage of Class Owned</u>
Elan Corporation, plc Lincoln House Lincoln Place Dublin 2, Ireland	12,015 (1)	100.0%

(1) Consists of 12,015 shares owned by Elan Pharmaceutical Investments III, Ltd.

Common Stock

As of the Record Date, we had 14,095,331 shares of common stock outstanding. Share ownership in each case includes shares issuable upon exercise of options that may be exercised within 60 days after the Record Date for purposes of computing the percentage of common stock owned by such person but not for purposes of computing the percentage owned by any other person. Except as indicated in footnotes to this table, the persons named in this table have sole voting and investment power with respect to all shares of common stock indicated below.

	<u>Beneficially Owned</u>	<u>Percentage Owned</u>
Clayton I. Duncan (1). 79 T.W. Alexander Drive, 4401 Research Commons, Suite 200 Research Triangle Park, North Carolina 27709	1,130,872	7.8%
David B. Sharrock (2).	112,993	*
Edgar H. Schollmaier (3)	100,993	*
Stephen M. Prescott, M.D. (3).	83,253	*
Eugene J. McDonald (4).	70,087	*
J. Misha Petkevich (5).	290,044	2.0%
David P. Ward, M.D. (6).	394,869	2.7%
Richard W. Reichow (7)	612,568	4.3%
Mark E. Furth (8).	722,643	5.1%
W. Bennett Love (9).	219,980	1.6%
John P. Richert (10).	210,628	1.5%
Elan Corporation, plc (11) Lincoln House Lincoln Place Dublin 2, Ireland	1,305,000	9.3%
W. Ruffin Woody, Jr. (12) P.O. Box 381 Roxboro, NC 27573	906,380	6.4%
All directors and executive officers as a group (11 persons) (13)	3,948,930	24.8%

* Less than one percent

(1) Includes 482,470 shares owned (of which, 124,444 shares are unvested shares of restricted stock) by Mr. Duncan, 192,000 shares owned by Mr. Duncan's children, 102,700 shares owned by a family LLC, 338,822 shares issuable upon exercise of options held by Mr. Duncan and 14,880 shares issuable upon exercise of warrants held by the family LLC. Mr. Duncan disclaims beneficial ownership of the shares held by his children.

- (2) Includes 1,000 shares owned and 111,993 shares issuable upon exercise of options held by Mr. Sharrock.
- (3) Consists of shares issuable upon exercise of options held by the named individual.
- (4) Includes 6,175 shares owned, 62,430 shares issuable upon exercise of options held by Mr. McDonald and 1,482 shares issuable upon exercise of warrants held by Mr. McDonald.
- (5) Includes 61,700 shares owned by a family trust, 14,808 shares issuable upon exercise of warrants held by the family trust, 64,634 shares issuable by exercise of options held by Mr. Petkevich, and 148,902 shares issuable upon exercise of warrants held by Petkevich and Partners, LLC.
- (6) Includes 97,014 shares owned and 297,855 shares issuable upon exercise of options held by Dr. Ward.
- (7) Includes 393,886 shares owned (of which, 97,222 shares are unvested shares of restricted stock), 214,842 shares issuable upon exercise of options held by Mr. Reichow and 3,840 shares issuable upon exercise of warrants held by Mr. Reichow.
- (8) Includes 237,478 shares owned by Dr. Furth, 57,179 shares issuable upon exercise of options held by Dr. Furth, 316,786 shares owned by Dr. Lola M. Reid, Dr. Furth's spouse, 110,000 shares issuable upon exercise of options held by Dr. Reid and 1,200 shares issuable upon exercise of warrants held by Dr. Reid.
- (9) Includes 128,214 shares owned (of which, 28,778 shares are unvested shares of restricted stock), 87,926 shares issuable upon exercise of options held by Mr. Love and 3,840 shares issuable upon exercise of warrants held by Mr. Love.
- (10) Includes 122,702 shares owned (of which, 28,778 shares are unvested shares of restricted stock) and 87,926 shares issuable upon exercise of options held by Mr. Richert.
- (11) Includes 825,000 shares owned by Elan Pharmaceutical Investments III, Ltd. and 480,000 shares owned by Elan Pharma International Limited.
- (12) Includes 891,500 shares owned and 14,880 shares issuable upon exercise of warrants held by Mr. Woody.
- (13) See footnotes (1) - (10).

Executive Compensation*Summary Compensation*

The following table sets forth all compensation earned for services rendered to Incara in all capacities for the fiscal years ended September 30, 2002, 2001 and 2000, by its Chief Executive Officer and by the four most highly compensated executive officers who earned at least \$100,000 in the respective fiscal year, collectively referred to as the Named Officers .

Summary Compensation Table

Name and Principal Position	Fiscal Year	Annual Compensation		Long Term Compensation Awards		All Other Compensation (1)
		Salary	Bonus	Stock Options (Shares)	Restricted Stock (Shares) (2)	
Clayton I. Duncan Chairman, President and Chief Executive Officer	2002	\$ 360,000	\$	70,599	160,000	\$ 2,187
	2001	\$ 352,500	\$ 132,000	150,000		\$ 1,628
	2000	\$ 322,500	\$ 30,000			\$ 2,823
David P. Ward, M.D. Executive Vice President, Research & Development (3)	2002	\$ 275,000	\$	193,857		\$ 3,765
	2001	\$ 270,875	\$ 77,550	100,000		\$ 3,221
	2000	\$ 252,625	\$ 30,844			\$ 3,340
Richard W. Reichow Executive Vice President, Chief Financial Officer, Treasurer and Secretary	2002	\$ 275,000	\$	71,265	125,000	\$ 2,905
	2001	\$ 270,875	\$ 93,060	100,000		\$ 2,769
	2000	\$ 252,625	\$ 31,844			\$ 2,762
Mark E. Furth, Ph.D. Senior Vice President, Research (4)	2002	\$ 240,000	\$	16,555	100,000	\$ 1,375
	2001	\$ 20,000	\$	68,750		\$ 77
W. Bennett Love Vice President, Corporate Planning/Communications	2002	\$ 142,000	\$	28,593	37,000	\$ 1,703
	2001	\$ 140,050	\$ 33,550	30,000		\$ 1,694
	2000	\$ 131,150	\$ 13,344			\$ 1,664

- (1) Consists of life and long-term disability insurance premiums and health club fees reimbursed or paid on behalf of the Named Officers.
- (2) In May 2002, the Named Officer purchased the number of shares of restricted stock indicated at par value (\$0.001 per share). The shares of restricted stock vest over three years from the date of grant. As of September 30, 2002 a total of 17,778 shares had vested for Mr. Duncan, 13,889 shares for Mr. Reichow, 11,111 shares for Dr. Furth and 4,111 shares for Mr. Love. The value of the restricted stock received by the Named Officer, based on the closing price of Incara's common stock on the date of purchase was \$55,840 for Mr. Duncan, \$43,625 for Mr. Reichow, \$34,900 for Dr. Furth and \$14,023 for Mr. Love.
- (3) Dr. Ward resigned effective January 31, 2003.
- (4) Dr. Furth became an employee on September 4, 2001 and resigned effective November 1, 2002.

Management Incentive Plan

The Compensation Committee and the Board of Directors have approved a Management Incentive Plan, or MIP, for the executive officers of Incara. The MIP provides for cash payments to the executive officers upon the achievement of certain corporate and individual objectives. The MIP is intended to be an annual compensation program. For the calendar years ended December 31, 2002, 2001 and 2000, the corporate objectives related to obtaining financing and our three research and development programs. The corporate objectives for calendar 2002 have not yet been evaluated.

Option Grants, Exercises and Holdings and Fiscal Year-End Option Values

The following table summarizes all option grants during the fiscal year ended September 30, 2002 to the Named Officers:

Option Grants During Fiscal Year Ended September 30, 2002

Number of Shares Underlying Options Granted	% of Total Options Granted to Employees in Fiscal 2002	Exercise or Base Price per Share	Expire Date
70,599 (1)	8.4%	\$	

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.

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

**THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS
VOTE "FOR" RATIFICATION OF THE APPOINTMENT OF YOUNT, HYDE &
BARBOUR, P.C. AS THE COMPANY'S INDEPENDENT REGISTERED PUBLIC
ACCOUNTING FIRM**

FOR THE YEAR ENDING DECEMBER 31, 2015.

OTHER BUSINESS

Management knows of no other matters to be presented for consideration at the Annual Meeting or any adjournments thereof. If any other matters shall properly come before the Annual Meeting, it is intended that the proxy holders named in the enclosed form of proxy will vote the shares represented thereby in accordance with their judgment, pursuant to the discretionary authority granted therein.

CORPORATE GOVERNANCE MATTERS

The Board and Board of Directors Meetings

Each director is expected to devote sufficient time, energy and attention to ensure diligent performance of the director's duties and to attend all regularly scheduled Board, committee, and stock meetings. The Company's Board of Directors meets monthly. In 2014, there were 12 regular Board meetings. During 2014, 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. All directors attended the Company's 2014 Annual Meeting. The Board does not have a formal policy regarding directors' attendance at the Annual Meeting of Stockholders.

Board Leadership Structure

The Company 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 its incorporation in 1986. In addition Mr. Rakes is Executive Chairman of the Company's primary subsidiary, The National Bank of Blacksburg, where nearly all of the Company's business operations occur. Mr. Rakes has spent his long career in banking and 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 the Company. 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 Company's Board has standing Executive, Audit, Compensation and Nominating Committees. The purpose of these committees is outlined below.

The **Executive Committee** met one time in 2014. Mr. Rakes, Dr. Lewis and Dr. Shuler serve on the Committee. The Committee, which is subject to the supervision and control of the Board of Directors, has been delegated substantially all of the powers of the Board of Directors to act between meetings of the Board, except for certain matters reserved to the Board by law. Mr. Rakes serves as Chairman of the Executive Committee because of his day-to-day management responsibilities, which include identifying issues that require either the involvement of the Executive Committee or the full Board during interim periods between regularly scheduled Board meetings. Mr. Rakes is well suited to convene such meetings with proper notices in an expeditious and efficient manner.

The **Audit Committee** met four times in 2014. The Committee is composed of Dr. Lewis (Chairman), Mr. Ball, Dr. Dooley and Mr. Green. The Committee reviews significant audit, accounting and financial reporting principles, policies and practices; is directly responsible for engaging and monitoring the independent auditors of the Company; and provides oversight of the financial reporting and internal auditing functions. A more detailed description of the functions of this Committee is contained under the heading "Audit Committee Report." All of the members of this Committee are considered independent within the meaning of SEC regulations and the listing standards of NASDAQ. Jack Lewis, Chairman of the Committee, is qualified as an audit committee financial expert within the meaning of SEC regulations and the Board has determined that he has the accounting and related financial management expertise within the meaning of the listing standards of NASDAQ.

The **Compensation Committee** met one time in 2014. The Compensation Committee consists of the independent directors of the Company's Board, including Dr. Shuler (Chairman), Mr. Ball, Dr. Dooley, Mr. Green, Dr. Lewis, Dr. Miller, Mr. Peery, and Mr. Reynolds. This Committee is responsible for establishing and approving the compensation of executive officers of the Company. Reference is made to the "Compensation Discussion and Analysis" section of this proxy statement for further information on the duties and responsibilities of this Committee. No member of the Compensation Committee is a current officer or employee of the Company. All members of this Committee are considered independent within the meaning of SEC regulations and the standards of NASDAQ.

The **Nominating Committee** met two times in 2014. The Committee consists of Dr. Miller (Chairwoman), Mr. Peery, Mr. Reynolds and Dr. Shuler. The Nominating Committee held its meetings on January 6, 2014 and December 9, 2014. The Committee is responsible for developing and reviewing background information on candidates for the Board and makes recommendations to the Board regarding such candidates. All the members of this Committee are considered independent within the meaning of SEC regulations and the listing standards of NASDAQ.

The charters of the Board Committees are available on the Company's website, www.nationalbankshares.com. For access to the charters, select the "Corporate Governance" tab.

Board Compensation

In 2014, the members of the NBI Board of Directors received \$1,100 for each regular or special Board meeting they attended. They were paid \$600 for each committee meeting unless the committee meeting was held concurrently with the regular board meeting. Directors were also paid an annual retainer fee of \$16,000. The Chairmen of the Audit and Compensation Committees each received an additional \$1,500 annual retainer. The Company's Directors receive no other forms of compensation, except as described in the table below.

Directors Compensation Table⁽¹⁾

	Fees Earned or Paid in Cash (\$)	Other (\$)	Total (\$)
Lawrence J. Ball	28,800	---	28,800
John E. Dooley	29,900	---	29,900
Charles E. Green, III	28,200	---	28,200
Jack M. Lewis	32,500	---	32,500
Mary G. Miller	28,200	---	28,200
William A. Peery	30,400	---	30,400
Glenn P. Reynolds	29,300	---	29,300
James M. Shuler	31,400	37,811	⁽²⁾ 69,211

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

Represents \$26,900 in fees paid to Dr. Shuler for his service on the Board of Directors of NBB in 2014, 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 the Company, except for Mr. Rakes, is independent, as defined by the listing standards for NASDAQ, the national securities exchange on which the Company's common stock is listed and none of them is a present or past employee or officer of the Company or its subsidiaries.

In determining that each director meets the NASDAQ listing standards for independence, the Board of Directors recognized that NBB extends credit in the ordinary course of business to the Company's directors and executive officers. Extensions of credit are also made to business organizations and persons with whom Company directors and executive officers are associated or related. These extensions of credit are made at interest rates and with the same requirements

as to collateral as is prevailing for comparable transactions with the general public at the time credit is extended. In the opinion of bank management, none of the outstanding transactions with directors and executive officers involve a greater than normal risk of collectability or present other unfavorable features. In making the determination that all of the directors are independent, except for Mr. Rakes, the Board of Directors considered that Mr. Green rents a small office space at an NBB branch location. He has a year-to-year lease with the Bank and pays market rate rent of \$4,200 each year, including in 2014. The Board also considered that Dr. Miller's technology firm provided website services to the Company and NBB in 2014. Dr. Miller's technology firm was paid \$3,720 for such services. Except for the transactions listed in this paragraph and the directors' fees, no director received direct or indirect compensation from the Company in 2014.

Board Tenure

The Company does not have a formal board tenure policy. However, in order to promote director succession planning, the Company's by-laws state that directors reaching the age of 73 shall be ineligible for re-nomination to the Board at the expiration of the term of office during which the director becomes 73 years of age.

Risk Oversight Practices

In a financial institution, the role of the board is critical to the organization. To fulfill its responsibility to oversee the Company's risk management processes, the full Board of Directors receives extensive and regular reports from management outlining the status of credit risk, interest rate risk, liquidity risk and major areas of operational risk. The Company's Treasurer and Chief Financial officer, who serves as the subsidiary bank's Senior Vice President/Operations & Risk Management, attends most 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 from the Vice President, Corporate Compliance Officer. They report directly to the Board, supply 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.

Code of Ethics

We expect all of our directors, executive officers and employees to adhere to the highest standards of ethics and business conduct with each other, customers, stockholders and communities we serve, and to comply with all applicable laws, rules and regulations that govern our business. The Board of Directors has adopted a Directors' Code of Ethics and an Employees' Code of Ethics. A portion of the Code of Ethics contains special provisions for the principal executive officer and senior financial officers of the Company or person performing similar functions for the Company. The Code of Ethics for senior financial officers meets the requirements of a "code of ethics" as defined by Item 406 of the SEC's Regulation S-K. The Code of Conduct is available on the Company's website, www.nationalbankshares.com. Select the "Corporate Governance" tab. The respective Codes of Ethics are reviewed on an annual basis by the Board and the executive officers.

Stockholder Communication

Stockholders may communicate with all or any member of the Board of Directors by addressing correspondence to the "Board of Directors" or to the individual director and addressing such correspondence to National Bankshares, Inc., P. O. Box 90002, Blacksburg, Virginia 24062-9002, Attention: Board of Directors (in the case of correspondence addressed to the "Board of Directors"), or to the individual director. All stockholder communications are forwarded to the Board or to the specified directors.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed this Compensation Discussion and Analysis with management. The Committee reviewed and fully discussed the Compensation Discussion and Analysis, and the report was recommended to the Board of Directors to be included in this proxy statement. The Compensation Committee of Bankshares is made up of all independent, non-employee directors. In 2014, Dr. Shuler was Committee Chairman, and Mr. Ball, Dr. Dooley, Mr. Green, Dr. Lewis, Dr. Miller, Mr. Peery and Mr. Reynolds were its members.

The Company and the Compensation Committee do not engage an outside compensation consultant in connection with determining the compensation of the named executive officers.

COMPENSATION DISCUSSION AND ANALYSIS

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

National Bankshares, Inc. has four goals for its compensation program for named executive officers. In 2014, these officers were Chairman, President & CEO James G. Rakes, Treasurer and CFO David K. Skeens, Executive Vice President F. Brad Denardo, Secretary and Counsel Bryson J. Hunter.

- To offer salaries and bonuses to 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.

The Compensation Committee considers the results of the stockholder advisory “say-on-pay” vote in its deliberations regarding compensation of the named executive officers. At the Company’s 2014 Annual Meeting, the stockholders voted to approve, on an advisory basis, the compensation of the Company’s named executive officers, as described in the Compensation Discussion and Analysis set forth in the Company’s 2013 Annual Meeting proxy statement. The vote was 4,736,983 shares “For” (85.86% of the shares voted) and 721,456 shares “Against” (14.14% of the shares voted).

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 peer group did the Compensation Committee use as a guide during 2014?

During 2014, the Company’s peer group consisted of the following financial institutions: American National Bankshares, Inc., First Community Bankshares, Inc., First Century Bankshares, Inc., Old Point Financial Corporation, StellarOne Corporation and Union Bankshares Corporation. Because several of the peer group financial institutions merged and/or delisted from national securities exchanges, in early 2015, the Compensation Committee revised its peer group comparison list. Going forward, Committee will compare the principal elements of total direct compensation against a peer group of publicly traded financial institutions with assets ranging from approximately \$825 million to \$2.6 billion. The companies comprising that peer group as of February 11, 2015 were:

Access National Corporation	Franklin Financial Services Corporation
ACNB Corporation	Middleburg Financial Corporation
American National Bankshares, Inc.	Monarch Financial Holdings, Inc.

AmeriServe Financial, Inc.	Old Point Financial Corporation
Bank of Marin Bancorp	Palmetto Bancshares, Inc
Bridge Bancorp, Inc.	Park Sterling Corporation
C&F Financial Corporation	Peoples Bancorp of North Carolina
CenterState Banks, Inc.	SeaCoast Banking Corporation of Florida
Citizens & Northern Corporation	Shore Bancshares, Inc.
CNB Financial Corporation	Valley Financial Corporation
Eastern Virginia Bankshares, Inc.	Yadkin Financial Corporation
First Community Bancshares, Inc.	

What factors did the Compensation Committee consider in selecting the peer group?

The Compensation Committee considered the “compatibility” and “comparability” of each company when selecting the peer group. The Compensation Committee reviewed, among other things, each peer company’s asset size, earnings, geographical locations, organizational structure and governance, numbers of employees, numbers of branch offices, and service offerings.

What is each element of compensation?

The elements of compensation are:

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

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

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

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

Each named executive officer, along with all other eligible Company employees, participates in three qualified retirement plans. NBI sponsors a defined benefit pension plan, the National Bankshares, Inc. Retirement Income Plan. The National Bankshares, Inc. Retirement Accumulation Plan is a 401(k) plan, and the Company also offers the National Bankshares, Inc. Employee Stock Ownership Plan. The Company believes that it is important to assist its

long-term employees, including its executive officers, in assuring financial security in retirement for themselves and their families. National Bankshares, Inc. also believes that its Employee Stock Ownership Plan helps to align the interests of all employees, including executive officers, with the interests of its stockholders. More information is contained in “Qualified Retirement Plans.”

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

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

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

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

How does the Company determine the amount for each element?

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

The base salary of the Chairman, President & CEO of at least \$225,500 was set in an employment agreement effective on January 1, 2002. The employment agreement was amended and restated in its entirety on December 17, 2008, effective December 31, 2008, and the base salary was increased to Mr. Rakes' 2008 salary of \$445,183. The agreement was again amended and restated in its entirety on February 11, 2015, effective January 1, 2015, and the base salary was increased to Mr. Rakes' 2014 salary of \$756,300. The base salary was determined after considering compensation for this position reported in the Virginia Bankers Association's annual salary survey and from the public documents of peer institutions that disclose salaries paid to other individuals holding similar positions. The Board of Directors Compensation Committee determines annual salary increases after assessing the CEO's contributions to the success of the Company. In measuring the Company's success, the Committee compares NBI's financial results to the peer group listed on page 10. Specifically, the Compensation Committee compares Bankshares' return on assets (ROA) and return on equity (ROE) with the average ROA and ROE of the peer bank holding companies. The fact that National Bankshares once again significantly outperformed its peers in 2014, particularly during a difficult operating environment for banks, is reflected in the amount of salary awarded by the Compensation Committee to the Chairman, President & CEO. The Committee also considered Mr. Rakes' long track record of success in profitably leading the Company and in managing risks to the Company encountered in a challenging economic environment. Although the Committee weighs the peer comparison heavily in determining Mr. Rakes' salary increase, it does not utilize an objective formula. The Committee considers the Company's progress in meeting budget goals for the year, but it does not utilize a quantitative assessment of budget goals in determining the amount of annual salary increase. Likewise, although there are no objective measures utilized, the Committee considers stock performance and the level of stockholder dividends in establishing salary. In assessing Bankshares' stock performance, the Compensation Committee looks at its price, the price to earnings ratio and dividend yield as compared with the stock of the Company's identified peers. The Committee validates salary increases by referring to the Virginia Bankers Association salary survey and to public documents from peer institutions.

Cash Bonus: The annual incentive bonus paid to the Chairman, President & CEO is determined with the same criteria that are used in establishing his annual salary increase. In 2014, the Committee did not award any cash bonus to the Chairman, President & CEO.

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

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

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

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

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

Perquisites and Other Personal Benefits: The Board Compensation Committee negotiated with the Chairman, President & CEO to develop a comprehensive and competitive total compensation package, including perquisites. This package was included in Mr. Rakes' January 1, 2002 employment agreement and was included in the amended and restated employment agreement effective on January 1, 2015. The Chairman, President & CEO determines perquisites available to the other named executive officers. These perquisites are limited to a Company-owned automobile for Mr. Denardo, which facilitate business travel, as well as sports tickets and club memberships, which assist Mr. Denardo with marketing and business development efforts. Mr. Rakes reports annually to the Committee on these items.

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

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

In determining Mr. Rakes' total annual compensation, the Committee has maintained the same proportionate relationship of salary to annual bonus in recent years, except for 2014 in which the Committee did not award him a cash bonus or an increase in salary. The Committee reviews Mr. Rakes' decisions regarding the compensation packages of the other executive officers. These packages remain focused heavily on salary. The executive officers participate in the qualified retirement plans available to all employees, as well as in the Officers Salary Continuation Plan. The allocation of all executive officers' compensation, including Mr. Rakes', among the various elements of compensation has not changed substantially in a number of years.

Compensation Clawback

We the Compensation Committee have adopted a clawback policy applicable to our named executive officers. Under our clawback policy, the Compensation Committee may, in its reasonable discretion, require an executive officer to reimburse the Company for the amount of any payment previously received by such officer under the cash bonus plan as well as equity plan. The clawback would apply if the Company is required to restate financial statements during the three year period preceeding the date on which the Company would be required to prepare a restatement, regardless of whether such restatement was a result of an officer's intentional misconduct or gross negligence. Once the SEC and NASDAQ adopt and implement a final rule for clawback policies as mandated by the Dodd-Frank Act, the Company will modify its existing policy as necessary.

COMPENSATION COMMITTEE PROCEDURES

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

In carrying out its responsibilities, the Compensation Committee meets at least once each year. There are no officers or employees present at the Compensation Committee's annual meeting to evaluate the performance of the Chairman, President & CEO and to determine his compensation. The Committee considers a package of data provided to it by the Executive Committee. The package includes the Company's financial performance data; information about the financial performance of peer institutions; and salary data from salary surveys and publicly available sources. The Committee also monitors the results of the annual advisory "say-on-pay" proposal and incorporates such results as one of many factors considered in connection with the discharge of its responsibilities, although no such factor is assigned a quantitative weighting.

Because a substantial majority of our stockholders approved the compensation program described in the Company's proxy statement in 2014, the Committee did not implement changes to the Company's executive compensation program as a result of the stockholder advisory vote. At the conclusion of the Committee's meeting or at a separate meeting, the Chairman, President & CEO will provide the Committee with a report on the performance and compensation of the remaining named executive officers.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

None of the directors who serve on the Compensation Committee is now, or has been in the past, an officer or employee of Bankshares or of Bankshares' subsidiaries. This includes Chairman Shuler and Committee members: Mr. Ball, Dr. Dooley, Mr. Green, Dr. Lewis, Dr. Miller, Mr. Peery and Mr. Reynolds. Dr. Shuler serves on the Salary and Personnel Committee of NBB. No executive officer of Bankshares, NBB or NBFS served as a director of another entity which had an executive officer serving on the Bankshares Compensation Committee. No executive officer of Bankshares, NBB or NBFS served as a member of the compensation committee of another entity which has an executive officer who served as a director or member of Bankshares' Compensation Committee. None of the members of the Bankshares Compensation Committee, or any business organizations or persons with whom they may be associated, has had any transactions with Bankshares or its subsidiaries, except as explained in "Director Independence and Certain Transactions with Officers and Directors."

EXECUTIVE COMPENSATION**Summary Compensation Table**

The following table sets forth information concerning total compensation earned or paid to the individuals who served as Bankshares' named executive officers during 2014.

Summary Compensation Table

Name and Principal Position	Year	Salary (\$)	Bonus (\$)
James G. Rakes	2014	756,300	---
Chairman, President & CEO – NBI	2013	706,800	300,440
(Principal Executive Officer)	2012	706,800	286,133
Executive Chairman – NBB			
Chairman, President & CEO – NBFS			
David K. Skeens	2014	143,417	---
Treasurer & CFO – NBI	2013	137,542	---
(Principal Financial Officer)	2012	125,625	---
Senior Vice President/Operations & Risk Management & CFO – NBB			
F. Brad Denardo	2014	355,831	---
Executive Vice President – NBI	2013	300,025	---
President & CEO – NBB	2012	300,000	---
Treasurer – NBFS			
Bryson J. Hunter	2014	136,320	---
Senior Vice President, Secretary & Counsel – NBI	2013	133,980	---
Counsel – NBB	2012	130,250	---
Secretary & Counsel - NBFS			

Summary Compensation Table (continued)

Name	Year	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)⁽¹⁾	All Other Compensation (\$)⁽²⁾	Total (\$)
James G. Rakes	2014	---	564,908	106,131	1,427,339
	2013	---	19,267	117,927	1,144,434
	2012	---	267,016	111,940	1,371,889
David K. Skeens	2014	---	104,877	7,171	255,465
	2013	---	10,756	12,435	160,733

	2012 ---	51,448	13,221	190,294
F. Brad Denardo	2014 ---	372,341	50,731	778,903
	2013 ---	85,744	63,527	449,296
	2012 ---	262,834	61,519	624,353
Bryson J. Hunter	2014 ---	29,283	6,816	172,419
	2013 ---	17,031	12,113	163,124
	2012 ---	8,750	10,469	149,469

“Changes in Pension Value” includes changes in the actuarial present value in the National Bankshares Retirement Income Plan and in the Officers Salary Continuation Plan. All (1) changes in values are based on reports from independent advisors, using the assumptions described in the “Retirement Income Plan” and “Officer Salary Continuation Plan” sections of this Proxy Statement.

(2) Additional information about “All Other Compensation” for the executive officers is provided in the following chart.

Detail of All Other Compensation							
Name	Year	Directors Fees (\$)⁽¹⁾	Matching	Contribution	Nonqualified Deferred Compensation Plan Payments (\$)⁽⁴⁾	Total All Other Compensation (\$)	
			Contribution Under National Bankshares, Inc. Retirement Accumulation Plan (\$)	Under National Bankshares, Inc. Employee Stock Ownership Plan (\$)⁽²⁾			Perquisites (\$)⁽³⁾
James G. Rakes	2014	58,500	13,000	---	15,305	19,326	106,131
	2013	60,700	12,750	10,305	14,846	19,326	117,927
	2012	52,300	12,250	13,812	14,252	19,326	111,940
David K. Skeens	2014	---	7,171	---	---	---	7,171
	2013	---	6,877	5,558	---	---	12,435
	2012	---	6,281	6,940	---	---	13,221
F. Brad Denardo	2014	26,900	13,000	---	10,831	---	50,731
	2013	29,100	12,750	10,305	11,372	---	63,527
	2012	24,000	12,250	13,812	11,457	---	61,519
Bryson J. Hunter	2014	---	6,816	---	---	---	6,816
	2013	---	6,699	5,414	---	---	12,113
	2012	---	3,300	7,196	---	---	10,496

See “All Other Compensation” in the Summary Compensation Table above.

(1) Director’s fees for Mr. Rakes include fees from NBI and NBB. All of Mr. Denardo’s director’s fees are from his service on the NBB Board.

(2) The 2014 plan year contribution to the Employee Stock Ownership Plan has not yet been allocated among the participants.

In 2014, perquisites for Mr. Rakes included \$8,721 for the personal use of a Company-owned automobile and \$6,584 for club dues, sports tickets and tax preparation fees. Mr. Denardo’s (3) 2014 perquisites totaled \$5,821 for personal use of a Company car and \$5,010 for club dues and sports tickets.

On September 1, 2009, at age 65, Mr. Rakes began receiving monthly payments of \$1,610.50 (4) from the Bank Directors Deferred Compensation Plan. Please see “Nonqualified Retirement Plans” below.

Several of National Bankshares, Inc.'s executive officers have been employed by the Company and its subsidiaries for many years. These officers have provided guidance in the growth and long term development of the Company's business. Their experience and knowledge of the operations and customs of Bankshares is a benefit to the future success of the Company. As an inducement to these executive officers' continued employment, the Board of Directors determined that Bankshares should enter into employment and change in control agreements with Mr. Rakes and Mr. Denardo. The Board implemented the change in control provisions in part to insure that Bankshares would be more likely to retain the services of key executives during periods of uncertainty resulting from significant ownership changes, should they occur.

Employment Agreement with Mr. Rakes

The employment agreement between Bankshares and Mr. Rakes (the "agreement") was originally effective January 1, 2002 and was amended and restated to be effective on December 31, 2008.

It was amended and restated again on March 11, 2015, effective January 1, 2015. The agreement provides for the continued employment of Mr. Rakes as President and Chief Executive Officer of Bankshares and at one or more of its affiliated companies, at an annual base salary of at least \$756,300. In addition, the agreement provides that Mr. Rakes may be awarded an annual bonus and certain stock-based incentives in the discretion of the Board, as well as employee fringe benefits and executive perquisites. The agreement has an initial two year term, and it will be extended for successive one-year terms unless either party gives notice at least one year prior to the end of the current term.

Mr. Rakes' employment agreement deleted inclusion of the non-equity incentive plan, the Capital Accumulation Plan ("CAP"). The CAP terminated on December 31, 2011. The agreement provides that the account administered for the CAP with the Company's subsidiary, The National Bank of Blacksburg, will be maintained with no fees incurred by Mr. Rakes.

The agreement has provisions which have the effect of continuing Mr. Rakes' benefits and compensation under the agreement beyond his employment with Bankshares if Bankshares terminates his employment "without cause" or if Mr. Rakes resigns "for good reason", as those terms are defined in the agreement. Under these circumstances, Mr. Rakes will continue to receive his base salary and certain executive benefits for 24 months after his employment terminates. "Cause" is defined in the agreement as i) deliberate neglect in the performance of job duties or deliberate failure to follow reasonable instructions or Company policies, ii) conviction of or pleading no contest to a felony, a crime of moral turpitude, fraud or embezzlement or any crime for which imprisonment is a possible punishment, iii) a material breach of the agreement, iv) material dishonesty or breach of fiduciary duty with respect to Bankshares, or v) willful conduct likely to result in material injury to the Company. The agreement defines "for good reason" as i) assignment of duties inconsistent with the position, ii) Company action that results in a material reduction in status, authority or duties, iii) relocation, without consent, more than 50 miles from initial place of employment, and iv) failure by the Company or any successor to comply with the agreement.

The current agreement removed the "for good reason" definition that would allow Mr. Rakes to voluntarily terminate during the 30-day period immediately following the first anniversary of a change in control.

The agreement also contains provisions which can have the effect of prolonging, enhancing and accelerating Mr. Rakes' benefits and compensation under certain circumstances involving a change in control of The Company. A change in control generally involves circumstances where an individual or group acquires 20% or more of the Company's stock or a merger occurs which results in a change in the majority of the Company's Board of Directors and the Company's shareholders do not constitute a majority of the shareholders in the surviving company. The sale or disposition of all or substantially all of the Company's assets is also defined as a change in control.

The term of the agreement is automatically extended for three years from the date of a change in control and Mr. Rakes is entitled to continue to receive all of his compensation and benefits during that period, except that he becomes entitled to minimum annual stock-based awards equal to one-third of his base salary. In addition, if after a change in control, Mr. Rakes' employment is terminated by the Company "without cause" or by Mr. Rakes "for good reason," he becomes entitled to receive a lump sum salary continuation benefit equal to 2.99 times his

average annual compensation includable in his annual gross income for the period of five years preceding the change in control, a continuation of certain executive benefits for 36 months, and certain enhancements to his retirement benefits.

The amended and restated employment agreement for Mr. Rakes includes provisions stating that all payments under the agreement are intended either to be outside the scope of Internal Revenue Code Section 409 or to comply with its provisions.

Mr. Rakes' employment agreement includes requirements that he never disclose the Company's confidential information or use confidential information for any purpose that does not benefit the Company. The agreement also includes a clause providing that Mr. Rakes will not engage in competition with the Company for 24 months after termination of his employment, unless the termination was "for good reason" or by the Company "without cause" or if his employment is terminated following a change in control.

Employment Agreements with Mr. Denardo

Mr. Denardo has an executive employment agreement with the Company that is dated December 17, 2008, and which became effective on December 31, 2008. It was amended and restated again on March 11, 2015, effective January 1, 2015 (the "employment agreement"). Mr.

Denardo's employment agreement provides for his employment as the Company's Executive Vice President and for his service in any executive or management position with the Company's affiliates at an annual base salary of \$360,000. Mr. Denardo's employment agreement had a two-year term and continued for successive one-year terms unless either party had provided a one year notice of termination.

Mr. Denardo's employment agreement states that compensation will be paid and benefits provided for 12 months if the Company terminates his employment "without cause" or if he resigns "for good reason," as those terms are defined in the employment agreement. "Cause" and "for good reason" are defined in the same manner as in Mr. Rakes' employment agreement described above. If Mr. Denardo were to be terminated without cause or resign for good reason after a change in control, he would receive a salary continuance benefit equal to two times his average annual compensation for the five most recent tax years. He would also be entitled to a continuation of benefits for 24 months following termination. Change in control is defined using the same terms as in Mr. Rakes' employment agreement.

The employment agreements for Mr. Denardo contain provisions requiring the executive officers to maintain the confidentiality of Company information. The agreements provide that Mr. Denardo will not compete with the Company for 12 months after ceasing employment with the Company, unless the termination is by the Company "without cause," by the executive officers "for good reason" or following a change in control.

The following table provides additional information concerning payments to executive officers upon termination or change in control, assuming this occurred on December 31, 2014.

Name	Benefit	Potential Payments Upon Termination or Change in Control			
		Before Change in Control Termination Without Cause Resignation For Good Reason (\$)	After Change in Control Termination Without Cause Resignation For Good Reason (\$)	Long Term Incapacity (\$)	Death (\$)
James G. Rakes ⁽¹⁾	Post-Termination Compensation	1,512,600	2,809,149	1,512,600	189,075
	Welfare & Executive Benefits Continuation	71,260	106,890	71,260	8,908
	Officers Salary Continuation Plan ⁽²⁾	130,519	⁽³⁾ 130,519	⁽⁴⁾ 130,519	⁽⁵⁾ 130,519 ⁽⁶⁾
F. Brad Denardo	Post-Termination Compensation	355,831	571,523	---	---
	Welfare & Executive Benefits Continuation	21,256	42,512	---	---
	Officers Salary Continuation Plan	55,007	⁽³⁾ 61,706	⁽⁴⁾ 55,007	⁽⁵⁾ 72,488 ⁽⁶⁾

If he is terminated without cause or leaves for good reason after a change in control, Mr. Rakes will be entitled to receive an additional retirement benefit equal to the actuarial
(1) equivalent of the additional amount he would have earned under the National Bankshares, Inc. Retirement Income Plan had it accumulated for four more years of service.

Mr. Rakes' payments under the Officers Salary Continuation Plan will increase from the
(2) stated amount with the addition of interest from December 31, 2009 to his actual retirement date.

The Officers Salary Continuation Plan early termination benefit is an annual amount
(3) commencing at normal retirement payable to the officer for the longer of life or to the officer's beneficiary for up to 15 years.

The Officers Salary Continuation Plan change of control benefit is an annual amount
(4) commencing at termination payable to the officer for the longer of life or to the officer's beneficiary for up to 15 years.

The Officers Salary Continuation Plan disability benefit is an annual amount commencing at
(5) normal retirement payable to the officer for the longer of life or to the officer's beneficiary for 15 years.

The Officers Salary Continuation Plan death benefit is an annual amount commencing at
(6) death payable to the officer's beneficiary for 15 years.

Grants of Plan-Based Awards

The former employment agreement for Mr. Rakes, which is dated January 1, 2002 and which was amended and restated effective on December 31, 2008, included a non-equity incentive plan, the Capital Accumulation Plan (“CAP”). Under the agreement, the total amount allocated to the CAP for the calendar year was established by the Board of Directors with a maximum of \$60,000 per year to be allocated. This total amount was then divided equally between two target areas: (1) return on equity, and (2) return on assets. The amount actually contributed to the CAP for a year was based on Bankshares’ performance relative to the average performance of a peer group of Virginia bank holding companies in the two target areas during that year. The 2011 peer group of six community bank holding companies were headquartered in Virginia and southern West Virginia, and were similar to or larger than National Bankshares, Inc. in asset size. A minimum of 85% of the peer group average was to be achieved in a target area for any contribution to be made for that target area. The amount of the contribution for each target area increased beyond the minimum contribution to the extent Bankshares’ performance exceeded 85% of the peer group average with a maximum contribution for performance which equaled 150% or more of the peer group average. Contributions to the CAP for achievements in any calendar year were to be made prior to June 1 of the next year. Accrued CAP benefits became payable 12 months after an election by Mr. Rakes or, in the absence of an election, on the first day of the seventh month following his separation from service or the first day of the month following his death, or earlier, if Mr. Rakes retired or his employment terminated under certain circumstances. Once the CAP benefits became payable, they have been paid in quarterly installments over ten years unless Mr. Rakes chooses, with the Board’s consent, to receive them in some alternate form of payment. The CAP contribution for 2011, which was paid in 2012, was \$60,000. The CAP terminated on December 31, 2011 and was not renewed. Accordingly, there were no CAP contributions for 2012, 2013 and 2014. As referenced above, Mr. Rakes’ amended and restated employment agreement, effective January 1, 2015, excluded the CAP provisions.

Stock Options

In March 1999, the Company established a stock option plan, the National Bankshares, Inc. 1999 Stock Option Plan, which permitted the grant of incentive stock options and nonqualified stock options. The plan terminated on March 9, 2009. Grants of stock options were made annually each November from 1999 through 2005.

The following table provides additional information about the outstanding equity awards in the 1999 Stock Option Plan as it applies to Mr. Rakes and Mr. Denardo. All stock options are vested.

Outstanding Equity Awards at Fiscal Year End

Name	Number of Securities Underlying Exercisable but Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date
James G. Rakes	12,500	23.00	11/08/2015
F. Brad Denardo	8,000	23.00	11/08/2015

The following table lists the amounts realized by Mr. Rakes upon the exercise of stock options in 2014. The amount realized is determined using the mean between the market high and low price on the exercise date.

Option Exercise

Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)
James G. Rakes	2,500	73,025

Retirement Plans

Bankshares maintains several qualified and nonqualified employee benefit plans for employees of participating employees in the plans. These benefit plans are described below.

Qualified Retirement Plans

National Bankshares, Inc. Retirement Income Plan. Until December 31, 2001, NBB maintained a tax-qualified, noncontributory defined benefit retirement plan for qualified employees called the National Bank of Blacksburg Retirement Income Plan (the “NBB Plan”). Effective on December 31, 2001, the NBB Plan was amended; its name was changed to the National Bankshares, Inc. Retirement Income Plan (the “NBI Plan”); and the Bank of Tazewell County Employee Pension Plan (the “BTC Plan”) was merged into the NBI Plan. The NBB (now NBI) Plan became effective on February 1, 1984, when NBB amended and restated its previous pension plan. This plan covers all officers and employees of NBI and its subsidiaries who have reached age twenty-one and have had one year of eligible service on the January 1 or July 1 enrollment dates. Employee benefits are fully vested after five years of service, with no partial vesting. Prior to the December 31, 2001 plan amendment, retirement benefits at the normal retirement age of sixty-five were calculated at 66% of the employee’s average monthly compensation multiplied by the number of years of service, up to a maximum of twenty-five years. After December 31, 2001, retirement benefits at the normal retirement age were calculated at 1.75% of average monthly compensation multiplied by the number of years of service, up to thirty-five years. Added to this is .65% of “excess monthly average compensation” (defined in the NBI Plan as the amount of the average monthly compensation that is in excess of a participant’s monthly Social Security covered compensation, generally the rounded average of the Social Security taxable wage bases) multiplied by the number of years of service, up to thirty-five years. The benefit formula was amended again in 2008 to reduce the benefit formula for future accruals to 1.00% of monthly compensation, multiplied by the number of years of service up to thirty five years. Average monthly compensation is determined by averaging compensation over the five highest paid consecutive years in the employee’s final ten years of employment. Retirement benefits under the NBI Plan are normally payable in the form of a straight life annuity, with ten years guaranteed; but other payment options may be elected. Benefits accrued by participants in the NBB Plan and in the BTC Plan prior to December 31, 2001, will be calculated based upon compensation and service under the old NBB and BTC Plan formulas. Benefits accrued by participants after January 1, 2002, are calculated under the NBI Plan formulas. The compensation covered by the NBI Plan includes the total of all amounts paid to a participant for personal services reported on the participant’s federal income tax withholding statement (Form W-2), except that earnings were limited to \$200,000, indexed for the cost of living, until 1994. In 1994, the earnings limit was decreased to \$150,000, which is indexed for the cost of living after 1994. For 2014, the limit on compensation was \$260,000.

National Bankshares, Inc. Employee Stock Ownership Plan. Bankshares sponsors a non-contributory Employee Stock Ownership Plan (the “ESOP”), in which NBB and NBFS were participating employers for 2014. All full-time employees who are over the age of 21 and who have been employed for one year are eligible to participate. Contributions under the ESOP are discretionary for each participating employer and participants are not permitted to make contributions to the plan. Contributions are allocated to a participant’s account based upon a participant’s covered compensation, which is W-2 compensation. The contributions are fully vested after three years.

National Bankshares, Inc. Retirement Accumulation Plan. Bankshares sponsors the NBI Retirement Accumulation Plan which qualifies under IRS Code Section 401(k) (the “401(k) plan”). For 2014, NBB and NBFS were participating employers. All full-time employees who have one year of service and who are over the age of 21 are eligible to participate. Participants may contribute up to 100% of their total annual compensation to the plan, subject to IRS deferral annual dollar limits. Employee contributions are matched by the employer at 100% for the first 4% of salary contributed and at 50% of the next 2% of salary contributed. Employees are fully vested at all times in contributions and employer match sums.

Nonqualified Retirement Plans

Bank Directors Deferred Compensation Plan. From 1985 to 1989 NBB maintained a voluntary deferred compensation plan for its directors, which permitted a director to defer receipt of a portion of director’s fees for a period of five years. NBB purchased life insurance on all of the participants in amounts that, in the aggregate, actuarially funded its future liabilities under the program. While the insurance policies were purchased to fund the directors’ deferred compensation plan, there is no obligation to use any insurance proceeds from policy loans or death benefits to curtail the deferral compensation liability. Under the terms of the plan, at age 65, a participant or beneficiary receives 120 monthly benefit payments. The plan also provides for 120 monthly payments to the participant’s beneficiary in the event of the participant’s death prior to age 65. Mr. Rakes became entitled to receive 120 months of payments of \$1,610.50 beginning at age 65. In 2014, there were no contributions to the Bank Directors’ Deferred Compensation Plan. The plan had no earnings. Mr. Rakes began receiving monthly payments on September 1, 2009. Those payments are included in “All Other Compensation” in the Summary Compensation Table above.

Officers Salary Continuation Plan. In early 2006, Bankshares and its subsidiaries entered into salary continuation agreements with a select group of Company and subsidiary bank officers, including Mr. Rakes, Mr. Skeens and Mr. Denardo. Effective January 1, 2012, Bankshares’ subsidiary entered into a salary continuation agreement with Mr. Hunter. The Salary Continuation Plan benefits are funded by investments in bank subsidiary-owned life insurance policies on the lives of the participating officers. The officers and their beneficiaries are unsecured creditors of NBI and of NBB with respect to the benefits under the Salary Continuation Plan.

Each of the salary continuation agreements, except for Mr. Rakes', provides an annual benefit for the participating officer at normal retirement age (age 65) while in the active service of the Company. In Mr. Rakes' case, the salary continuation agreement was amended on December 17, 2008 to provide that benefits will be payable to him upon his separation from service after reaching the normal retirement age (65). At the time of the amendment, Mr. Rakes' benefit was equal to 30% of 2005 salary, adjusted for inflation. Starting in 2009, his benefit has been adjusted annually based on his then current salary. It is equal to 25% of 2008 annual compensation adjusted for inflation, for Mr. Denardo and 25% of 2012 annual compensation, adjusted for inflation, for Mr. Skeens. The benefit is payable for the greater of 15 years or the officer's lifetime. If the officer dies before receiving the annual benefit for 15 years, the benefit is paid to his or her beneficiary for the remainder of that period. A reduced benefit is available upon the officer's early termination if he or she is 50 years of age or older, upon disability or upon a change in control of the officer's employer. "Early termination," "disability" and "change in control" are all defined in the salary continuation agreements. A death benefit that is equal in amount to the annual retirement benefit is paid to the officer's beneficiary for 15 years in the event of the officer's death while an active employee. No benefit is payable if the officer is terminated for cause, as that term is defined in the agreements.

The amended salary continuation agreement with Mr. Rakes provides that he would have received annual payments of \$106,268 if he had left the Company at his normal retirement age in 2009. Upon Mr. Rakes' separation from service, his benefit will increase by adding interest for each full month between his normal retirement and his actual separation from service. The method for calculating this interest is specified in the amended salary continuation agreement. Mr. Skeens' agreement provides that he will be paid \$65,940 annually at his normal retirement in 2031. Under his agreement, Mr. Denardo will be paid annual payments of \$72,488 at his normal retirement in 2017. The salary continuation agreement with Mr. Hunter provides for annual payment of \$54,862 at normal retirement in 2033.

Pension Benefits Table

The following table provides additional information about the pension benefits from the National Bankshares, Inc. Retirement Income Plan and from the Officers Salary Continuation Plan for Mr. Rakes, Mr. Skeens, Mr. Denardo and Mr. Hunter.

Pension Benefits Table

Name	Plan Name	Number of Years of Credited Service (#)	Present Value of Accumulated Benefits (\$) ⁽¹⁾	Payments During Last Fiscal Year (\$)
James G. Rakes	NBI Retirement Income	31	2,789,337	---

	Officers Salary Continuation	n/a	1,234,407	---
David K. Skeens	NBI Retirement Income	23	238,680	---
	Officers Salary Continuation	n/a	58,875	---
F. Brad Denardo	NBI Retirement Income	30	1,241,798	---
	Officers Salary Continuation	n/a	492,120	---
Bryson J. Hunter	NBI Retirement Income	3	32,578	---
	Officers Salary Continuation	n/a	32,063	---

For the NBI Retirement Income Plan, based on December 31, 2014 disclosure assumptions: (1) 3.75% interest, RP –2000 Combined Mortality. For the Officers Salary Continuation Plan, based on 2014 assumptions: 6.25% interest.

Mr. Rakes has reached normal retirement age under the National Bankshares, Inc. Retirement Income Plan and is eligible to receive his full benefit upon retirement. Mr. Denardo is eligible for early retirement under the Plan. Early retirement is defined as having reached age 55, with five years of participation in the Retirement Income Plan. Upon early retirement, vested benefits are reduced by multiplying the full retirement benefit by an early payment factor that ranges from 41.29% at age 55 to 90.76% at age 64.

Nonqualified Deferred Compensation Table

The following table supplies detailed information about nonqualified deferred compensation plans for Mr. Rakes.

Nonqualified Deferred Compensation Table					
Name	Executive Contributions in Last FY (\$)	Registrant Contributions in Last FY (\$)	Aggregate Earnings in Last FY (\$)	Aggregate Withdrawals/ Distributions (\$)	Aggregate Balance at Last FYE (\$)
James G. Rakes Capital Accumulation Plan	---	---	44,550	---	1,911,510
Directors Deferred Compensation Plan	---	---	---	19,326	---

RISK FROM COMPENSATION POLICIES AND PRACTICES**FOR ALL EMPLOYEES**

National Bankshares, Inc. has determined that its conservative compensation policies and practices for all employees are unlikely to create risks that are reasonably likely to have a materially adverse effect on the Company. Substantially all of the compensation paid to the Company's employees is in the form of salary. The only exception to this rule are the bonus payments that are a part of Mr. Rakes' compensation package, which is discussed in "Compensation Discussion and Analysis" above, and a small percentage of incentive compensation paid by NBFS. While Mr. Rakes' annual bonus is a large component of his compensation, the Board believes that the historical performance of the Company during Mr. Rakes' tenure while the bonus program has been in effect reflects that the bonus plan, as implemented by the Board, has not and is not likely to create risks that are reasonably likely to harm the Company. Rather, this compensation element has proven to be beneficial in enhancing the Company's success. The Company utilizes a formal salary administration structure that limits annual salary increases to predetermined percentages within salary ranges that are established for each position.

NOMINATING COMMITTEE

The Company has a standing Nominating Committee that was chaired by Dr. Miller in 2014. Mr. Peery, Mr. Reynolds and Dr. Shuler served on the Committee. Each of these directors was independent. The Nominating Committee's sole function is to review and recommend nominees for the Board of Directors. A current copy of the Committee's Charter is available on the Company's web site at www.nationalbankshares.com under the "Corporate Governance" tab. The Nominating Committee does not have a specific policy with regard to the consideration of any director candidates recommended by stockholders, because the Committee will evaluate all candidates for directors using the same criteria, regardless of the source of the referral. Stockholders wishing to refer director candidates to the Nominating Committee should do so in writing mailed by first class mail to the Committee, c/o National Bankshares, Inc., P. O. Box 90002, Blacksburg, VA 24062-9002.

In considering candidates for director, the Nominating Committee seeks individuals who meet the following minimum criteria that are set forth in the Committee's Charter. The candidate must be an individual of the highest character and integrity. He or she must be able to work well with others and must be free of any conflict of interest that would violate law or regulation or interfere with the proper performance of a director's responsibilities. The candidate should be willing to devote sufficient time to the business of the Board. Finally, he or she should have the capacity to represent the best interests of the stockholders as a whole in a balanced way. The Nominating Committee insures that the Board of Directors will have a sufficient number of independent directors to fill all Board and Committee positions that require independent directors. In addition, the Nominating Committee seeks directors who have good business experience as well as directors who have experience in academia and public service. The Committee looks for directors who are knowledgeable about and who reside in the locations in which the Company and its subsidiaries do business and who have the ability and willingness to refer new business to the Company. While there is no formal policy regarding consideration of diversity in identifying director nominees, the Nominating Committee seeks candidates who reflect the Company's belief that gender and ethnic diversity provide additional perspectives that are helpful to the Board of Directors. As a result, the Nominating Committee considers the additional diversity a candidate may add to the overall membership mix of the Board to be a positive factor in the selection of a nominee. The Board believes that its policy of seeking diverse Directors has been moderately successful.

The Nominating Committee actively solicits the names of potential Board candidates from the directors and officers of Bankshares and, as stated here, will consider candidates suggested by stockholders. Information about potential candidates is sought from diverse sources, and the Nominating Committee compares the experience, expertise and personal qualities of the potential candidates with the experience, expertise, and personal qualities that are identified as being desirable for the Board of Directors at any given time.

AUDIT COMMITTEE REPORT

The Audit Committee has a charter that was last amended on February 11, 2004. The Charter reflects standards set forth in SEC regulations and NASDAQ Listing Rules, and it is posted on the Company's web site at www.nationalbankshares.com.

The Audit Committee monitors the integrity of the Bankshares financial reporting process and its systems of internal controls concerning finance, accounting and legal compliance. Each of the Audit Committee members satisfies the definition of an independent director as established in the listing standards for the NASDAQ Stock Market. Although each member of the Audit Committee has extensive business experience, the Committee has identified Dr. Lewis as the financial expert, because he has a background which involves financial oversight responsibilities. Dr. Lewis currently oversees the preparation of financial statements in his role as President of New River Community College. He previously served as the College's Chief Financial Officer. In 2014, the Audit Committee was comprised of Dr. Lewis, (Chairman), Mr. Ball, Dr. Dooley and Mr. Green.

In discharging its oversight responsibility with regard to the audit process, the Audit Committee has reviewed and discussed the audited consolidated financial statements with management, discussed with the independent auditors Yount, Hyde & Barbour the matters to be discussed by Statement of Auditing Standards No. 61 (Communication with Audit Committees), received communications from the auditors as to their independence required by Independence Standards Board Standard No. 1 and discussed with them their independence.

Based upon its review and discussions with management and Yount, Hyde & Barbour, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, that was filed with the SEC on March 11, 2015.

The following fees were paid to Yount, Hyde & Barbour, P.C., Certified Public Accountants & Management Consultants, for services provided to Bankshares for the years ended December 31, 2014 and December 31, 2013. The Audit Committee determined that the provision of non-audit services by Yount, Hyde & Barbour did not compromise the firm's ability to maintain its independence.

Principal Accounting Fees and Services

	2014		2013		
	Fees (\$)	Percentage	Fees (\$)	Percentage	
Audit fees	118,850	79	% 125,250	80	%
Audit-related fees	22,625	15	% 22,650	15	%
Tax fees	8,950	6	% 8,000	5	%
	150,425	100	% 155,900	100	%

Audit fees: Audit and review services and review of documents filed with the SEC.

Audit-related fees: Employee benefit plan audits and consultation concerning financial accounting and reporting standards.

Tax fees: Preparation of federal and state tax returns, review of quarterly estimated tax payments and consultation concerning tax compliance issues.

The Audit Committee meets and specifically approves in advance the provision of all services of Yount, Hyde & Barbour, P.C.

EXPENSES OF SOLICITATION

The cost of solicitation of proxies will be borne by the Company. In addition to solicitations by mail, directors, officers and regular employees of the Company, NBB and NBFS may solicit proxies personally or by telephone, telegraph, facsimile, or other electronic means without additional compensation. It is contemplated that brokerage houses and nominees will be requested to forward proxy solicitation material to the beneficial owners of the stock held of record by such persons, and the Company may reimburse them for their charges and expenses in this connection.

2016 STOCKHOLDER PROPOSALS

In order to be considered for inclusion in the proxy materials of Bankshares for the 2016 Annual Meeting of Stockholders, a stockholder proposal intended to be presented at the Meeting must be delivered to Bankshares' headquarters at 101 Hubbard Street, Blacksburg, Virginia, 24060, or received by mail at P.O. Box 90002, Blacksburg, Virginia 24062-9002, no later than December 6, 2015. The Company's bylaws provide that a stockholder must give timely advance notice in writing to the Chairman, President and CEO, James G. Rakes, in order to bring business before an Annual Meeting of Stockholders. To bring business before the 2016 Annual Meeting, a stockholder notice must be delivered to 101 Hubbard Street, Blacksburg, 24060, or received by mail at P.O. Box 90002, Blacksburg, Virginia 24062-9002 no sooner than February 9, 2016 and no later than March 10, 2016.

BY ORDER OF THE BOARD OF DIRECTORS

Bryson J. Hunter
Secretary and Counsel

Blacksburg, Virginia

March 27, 2015

BANKSHARES IS PROVIDING STOCKHOLDERS WITH A COPY OF THE ITS ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2014, INCLUDING FINANCIAL STATEMENTS (BUT NOT INCLUDING EXHIBITS), FREE OF CHARGE, WITH THIS PROXY STATEMENT. STOCKHOLDERS AS OF THE RECORD DATE MAY OBTAIN ADDITIONAL COPIES OF THE FORM 10-K AND COPIES OF EXHIBITS TO THE FORM 10-K BY MAKING A WRITTEN REQUEST TO: BRYSON J. HUNTER, SECRETARY AND COUNSEL, NATIONAL BANKSHARES, INC., P.O. BOX 90002, BLACKSBURG, VIRGINIA 24062-9002.

**NATIONAL
BANKSHARES, INC.**

101 Hubbard Street

Blacksburg, VA 24060

P.O. Box 90002

Blacksburg, VA 24062-9002

PROXY

**THIS PROXY IS SOLICITED ON BEHALF OF THE
BOARD OF DIRECTORS**

The undersigned hereby appoints Lindsay Coleman, of Blacksburg, Virginia and William T. Peery of Tazewell, Virginia, or each of them, as Proxies, each with the power to appoint his substitute, and hereby authorizes them to represent and to vote as designated below, all the shares of Common Stock of National Bankshares, Inc. held of record by the undersigned on March 18, 2015, at the Annual Meeting of Stockholders to be held on May 12, 2015, or at any adjournments thereof.

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED

The Board of Directors recommends you vote **FOR** the following:

To withhold authority to vote for any individual nominee (s), mark "For All Except" and write the name (s) of the nominees (s) on the line below.

Vote on Directors	FOR ALL	WITHHOLD ALL	FOR ALL EXCEPT
1. Election of Directors Nominees: 01) Lawrence J. Ball 02) Mary G. Miller 03) Glenn P. Reynolds			

The Board of Directors recommends you vote (i) **FOR** the non-binding advisory vote to approve the compensation of our named executive officers; and (ii); **FOR** the ratification of the appointment of Yount, Hyde, & Barbour, P.C. as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2015.

Vote on Proposals

FORAGAINSTABSTAIN

2. Cast a non-binding advisory vote to approve the compensation of our named executive officers.

3. Ratification of the appointment of Yount, Hyde & Barbour P.C. as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2015.

When properly executed, this proxy will be voted in the manner directed by the undersigned stockholder. If no direction is made the proxy will be voted "for" Proposals 1, 2, and 3 as set forth above.

Please sign exactly as your name appears below. Joint owners should each sign personally. When signing as attorney, executor, trustee, guardian or other fiduciary, please give full title as such. If a corporation or partnership, please sign in full corporate or partnership name, by authorized officer.

Signature Date Signature if held jointly Date

**PLEASE MARK, SIGN, DATE AND RETURN THE PROXY PROMPTLY USING
THE ENCLOSED POSTAGE-PAID ENVELOPE.**