

## Estimate Change

Banks/Thriffs

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**National Bankshares, Inc.** (NKSH-\$29.34)

**Hold (2)**

### Company Statistics

<b>12-month Price Target:</b>	NA
<b>52-wk Range:</b>	\$22.57-\$31.16
<b>Market Capitalization (M):</b>	\$204
<b>Shares Outstanding (M) fd:</b>	6.9
<b>Avg. Daily Vol. (000):</b>	9.7
<b>Dividend:</b>	\$1.04
<b>Yield:</b>	3.50%
<b>Price/Book Value:</b>	144%
<b>Price/Tangible Book Value:</b>	156%
<b>Equity/Assets:</b>	13.2%
<b>NPAs +90/Assets:</b>	1.04%
<b>NCO Ratio:</b>	0.65%
<b>Reserves/Loans:</b>	1.44%

### Financials

FYE Dec	2009A	2010A	2011A	2012E	2013E	
P/E Ratio:	14.2x	13.0x	11.6x	11.5x	11.5x	
ROE:	12.23%	12.13%	12.92%	12.01%	11.25%	
ROA:	1.47%	1.58%	1.71%	1.65%	1.63%	
EPS:						
	Q1	\$0.49	\$0.54	\$0.58	\$0.65	-
	Q2	\$0.48	\$0.58	\$0.61	\$0.65	-
	Q3	\$0.54	\$0.58	\$0.65	\$0.64	-
	Q4	\$0.55	\$0.55	\$0.70	\$0.61	-
<b>Total</b>		<b>\$2.06</b>	<b>\$2.25</b>	<b>\$2.54</b>	<b>\$2.55</b>	<b>\$2.55</b>
Prior EPS:						
	Q1	-	-	-	\$0.64	-
	Q2	-	-	-	\$0.64	-
	Q3	-	-	-	\$0.63	-
	Q4	-	-	-	\$0.63	-
<b>Total</b>		-	-	-	<b>\$2.54</b>	-

### Company Description

National Bankshares, Inc., is the bank holding company for The National Bank of Blacksburg. The company, headquartered in Blacksburg, VA, operates in Southwestern Virginia in an area commonly known as New River Valley and the communities of Tazewell and Bluefield through a total of 25 full-service banking offices.

## NKSH: A GOOD WAY TO FINISH THE YEAR; RESULTS SUPPORT PREMIUM VALUATION; MAINTAIN HOLD

### Key Points

- **Reported Q4 EPS of \$0.70** vs. BBT/consensus of \$0.64/\$0.63. We note a reversal of FDIC expenses added ~\$0.07 to EPS bringing earnings more in line with expectations. Excluding this benefit, results were consistent with expectations despite a reduction in NIM as higher earning asset balances offset. Credit results remain a positive with NPAs falling to 1.0% of assets vs. 1.15% at Q3. Capital remains full with TCE of 12.4%.
- **Asset quality metrics improve from already strong levels.** Following 19% increase in NPAs in Q3, balances fell 8% to 1.0% of assets vs. peers at north of 4%. NCOs were higher than expected at 65 bps vs. our 35 bps estimate, however modest reserve bleed reduced the overall negative impact on provisioning which clipped EPS by \$0.02. Despite the reserve reduction (1.44% vs. 1.46% at Q3) coverage of NPLs improved to 89% vs. peers at 70%. Excluding accruing TDRs, coverage of NPLs is ~180%.
- **NIM compression offset by higher than expected earning assets.** Q4 NIM declined 14 bps LQ to 4.50% and effectively flat y/y. Quarterly results were influenced by higher levels of low yielding assets while loan balances declined modestly. In addition, deposit repricing power decreased in the quarter only partially offsetting. We note NIM results will likely compress in 2012 but will continue to compare favorably to peers.
- **Capital remains full.** NKSH continues to boast best-in-class capital levels despite a modest reduction in TCE to 12.4% from 12.7% and vs. 7.5% for peers. We expect the company to continue its prudent capital management strategy with modest dividend increases and opportunistic share repurchases. We note the company paid a \$0.52 semiannual dividend in Q4 vs. \$0.48 paid in Q2. Based on our current projections and given the earnings power and capital levels, we believe additional dividend increases are likely. While select strategic M&A remains an option, we have not incorporated a transaction in our estimates at this time.
- **Tweaking 2012, establishing 2013, maintain Hold.** We are tweaking our 2012 EPS estimate to \$2.55 and also establishing a 2013 EPS of \$2.55. NKSH remains a core holding, in our view, given their significant earnings power (ROA of 1.7%), ample capital levels, attractive dividend yield (3.5%) and excellent credit quality. However, given the regulatory and macroeconomic headwinds combined with the premium (and justified in our opinion) valuation (1.56x TBV vs. 0.95x for peers) we are maintaining our Hold rating on the shares. As we have said in the past, we would look to be more constructive upon a material pull back, all else equal.

**National Bankshares, Inc. (NKSH-NASDAQ)**
*(Smil, except per share data)*

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2009	2010	2011	2012E	2013E		4Q10	1Q11	2Q11	3Q11	4Q11	1Q12E	2Q12E	3Q12E	4Q12E
<b>Income Statement</b>														
\$38.62	\$41.89	\$44.64	\$44.33	\$44.47	Net Interest Income, FTE	\$10.65	\$11.07	\$11.08	\$11.26	\$11.23	\$11.13	\$11.09	\$11.07	\$11.05
11%	8%	7%	-1%	0%	% change vs. prior year	3%	8%	6%	7%	5%	1%	0%	-2%	-2%
1.63	3.41	2.95	2.44	2.14	Loan Loss Provision	1.20	0.80	0.75	0.64	0.75	0.52	0.54	0.54	0.84
46%	109%	-13%	-17%	-12%	% change vs. prior year	76%	24%	-12%	-9%	-37%	-35%	-28%	-16%	11%
8.76	8.36	8.40	8.98	9.03	Total Noninterest Income	2.17	1.92	2.10	2.13	2.24	2.24	2.24	2.25	2.25
2%	-5%	0%	7%	1%	% change vs. prior year	-7%	-3%	0%	2%	3%	17%	7%	5%	1%
23.44	23.13	23.34	23.85	24.26	Total Noninterest Expense	5.82	6.08	6.03	5.89	5.34	5.92	5.95	5.98	6.01
6%	-1%	1%	2%	2%	% change vs. prior year	-3%	5%	6%	1%	-8%	-3%	-1%	2%	12%
(0.37)	(0.01)	0.01	-	-	Nonrecurring Gains (Expense)	(0.01)	0.01	-0.01	0.00	0	-	-	-	-
21.94	23.70	26.76	27.02	27.09	Net Income Before Taxes	5.79	6.12	6.39	6.86	7.39	6.93	6.85	6.80	6.45
35%	34%	34%	34%	34%	Effective Tax Rate	34%	34%	34%	34%	34%	34%	34%	34%	34%
\$2.06	\$2.25	\$2.54	\$2.55	\$2.55	Diluted EPS, Stated	\$0.55	\$0.58	\$0.61	\$0.65	\$0.70	\$0.65	\$0.65	\$0.64	\$0.61
<b>\$2.09</b>	<b>\$2.24</b>	<b>\$2.54</b>	<b>\$2.55</b>	<b>\$2.55</b>	<b>Dil. EPS, Operating*</b>	<b>\$0.55</b>	<b>\$0.58</b>	<b>\$0.61</b>	<b>\$0.65</b>	<b>\$0.70</b>	<b>\$0.65</b>	<b>\$0.65</b>	<b>\$0.64</b>	<b>\$0.61</b>
10%	7%	13%	0%	0%	% change vs. prior year	0%	7%	6%	13%	28%	13%	6%	-1%	-13%
\$0.84	\$0.91	\$1.00	\$1.05	\$1.07	Common Dividend/Share	\$0.47	\$0.00	\$0.48	\$0.00	\$0.52	\$0.00	\$0.52	\$0.00	\$0.53
41%	40%	39%	41%	42%	Payout Ratio	86%	0%	79%	0%	74%	0%	81%	0%	87%
6.95	6.95	6.95	6.95	6.95	Avg. Diluted Shares	6.96	6.96	6.95	6.95	6.95	6.95	6.95	6.95	6.95
<b>Balance Sheet</b>														
\$343.04	\$395.17	\$429.17	\$433.47	\$437.82	Cash & Securities	\$395.17	\$390.99	\$394.95	\$400.71	\$429.17	\$430.24	\$431.31	\$432.39	\$433.47
589.95	576.44	589.86	595.78	610.82	Loans	576.44	587.90	593.57	596.42	589.86	591.34	592.82	594.30	595.78
3%	-2%	2%	1%	3%	% change vs. prior year	-2%	0%	2%	2%	2%	1%	0%	0%	1%
6.93	7.66	8.51	8.58	8.31	Loan Loss Reserves	7.66	8.25	8.49	8.72	8.51	8.52	8.54	8.56	8.58
12.63	11.54	10.46	9.40	8.33	Total Intangibles	11.54	11.27	11.00	10.73	10.46	10.19	9.93	9.66	9.40
43.68	46.75	46.12	45.83	48.25	Other Assets	46.75	44.75	43.82	42.99	46.12	45.93	46.13	45.80	45.83
982.37	1022.24	1067.10	1075.91	1096.92	Total Assets	1022.24	1026.66	1034.86	1042.12	1067.10	1069.19	1071.65	1073.59	1075.91
5%	4%	4%	1%	2%	% change vs. prior year	4%	3%	4%	6%	4%	4%	4%	3%	1%
852.11	884.58	919.33	944.87	973.54	Deposits	884.58	885.90	892.19	894.24	919.33	923.93	930.86	937.84	944.87
4%	4%	4%	3%	3%	% change vs. prior year	4%	3%	4%	6%	4%	4%	4%	5%	3%
-	-	-	-	-	Other Borrowings	-	-	-	-	-	-	-	-	-
-	-	-	-	-	Preferred Equity	-	-	-	-	-	-	-	-	-
122.08	129.19	141.30	151.70	162.02	Common Equity	129.19	133.67	136.31	141.82	141.30	145.84	146.71	151.16	151.70
122.08	129.19	141.30	151.70	162.02	Total Equity	129.19	133.67	136.31	141.82	141.30	145.84	146.71	151.16	151.70
69%	65%	64%	63%	63%	Loans/Deposits	65%	66%	67%	67%	64%	64%	64%	63%	63%
579.8	585.6	589.4	592.8	603.3	Average Loans	585.5	585.4	588.1	593.5	590.4	590.6	592.1	593.6	595.0
913.1	928.1	972.9	995.9	1,010.4	Avg. Earning Assets (EA)	944.8	959.6	967.3	973.7	991.0	992.2	994.7	997.1	999.6
9%	2%	5%	2%	1%	% change vs. prior year	4%	5%	4%	5%	5%	3%	3%	2%	1%
117.1	129.0	136.8	147.6	157.9	Avg. Equity	133.1	131.2	135.1	138.8	142.3	143.6	146.3	148.9	151.4
12.4%	12.6%	13.2%	14.1%	14.8%	Equity/Assets	12.6%	13.0%	13.2%	13.6%	13.2%	13.6%	13.7%	14.1%	14.1%
11.3%	11.6%	12.4%	13.3%	14.1%	Tangible Equity/Tang. Assets	11.6%	12.1%	12.2%	12.7%	12.4%	12.8%	12.9%	13.3%	13.3%
\$17.61	\$18.63	\$20.36	\$21.86	\$23.35	Tg. Book Value/Share	\$16.97	\$17.65	\$18.06	\$18.89	\$18.85	\$19.55	\$19.71	\$20.39	\$20.51
<b>Profitability</b>														
1.47%	1.58%	1.71%	1.65%	1.63%	Return on Assets (ROA)	1.50%	1.60%	1.65%	1.75%	1.85%	1.70%	1.68%	1.66%	1.57%
12.23%	12.13%	12.92%	12.01%	11.25%	Return on Equity (ROE)	11.43%	12.44%	12.51%	13.03%	13.71%	12.64%	12.27%	11.96%	11.16%
4.23%	4.52%	4.60%	4.45%	4.40%	Net Interest Margin	4.47%	4.68%	4.59%	4.64%	4.50%	4.48%	4.46%	4.44%	4.42%
2%	7%	2%	-3%	-1%	% change vs. prior year	-1%	2%	1%	3%	1%	-4%	-3%	-4%	-2%
46%	43%	41%	43%	43%	Efficiency Ratio	43%	44%	44%	42%	36%	42%	43%	43%	43%
18%	17%	16%	17%	17%	Nonint. Income/Total Rev.	17%	15%	16%	16%	17%	17%	17%	17%	17%
37%	36%	36%	38%	37%	Nonint. Income/Nonint. Exp.	37%	32%	35%	36%	42%	38%	38%	38%	37%
<b>Credit Quality</b>														
1.08%	1.12%	1.04%	0.00%	0.00%	NPAs + 90/Assets	1.12%	1.15%	0.97%	1.15%	1.04%	0.00%	0.00%	0.00%	0.00%
1.17%	1.33%	1.44%	1.44%	1.36%	Reserves/Loans	1.33%	1.40%	1.43%	1.46%	1.44%	1.44%	1.44%	1.44%	1.44%
169%	91%	89%	-	-	Reserves/NPAs + 90	91%	97%	104%	85%	89.04%	-	-	-	-
0.10%	0.46%	0.36%	0.40%	0.40%	Net Charge-off Ratio	0.92%	0.15%	0.34%	0.30%	0.65%	0.35%	0.35%	0.35%	0.55%
289%	127%	139%	103%	89%	LLP/NCO's	90%	365%	149%	144%	78%	101%	104%	104%	103%
<b>Market Information</b>														
\$28.29	\$31.49	\$27.92			End of Period (EOP) Price	\$31.49	\$28.91	\$25.04	\$24.13	\$27.92				
13.74x	14.07x	10.99x			EOP Price/LTM EPS	14.07x	12.70x	10.85x	10.13x	10.99x				
179%	186%	148%			EOP Price/EOP Tg. Book Value	186%	164%	139%	128%	148%				
3.0%	3.0%	3.7%			EOP Current Div. Yield	3.0%	3.3%	3.8%	4.0%	3.7%				

\* Operating EPS excludes gains/losses in investment securities and other nonrecurring items.

**IMPORTANT DISCLOSURES**

**Price Chart**

NKSH

1) 02/09/09	2) 06/22/09
Buy (1) \$21	Hold (2) NA



**BB&T Capital Markets rating distribution by percentage (as of December 31, 2011):**

All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
Buy (1)	55.2%	Buy (1)	10.6%
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Underweight/Sell (3)	1.2%	Underweight/Sell (3)	0.0%
Not Rated (NR)	0.0%	Not Rated (NR)	0.0%
Suspended (SP)	0.0%	Suspended (SP)	0.0%

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The definition of each rating is as follows:

- Buy (1): estimated total return potential greater than or equal to 10%
- Hold (2): estimated total return potential greater than or equal to 0% and less than 10%
- Underweight (3): estimated total return potential less than 0%

**NR:** Not Rated      **NA:** Not Applicable      **NM:** Not Meaningful      **SP:** Suspended

Stocks rated Buy (1) are required to have a published 12-month price target, while it is not required on stocks rated Hold (2) and Underweight (3).

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COMPANY	DISCLOSURE
National Bankshares, Inc. (NKSH)	1, 6

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