

National Bankshares Inc.

BANK

NASDAQ: NKSH - \$39.70

RATING: BUY
12-Month Price Target: \$46.00

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Brendan Nosal, Director
212-466-7918
bnosal@sandleroneill.com

MARKET DATA

Market Cap.	\$277.9 Mil.
52-Week High	\$47.70
Price/Book	149%
Price/Tang. Book	154%
52-Week Low	\$36.05
3-Mo. Avg. Daily Volume	7,119
Dividend Yield	2.95%
Total Assets	\$1.3 Bil.
ROE	6.53%
ROTE	6.60%
Shares Outstanding (Mil)	7.0
Annual Dividend	\$1.17
Institutional Ownership	36.8%
Insider Ownership	3.7%

Market data as of most recently available data.

NKSH 4Q17 Earnings Review: Upgrading Shares to BUY

EPS					Year	Growth	Est. Change	P/E
	Mar	Jun	Sep	Dec				
2017A	\$0.52	\$0.51	\$0.54	\$0.44	\$2.03	(5.6)%	—	19.6x
2018E	\$0.63	\$0.68	\$0.71	\$0.72	\$2.74	35.0%	\$0.11	14.5x
2019E	\$0.67	\$0.71	\$0.74	\$0.76	\$2.88	5.1%	\$0.12	13.8x

[Click here](#) for our First Look note.

Reported: \$0.44
Core: \$0.66
SOP Estimate: \$0.56
Consensus Estimate: \$0.56

Core EPS above our estimate: NKSH reported 4Q17 EPS of \$0.44. We estimate core EPS of \$0.66, as compared to our estimate of \$0.56. Our First Look note called core \$0.67 – we now exclude the estimated gain on sale of a branch. We are the only estimate on the street. Please see our core EPS reconciliation at the end of the report for further detail.

Variance to our expectations: NKSH's 4Q results were better than expected for the provision (\$0.08/sh better), NII (\$0.01/sh better, and expenses (\$0.01/sh better).

Raising EPS estimates. For 2018, we are taking our EPS estimate from \$2.63 to \$2.74 (+4.3%). For 2019, we are taking our EPS estimate from \$2.76 to \$2.88 (+4.3%). Please see the attached exhibit further detailing where we altered our forward expectations.

Upgrading shares of NKSH to BUY following strong 4Q and improved outlook. Following NKSH's 4Q17 earnings release and our conversation with management, we are upgrading shares from HOLD to BUY. Overall, we viewed the 4Q favorably, as the company outperformed in a number of areas. Importantly, pre-tax, pre-provision net revenue (PPNR) came in ahead of our forecast. Our updated model places a few percentage points of upward pressure



National Bankshares, Inc. is the Blacksburg, Virginia-based financial holding company of the National Bank of Blacksburg, a community bank operating 25 branches in Southwest Virginia. For historical perspective, the National Bank of Blacksburg was first chartered in 1891 as the Bank of Blacksburg.

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on our estimates, which coupled with a discounted valuation led us to get more constructive on the shares. As a result, we are upgrading the shares to BUY for the following five reasons:

- **First, NKSH remains one of the country's highest performing community banks quarter-in and quarter-out.** NKSH has not reported an ROAA below 1.00% since 1995, which is as far back as our data set goes. Adjusting for this Q's DTA impairment, core ROAA came to 1.44% (~1.25% with our forecasted level of provisioning). The fact of the matter is that NKSH delivers top-tier performance on a continual basis with little flair to the business model. We attribute the company's long history of success to (1) a strong management team with decades of bank experience, (2) a highly efficient operating model, (3) a conservative balance sheet/ credit profile, and (4) a stable economic footprint anchored by the presence of Virginia Tech in the company's hometown. We expect pre-tax, pre-provision (PPNR) ROAA to advance from an avg. of 1.94% over the prior 8Qs to 2.08% by 4Q18 and 2.14% by 4Q19.
- **Second, the NIM appears to have reached an inflection point.** Investors will recall that chronic NIM compression in recent years has pressured returns, as well as the bottom line. Thankfully, our belief is that margin erosion is a thing of the past. NKSH's NIM has advanced from a 4Q16 low of 3.39% to 3.47% today, and we foresee continued expansion ahead. Aside from some 1Q18 noise related to a lower FTE adjustment, we look for a modest, but steady ramp in the margin to 3.51% by year-end 2018 and 3.57% by year-end 2019. The improving margin dynamic is visible in bottom line returns, as well. 2017 marked the first year since 2013 that EPS did not decline, and future NIM expansion should only help further in the years ahead.
- **Third, NKSH has ample balance sheet capacity in a rising rate environment, coupled with a stellar deposit base.** NKSH's balance sheet has incredible potential, particularly in a rising rate environment. With a loan to deposit ratio of 63.0%, a low loan to asset level of 53.2%, low level of RWAs to GAAP assets (64.3%), and ample capital levels, NKSH's balance sheet is both strong and full of potential. As loans continue to grow and become a larger part of the earning asset base, the NIM and return profile should benefit. Plus, the asset side of NKSH's balance sheet is funded entirely with its strong deposit base (17% noninterest-bearing, 89% core, 39 bps cost of deposits), thanks to the company's 20%+ market share in Montgomery and Tazewell counties. Finally, while we do not view NKSH as a seller, we readily acknowledge that the above balance sheet complexion is quite attractive to potential acquirers.
- **Fourth, credit quality remains solid.** Through the cycle, NKSH charged-off 3.2% of 4Q07 loan balances, which is in-line with high performing peers and compares favorably to the industry average of 5.7%. Credit quality remains strong today with NPAs to assets of 85 bps, or only 44 bps excluding accruing TDRs (48% of total NPAs). Plus, the company continues to have solid reserve coverage of 1.19%, even after this Q's reserve release. While reserve releases of this quarter's magnitude are unlikely going forward and we expect provision to slowly normalize, we do not sense anything on management's part that would indicate credit issues ahead.
- **Fifth, shares have underperformed meaningfully this year, and trade at a steep discount to peers.** YTD, shares of NKSH are down 12.7%, vs. a 4.4% increase in the Nasdaq Bank Index and median 1.8% decline for high-performing peers. While some of the recent underperformance can be attributed to the shares' strong run in the final four months of 2017, the recent decline has left shares trading at a steep discount to peers at a time when the fundamental outlook for the company is brighter. As the chart below illustrates, NKSH is trading basically in-line with high-performing peers on a P/E basis, but at a deep discount on TBVPS. Adjusting for NKSH's substantial excess capital position narrows the discount on TBV, but places the P/E discount at 2.5x. We simply do not believe a ~30% discount on fully-levered TBV and 2.5x multiple on levered earnings is reasonable at this time.

NKSH Valuation vs Peers

	NKSH	NKSH @ 10% TCE	High Performing Peers	Geographic Peers
P/18E	14.5x	11.7x	15.1x	14.1x
P/19E	13.8x	11.1x	13.7x	12.8x
P/TBV	154%	178%	244%	160%

Peer median used

Geographic peers defined as major-exchange traded banks with assets between \$750 mil. and \$5.0 bil. located in VA, WV, NC, E. TN & E. KY

High-performing peers defined as \$750 mil. to \$5.0 bil. in assets with a core ROAA>1% in 18 of the past 20Qs, no significant mortgage contribution, and traditional bank-like business models

The story is not without pushbacks; capital deployment remains the largest stumbling block. We believe the thesis we lay out above argues for upside to the shares and warrants a BUY rating. With that said, capital deployment remains the largest stumbling block to our favorable outlook. The company's TCE ratio has been in excess of 13% since 1Q15 and currently stands at 14.31%. Regulatory ratios are even higher, with a CET1 ratio of 23.6%. Our sense is that management's strategy has been to retain dry powder for organic growth and M&A while paying out ~50% of earnings via dividends. Unfortunately, loan growth has not been strong enough to lever the capital base, and a deal has not materialized. We applaud management's organic focus and discipline, but also acknowledge that the right transaction could solve the capital issue while also augmenting the earnings stream of NKSH's slower-growth markets. An increased dividend and/or special dividend could also make sense until growth picks up or the right opportunity crosses management's desk. We do believe management remains interested in M&A, but that a deal has to "make sense"; cultural considerations are key, as is location. Our belief is that an institution within a three hour drive is in management's sweet spot.

Even so, retaining dry powder for this long has pressured returns on equity and introduced a valid pushback into an otherwise strong story. Our position is this: first, if a community bank is going to have something to pick at, modest excess capital is probably the best problem to have; second, after years of compressing EPS and ROAA, NKSH is poised to deliver its second straight year of improvement in 2018; third, NKSH's enviable deposit base and balance sheet complexion should provide downside support around the current valuation.

NKSH 4Q17 Variance Analysis

	Historical Results				4Q17		Variance to Estimate		Q/Q Chg. (%/bps)		Y/Y Chg. (%/bps)		
	4Q16	1Q17	2Q17	3Q17	Actual	Expected	▲/▼ than Exp.	(\$mil.)	(per sh.)	Actual	Expected	Actual	Expected
PER SHARE INFO													
Reported EPS	\$ 0.50	\$ 0.52	\$ 0.51	\$ 0.54	\$ 0.44	\$ 0.56	▼	\$ (0.12)		-18.4%	3.5%	-11.0%	12.9%
Core EPS	\$ 0.50	\$ 0.52	\$ 0.51	\$ 0.54	\$ 0.67	\$ 0.56	▲	\$ 0.11		23.3%	3.5%	35.2%	13.6%
Book Value Per Share	\$ 25.62	\$ 26.30	\$ 26.49	\$ 26.97	\$ 26.57	\$ 26.92	▼	\$ (0.35)		-1.5%	-0.2%	3.7%	5.1%
Tangible Book Value Per Share	\$ 24.76	\$ 25.45	\$ 25.63	\$ 26.12	\$ 25.73	\$ 26.08	▼	\$ (0.35)		-1.5%	-0.2%	3.9%	5.3%
Dividend Per Share	\$ 0.61	\$ -	\$ 0.56	\$ -	\$ 0.61	\$ 0.61		\$ -		-	-	0.0%	0.0%
Avg. Diluted Shares	6.96	6.96	6.96	6.96	6.96	6.96		-		0.0%	0.0%	0.0%	0.0%
EOP Shares	6.96	6.96	6.96	6.96	6.96	6.96		-		0.0%	0.0%	0.0%	0.0%
AVG. BALANCE SHEET (\$mil.)													
Avg. Loans	637.8	650.5	652.6	651.6	661.4	658.1	▲	3.3		1.5%	1.0%	3.7%	3.2%
Avg. Securities	516.0	516.6	528.8	511.5	508.6	514.1	▼	(5.4)		-0.6%	0.5%	-1.4%	-0.4%
Avg. Earning Assets	1,153.8	1,167.1	1,181.4	1,163.1	1,170.0	1,172.1	▼	(2.1)		0.6%	0.8%	1.4%	1.6%
Ann'l Growth Rate: Avg. Loans					6.0%	4.0%	▲						
Ann'l Growth Rate: Avg. Securities					-2.2%	2.0%	▼						
Ann'l Growth Rate: Avg. Earning Assets					2.4%	3.1%	▼						
INCOME STATEMENT (\$mil.)													
Net Interest Income (FTE)	9.8	10.0	10.1	10.1	10.2	10.2	▲	0.1	\$ 0.01	1.4%	0.8%	4.2%	3.5%
Service charges on deposit accounts	0.7	0.7	0.7	0.7	0.7	0.7	▼	(0.0)	\$ (0.00)	-0.1%	3.0%	4.3%	7.5%
Other service charges and fees	0.0	0.1	0.0	0.0	0.1	0.0	▲	0.0	\$ 0.00	31.7%	0.0%	14.9%	-12.8%
Credit card fees	1.0	0.9	1.0	1.0	1.0	1.1	▼	(0.1)	\$ (0.01)	-2.8%	4.0%	0.5%	7.6%
Trust income	0.3	0.4	0.4	0.4	0.4	0.4	▲	0.0	\$ 0.00	10.4%	3.0%	18.9%	10.9%
Bank-owned life insurance	0.2	0.1	0.1	0.2	0.2	0.2	▲	0.0	\$ 0.00	1.3%	0.0%	57.3%	55.3%
Other	0.2	0.3	0.2	0.2	0.3	0.2	▲	0.1	\$ 0.01	31.6%	0.0%	14.6%	-13.0%
Total Noninterest Income	2.5	2.5	2.5	2.6	2.7	2.7	▲	0.0	\$ 0.00	3.5%	2.8%	9.2%	8.5%
Operating Revenue	12.3	12.6	12.5	12.7	12.9	12.8	▲	0.1	\$ 0.01	1.9%	1.2%	5.2%	4.5%
Noninterest Expense	6.6	6.9	6.7	6.7	6.6	6.7	▼	(0.1)	\$ 0.01	-2.3%	-1.0%	0.1%	1.4%
Goodwill	-	-	-	-	-	-		-	\$ -	-	-	-	-
Other Intangible Amortization	0.0	0.0	0.0	0.0	0.0	0.0	▼	(0.0)	\$ 0.00	-7.7%	0.0%	-69.2%	-66.7%
Total Noninterest Expense	6.6	6.9	6.7	6.7	6.6	6.7	▼	(0.1)	\$ 0.01	-2.3%	-1.0%	-0.3%	1.0%
Pretax Preprovision Net Revenue	5.7	5.6	5.8	5.9	6.3	6.2	▲	0.2	\$ 0.02	6.6%	3.7%	11.6%	8.6%
Provision for Loan Loss	0.5	0.1	0.5	0.2	(0.6)	0.3	▼	(0.8)	\$ 0.08	-382.1%	31.2%	-212.9%	-47.5%
Pretax Operating Income	5.2	5.6	5.4	5.7	6.9	5.9	▲	1.0	\$ 0.09	20.2%	2.8%	33.4%	14.0%
Net Securities Gains	0.0	-	0.0	0.0	0.0	-		0.0	\$ 0.00				
Net Nonrecurring Items	-	-	-	-	0.1	-		0.1	\$ 0.01				
Pretax Income	5.2	5.6	5.4	5.7	7.0	5.9	▲	1.1	\$ 0.11	22.5%	2.7%	35.1%	13.3%
Income Taxes (incl. FTE adjustment)	1.7	1.9	1.8	1.9	3.9	2.0	▲	2.0	\$ (0.28)	102.0%	1.2%	127.8%	14.2%
Net Income	3.5	3.6	3.6	3.8	3.1	3.9	▼	(0.8)	\$ (0.12)	-18.4%	3.5%	-11.0%	12.9%
Income to Noncontrolling Interests	-	-	-	-	-	-		-	\$ -	-	-	-	-
Preferred Dividends	-	-	-	-	-	-		-	\$ -	-	-	-	-
Net Income avail. to Common	3.5	3.6	3.6	3.8	3.1	3.9	▼	(0.8)	\$ (0.12)	-18.4%	3.5%	-11.0%	12.9%
PERFORMANCE METRICS													
Core ROAA	1.11%	1.18%	1.12%	1.21%	1.44%	1.26%				24	3	34	15
Core ROAE	7.35%	8.00%	7.57%	8.01%	6.46%	8.35%				(155)	22	(89)	100
Core ROATCE	7.60%	8.27%	7.83%	8.27%	9.86%	8.63%				159	22	226	102
PPNR ROAA	1.87%	1.83%	1.88%	1.92%	2.04%	1.98%				12	6	17	11
NIM	3.39%	3.49%	3.42%	3.44%	3.47%	3.44%				3	-	8	5
NIM L/Q Δ (bps)					3	0							
Fee Income / Operating Revenue	20.0%	19.9%	19.6%	20.5%	20.8%	20.8%				34	33	77	76
Efficiency Ratio	53.5%	55.0%	53.4%	53.1%	51.0%	51.9%				(216)	(116)	(257)	(158)
Expenses / Avg. Assets	2.18%	2.27%	2.16%	2.18%	2.12%	2.15%				(6)	(4)	(5)	(3)
Operating Revenue / Avg. Assets	4.04%	4.10%	4.03%	4.11%	4.16%	4.12%				6	2	12	8
TCE/TA	14.03%	14.31%	14.23%	14.82%	14.31%	14.68%				(51)	(14)	28	65
Effective Tax Rate	33.2%	34.3%	33.5%	34.0%	56.0%	33.5%				2,205	(49)	2,280	26
CREDIT QUALITY (\$mil.)													
Loan Loss Reserve	8.3	8.3	8.4	8.5	7.9	8.4	▼	(0.5)		-6.5%	-0.8%	-4.5%	1.3%
Net Charge-Offs	0.5	0.1	0.4	0.1	(0.0)	0.3	▼	(0.3)					
Nonaccrual Loans	5.9	5.7	3.2	3.2	2.8	-				-12.3%	-	-52.7%	-
Restructured Loans	3.8	3.7	3.7	4.8	5.1	-				6.6%	-	36.2%	-
Foreclosed Assets	3.2	3.0	3.0	2.9	2.8	-				-3.6%	-	-10.7%	-
Nonperforming Assets	12.8	12.4	9.9	10.9	10.7	10.9	▼	(0.2)		-1.6%	0.0%	-16.1%	-14.8%
NALs / Loans	0.90%	0.87%	0.49%	0.48%	0.41%	-							
NPAs / Assets	1.04%	1.00%	0.79%	0.88%	0.85%	0.88%				(3)	(1)	(18)	(16)
NPAs (ex-TDRs) / Assets	0.73%	0.69%	0.49%	0.49%	0.44%	-							
TDRs / NPAs	29.5%	30.3%	37.4%	44.2%	47.9%	-							
Reserve / Loan	1.28%	1.27%	1.28%	1.28%	1.19%	1.26%				(10)	(2)	(10)	(2)
NCO Ratio	0.32%	0.06%	0.22%	0.06%	-0.01%	0.20%				(7)	14	(33)	(12)
Provision / Avg. Loans	0.31%	0.04%	0.28%	0.12%	-0.34%	0.16%				(47)	4	(66)	(15)

NKSH Forward EPS Variance Analysis

Dollar values in \$mil.

2018E
2019E

	2018E					2019E						
	New	Prior	Revision	Diff. (\$)	Diff. (%/BPS)	EPS Impact	New	Prior	Revision	Diff. (\$)	Diff. (%/BPS)	EPS Impact
PER SHARE INFO												
Reported EPS	\$ 2.74	\$ 2.63	▲	\$ 0.11	4.3%		\$ 2.88	\$ 2.76	▲	\$ 0.12	4.3%	
Core EPS	\$ 2.74	\$ 2.63	▲	\$ 0.11	4.3%		\$ 2.88	\$ 2.76	▲	\$ 0.12	4.3%	
Book Value Per Share	\$ 28.15	\$ 28.38	▼	\$ (0.24)	-0.8%		\$ 29.86	\$ 29.97	▼	\$ (0.12)	-0.4%	
Tangible Book Value Per Share	\$ 27.30	\$ 27.54	▼	\$ (0.24)	-0.9%		\$ 29.02	\$ 29.14	▼	\$ (0.12)	-0.4%	
Dividend Per Share	\$ 1.17	\$ 1.17		\$ -	0.0%		\$ 1.17	\$ 1.17		\$ -	0.0%	
Avg. Diluted Shares	6.96	6.96		-	0.0%		6.96	6.96		-	0.0%	
EOP Shares	6.96	6.96		-	0.0%		6.96	6.96		-	0.0%	
AVG. BALANCE SHEET												
Avg. Loans	678.1	674.7	▲	3.4	0.5%		710.0	706.5	▲	3.6	0.5%	
Avg. Securities	515.0	520.5	▼	(5.5)	-1.1%		522.1	527.7	▼	(5.6)	-1.1%	
Avg. Earning Assets	1,193.1	1,195.2	▼	(2.1)	-0.2%		1,232.2	1,234.2	▼	(2.0)	-0.2%	
<i>Ann'l Growth Rate: Avg. Loans</i>	3.7%	3.3%			0.4%		4.7%	4.7%			0.0%	
<i>Ann'l Growth Rate: Avg. Securities</i>	-0.3%	0.5%			-0.8%		1.4%	1.4%			0.0%	
<i>Ann'l Growth Rate: Avg. Earning Assets</i>	1.9%	2.1%			-0.1%		3.3%	3.3%			0.0%	
INCOME STATEMENT												
Net Interest Income (FTE)	41.5	41.1	▲	0.5	1.1%	\$ 0.04	43.7	43.0	▲	0.8	1.8%	\$ 0.07
Service charges on deposit accounts	2.9	3.0	▼	(0.1)	-3.0%	\$ (0.01)	3.1	3.2	▼	(0.1)	-3.0%	\$ (0.01)
Other service charges and fees	0.2	0.2	▲	0.1	31.7%	\$ 0.01	0.2	0.2	▲	0.1	31.7%	\$ 0.01
Credit card fees	3.9	4.2	▼	(0.3)	-6.6%	\$ (0.03)	4.0	4.3	▼	(0.3)	-6.6%	\$ (0.03)
Trust income	1.7	1.5	▲	0.1	7.2%	\$ 0.01	1.7	1.6	▲	0.1	7.2%	\$ 0.01
Bank-owned life insurance	0.9	0.9	▲	0.0	1.3%	\$ 0.00	0.9	0.9	▲	0.0	1.3%	\$ 0.00
Other	1.2	1.0	▲	0.2	14.5%	\$ 0.01	1.3	1.1	▲	0.2	14.5%	\$ 0.01
Total Noninterest Income	10.8	10.9	▼	(0.0)	-0.3%	\$ (0.00)	11.3	11.3	▼	(0.0)	-0.3%	\$ (0.00)
Operating Revenue	52.4	51.9	▲	0.4	0.8%	\$ 0.04	55.0	54.2	▲	0.7	1.3%	\$ 0.07
Noninterest Expense	27.3	27.6	▼	(0.2)	-0.9%	\$ 0.02	28.2	28.3	▼	(0.1)	-0.4%	\$ 0.01
Goodwill	-	-		-	-	\$ -	-	-		-	-	\$ -
Other Intangible Amortization	0.0	0.1	▼	(0.0)	-7.7%	\$ 0.00	0.0	0.1	▼	(0.0)	-7.7%	\$ 0.00
Total Noninterest Expense	27.4	27.6	▼	(0.2)	-0.9%	\$ 0.02	28.3	28.4	▼	(0.1)	-0.4%	\$ 0.01
Pretax Preprovision Net Revenue	25.0	24.3	▲	0.7	2.8%	\$ 0.06	26.7	25.8	▲	0.8	3.3%	\$ 0.08
Provision for Loan Loss	1.1	1.4	▼	(0.3)	-19.2%	\$ 0.03	1.6	1.8	▼	(0.2)	-9.1%	\$ 0.02
Pretax Operating Income	23.9	22.9	▲	1.0	4.2%	\$ 0.09	25.1	24.0	▲	1.0	4.2%	\$ 0.09
Net Securities Gains	-	-		-	-	\$ -	-	-		-	-	\$ -
Net Nonrecurring Items	-	-		-	-	\$ -	-	-		-	-	\$ -
Pretax Income	23.9	22.9	▲	1.0	4.2%	\$ 0.09	25.1	24.0	▲	1.0	4.2%	\$ 0.09
Income Taxes (incl. FTE adjustment)	4.8	4.6	▲	0.2	3.6%	\$ (0.02)	5.0	4.8	▲	0.2	3.7%	\$ (0.03)
Net Income	19.1	18.3	▲	0.8	4.3%	\$ 0.11	20.0	19.2	▲	0.8	4.3%	\$ 0.12
Income to Noncontrolling Interests	-	-		-	-	\$ -	-	-		-	-	\$ -
Preferred Dividends	-	-		-	-	\$ -	-	-		-	-	\$ -
Net Income avail. to Common	19.1	18.3	▲	0.8	4.3%	\$ 0.11	20.0	19.2	▲	0.8	4.3%	\$ 0.12
PERFORMANCE METRICS												
Core ROAA	1.49%	1.44%	▲		5		1.51%	1.47%	▲		5	
Core ROAE	9.85%	9.47%	▲		39		9.77%	9.42%	▲		34	
Core ROATCE	10.17%	9.76%	▲		40		10.05%	9.70%	▲		36	
PPNR ROAA	1.97%	1.92%	▲		6		2.04%	1.97%	▲		7	
NIM	3.48%	3.44%	▲		5		3.55%	3.48%	▲		7	
Fee Income / Operating Revenue	20.7%	20.9%	▼		(24)		20.5%	20.8%	▼		(34)	
Efficiency Ratio	52.2%	53.1%	▼		(91)		51.4%	52.3%	▼		(89)	
Expenses / Avg. Assets	2.16%	2.18%	▼		(1)		2.16%	2.17%	▼		(0)	
Operating Revenue / Avg. Assets	4.14%	4.09%	▲		5		4.21%	4.14%	▲		7	
TCE/TA	14.72%	15.03%	▼		(31)		15.14%	15.39%	▼		(25)	
Effective Tax Rate	20.0%	20.1%	▼		(10)		20.0%	20.1%	▼		(10)	
CREDIT QUALITY												
Loan Loss Reserve	8.0	8.5	▼	(0.4)			8.2	8.5	▼	(0.2)		
Net Charge-Offs	1.0	1.4	▼	(0.3)			1.4	1.8	▼	(0.3)		
Nonperforming Assets	10.7	10.9	▼	(0.2)			10.7	10.9	▼	(0.2)		
NPAs / Assets	0.83%	0.85%	▼		(2)		0.80%	0.82%	▼		(2)	
Reserve / Loan	1.16%	1.22%	▼		(6)		1.13%	1.16%	▼		(3)	
NCO Ratio	0.15%	0.20%	▼		(5)		0.20%	0.25%	▼		(5)	
Provision / Avg. Loans	0.17%	0.21%	▼		(4)		0.23%	0.25%	▼		(2)	

APPENDIX

Time of dissemination: February 26, 2018, 07:26 ET.

I attest that all of the views expressed in this report accurately reflect my personal views about the security and/or industry covered by this report as of the date of this report, and that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed by me in this report. S/ Brendan Nosal

IMPORTANT DISCLOSURES:



Price Target

Our 12 month price target is \$46.00.

Valuation Methodology

Our price target of \$46.00 assumes shares of NKSH will trade at 16.0x our 2019E EPS in one year's time.

Risk Factors

The primary risks to our price target include key man risk, NKSH's geographically concentrated SW VA footprint, weakness in the local economy, illiquidity, cyber-security risks, and lower bank equity valuations in general.

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Sandler O'Neill + Partners

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			Count	Percent
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HOLD [H]	165	50.30	38	23.03
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