

Estimate Change

Cary A. Morris / (804) 782-8831 / cmorris@scottstringfellow.com

Nicole M. Peterson / (804) 727-2604 / npeterson@scottstringfellow.com

Banks/Thriffs

National Bankshares, Inc. (NKSH-\$27.60)

Hold (2)

Company Statistics

12-month Price Target:	NA
52-wk Range:	\$18.08-\$29.48
Market Capitalization (M):	\$191
Shares Outstanding (M) fd:	6.9
Avg. Daily Vol. (000):	18.0
Dividend:	\$0.86
Yield:	3.1%
Price/Book Value:	151%
Price/Tangible Book Value:	168%
Equity/Assets:	12.7%
NPAs +90/Assets:	1.26%
NCO Ratio:	0.29%
Reserves/Loans:	1.21%

Financials

FYE Dec	2007A	2008A	2009A	2010E	2011E
P/E Ratio:	15.2x	14.1x	13.4x	13.0x	12.8x
ROE:	12.58%	12.51%	12.23%	11.59%	10.96%
ROA:	1.46%	1.51%	1.47%	1.49%	1.48%
EPS:					
Q1	\$0.45	\$0.46	\$0.49	\$0.54A	\$0.54
Q2	\$0.45	\$0.50	\$0.48	\$0.53	\$0.54
Q3	\$0.46	\$0.51	\$0.54	\$0.52	\$0.54
Q4	\$0.46	\$0.48	\$0.55	\$0.53	\$0.54
Total	\$1.82	\$1.96	\$2.06	\$2.12	\$2.15
Prior EPS:					
Q1	--	--	--	--	\$0.53
Q2	--	--	--	\$0.53	\$0.54
Q3	--	--	--	\$0.52	\$0.54
Q4	--	--	--	\$0.52	\$0.54
Total	--	--	--	\$2.10	\$2.16

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: MARGIN DRIVES ANOTHER SOLID QUARTER; REITERATE HOLD (2) ON VALUATION

Key Points

- NKSH reported diluted Q1'10 EPS of \$0.54 vs. \$0.55 in Q4 and \$0.49 a year ago. Q1'10 EPS were \$0.01 ahead of our estimate primarily due to a higher-than-anticipated NIM and lower operating expenses, partially offset by a higher-than-expected loan loss provision.
- **Slight Sequential Decline in NII Despite Expanded Margin.** NIM expanded 6 bps from Q4 and 49 bps from Q1'09 to 4.57%. Tax-equivalent NII was 3% lower on an annualized sequential basis as loans fell in the quarter and average earning assets remained flat. From one year ago, NII was 13% higher, primarily as a result of lower funding costs.
- **Loan Growth Stymied, Sequential Growth in Deposits.** Loans were 1% lower on an annualized sequential basis but grew 2% from one year ago to \$588M while deposits grew 3% (ann.) from Q4'09 and were flat from one year ago. Consumer loans fell by \$3.8M from Q4'09 while the other major categories of loans grew by only \$1.9M. From the prior-year period, commercial and industrial loans were 14% higher and comprised the majority of the loan growth. Time deposits continued to decline from both the prior year and prior quarter while savings and interest-bearing demand deposits continued to grow over comparable time periods. Non-interest bearing demand deposits were 3% higher than one year ago and fell 21% (ann.) from Q4'09.
- **Provision Higher to Prudently Grow Reserves.** NKSH recorded a loan loss provision of \$647,000, which was lower than \$681,000 from Q4'09 but elevated from \$370,000 one year ago. The elevated LLP allowed NKSH to increase its loan loss reserves by 12% (ann.) from Q4'09 and 17% from one year ago. Non-performing assets increased to \$12.5M at the end of Q1 from \$10.6M in Q4'09 and \$4.9M a year ago, bringing the NPA+90 to total assets ratio to 1.26% from 1.08% and 0.50%, respectively. Net charge-offs also increased to \$432,000 from \$208,000 and \$110,000, respectively, bringing the annualized net charge-off ratio to 0.29% from 0.14% and 0.08% over comparable periods. Both ratios continue to compare favorably to our view of current peer group averages of 3.40% and 2.10%, respectively.
- **Tweaking Estimates.** Our '10 EPS estimate goes to \$2.12 from \$2.10 and 2011 goes to \$2.15 from \$2.16. We believe NKSH will be able to consistently grow quality earnings, especially once it's on the other side of this credit cycle. Due to its consistently solid performance, it is rewarded with a premium price-to-book (tangible book) valuation of 151% and 168% vs. peer group averages of 87% and 106%, respectively. Based on current valuation, we maintain our **Hold (2)** rating.

National Bankshares, Inc. (NKSH-OTC)

(Smil, except per share data)

Cary A. Morris (804) 782-8831

cmorris@scottstringfellow.com

2007	2008	2009	2010E	2011E		1Q09	2Q09	3Q09	4Q09	1Q10	2Q10E	3Q10E	4Q10E	1Q11E
Income Statement														
\$32.47	\$34.67	\$38.62	\$40.04	\$39.32	Net Interest Income, FTE	\$9.08	\$9.43	\$9.78	\$10.33	\$10.24	\$10.03	\$9.94	\$9.83	\$9.82
0%	7%	11%	4%	-2%	% change vs. prior year	12%	11%	8%	15%	13%	6%	2%	-5%	-4%
0.42	1.12	1.63	2.06	0.69	Loan Loss Provision	0.37	0.28	0.31	0.68	0.65	0.55	0.52	0.34	0.25
763%	165%	46%	26%	-67%	% change vs. prior year	270%	106%	9%	13%	75%	99%	71%	-49%	-62%
8.76	8.62	8.76	7.97	8.10	Total Noninterest Income	2.03	2.18	2.23	2.32	1.99	1.99	1.99	2.00	2.01
0%	-2%	2%	-9%	2%	% change vs. prior year	1%	-3%	-2%	12%	-2%	-9%	-11%	-14%	1%
20.96	22.02	23.44	23.25	23.87	Total Noninterest Expense	5.63	5.77	5.89	6.15	5.78	5.80	5.81	5.86	5.90
-3%	5%	6%	-1%	3%	% change vs. prior year	3%	9%	7%	7%	3%	1%	-1%	-5%	2%
0.00	0.47	(0.37)	(0.01)	-	Nonrecurring Gains (Expense)	0.08	(0.42)	(0.02)	(0.01)	(0.01)	-	-	-	-
19.85	20.62	21.94	22.68	22.86	Net Income Before Taxes	5.18	5.15	5.80	5.81	5.78	5.67	5.60	5.63	5.69
36%	35%	35%	35%	35%	Effective Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%
\$1.82	\$1.96	\$2.06	\$2.12	\$2.15	Diluted EPS, Stated	\$0.49	\$0.48	\$0.54	\$0.55	\$0.54	\$0.53	\$0.52	\$0.53	\$0.54
\$1.82	\$1.90	\$2.09	\$2.12	\$2.15	Dil. EPS, Operating*	\$0.48	\$0.52	\$0.55	\$0.55	\$0.54	\$0.53	\$0.52	\$0.53	\$0.54
1%	5%	10%	1%	1%	% change vs. prior year	12%	5%	5%	20%	13%	2%	-4%	-4%	-1%
\$0.76	\$0.80	\$0.84	\$0.86	\$0.88	Common Dividend/Share	\$0.00	\$0.41	\$0.00	\$0.43	\$0.00	\$0.43	\$0.00	\$0.43	\$0.00
42%	41%	41%	41%	41%	Payout Ratio	0%	85%	0%	79%	0%	81%	0%	82%	0%
7.00	6.94	6.95	6.95	6.95	Avg. Diluted Shares	6.93	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95
Balance Sheet														
\$316.18	\$310.97	\$343.04	\$357.21	\$360.79	Cash & Securities	\$356.02	\$359.01	\$337.07	\$343.04	\$354.54	\$355.43	\$356.31	\$357.21	\$358.10
524.77	575.56	589.95	592.50	608.96	Loans	574.72	576.14	581.64	589.95	588.07	589.54	591.02	592.50	595.46
5%	10%	3%	0%	3%	% change vs. prior year	9%	8%	6%	3%	2%	2%	2%	0%	1%
5.22	5.86	6.93	7.76	7.55	Loan Loss Reserves	6.12	6.28	6.45	6.93	7.14	7.43	7.68	7.76	7.74
14.84	13.72	12.63	11.56	10.49	Total Intangibles	13.44	13.17	12.90	12.63	12.36	12.09	11.82	11.56	11.29
37.08	29.27	29.83	31.83	32.70	Other Assets	29.49	30.16	27.83	29.83	30.83	31.60	31.96	31.83	32.14
887.65	935.37	982.37	1000.85	1020.49	Total Assets	979.79	984.76	965.89	982.37	992.94	996.09	998.80	1000.85	1004.73
2%	5%	5%	2%	2%	% change vs. prior year	7%	10%	7%	5%	1%	1%	3%	2%	1%
776.34	817.85	852.11	876.91	903.51	Deposits	857.83	861.86	835.87	852.11	857.47	863.90	870.38	876.91	883.48
2%	5%	4%	3%	3%	% change vs. prior year	8%	10%	6%	4%	0%	0%	4%	3%	3%
0.06	0.05	0.00	-	-	Other Borrowings	0.05	0.05	0.05	0.00	0.00	-	-	-	-
-	-	-	-	-	Preferred Equity	-	-	-	-	-	-	-	-	-
104.80	110.11	122.08	131.51	140.37	Common Equity	113.56	114.98	121.47	122.08	126.50	127.20	130.84	131.51	135.24
104.80	110.11	122.08	131.51	140.37	Total Equity	113.56	114.98	121.47	122.08	126.50	127.20	130.84	131.51	135.24
68%	70%	69%	68%	67%	Loans/Deposits	67%	67%	70%	69%	69%	68%	68%	68%	67%
511.2	539.5	579.8	590.1	600.1	Average Loans	574.2	578.2	579.2	587.2	589.4	588.8	590.3	591.8	594.0
807.9	841.4	913.1	911.5	924.8	Avg. Earning Assets (EA)	901.8	922.9	916.8	909.4	909.7	909.9	912.2	914.4	917.5
4%	4%	9%	0%	1%	% change vs. prior year	8%	9%	10%	6%	1%	-1%	-1%	1%	1%
100.8	108.6	117.1	127.9	136.7	Avg. Equity	113.1	115.0	117.9	122.3	124.5	126.9	129.0	131.2	133.4
11.8%	11.8%	12.4%	13.1%	13.8%	Equity/Assets	11.6%	11.7%	12.6%	12.4%	12.7%	12.8%	13.1%	13.1%	13.5%
10.1%	10.5%	11.3%	12.1%	12.9%	Tangible Equity/Tang. Assets	10.4%	10.5%	11.4%	11.3%	11.6%	11.7%	12.1%	12.1%	12.5%
\$15.07	\$15.89	\$17.61	\$18.97	\$20.24	Book Value/Share	\$16.39	\$16.58	\$17.52	\$17.61	\$18.25	\$18.35	\$18.87	\$18.97	\$19.50
Profitability														
1.46%	1.51%	1.47%	1.49%	1.48%	Return on Assets (ROA)	1.43%	1.37%	1.56%	1.55%	1.57%	1.48%	1.46%	1.46%	1.49%
12.58%	12.52%	12.23%	11.59%	10.96%	Return on Equity (ROE)	12.14%	11.71%	12.86%	12.31%	12.27%	11.62%	11.29%	11.16%	11.17%
3.98%	4.13%	4.23%	4.41%	4.25%	Net Interest Margin	4.08%	4.10%	4.26%	4.51%	4.57%	4.40%	4.36%	4.30%	4.28%
-4%	4%	2%	4%	-4%	% change vs. prior year	4%	1%	-2%	7%	12%	7%	2%	-5%	-6%
48%	49%	46%	46%	48%	Efficiency Ratio	48%	47%	47%	44%	45%	46%	46%	47%	48%
21%	20%	18%	17%	17%	Nonint. Income/Total Rev.	18%	19%	19%	18%	16%	17%	17%	17%	17%
42%	39%	37%	34%	34%	Nonint. Income/Nonint. Exp.	36%	38%	38%	38%	34%	34%	34%	34%	34%
Credit Quality														
0.29%	0.48%	1.08%	1.25%	1.23%	NPAs + 90/Assets	0.50%	0.64%	0.83%	1.08%	1.26%	1.26%	1.25%	1.25%	1.25%
0.99%	1.02%	1.17%	1.31%	1.24%	Reserves/Loans	1.06%	1.09%	1.11%	1.17%	1.21%	1.26%	1.30%	1.31%	1.30%
201%	439%	169%	-	-	Reserves/NPAs + 90	458%	230%	166%	169%	92%	-	-	-	-
0.10%	0.09%	0.10%	0.21%	0.15%	Net Charge-off Ratio	0.08%	0.08%	0.09%	0.14%	0.29%	0.18%	0.18%	0.18%	0.18%
80%	235%	289%	168%	76%	LLP/NCO's	336%	248%	224%	327%	150%	208%	196%	129%	92%
Market Information														
\$17.10	\$19.45	\$28.29			End of Period (EOP) Price	\$18.90	\$24.03	\$25.45	\$28.29	\$27.25				
9.36x	10.00x	13.74x			EOP Price/TM EPS	9.55x	12.23x	12.77x	13.74x	12.90x				
113%	122%	161%			EOP Price/EOP Book Value	115%	145%	145%	161%	149%				
4.6%	4.2%	3.0%			EOP Current Div. Yield	4.3%	3.4%	3.2%	3.0%	3.2%				

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

IMPORTANT DISCLOSURES
Price Chart

NKSH

1) 04/20/07	2) 07/20/07	3) 10/22/07	4) 02/08/08	5) 04/18/08	6) 02/09/09	7) 06/22/09
Buy (1) \$25	Buy (1) \$24	Buy (1) \$22	Buy (1) \$23	Buy (1) \$22	Buy (1) \$21	Hold (2) NA



Scott & Stringfellow, LLC's rating distribution by percentage (as of March 31, 2010):

All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
Buy (1)	51.2%	Buy (1)	14.5%
Hold (2)	47.2%	Hold (2)	6.6%
Underweight/Sell (3)	1.6%	Underweight/Sell (3)	0.0%
Not Rated (NR)	0.0%	Not Rated (NR)	0.0%
Suspended (SP)	0.0%	Suspended (SP)	0.0%

Scott & Stringfellow, LLC, Ratings System:

The Scott & Stringfellow, LLC, Stock Rating System consists of three separate ratings. The appropriate rating is determined by a stock's estimated 12-month total return potential, which consists of the percentage price change to the 12-month price target and the current yield on anticipated dividends. A 12-month price target is the analyst's best estimate of the market price of the stock in 12 months. A 12-month price target is highly subjective and the result of numerous assumptions, including company, industry, and market fundamentals, both on an absolute and relative basis, as well as investor sentiment, which can be highly volatile.

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).

Scott & Stringfellow, LLC, Equity Research Disclosures as of April 16, 2010

Company	Disclosure
National Bankshares, Inc. (NKSH)	1, 6

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

Scott & Stringfellow, LLC, Equity Research Disclosure Legend

1. Scott & Stringfellow, LLC, makes a market in the securities of the subject company.
2. The analyst serves as an officer, director, or advisory board member of the subject company.

3. The analyst or a member of the analyst's household owns shares of the subject company.
4. Scott & Stringfellow, LLC, has managed or co-managed a public offering of securities for the subject company in the last 12 months.
5. Scott & Stringfellow, LLC, has received compensation for investment banking services from the subject company in the last 12 months.
6. Scott & Stringfellow, LLC, expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.
7. Scott & Stringfellow, LLC, or its affiliates beneficially own 1% or more of the common stock of the subject company as calculated in accordance with Section 13(d) of the Securities Exchange Act of 1934.
8. The subject company is, or during the past 12 months was, a client of Scott & Stringfellow, LLC, which provided non-investment banking, securities-related services to, and received compensation from, the subject company for such services. The analyst or employees of Scott & Stringfellow, LLC, with the ability to influence the substance of this report knows the foregoing facts.
9. An affiliate of Scott & Stringfellow, LLC, received compensation from the subject company for products or services other than investment banking services during the past 12 months. The analyst or employees of Scott & Stringfellow, LLC, with the ability to influence the substance of this report know or have reason to know the foregoing facts.

For valuation methodology and related risk factors on Buy (1)–rated stocks, please refer to the body text of this report or to individual reports on any covered companies referenced in this report.

The analyst(s) principally responsible for preparation of this report received compensation that is based upon many factors, including the firm's overall investment banking revenue.

Analyst Certification

The analyst(s) principally responsible for the preparation of this research report certify that the views expressed in this research report accurately reflect his/her (their) personal views about the subject security(ies) or issuer(s) and that his/her (their) compensation was not, is not, or will not be directly or indirectly related to the specific recommendations or views contained in this research report.

OTHER DISCLOSURES

The information and statistics in this report have been obtained from sources we believe are reliable but we do not warrant their accuracy or completeness. We do not undertake to advise the reader as to changes in figures or our views. This is not a solicitation of an order to buy or sell any securities.

BB&T Capital Markets is a division of Scott & Stringfellow, LLC, a registered broker/dealer subsidiary of BB&T Corporation. Member NYSE/SIPC. NOT A DEPOSIT, NOT FDIC INSURED, NOT GUARANTEED BY THE BANK, NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY AND MAY GO DOWN IN VALUE.

The opinions expressed are those of the analyst(s) and not those of BB&T Corporation or its executives.

Important Information Regarding the Distribution of this Report in the United Kingdom

This report has been produced by BB&T Capital Markets and is being distributed in the United Kingdom (UK) by Seymour Pierce Limited (SPL). SPL is authorized and regulated in the UK by the Financial Services Authority to carry out both corporate finance and investment services and is a member of the London Stock Exchange. Although BB&T Capital Markets is under separate ownership from SPL, BB&T Capital Markets has appointed SPL as its exclusive distributor of this research in the UK, and BB&T Capital Markets will be remunerated by SPL by way of a fee. This report has not been approved for purposes of section 21 of the UK's Financial Services and Markets Act 2000, and accordingly is only provided in the UK for the use of persons to whom communications can be made without being so approved, as detailed in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

Home Office
Richmond, VA
 909 East Main Street
 (800) 552-7757 • (804) 643-1811

Alexandria, VA Lexington, VA
 201 N. Union Street, Ste. 240 158 South Main Street
 (888) 250-7212 • (703) 836-9755 (800) 436-7218 • (540) 463-4302

Anderson, SC Lynchburg, VA
 1912 North Main Street 810 Main Street
 (888) 246-8311 • (864) 226-9820 (800) 868-0413 • (434) 846-2711

Asheville, NC Manassas, VA
 One W. Pack Square, Suite 405 9200 Church Street, Ste. 100
 (866) 231-7650 • (828) 258-7031 (800) 476-5288 • (703) 368-4970

Atlanta, GA Martinsville, VA
 3455 Peachtree Road NE, Ste. 650 20 Ellsworth Street
 (866) 329-5338 • (404) 264-6800 (800) 476-6547 • (276) 632-6027

Blacksburg, VA Morehead City, NC
 200 Professional Park Drive, Ste. 8 147 Highway 24, Ste. 101
 (800) 553-1574 • (540) 953-0003 (800) 810-2763 • (252) 222-0022

Bluefield, VA Myrtle Beach, SC
 1934 Leatherwood Lane 604 27th Avenue North
 (800) 733-0850 • (276) 322-2900 (888) 728-2265 • (843) 918-7600

Charleston, SC Norfolk, VA
 288 Meeting Street, 2nd Floor 500 East Main Street, Ste. 300
 (800) 400-7078 • (843) 577-9929 (800) 515-0294 • (757) 446-6800

Charleston, WV Raleigh, NC
 300 Summers Street, Ste. 500 3605 Glenwood Avenue, Ste. 400
 (800) 448-5480 • (304) 357-6500 (800) 763-1893 • (919) 571-1893

Charlotte, NC Roanoke, VA
 4500 Cameron Valley Pky, Ste. 250 601 South Jefferson Street, Ste. 160
 (800) 476-3768 • (704) 367-3800 (800) 476-0014 • (540) 344-5414

Charlottesville, VA Rock Hill, SC
 310 4th Street, NE, Ste. 100 241 Oakland Avenue
 (800) 868-7726 • (434) 971-8557 (877) 550-9614 • (803) 324-1450

Columbia, SC Staunton, VA
 1333 Main Street, Ste. 170 205 North Central Avenue
 (888) 825-1234 • (803) 748-1177 (800) 541-3851 • (540) 886-2396

Culpeper, VA Suffolk, VA
 1300 Sunset Lane, Ste. 3210 330 W. Constance Road, 2nd Fl., Ste. A
 (800) 476-2566 • (540) 825-0783 (800) 768-8787 • (757) 446-6800

Danville, VA Sumter, SC
 120 Crown Drive, Ste. A 690 Bultman Drive
 (800) 476-0587 • (434) 791-1041 (888) 901-6688 • (803) 905-2600

Greensboro, NC Virginia Beach, VA
 3318 W. Friendly Avenue, Ste. 330 402 Pavilion Center, 2101 Parks Ave.
 (800) 476-1824 • (336) 378-1824 (800) 745-2355 • (757) 417-4900

Greenville, NC Warrenton, VA
 1440 E Arlington Blvd., Ste. B 550 Broadview Avenue, Ste. 101
 (800) 207-3201 • (252) 321-7808 (800) 476-3547 • (540) 347-0200

Greenville, SC Waynesboro, VA
 101 E. Washington Street, Ste. 210 500 West Main Street
 (800) 476-3662 • (864) 233-3655 (888) 609-4616 • (540) 943-4592

Greenwood, SC Williamsburg, VA
 212 Oak Avenue, Ste. B 4097 Ironbound Road, Ste. C
 (800) 589-2004 • (864) 388-2000 (800) 851-4313 • (757) 220-3800

Harrisonburg, VA Wilmington, NC
 560 Neff Avenue, Ste. 400 2512 Independence Blvd., Ste. 100
 (800) 768-2882 • (540) 434-2882 (800) 476-0405 • (910) 392-7200

FINANCIAL INSTITUTIONS GROUP

Equity Research

Cary A. Morris (804) 782-8831
cmorris@scottstringfellow.com

Nicole M. Peterson (804) 727-2604
npeterson@scottstringfellow.com

Equity Trading

J.B. Trivette (804) 782-8819
 Reid Burford, *Share repurchases/144* (804) 782-8700



Institutional Fixed Income Sales

Richmond, Virginia (804) 649-3900

Institutional Equity Sales

Richmond, Virginia (804) 782-8870
 Boston, Massachusetts (617) 316-1300
 New York, New York (800) 896-9868
 San Francisco, CA (415) 276-0329



Director of Research

Vernon C. Plack, CFA (804) 780-3257

Assistant Director of Research

James H. Weber, CFA (804) 782-8773

Supervisory Analysts

Kathleen R. Schneider (732) 567-8766
 Denise Bossé Tyznar (804) 782-8880
 James H. Weber, CFA (804) 782-8773

Editor

Peggy Myers Walz (804) 782-8785

Publishing Coordinator

Peter W. Councill (804) 782-8850

Publishing Specialists

Wykinnya Hightower (804) 787-8235
 Kimberly M. Roane (804) 787-8206
 Daphne A. Steed (804) 344-8380