

Company Update

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Banks/Thriffs

National Bankshares, Inc. (NKSH-\$27.95)

Hold (2)

Company Statistics

12-month Price Target:	NA
52-wk Range:	\$21.27-\$29.48
Market Capitalization (M):	\$194
Shares Outstanding (M) fd:	6.9
Avg. Daily Vol. (000):	11.0
Dividend:	\$0.94
Yield:	3.4%
Price/Book Value:	146%
Price/Tangible Book Value:	160%
Equity/Assets:	13.5%
NPAs +90/Assets:	1.14%
NCO Ratio:	0.32%
Reserves/Loans:	1.34%

Financials

FYE Dec	2007A	2008A	2009A	2010E	2011E	
P/E Ratio:	15.4x	14.3x	13.6x	12.3x	12.4x	
ROE:	12.58%	12.51%	12.23%	12.23%	11.33%	
ROA:	1.46%	1.51%	1.47%	1.60%	1.59%	
EPS:						
	Q1	\$0.45	\$0.46	\$0.49	\$0.54A	\$0.56
	Q2	\$0.45	\$0.50	\$0.48	\$0.58A	\$0.57
	Q3	\$0.46	\$0.51	\$0.54	\$0.58A	\$0.57
	Q4	\$0.46	\$0.48	\$0.55	\$0.57	\$0.56
Total		\$1.82	\$1.96	\$2.06	\$2.27	\$2.26

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: INCREASES DIVIDEND AGAIN; MAINTAIN HOLD (2) ON VALUATION

Key Points

- Yesterday, National Bankshares announced an increased semi-annual dividend of \$0.47 payable on December 1 to shareholders of record on November 19. This is a \$0.03 increase from the most recent dividend, which brought the annualized yield to 3.4% from 3.1%. NKSH has increased its dividend 24 times over the past 16 years, resulting in a compound annual growth rate (CAGR) of 8.4%. Management cited a continued high level of earnings, despite the economic downturn, as the impetus for the increase.
- **Maintaining Estimates.** We are maintaining our '10 EPS estimate of \$2.27 and our '11 estimate of \$2.26. NKSH is currently trading at 12.4x our '11 estimate compared to our view of the peer group average of 13.8x. We believe that NKSH is rewarding its shareholders with a higher dividend and continue to believe that the company will be able to consistently grow quality earnings, especially once it's on the other side of the current credit cycle.
- **Valuation Dictates Hold (2) Rating.** Due to its stable and solid performance, the company is rewarded with a premium price-to-book (tangible book) valuation of 146% and 160% vs. peer group averages of 74% and 88%, respectively. NKSH has grown its tangible book value from \$4.29 at year-end 1992 to \$17.42 in Q3'10, which equates to a CAGR of 8.2%. Based on current valuation, we maintain our **Hold (2)** rating.

National Bankshares, Inc. (NKSH-OTC)

(Smil. except per share data)

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2007	2008	2009	2010E	2011E		3Q09	4Q09	1Q10	2Q10	3Q10	4Q10E	1Q11E	2Q11E	3Q11E
Income Statement														
\$32.47	\$34.67	\$38.62	\$41.56	\$40.83	Net Interest Income, FTE	\$9.78	\$10.33	\$10.24	\$10.47	\$10.53	\$10.32	\$10.26	\$10.22	\$10.18
0%	7%	11%	8%	-2%	% change vs. prior year	8%	15%	13%	11%	8%	0%	0%	-2%	-3%
0.42	1.12	1.63	2.70	1.47	Loan Loss Provision	0.31	0.68	0.65	0.85	0.71	0.49	0.48	0.36	0.32
763%	165%	46%	65%	-45%	% change vs. prior year	9%	13%	75%	206%	133%	-28%	-25%	-58%	-55%
8.76	8.62	8.76	8.30	8.52	Total Noninterest Income	2.23	2.32	1.99	2.11	2.10	2.10	2.11	2.13	2.14
0%	-2%	2%	-5%	3%	% change vs. prior year	-2%	12%	-2%	-3%	-6%	-9%	7%	1%	2%
20.96	22.02	23.44	23.18	23.92	Total Noninterest Expense	5.89	6.15	5.78	5.70	5.83	5.87	5.91	5.96	6.00
-3%	5%	6%	-1%	3%	% change vs. prior year	7%	7%	3%	-1%	-1%	-5%	2%	5%	3%
0.00	0.47	(0.37)	(0.00)	-	Nonrecurring Gains (Expense)	(0.02)	(0.01)	(0.01)	0.01	0.00	-	-	-	-
19.85	20.62	21.94	23.98	23.96	Net Income Before Taxes	5.80	5.81	5.78	6.04	6.10	6.07	5.98	6.03	6.00
36%	35%	35%	34%	34%	Effective Tax Rate	35%	35%	35%	34%	34%	34%	34%	34%	34%
\$1.82	\$1.96	\$2.06	\$2.27	\$2.26	Diluted EPS, Stated	\$0.54	\$0.55	\$0.54	\$0.58	\$0.58	\$0.57	\$0.56	\$0.57	\$0.57
\$1.82	\$1.90	\$2.09	\$2.27	\$2.26	Dil. EPS, Operating*	\$0.55	\$0.55	\$0.54	\$0.57	\$0.58	\$0.57	\$0.56	\$0.57	\$0.57
1%	5%	10%	8%	0%	% change vs. prior year	5%	20%	13%	10%	5%	5%	4%	-1%	-2%
\$0.76	\$0.80	\$0.84	\$0.91	\$0.94	Common Dividend/Share	\$0.00	\$0.43	\$0.00	\$0.44	\$0.00	\$0.47	\$0.00	\$0.47	\$0.00
42%	41%	41%	40%	42%	Payout Ratio	0%	79%	0%	76%	0%	82%	0%	83%	0%
7.00	6.94	6.95	6.95	6.95	Avg. Diluted Shares	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95	6.95
Balance Sheet														
\$316.18	\$310.97	\$343.04	\$351.24	\$354.77	Cash & Securities	\$337.07	\$343.04	\$354.54	\$360.50	\$350.37	\$351.24	\$352.12	\$353.00	\$353.88
524.77	575.56	589.95	581.18	592.88	Loans	581.64	589.95	588.07	582.93	582.63	581.18	582.63	585.54	588.47
5%	10%	3%	-1%	2%	% change vs. prior year	6%	3%	2%	1%	0%	-1%	-1%	0%	1%
5.22	5.86	6.93	7.79	7.59	Loan Loss Reserves	6.45	6.93	7.14	7.55	7.79	7.79	7.81	7.73	7.65
14.84	13.72	12.63	11.55	10.48	Total Intangibles	12.90	12.63	12.36	12.08	11.81	11.55	11.28	11.02	10.75
37.08	40.99	43.68	46.33	46.72	Other Assets	40.73	43.68	45.12	46.92	45.43	46.33	46.33	46.23	46.62
887.65	935.37	982.37	982.51	997.27	Total Assets	965.89	982.37	992.94	994.88	982.45	982.51	984.55	988.06	992.07
2%	5%	5%	0%	2%	% change vs. prior year	7%	5%	1%	1%	2%	0%	-1%	-1%	1%
776.34	817.85	852.11	848.17	873.90	Deposits	835.87	852.11	857.47	859.34	841.86	848.17	854.53	860.94	867.40
2%	5%	4%	0%	3%	% change vs. prior year	6%	4%	0%	0%	1%	0%	0%	0%	3%
0.06	0.05	0.00	0.00	-	Other Borrowings	0.05	0.00	0.00	0.00	0.00	-	-	-	-
-	-	-	-	-	Preferred Equity	-	-	-	-	-	-	-	-	-
104.80	110.11	122.08	133.33	142.51	Common Equity	121.47	122.08	126.50	127.83	132.61	133.33	137.25	137.93	141.87
104.80	110.11	122.08	133.33	142.51	Total Equity	121.47	122.08	126.50	127.83	132.61	133.33	137.25	137.93	141.87
68%	70%	69%	69%	68%	Loans/Deposits	70%	69%	69%	68%	69%	69%	68%	68%	68%
511.2	539.5	579.8	586.0	585.9	Average Loans	579.2	587.2	589.4	588.1	584.5	581.9	581.9	584.1	587.0
807.9	841.4	913.1	923.5	932.6	Avg. Earning Assets (EA)	916.8	909.4	909.7	929.9	928.1	926.4	927.3	930.3	934.1
4%	4%	9%	1%	1%	% change vs. prior year	10%	6%	1%	1%	1%	2%	2%	0%	1%
100.8	108.6	117.1	128.9	138.7	Avg. Equity	117.9	122.3	124.5	127.7	130.5	133.0	135.3	137.6	139.9
11.8%	11.8%	12.4%	13.6%	14.3%	Equity/Assets	12.6%	12.4%	12.7%	12.8%	13.5%	13.6%	13.9%	14.0%	14.3%
10.1%	10.5%	11.3%	12.5%	13.4%	Tangible Equity/Tang. Assets	11.4%	11.3%	11.6%	11.8%	12.4%	12.5%	12.9%	13.0%	13.4%
\$15.07	\$15.89	\$17.61	\$19.23	\$20.55	Book Value/Share	\$17.52	\$17.61	\$18.25	\$18.44	\$19.13	\$19.23	\$19.79	\$19.89	\$20.46
Profitability														
1.46%	1.51%	1.47%	1.60%	1.59%	Return on Assets (ROA)	1.56%	1.55%	1.57%	1.62%	1.60%	1.62%	1.59%	1.60%	1.59%
12.58%	12.52%	12.23%	12.23%	11.33%	Return on Equity (ROE)	12.86%	12.31%	12.27%	12.55%	12.15%	11.96%	11.59%	11.49%	11.25%
3.98%	4.13%	4.23%	4.51%	4.38%	Net Interest Margin	4.26%	4.51%	4.57%	4.53%	4.50%	4.45%	4.42%	4.39%	4.36%
-4%	4%	2%	7%	-3%	% change vs. prior year	-2%	7%	12%	10%	6%	-1%	-3%	-3%	-3%
48%	49%	46%	44%	46%	Efficiency Ratio	47%	44%	45%	43%	43%	45%	46%	46%	47%
21%	20%	18%	17%	17%	Nonint. Income/Total Rev.	19%	18%	16%	17%	17%	17%	17%	17%	17%
42%	39%	37%	36%	36%	Nonint. Income/Nonint. Exp.	38%	38%	34%	37%	36%	36%	36%	36%	36%
Credit Quality														
0.29%	0.48%	1.08%	1.14%	1.12%	NPAs + 90/Assets	0.83%	1.08%	1.26%	1.08%	1.14%	1.14%	1.14%	1.13%	1.13%
0.99%	1.02%	1.17%	1.34%	1.28%	Reserves/Loans	1.11%	1.17%	1.21%	1.30%	1.34%	1.34%	1.34%	1.32%	1.30%
201%	439%	169%	-	-	Reserves/NPAs + 90	166%	169%	92%	105%	102%	-	-	-	-
0.10%	0.09%	0.10%	0.31%	0.29%	Net Charge-off Ratio	0.09%	0.14%	0.29%	0.30%	0.32%	0.34%	0.32%	0.30%	0.27%
80%	235%	289%	147%	88%	LLP/NCO's	224%	327%	150%	194%	151%	99%	104%	82%	80%
Market Information														
\$17.10	\$19.45	\$28.29			End of Period (EOP) Price	\$25.45	\$28.29	\$27.25	\$24.23	\$25.80				
9.36x	10.00x	13.74x			EOP Price/LTM EPS	12.77x	13.74x	12.90x	10.98x	11.53x				
113%	122%	161%			EOP Price/EOP Book Value	145%	161%	149%	131%	135%				
4.6%	4.2%	3.0%			EOP Current Div. Yield	3.2%	3.0%	3.2%	3.6%	3.4%				

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

IMPORTANT DISCLOSURES
Price Chart

NKSH

1) 10/22/07	2) 02/08/08	3) 04/18/08	4) 02/09/09	5) 06/22/09
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 September 30, 2010):

All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
Buy (1)	57.3%	Buy (1)	13.3%
Hold (2)	42.0%	Hold (2)	6.0%
Underweight/Sell (3)	0.7%	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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