



## Estimate Change

Banks/Thriffs

**Cary A. Morris** / (804) 782-8831 / cmorris@bbandtcm.com  
**Blair C. Brantley, CFA** / (804) 727-2604 / bbrantley@bbandtcm.com

**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)*

Cary A. Morris (804) 782-8831

cmorris@bbandtc.com

Blair C. Brantley, CFA (804) 727-2604

bbrantley@bbandtc.com

| 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   |
| \$2.09                    | \$2.24   | \$2.54   | \$2.55   | \$2.55   | Dil. EPS, Operating*         | \$0.55   | \$0.58   | \$0.61   | \$0.65   | \$0.70   | \$0.65   | \$0.65   | \$0.64   | \$0.61   |
| 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                | 580.5    | 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% |
| Hold (2)                      | 43.6% | Hold (2)   | 4.2%  |
| 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 BBTCM Equity Research Department 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).

**BB&T Capital Markets Equity Research Disclosures as of February 10, 2012**

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

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4. BB&T Capital Markets has managed or co-managed a public offering of securities for the subject company in the last 12 months.
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6. BB&T Capital Markets expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.
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# EQUITY RESEARCH

**Director of Research** - Vernon C. Plack, CFA (804) 780-3257

**Assistant Director of Research** - James H. Weber, CFA (804) 782-8773

## COMMERCIAL AND INDUSTRIAL

### Building Materials

John F. Kasprzak Jr. (804) 782-8715  
Paul Betz (804) 782-8746  
Teresa T. Nguyen, CFA (804) 782-8745

### Commercial Durables

Matthew S. McCall, CFA (804) 780-3582  
Jack C. Stimac, CFA (804) 782-8884

### Industrial Equipment—Distribution & Components

Holden Lewis (804) 782-8820  
John C. Cooper (804) 787-8293

### Industrial Equipment—Flow Control

Kevin R. Maczka, CFA (804) 782-8811  
Nicholas V. Prendergast (804) 782-2006

### Industrial Equipment—Machinery

C. Schon Williams (804) 782-8769  
Aaron M. Reeves (804) 780-3237

### Specialty Construction & Facilities Services

Adam R. Thalhimer, CFA (804) 344-8377  
Charles E. Redding (804) 782-8853

## CONSUMER

### Agribusiness/Consumer Foods

Heather L. Jones (804) 780-3280  
Brett M. Hundley, CFA (804) 782-8753  
Harsh Nahata (804) 482-5775

### Apparel, Footwear, & Specialty Retail

Scott D. Krasik, CFA (212) 822-8138  
Kelly L. Halsor (212) 822-8132

### Automotive Aftermarket

Anthony F. Cristello (804) 780-3269

### Food & Drug Merchandising

Andrew P. Wolf, CFA (804) 787-8224  
Ashby W. Price (804) 782-8711

### Specialty Hardlines Retailers

Anthony C. Chukumba (212) 822-8143  
Eric Cohen (212) 822-8140

## ENERGY

### Coal/Natural Resources

Mark A. Levin (804) 782-8856  
Garrett S. Nelson (804) 787-8259

### Energy Infrastructure

Robert F. Norfleet III (804) 787-8231  
Bryce D. Humphrey (804) 782-8893

## FINANCIAL SERVICES

### Banks/Thriffs

Cary A. Morris (804) 782-8831  
Blair C. Brantley, CFA (804) 727-2604

## FINANCIAL SERVICES (cont'd)

### Specialty Finance

Vernon C. Plack, CFA (804) 780-3257  
Peter W. Council, CFA (804) 782-8850

## HEALTHCARE SERVICES

### Healthcare Outsourcing/Health & Human Services

James J. Kumpel, CFA (212) 822-8139  
Eugene Park (212) 822-8126

### PBMs/Post-Acute Care

Eugene Goldenberg (212) 822-8149  
James C. Chen (212) 822-8158

## TECHNOLOGY

### Aerospace & Defense

F. Carter Leake (804) 482-7167

### Commercial IT Services/Government Services

George A. Price Jr. (703) 245-0903  
Jethro R. Solomon (703) 245-0905

### Defense

Jeremy W. Devaney (703) 245-0902

## TRANSPORTATION SERVICES

### Airfreight & Logistics/Maritime

Kevin W. Sterling, CFA (804) 782-8804  
William W. Horner (804) 787-1143  
Chip Rowe (804) 782-8787

### Surface Transportation

Thomas S. Albrecht, CFA (804) 787-8210  
E. Neal Deaton (704) 367-3805  
A. Rhem Wood Jr. (804) 782-8784

## RESEARCH DEPARTMENT

### Product Manager

W. Moultrie Dotterer, CFA (804) 780-3279

### 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

## RESEARCH OFFICES

### Richmond—Main Office

901 East Byrd St., Suite 310 (800) 552-7757  
Richmond, Virginia 23219

### New York—Research, Sales Trading, Sales

1133 Avenue of the Americas, 27th fl (800) 896-9868  
New York, New York 10036

### Tysons Corner—Research

8200 Greensboro Drive, Suite 825 (703) 761-2800  
McLean, VA 22102