

February 8, 2012

Eagle Financial Services Inc. (EFSI-OTC-US\$18.50)

We remain positive on Eagle's long-term outlook.

RATING: Buy SECTOR: Banks & Specialty Finance
 TARGET PRICE: US\$21 SECTOR RECOMMENDATION: Market-weight
 BASIS OF TARGET: just under 12 times our 2012E.

We remain positive on Eagle Financial's (EFSI) outlook. These shares have strengthened in recent trading sessions, but we feel further upside is likely given our current earnings outlook. EFSI's combination of improving profitability, relatively superior asset quality, strong capital and an attractive franchise make it a solid position within the community banking sector. Additionally, the shares provide an attractive 3.9% yield.

Fourth quarter results were modestly below expectations. EFSI reported earnings of \$0.21 compared to \$0.14 in the prior year and our expectations of \$0.25. This modest shortfall was primarily due to higher than forecast operating expenses that were partly offset by a stronger than expected net interest margin. The net interest margin grew to 4.47%, increasing 13 basis points sequentially. Non-interest expenses grew by \$1 million this quarter when compared to 4Q2010. The deactivation of EFSI's defined benefit plan was the leading cause of this increase as Eagle realized a \$589,000 loss on the distribution of the plan's assets as well as \$140,000 for employee retirement annuities. Core earnings were stronger than the inferred bottom line due to the addition to loan loss reserves discussed below.

The company continues to make progress on the asset quality front. Total non-performing assets (NPAs) fell from \$6.3MM at the end of September to just under \$5.0MM at year-end mostly due to a decline in non-accrual loans. The company placed five loans worth \$421,000 on nonaccrual status during Q4, in which four are backed by real estate. Non-accrual loans declined modestly from \$2.635MM at the end of the third quarter to \$2.449MM reported at year-end. The loan loss reserve was \$8.7MM at the end of the quarter reflecting a \$852K increase from Q3. The company reported \$48K in net charge offs, which was a large drop compared to the \$993K reported during Q3. Still, EFSI provisioned \$900K despite lower credit losses and the improving trend in NPAs. EFSI foreclosed three real estate assets valued at \$355,000 in Q4, but also sold four foreclosed properties which grossed \$1.4 million.

EFSI's balance sheet remains strong and is able to support expansion. The company's equity-to-assets ratio increased to 10.23% from the 10.14% the company reported this time last year. EFSI has no material intangibles and no preferred stock, so this figure is a good proxy for tangible common equity. Period-end loans increased to \$401.7MM on a net basis, a \$3MM increase from the end of Q3. Total deposits were down slightly on a sequential basis, but the shift away from time deposits and into demand accounts continued.

EFSI did repurchase some shares in the quarter. EFSI repurchased 15,663 shares at an average of \$17.28 during the fourth quarter as part of their stock repurchase program.

Disclosure Code: I, I2

Important disclosures and analyst certifications are in the Disclosure Section.

Valuation Data

FYE Dec	2010A	2011A	2012E	
Projected P/E:	16.7x	14.1x	10.3x	
Projected				
EPS:	Q1	\$0.49	\$0.36	\$0.43
	Q2	\$0.46	\$0.40	\$0.45
	Q3	\$0.02	\$0.34	\$0.46
	Q4	\$0.14	\$0.21	\$0.46
Total		\$1.11	\$1.31	\$1.80

Basis of Estimate: GAAP Net Income

Trading & Operating Data

52-Wk Range:	\$14.50-\$19.00
Dividend Indicated FY1:	\$0.72
Dividend Yield Indicated:	3.9%
Avg. Shares O/S- LQ:	3.3
Market Value (\$M):	\$61.2
Book Value PS LQtr:	\$17.67
Price/BV:	1.0x
(source: Baseline)	

Company Profile

Eagle Financial is the holding company for the Bank of Clarke County. The bank currently operates 11 branches and enjoys solid deposit market share in its primary markets of Clarke and Frederick Counties and the City of Winchester, Virginia. EFSI had over \$568 million in assets at quarter-end.

RISK PROFILE: Average

RISK CONSIDERATIONS: Interest rate sensitivity; general economic conditions; asset quality trends; regulatory conditions; shares are thinly traded

**Eagle Financial
Actual & Estimated Earnings**

Davenport & Company
David M. West, CFA

Last updated: February 6, 2012

Figures in thousands except per share data

	2012 Projected	Fourth Quarter-E	Third Quarter-E	Second Quarter-E	First Quarter-E	2011 Projected	Fourth Quarter-A	Third Quarter-A	Second Quarter-A	First Quarter-A	2010 Actual	2009 Actual
Income Statement:												
Net interest income (TE)	\$24,480	\$6,201	\$6,140	\$6,087	\$6,052	\$23,591	\$6,072	\$5,946	\$5,808	\$5,765	\$23,066	\$21,415
Tax equivalent adjustment	844	210	210	212	212	823	214	214	202	193	806	755
Net interest income	23,636	5,991	5,930	5,875	5,840	22,768	5,858	5,732	5,606	5,572	22,260	20,660
Provision for loan losses	2,200	500	500	600	600	3,750	900	1,050	900	900	6,325	4,350
Net interest income after provision	21,436	5,491	5,430	5,275	5,240	19,018	4,958	4,682	4,706	4,672	15,935	16,310
Fiduciary income	960	220	220	250	270	907	209	189	241	268	917	818
Service charges	1,600	420	405	395	380	1,584	395	406	396	387	1,785	2,053
Other service charges and fees	3,250	810	840	820	780	3,191	717	861	839	774	2,992	2,148
Other	160	40	40	40	40	124	39	24	37	24	128	52
Core non-interest income	5,970	1,490	1,505	1,505	1,470	5,806	1,360	1,480	1,513	1,453	5,822	5,071
Gain (loss) on securities	0	0	0	0	0	67	(88)	(8)	163	0	98	(419)
Sales of foreclosed assets	(175)	(25)	(25)	(50)	(75)	(365)	(105)	(78)	(134)	(48)	(338)	(26)
Other	0	0	0	0	0	77	77	0	0	0	(83)	0
Total non-interest income	5,795	1,465	1,480	1,455	1,395	5,585	1,244	1,394	1,542	1,405	5,499	4,626
Salaries and benefits	10,700	2,700	2,750	2,650	2,600	10,609	3,021	2,688	2,487	2,413	9,263	9,262
Occupancy expenses	1,190	310	300	290	282	1,155	278	286	282	309	1,143	1,069
Equipment	705	180	180	175	170	677	169	164	183	161	624	665
Advertising & marketing	450	125	125	100	100	499	92	157	125	125	436	409
Supplies	305	80	80	75	70	292	71	53	69	99	246	311
ATM network fees	600	165	150	145	140	546	169	131	132	114	450	104
Other operating expenses	4,900	1,200	1,200	1,200	1,300	5,133	1,596	1,088	1,166	1,283	4,647	4,660
Nonrecurring expenses	0	0	0	0	0	0	0	0	0	0	0	0
Total non-interest expenses	18,850	4,760	4,785	4,635	4,670	18,911	5,396	4,567	4,444	4,504	16,809	16,480
Pretax income	8,381	2,196	2,125	2,095	1,965	5,692	806	1,509	1,804	1,573	4,625	4,456
Provision for taxes	2,433	659	616	608	550	1,370	113	370	481	406	1,019	1,015
Net income	\$5,948	\$1,537	\$1,509	\$1,488	\$1,415	\$4,322	\$693	\$1,139	\$1,323	\$1,167	\$3,606	\$3,441
Adjustment	0	0	0	0	0	0	0	0	0	0	0	0
Pro-forma net income	\$5,948	\$1,537	\$1,509	\$1,488	\$1,415	\$4,322	\$693	\$1,139	\$1,323	\$1,167	\$3,606	\$3,441
Average diluted shares	3,310	3,310	3,310	3,310	3,310	3,300	3,312	3,311	3,294	3,282	3,247	3,185
Earnings per share - Diluted	\$1.80	\$0.46	\$0.46	\$0.45	\$0.43	\$1.31	\$0.21	\$0.34	\$0.40	\$0.36	\$1.11	\$1.08
Earnings per share - Operating	\$1.80	\$0.46	\$0.46	\$0.45	\$0.43	\$1.31	\$0.21	\$0.34	\$0.40	\$0.36	\$1.11	\$1.08
Assumptions:												
Average earning assets	\$54,827	\$565,011	\$556,201	\$552,127	\$543,968	\$538,466	\$538,562	\$543,381	\$539,182	\$532,719	\$524,553	\$496,357
Growth - earning assets*	3.0%	1.2%	1.1%	1.5%	1.0%	2.7%	-0.9%	0.8%	1.2%	0.0%	7.5%	1.7%
Net interest margin	4.41%	4.39%	4.40%	4.41%	4.45%	4.39%	4.47%	4.34%	4.32%	4.39%	4.41%	4.31%
Avg earning assets/avg assets	94.00%	94.00%	94.00%	94.00%	94.00%	93.91%	93.82%	93.96%	93.86%	94.00%	94.66%	94.34%
Avg equity/avg assets	10.29%	10.40%	10.30%	10.25%	10.20%	9.90%	10.07%	9.88%	9.64%	10.00%	9.73%	9.26%
Effective tax rate	29.03%	30.00%	29.00%	29.00%	28.00%	24.07%	14.02%	24.52%	26.66%	25.81%	22.03%	22.78%
Projected:												
Average assets	\$590,241	\$601,075	\$593,831	\$587,369	\$578,689	\$579,385	\$574,065	\$578,311	\$574,453	\$562,159	\$554,155	\$526,157
Average equity	\$60,721	\$62,512	\$61,165	\$60,205	\$59,847	\$58,751	\$57,733	\$57,137	\$55,377	\$53,847	\$53,932	\$48,719
Return on average assets	1.01%	1.02%	1.02%	1.01%	0.98%	0.75%	0.48%	0.79%	0.92%	0.83%	0.65%	0.65%
Return on average equity	9.80%	9.84%	9.87%	9.86%	10.51%	7.62%	4.80%	7.97%	9.56%	8.67%	6.69%	7.06%
Efficiency ratio	62.26%	62.09%	62.79%	61.45%	62.71%	64.82%	73.76%	62.22%	60.46%	62.82%	58.84%	63.28%

*period over period

Source: Company reports and Davenport & Company LLC estimates

Eagle Financial Services Inc.

EFSI

1) 02/22/11
Buy 21**Disclosure Section**

As of 01/01/12, Davenport's ratings of covered companies were distributed as follows: 65.71% Buy, 34.29% Neutral, 0.0% Sell

As of 01/01/12, Davenport's percentages of covered companies that were investment banking clients within the past 12 months by rating were: 10.87% Buy, 8.33% Neutral, 0.0% Sell

Companies Mentioned in this Report and Associated Disclosures

Eagle Financial Services Inc. (EFSI - OTC):I, I2

Description of Rating System

Buy These shares offer attractive long-term appreciation potential from current prices. We would expect these shares to outperform the market over a longer-term horizon and long-term investors can buy at current prices.

Neutral These shares should perform roughly in-line with the current market. We neither encourage the purchase nor the sale of these securities at current prices.

Reduce/Sell These shares have more downside risk than upside potential at current prices. We expect these shares to underperform the market at current prices.

Risk Profile Considerations

This risk classification has been determined primarily from considering the level and predictability of earnings, the volatility of the stock relative to the market, applicable debt ratings, the composition and level of the company's capital structure, the dependence on key customers, and other relevant risk considerations.

Description of Possible Disclosure Codes

- A1** The Research Analyst or a member of the Analyst's household owns common stock of the subject company.
- A2** The Research Analyst or a member of the Analyst's household owns preferred stock of the subject company.
- A3** The Research Analyst or a member of the Analyst's household has options on the common stock of the subject company.
- A4** The Research Analyst or a member of the Analyst's household owns rights for the securities of the subject company.
- A5** The Research Analyst or a member of the Analyst's household owns warrants for the securities of the subject company.
- A6** The Research Analyst or a member of the Analyst's household has futures contracts on the securities of the subject company.
- A7** The Research Analyst or a member of the Analyst's household has a short position in the common stock of the subject company.
- A8** The Research Analyst or a member of the Analyst's household owns a debt security issued by the subject company.
- B** The Research Analyst or a member of the Analyst's household serves as an officer, director, or advisory board member of the subject company.
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- I2** Davenport or its affiliates expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.
- I/F** Davenport or its affiliates received fixed income investment banking fees from this company within the past 12 months.
- S/C** The subject company was a non-investment banking – securities related services client of Davenport or its affiliates for which compensation was received during the past 12-months.
- N/C** The subject company was a non-securities services client of Davenport or its affiliates for which compensation was received during the past 12-months.

- O** As of the end of the month immediately preceding the date of this report (or the end of the second most recent month if the report date is less than 10 calendar days after the end of the most recent month), Davenport or its affiliates beneficially owned 1% or more of any class of common equity securities of the subject company calculated in accordance with Section 13(d) of the Securities Exchange Act of 1934.
- SCC** The Research Analyst received non-investment banking related compensation from the subject company in the past 12 months.
- U** Davenport or its affiliates managed or co-managed a public offering of securities for the subject company in the past 12 months.
- C** Any other actual, material conflict of interest of the Research Analyst or Davenport and its affiliates, of which Davenport and its affiliates or the Research Analyst knows, or has reason to know, at the time of this report.

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Additional information is available upon request.

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Certification

As the primary author of this report, I hereby certify that the views and opinions expressed herein accurately reflect my personal views and opinions about the principal subject(s) of this report. Further, I hereby certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or personal views expressed here.

David M. West, CFA