

**PROUD TO BE MAIN STREET  
BANKERS..**



**.. NOT WALL STREET**

# LETTER TO OUR SHAREHOLDERS

2011 was a year of successes for Eagle Financial Services and Bank of Clarke County. While banks around the country struggled to meet minimum capital requirements, shore up dwindling income, wring their hands over bottom dollar stock prices and make tough decisions on eroding loan portfolios, your company continued the long successful legacy of knowing how much risk to take, how to lend, how to take advantage of opportunity and how to be a high-performing community bank and achieve a reasonable return to our shareholders. This legacy has carried us into our 131st year of continuous operation, a milestone of which we are extremely proud.

Many Americans remain frustrated with the slow economic recovery and the perceived guilt of some of the nation's largest banks as a contributor to this malaise. As a result, they have lost faith in many of these same institutions. We have recognized this dissatisfaction and have seized on the opportunity to tap into the feelings of our market by utilizing compelling advertising slogans such as "not accepting government bailout money since 1881" and "proud to be main street bankers, not Wall Street". These straightforward campaigns resonate with many customers and further separates and defines us as a strong, independent community bank.

Your company continues to be categorized as a "well capitalized" company by virtue of a risk-based capital ratio of 16.96% and total capital of \$67.2 million. Because of this capital level, 2011 was the 25th consecutive year in which the company increased your dividend. For 2011, dividends totaled \$0.72 per share, up 4.3% from the 2010 total dividend of \$0.69. Eagle Financial was one of the few holding companies in Virginia to increase its dividend last year. Our stock price closed the year at \$16.81, resulting in a dividend yield of 4.3%.

Some financial highlights for 2011:

- Net income - \$4.3 million (an increase of 19.9%)
- Earnings per share - \$1.31 (an increase of 18.0%)
- Total assets - \$568 million (an increase of 1.6%)
- Total loans - \$2 million increase in portfolio (in a year where most banks saw their portfolios shrink).

Regulatory burden is a never-ending reality among bankers and is recognized as necessary to keeping our industry sound and our country's

economic engine running. However, as with most recessions, the regulatory pendulum has swung to the extreme in the case of regulatory reform. The Dodd-Frank Act, consisting of 2,700 pages of regulation, has added significantly to the workload of bankers already struggling with understanding and complying with existing regulation.

Embracing sound lending practices, developed through the years, has helped us avoid the disastrous trap that has befallen many competitors. We continue to lend with a commitment to strong lending parameters in the communities we serve. We have purposely missed an opportunity or two to garner short-term profit with the offering of new products we did not understand; knowing full well that with that short-term profit comes potential long-term damage to the company's financial position. Many national banks have learned this lesson the hard way.

One focus in which we continue to give priority is commercial and small business lending, widely viewed as the engine of America's job growth. Because of our success in attracting low-cost core deposits, we remain open for business to any and all loan applicants. We have a qualified group of lenders who have commercial expertise and who embrace the Bank of Clarke standards of lending while doing everything they can to say "yes" to creditworthy borrowers. They have made a huge impact in the markets we serve by virtue of their lending decisions.

Our loan portfolio quality is a constant area of review for us. Anticipating potential problems allows your company to proactively decide the best course of action for troubled loans. We work tirelessly to uncover these problems, assess their potential negative impact on the bottom line and make decisions to mitigate that impact. We are one of the only banks in our market to actively advertise our foreclosed properties and clear them from the portfolio as quickly and profitably as possible. We remain in control of the process and the results are a portfolio with minimal losses and loans that retain high quality characteristics.

Business development remains a priority for your company. We are not just order-takers – rather, we make a consistent effort to build relationships with current and potential customers by constantly assessing their core financial services needs and providing customized solutions. Although we recognize that competing with our larger competitors on new and innovative products can be challenging, we nevertheless have the oblig-

ation to offer these same services as customers demand them. It is still an option for customers to switch their banking relationships, and we do not take that possibility lightly. As a result of this business development effort, customers entrusted us with even more of their business. Market share as of June 30, 2011 stood strong at 20.62% as reported by FDIC.

On April 18, 2011, our first market expansion in nineteen years was accomplished with the opening of our eleventh branch, located in Round Hill, Virginia. We recognize value in offering "our way" of banking to the residents of Loudoun County and feel that our presence in that market will prove beneficial as we continue to expand in this market. Plans are underway for a second location in Loudoun County at 203 Hirst Road in Purcellville, Virginia. Town officials have been extremely helpful and welcoming and groundbreaking could occur as early as June 2012. If that date is achieved, this new branch could conceivably be open for business before the end of this year.

Due to our expansion into Loudoun County, the definition of "market" has changed for us. Before, we were proud of the fact that we had earned the 2nd largest market share position (behind BB&T) in the counties of Clarke and Frederick and the City of Winchester. However, branching into Loudoun changes the calculation of market share and we are now competing with many more local, regional and national financial institutions and non-bank companies. But even with this expanded definition of market, Bank of Clarke County comes in at a strong 5th position (behind BB&T, Wells Fargo, Middleburg Bank and Capital One), at 7.01% of share of deposits as reported to FDIC in 2011. This impressive position is due in no small part to our successes in Clarke, Frederick and Winchester and gives us momentum to go head-to-head with all these competitors. If we didn't think we could compete effectively, profitably and successfully, we would never have made the decision to expand our market into Loudoun County, in most years the fastest growing county in the country and, in 2011, ranked as the wealthiest county in the United States.

Our employee family, numbering 175, delivered exceptional service in a consistent manner to more than 20,000 customers in 2011, a record for your company. Our employees understand what it means to be community bankers – satisfying the financial needs of their customers in a customer-focused, personal, professional way

while at the same time being truly concerned about the communities in which we operate. In short, doing what is right for our customers.

We celebrated the well-earned retirement of three of our staff at the end of 2011. Thelma Lloyd (32 years, 4 months), Regina Baldwin (19 ½ years) and Janet Willingham (31 years, 51 weeks) all retired on December 31, 2011. We wish all three a restful and fulfilling retirement and we thank you for all your years of service to Bank of Clarke County! Cortney Maddox was hired as an Assistant Vice President and Branch Manager to fill Mrs. Baldwin's position. Kristin Foltz also joined your company as Assistant Vice President and Controller. Welcome to both officers!

Going forward, challenges will continue unabated – increased regulatory burden, increased competition from banks and non-banks such as credit unions, pressure on our margins, the growth of our loan portfolio with high quality loans and expansion of our list of products and services and the channels utilized to deliver them to current and future customers. That said, we will continue to focus on growing your company at a manageable pace with an eye to increased profitability and shareholder return. Costs will be managed, innovation will continue at the appropriate speed and the achievements of aggressive goals will be our objective. As we progress, I recognize that our employees will be the catalyst for success. The level of quality in these employees gives me reason to believe that we will most assuredly be successful.

Sincerely,



John R Milleison  
President and Chief Executive Officer



**ARCHITECT'S RENDERING OF THE NEW PURCELLVILLE BRANCH, OPENING IN LATE 2012. THIS DESIGN IS BASED ON OUR PLEASANT VALLEY BRANCH WITH EXPANDED OFFICE SQUARE FOOTAGE.**

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and BANK OF CLARKE COUNTY  
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Senior Vice President/Marketing Director

ELIZABETH M PENDLETON  
Senior Vice President/Senior Trust Officer

**EAGLE FINANCIAL SERVICES, INC  
ANNUAL MEETING**

The annual Shareholders' meeting will be held at John H Enders Fire Hall, 9 South Buckmarsh Street, Berryville, Virginia on Wednesday, May 16, 2012 at 12 Noon.

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**FORM 10K**  
A copy of the Company's 2011 Form 10K annual report to the Securities and Exchange Commission may be obtained without charge on the investor relations page of our website ([www.bankofclarke.com](http://www.bankofclarke.com)) or upon written request.

**EAGLE FINANCIAL SERVICES, INC  
DIVIDEND REINVESTMENT PLAN**  
Shareholders of record can acquire additional common stock through automatic reinvestment of quarterly dividends. For more information or to sign up, contact the Transfer Agent.