

AMERICAN NATIONAL BANKSHARES INC
Form 10-Q
August 08, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2008.

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM TO .

Commission file number 0-12820

AMERICAN NATIONAL BANKSHARES INC.
(Exact name of registrant as specified in its charter)

VIRGINIA
(State or other jurisdiction of
incorporation or organization)

54-1284688
(I.R.S. Employer
Identification No.)

628 Main Street
Danville, Virginia
(Address of principal executive
offices)

24541
(Zip Code)

(434) 792-5111
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer ☐ Accelerated
filer ☒ Non-accelerated filer ☐
Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ☐ No ☒

At August 7, 2008, the Company had 6,093,712 shares Common Stock outstanding, \$1 par value.

AMERICAN NATIONAL BANKSHARES INC.

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SIGNATURES

American National Bankshares Inc. and Subsidiaries
Consolidated Balance Sheets
(Dollars in thousands, except share data)

| | (Unaudited) June 30, 2008 | (Audited) December 31, 2007 |
|---|---------------------------------|-----------------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 20,082 | \$ 18,155 |
| Interest-bearing deposits in other banks | 8,265 | 149 |
| Securities available for sale, at fair value | 136,632 | 145,159 |
| Securities held to maturity (fair value of \$10,033 in 2008 and \$12,250 in 2007) | 9,828 | 11,990 |
| Total securities | 146,460 | 157,149 |
| Loans held for sale (includes \$47 at fair value in 2008) | 2,200 | 1,368 |
| Loans, net of unearned income | 568,830 | 551,391 |
| Less allowance for loan losses | (7,932) | (7,395) |
| Net loans | 560,898 | 543,996 |
| Premises and equipment, net | 13,659 | 13,348 |
| Goodwill | 22,468 | 22,468 |
| Core deposit intangibles, net | 2,264 | 2,452 |
| Accrued interest receivable and other assets | 14,399 | 13,203 |
| Total assets | \$ 790,695 | \$ 772,288 |
| LIABILITIES and SHAREHOLDERS' EQUITY | | |
| Liabilities: | | |
| Demand deposits -- noninterest bearing | \$ 98,005 | \$ 99,231 |
| Demand deposits -- interest bearing | 105,809 | 104,751 |
| Money market deposits | 52,772 | 50,254 |
| Savings deposits | 61,469 | 62,400 |
| Time deposits | 251,189 | 264,585 |
| Total deposits | 569,244 | 581,221 |
| Repurchase agreements | 57,973 | 47,891 |
| FHLB borrowings | 37,488 | 16,137 |
| Trust preferred capital notes | 20,619 | 20,619 |
| Accrued interest payable and other liabilities | 3,475 | 4,909 |
| Total liabilities | 688,799 | 670,777 |
| Shareholders' equity: | | |

| | | |
|--|------------|------------|
| Preferred stock, \$5 par, 200,000 shares authorized, | | |
| none outstanding | - | - |
| Common stock, \$1 par, 10,000,000 shares authorized, | | |
| 6,097,862 shares outstanding at June 30, 2008 and | | |
| 6,118,717 shares outstanding at December 31, 2007 | 6,098 | 6,119 |
| Capital in excess of par value | 26,463 | 26,425 |
| Retained earnings | 70,233 | 69,409 |
| Accumulated other comprehensive income (loss), net | (898) | (442) |
| Total shareholders' equity | 101,896 | 101,511 |
| Total liabilities and shareholders' equity | \$ 790,695 | \$ 772,288 |

The accompanying notes are an integral part of the consolidated financial statements.

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Income
(Dollars in thousands, except per share and per share data) (Unaudited)

| | Three Months Ended June 30 | |
|---|-------------------------------|-----------|
| | 2008 | 2007 |
| Interest and Dividend Income: | | |
| Interest and fees on loans | \$ 8,987 | \$ 10,408 |
| Interest and dividends on securities: | | |
| Taxable | 1,234 | 1,028 |
| Tax-exempt | 420 | 420 |
| Dividends | 73 | 82 |
| Other interest income | 74 | 168 |
| Total interest and dividend income | 10,788 | 12,106 |
| Interest Expense: | | |
| Interest on deposits | 3,116 | 3,860 |
| Interest on repurchase agreements | 339 | 449 |
| Interest on other borrowings | 259 | 170 |
| Interest on trust preferred capital notes | 344 | 344 |
| Total interest expense | 4,058 | 4,823 |
| Net Interest Income | 6,730 | 7,283 |
| Provision for Loan Losses | 600 | - |
| Net Interest Income After Provision for Loan Losses | 6,130 | 7,283 |
| Noninterest Income: | | |
| Trust fees | 916 | 924 |
| Service charges on deposit accounts | 601 | 625 |
| Other fees and commissions | 226 | 198 |
| Mortgage banking income | 200 | 329 |
| Brokerage fees | 101 | 159 |
| Securities gains (losses), net | (138) | 64 |
| Impairment of securities | (255) | - |
| Other | 190 | 132 |
| Total noninterest income | 1,841 | 2,431 |
| Noninterest Expense: | | |
| Salaries | 2,481 | 2,514 |
| Employee benefits | 777 | 737 |
| Occupancy and equipment | 928 | 850 |
| Bank franchise tax | 173 | 165 |
| Core deposit intangible amortization | 95 | 95 |
| Other | 1,189 | 1,087 |
| Total noninterest expense | 5,643 | 5,448 |
| Income Before Income Taxes | 2,328 | 4,266 |
| Income Taxes | 519 | 1,235 |

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| | | |
|------------------------------------|-----------|-----------|
| Net Income | \$ 1,809 | \$ 3,031 |
| Net Income Per Common Share: | | |
| Basic | \$ 0.30 | \$ 0.49 |
| Diluted | \$ 0.30 | \$ 0.49 |
| Average Common Shares Outstanding: | | |
| Basic | 6,098,184 | 6,150,216 |
| Diluted | 6,108,536 | 6,177,165 |

The accompanying notes are an integral part of the consolidated financial statements.

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Income
(Dollars in thousands, except per share and per share data) (Unaudited)

| | Six Months Ended June 30 | |
|---|-----------------------------|-----------|
| | 2008 | 2007 |
| Interest and Dividend Income: | | |
| Interest and fees on loans | \$ 18,431 | \$ 20,487 |
| Interest and dividends on securities: | | |
| Taxable | 2,465 | 2,164 |
| Tax-exempt | 852 | 843 |
| Dividends | 150 | 171 |
| Other interest income | 150 | 339 |
| Total interest and dividend income | 22,048 | 24,004 |
| Interest Expense: | | |
| Interest on deposits | 6,698 | 7,643 |
| Interest on repurchase agreements | 790 | 875 |
| Interest on other borrowings | 418 | 687 |
| Interest on trust preferred capital notes | 687 | 376 |
| Total interest expense | 8,593 | 9,581 |
| Net Interest Income | 13,455 | 14,423 |
| Provision for Loan Losses | 740 | 303 |
| Net Interest Income After Provision for Loan Losses | 12,715 | 14,120 |
| Noninterest Income: | | |
| Trust fees | 1,796 | 1,803 |
| Service charges on deposit accounts | 1,166 | 1,247 |
| Other fees and commissions | 429 | 398 |
| Mortgage banking income | 395 | 519 |
| Brokerage fees | 244 | 248 |
| Securities gains (losses), net | (108) | 89 |
| Impairment of securities | (255) | - |
| Other | 309 | 339 |
| Total noninterest income | 3,976 | 4,643 |
| Noninterest Expense: | | |
| Salaries | 4,950 | 4,904 |
| Employee benefits | 1,524 | 1,385 |
| Occupancy and equipment | 1,894 | 1,679 |
| Bank franchise tax | 350 | 333 |
| Core deposit intangible amortization | 189 | 189 |
| Other | 2,185 | 2,128 |
| Total noninterest expense | 11,092 | 10,618 |
| Income Before Income Taxes | 5,599 | 8,145 |
| Income Taxes | 1,485 | 2,410 |

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| | | |
|------------------------------------|-----------|-----------|
| Net Income | \$ 4,114 | \$ 5,735 |
| Net Income Per Common Share: | | |
| Basic | \$ 0.67 | \$ 0.93 |
| Diluted | \$ 0.67 | \$ 0.93 |
| Average Common Shares Outstanding: | | |
| Basic | 6,103,008 | 6,153,496 |
| Diluted | 6,114,911 | 6,181,107 |

The accompanying notes are an integral part of the consolidated financial statements.

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Six Months Ended June 30, 2008 and 2007
(Dollars in thousands) (Unaudited)

| | Common Stock Shares | Amount | Capital in Excess of Par Value | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|------------------------|----------|--------------------------------------|----------------------|---|----------------------------------|
| Balance, December 31, 2006 | 6,161,865 | \$ 6,162 | \$ 26,414 | \$ 64,584 | \$ (2,168) | \$ 94,992 |
| Net income | - | - | - | 5,735 | - | 5,735 |
| Change in unrealized gains on securities available for sale, net of tax of \$(177) | - | - | - | - | (214) | |
| Less: Reclassification adjustment for gains on securities available for sale, net of tax of \$(30) | - | - | - | - | (59) | |
| Other comprehensive income (loss) | | | | | (273) | (273) |
| Total comprehensive income | - | - | - | - | - | 5,462 |
| Stock repurchased and retired | (24,300) | (24) | (104) | (428) | - | (556) |
| Stock options exercised | 8,052 | 8 | 112 | - | - | 120 |
| Cash dividends declared (\$.45 per share) | - | - | - | (2,769) | - | (2,769) |
| Balance, June 30, 2007 | 6,145,617 | \$ 6,146 | \$ 26,422 | \$ 67,122 | \$ (2,441) | \$ 97,249 |
| | 6,118,717 | \$ 6,119 | \$ 26,425 | \$ 69,409 | \$ (442) | \$ 101,511 |

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Balance, December
31, 2007

| | | | | | | |
|--|-----------|----------|-----------|-----------|----------|------------|
| Net income | - | - | - | 4,114 | - | 4,114 |
| Change in unrealized gains on securities available for sale, net of tax of \$(332) | - | - | - | - | (618) | |
| Add: Reclassification adjustment for losses on impairment of securities, net of tax of \$89 | - | - | - | - | 166 | |
| Less: Reclassification adjustment for losses on securities available for sale, net of tax of \$38 | - | - | - | - | 70 | |
| Change in pension liability, net of tax of \$(40) | | | | | (74) | |
| Other comprehensive income (loss) | | | | | (456) | (456) |
| Total comprehensive income | | | | | | 3,658 |
| Stock repurchased and retired | (31,200) | (31) | (135) | (484) | - | (650) |
| Stock options exercised | 10,345 | 10 | 173 | - | - | 183 |
| Cash dividends declared (\$.46 per share) | - | - | - | (2,806) | - | (2,806) |
| Balance, June 30, 2008 | 6,097,862 | \$ 6,098 | \$ 26,463 | \$ 70,233 | \$ (898) | \$ 101,896 |

The accompanying notes are an integral part of the consolidated financial statements.

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Six Months Ended June 30, 2008 and 2007
(Dollars in thousands) (Unaudited)

| | 2008 | 2007 |
|---|----------|----------|
| Cash Flows from Operating Activities: | | |
| Net income | \$ 4,114 | \$ 5,735 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 740 | 303 |
| Depreciation | 692 | 564 |
| Core deposit intangible amortization | 188 | 188 |
| Net amortization (accretion) of bond premiums and discounts | (121) | (59) |
| Net loss (gain) on sale or call of securities | 108 | (89) |
| Impairment of securities | 255 | - |
| Gain on loans held for sale | (337) | (397) |
| Proceeds from sales of loans held for sale | 16,400 | 17,862 |
| Originations of loans held for sale | (16,895) | (18,109) |
| Net loss (gain) on foreclosed real estate | 7 | (6) |
| Change in valuation allowance for foreclosed real estate | - | (10) |
| Gain on sale of premises and equipment | - | (9) |
| Deferred income tax expense | 19 | 92 |
| Net change in interest receivable | 66 | (15) |
| Net change in other assets | (1,224) | 1,117 |
| Net change in interest payable | (258) | (100) |
| Net change in other liabilities | (1,176) | (1,128) |
| Net cash provided by operating activities | 2,578 | 5,939 |
| Cash Flows from Investing Activities: | | |
| Proceeds from sales of securities available for sale | 814 | 665 |
| Proceeds from maturities and calls of securities available for sale | 28,991 | 31,589 |
| Proceeds from maturities and calls of securities held to maturity | 2,164 | 725 |
| Purchases of securities available for sale | (22,109) | (4,861) |
| Net change in loans | (17,694) | (9,590) |
| Purchases of bank property and equipment | (1,003) | (1,016) |
| Proceeds from sales of foreclosed real estate | 119 | 30 |
| Net cash (used in) provided by investing activities | (8,718) | 17,542 |
| Cash Flows from Financing Activities: | | |
| Net change in demand, money market, and savings deposits | 1,419 | 865 |

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| | | |
|---|-----------|-----------|
| Net change in time deposits | (13,396) | (13,649) |
| Net change in repurchase agreements | 10,082 | 10,247 |
| Net change in FHLB borrowings | 21,351 | (5,075) |
| Cash dividends paid | (2,806) | (2,769) |
| Repurchase of stock | (650) | (556) |
| Proceeds from exercise of stock options | 183 | 120 |
| Net cash provided by (used in) financing activities | 16,183 | (10,817) |
| Net Increase in Cash and Cash Equivalents | 10,043 | 12,664 |
| Cash and Cash Equivalents at Beginning of Period | 18,304 | 26,124 |
| Cash and Cash Equivalents at End of Period | \$ 28,347 | \$ 38,788 |

The accompanying notes are an integral part of the consolidated financial statements.

AMERICAN NATIONAL BANKSHARES INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation

The unaudited consolidated financial statements include the accounts of American National Bankshares Inc. and its wholly owned subsidiary, American National Bank and Trust Company (collectively referred to as the “Company”). American National Bank offers a wide variety of retail, commercial, secondary market mortgage lending, and trust and investment services which also include non-deposit products such as mutual funds and insurance policies.

In April 2006, AMNB Statutory Trust I, a Delaware statutory trust (the “Trust”) and a wholly owned subsidiary of the Company was formed for the purpose of issuing preferred securities (the “Trust Preferred Securities”) in a private placement pursuant to an applicable exemption from registration. Proceeds from the securities were used to fund the acquisition of Community First Financial Corporation. In accordance with FASB Interpretation No. 46R, Consolidation of Variable Interest Entities, the Corporation did not eliminate through consolidation the Corporation’s \$619,000 equity investment in the Trust. Instead, the Corporation reflected this equity investment in the “Trust Preferred Capital Notes” line item in the consolidated balance sheets.

All significant inter-company transactions and accounts are eliminated in consolidation, with the exception of the Trust, as detailed above.

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information. Accordingly, the unaudited consolidated financial statements do not include all the information and footnotes required by GAAP for complete financial statements. The unaudited consolidated financial statements of the Company include, in the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of such financial statements for all periods presented. The financial position and results of operations as of and for the six months ended June 30, 2008, are not necessarily indicative of the results of operations that may be expected in the future. Please refer to the Company’s 2007 Annual Report on Form 10-K for additional information related to the Company’s audited consolidated financial statements for the three years ended December 31, 2007, including the related notes to consolidated financial statements.

The preparation of the financial statements in accordance with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates and assumptions. The Company regularly assesses various assets for impairment as dictated by applicable GAAP, giving appropriate consideration to general economic and specific market factors. The accounting policies that are particularly sensitive to judgments and the extent to which significant estimates are used include allowance for loan losses and the reserve for unfunded lending commitments, fair value of certain financial instruments, consolidation, goodwill impairment, and contingent liabilities.

Certain reclassifications have been made to prior period balances to conform to the current period presentation.

Note 2 – New Accounting Pronouncements

In March 2008, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 161, Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133. SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The Company does not expect the implementation of SFAS 161 to have a material impact on its consolidated financial statements.

Adoption of New Accounting Standards:

In the first quarter of 2008, the Company adopted SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the "fair value option") and requires an entity to report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. SFAS 159 was effective for fiscal years beginning after November 15, 2007. The adoption of SFAS 159 did not have a material effect on the Company's financial position or results of operations.

In the first quarter of 2008, the Company adopted SFAS 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. Further discussion on this standard can be found in Note 11 to the unaudited consolidated financial statements.

Refer to the Company's December 31, 2007 Annual Report on Form 10-K for previously announced accounting pronouncements.

Note 3 – Securities

The amortized cost and estimated fair value of investments in debt and equity securities at June 30, 2008 and December 31, 2007 were as follows:

| (in thousands) | June 30, 2008 | | | |
|-------------------------------------|-------------------|---------------------|----------------------|-------------------------|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| Federal agencies | \$ 43,625 | \$ 1,062 | \$ 48 | \$ 44,639 |
| Mortgage-backed | 48,614 | 490 | 421 | 48,683 |
| State and municipal | 36,849 | 199 | 180 | 36,868 |
| Corporate | 1,485 | - | 48 | 1,437 |
| Equity securities: | | | | |
| FHLB stock – restricted | 3,076 | - | - | 3,076 |
| Federal Reserve stock – restricted | 1,429 | - | - | 1,429 |
| FNMA and FHLMC preferred stock | 392 | - | - | 392 |
| Other | 108 | - | - | 108 |
| Total securities available for sale | 135,578 | 1,751 | 697 | 136,632 |
| Debt securities held to maturity: | | | | |
| Mortgage-backed | 279 | 10 | - | 289 |
| State and municipal | 9,549 | 203 | 8 | 9,744 |
| Total securities held to maturity | 9,828 | 213 | 8 | 10,033 |
| Total securities | \$ 145,406 | \$ 1,964 | \$ 705 | \$ 146,665 |

| (in thousands) | December 31, 2007 | | | |
|-------------------------------------|-------------------|---------------------|----------------------|-------------------------|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| Federal agencies | \$ 55,350 | \$ 1,059 | \$ 33 | \$ 56,376 |
| Mortgage-backed | 45,346 | 565 | 97 | 45,814 |
| State and municipal | 36,343 | 258 | 113 | 36,488 |
| Corporate | 1,485 | - | 40 | 1,445 |
| Equity securities: | | | | |
| FHLB stock – restricted | 2,125 | - | - | 2,125 |
| Federal Reserve stock – restricted | 1,429 | - | - | 1,429 |
| FNMA and FHLMC preferred stock | 1,346 | 42 | - | 1,388 |
| Other | 94 | - | - | 94 |
| Total securities available for sale | 143,518 | 1,924 | 283 | 145,159 |
| Debt securities held to maturity: | | | | |
| Mortgage-backed | 308 | 11 | - | 319 |
| State and municipal | 11,682 | 256 | 7 | 11,931 |
| Total securities held to maturity | 11,990 | 267 | 7 | 12,250 |
| Total securities | \$ 155,508 | \$ 2,191 | \$ 290 | \$ 157,409 |

The tables below show estimated fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2008 and December 31, 2007. The reference point for determining when securities are in an unrealized loss position is month-end. Therefore, it is possible that a security's market value exceeded its amortized cost on other days during the past twelve-month period.

Management evaluates securities for other-than-temporary impairment quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for anticipated recovery in fair value. As of June 30, 2008, the Company held five securities that had been in a continuous unrealized loss position for twelve months or more. The Company has reviewed these securities, in accordance with its accounting policy, for other-than-temporary impairment, and does not consider the balances presented in the table to be other-than-temporarily impaired as of June 30, 2008.

An other-than-temporary impairment expense of \$255,000 on FHLMC preferred stock was charged to earnings during the quarter ended June 30, 2008. The market value of the securities dropped significantly, and any near-term recovery in value was considered uncertain as of June 30, 2008. The Company's recorded investment in these securities, after the impairment charge, was \$392,000 at June 30, 2008.

June 30, 2008

| (in thousands) | Total | | Less than 12 Months | | 12 Months or More | |
|---------------------|----------------------------|--------------------|----------------------------|--------------------|----------------------------|--------------------|
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Federal agency | \$ 5,529 | \$ 48 | \$ 5,529 | \$ 48 | \$ - | \$ - |
| Mortgage-backed | 15,212 | 421 | 14,092 | 415 | 1,120 | 6 |
| State and municipal | 13,056 | 188 | 13,056 | 188 | - | - |
| Corporate | 1,437 | 48 | - | - | 1,437 | 48 |
| Total | \$ 35,234 | \$ 705 | \$ 32,677 | \$ 651 | \$ 2,557 | \$ 54 |

December 31, 2007

| (in thousands) | Total | | Less than 12 Months | | 12 Months or More | |
|---------------------|----------------------------|--------------------|----------------------------|--------------------|----------------------------|--------------------|
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Federal agencies | \$ 7,459 | \$ 33 | \$ - | \$ - | \$ 7,459 | \$ 33 |
| Mortgage-backed | 10,194 | 97 | 3,508 | 35 | 6,686 | 62 |
| State and municipal | 17,858 | 120 | 2,087 | 12 | 15,771 | 108 |
| Corporate | 1,445 | 40 | - | - | 1,445 | 40 |
| Total | \$ 36,956 | \$ 290 | \$ 5,595 | \$ 47 | \$ 31,361 | \$ 243 |

Note 4 - Loans

Loans, excluding loans held for sale, were comprised of the following:

| (in thousands) | June 30, 2008 | December 31, 2007 |
|-----------------------------------|------------------|----------------------|
| Construction and land development | \$ 66,740 | \$ 69,803 |
| Commercial real estate | 201,102 | 198,332 |
| Residential real estate | 140,024 | 133,899 |
| Home equity | 52,773 | 48,313 |
| Total real estate | 460,639 | 450,347 |
| Commercial and industrial | 99,603 | 91,028 |
| Consumer | 8,588 | 10,016 |
| Total loans | \$ 568,830 | \$ 551,391 |

The following is a summary of information pertaining to impaired and nonaccrual loans:

| (in thousands) | June 30, 2008 | December 31, 2007 |
|--|------------------|----------------------|
| Impaired loans with a valuation allowance | \$ 6,541 | \$ 3,092 |
| Impaired loans without a valuation allowance | 523 | 473 |

| | | | | |
|---|----|-------|----|-------|
| Total impaired loans | \$ | 7,064 | \$ | 3,565 |
| Allowance provided for impaired loans, included in the allowance for loan losses | \$ | 2,354 | \$ | 1,499 |
| Nonaccrual loans excluded from the impaired loan disclosure | \$ | 1,406 | \$ | 1,329 |

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| | As of and For the Three Months Ended June 30, 2008 | As of and For the Six Months Ended June 30, 2008 | As of and For the Three Months Ended June 30, 2007 | As of and For the Six Months Ended June 30, 2007 |
|--|--|--|--|--|
| (in thousands) | | | | |
| Average balance in impaired loans | \$ 5,729 | \$ 4,687 | \$ 2,292 | \$ 1,939 |
| Interest income recognized on impaired loans | 59 | 108 | 103 | 107 |
| Interest income recognized on nonaccrual loans | - | - | - | - |
| Interest on non-accrual loans had they been accruing | 96 | 169 | 73 | 148 |
| Loans past due 90 days and still accruing interest | 172 | 172 | - | - |

No additional funds are committed to be advanced in connection with impaired loans.

Foreclosed real estate was \$558,000 at June 30, 2008 and \$632,000 at December 31, 2007, and is included in other assets on the Consolidated Balance Sheets.

Note 5 – Allowance for Loan Losses and Reserve for Unfunded Lending Commitments

Changes in the allowance for loan losses and the reserve for unfunded lending commitments for the six months ended June 30, 2008 and 2007, and for the year ended December 31, 2007, are presented below:

| | Six Months Ended June 30, 2008 | Year Ended December 31, 2007 | Six Months Ended June 30, 2007 |
|--|---|---------------------------------------|---|
| (in thousands) | | | |
| Allowance for Loan Losses | | | |
| Balance, beginning of period | \$ 7,395 | \$ 7,264 | \$ 7,264 |
| Provision for loan losses | 740 | 403 | 303 |
| Charge-offs | (373) | (515) | (204) |
| Recoveries | 170 | 243 | 130 |
| Balance, end of period | \$ 7,932 | \$ 7,395 | \$ 7,493 |
| Reserve for Unfunded Lending Commitments | | | |
| Balance, beginning of period | \$ 151 | 123 | \$ 123 |
| Provision for unfunded commitments | 218 | 28 | 5 |
| Balance, end of period | \$ 369 | \$ 151 | \$ 128 |

The reserve for unfunded lending commitments is included in other liabilities.

Note 6 – Goodwill and Other Intangible Assets

In January 2002, the Company adopted SFAS 142, Goodwill and Other Intangible Assets. Accordingly, goodwill is no longer subject to amortization, but is subject to at least an annual assessment for impairment by applying a fair value test. A fair value-based test was performed during the third quarter of 2007 that determined the market value of the Company's shares exceeded the consolidated carrying value, including goodwill; therefore, there has been no impairment recognized in the value of goodwill.

The changes in the carrying amount of goodwill for the three months ended June 30, 2008, are as follows (in thousands):

| | |
|-------------------------------------|-----------|
| Balance as of December 31, 2007 | \$ 22,468 |
| Goodwill recorded during the period | - |
| Impairment losses | - |
| Balance as of June 30, 2008 | \$ 22,468 |

Core deposit intangible assets resulting from an acquisition were originally recorded at \$3,112,000 in April 2006, and are being amortized over 99 months on a straight-line basis.

Goodwill and intangible assets are as follows (in thousands):

| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
|---|----------------------------|-----------------------------|--------------------------|
| June 30, 2008 | | | |
| Amortizable core deposit intangibles | \$ 7,616 | \$ 5,352 | \$ 2,264 |
| Goodwill | 22,468 | - | \$ 22,468 |
| December 31, 2007 | | | |
| Amortizable core deposit intangibles | \$ 7,616 | \$ 5,164 | \$ 2,452 |
| Goodwill | 22,468 | - | \$ 22,468 |
| June 30, 2007 | | | |
| Amortizable core deposit intangibles | \$ 7,616 | \$ 4,975 | \$ 2,641 |
| Goodwill | 22,468 | - | \$ 22,468 |

Note 7 – Stock Based Compensation

A summary of stock option transactions for the three months ended June 30, 2008, is as follows:

| | Weighted Average | Weighted Average Remaining Contractual Term | Average Intrinsic Value |
|------------------|---------------------|---|-------------------------------|
| Option Shares | | | |

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| | | Exercise Price | | (\$000) |
|-------------------------------------|----------|-------------------|-----|---------|
| Outstanding at December 31, 2007 | 174,871 | \$ 21.15 | 4.3 | \$ 263 |
| Granted | - | - | | |
| Exercised | (10,345) | 17.65 | | |
| Forfeited | (2,200) | 14.54 | | |
| Outstanding at June 30, 2008 | 162,326 | 21.40 | | |