AMERICAN NATIONAL BANKSHARES INC
Form 10-Q
May 11, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT of 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2009.

¨ 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<br>(State or other jurisdiction of incorporation or organization) | 54-1284688<br>(I.R.S. Employer Identification No.) |
| 628 Main Street<br>Danville, Virginia<br>(Address of principal executive offices) | 24541<br>(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months.

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.

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)Yes¨Nox

At May 7, 2009, the Company had 6,100,323 shares Common Stock outstanding, $1 par value.

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Part I. Financial Information
Item 1. Financial Statements

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

| | (Unaudited) March 31, 2009 | (Audited) December 31, 2008 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 13,632 | $ 14,986 |
| Interest-bearing deposits in other banks | 18,188 | 9,112 |
| | | |
| Securities available for sale, at fair value | 167,981 | 133,695 |
| Securities held to maturity | 6,811 | 7,121 |
| Total securities | 174,792 | 140,816 |
| | | |
| Loans held for sale | 2,782 | 1,764 |
| | | |
| Loans, net of unearned income | 569,003 | 571,110 |
| Less allowance for loan losses | (7,836) | (7,824) |
| Net loans | 561,167 | 563,286 |
| | | |
| Premises and equipment, net | 18,282 | 17,431 |
| Other real estate owned | 3,345 | 4,311 |
| Goodwill | 22,468 | 22,468 |
| Core deposit intangibles, net | 1,981 | 2,075 |
| Accrued interest receivable and other assets | 12,841 | 12,935 |
| Total assets | $ 829,478 | $ 789,184 |
| | | |
| LIABILITIES and SHAREHOLDERS' EQUITY | | |
| Liabilities: | | |
| Demand deposits -- noninterest bearing | $ 98,926 | $ 95,703 |
| Demand deposits -- interest bearing | 94,505 | 116,132 |
| Money market deposits | 72,085 | 56,615 |
| Savings deposits | 63,553 | 59,624 |
| Time deposits | 286,819 | 261,064 |
| Total deposits | 615,888 | 589,138 |
| | | |
| Short-term borrowings: | | |
| Customer repurchase agreements | 60,768 | 51,741 |
| Other short-term borrowings | 12,440 | 7,850 |
| Long-term borrowings | 13,750 | 13,787 |
| Trust preferred capital notes | 20,619 | 20,619 |
| Accrued interest payable and other liabilities | 4,098 | 3,749 |
| Total liabilities | 727,563 | 686,884 |
| | | |
| Shareholders' equity: | | |

| | | | | |
|---|---|---|---|---|
| Preferred stock, $5 par, 200,000 shares authorized, | | | | |
| none outstanding | | - | | - |
| Common stock, $1 par, 10,000,000 shares authorized, | | | | |
| 6,079,161 shares outstanding at March 31, 2009 and | | | | |
| 6,085,628 shares outstanding at December 31, 2008 | | 6,079 | | 6,086 |
| Capital in excess of par value | | 26,488 | | 26,491 |
| Retained earnings | | 70,379 | | 71,090 |
| Accumulated other comprehensive loss, net | | (1,031) | | (1,367) |
| Total shareholders' equity | | 101,915 | | 102,300 |
| Total liabilities and shareholders' equity | $ | 829,478 | $ | 789,184 |

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

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

| | Three Months Ended March 31 | |
|---|---|---|
| | 2009 | 2008 |
| Interest and Dividend Income: | | |
| Interest and fees on loans | $ 8,034 | $ 9,444 |
| Interest and dividends on securities: | | |
| Taxable | 1,120 | 1,231 |
| Tax-exempt | 386 | 432 |
| Dividends | 22 | 77 |
| Other interest income | 88 | 76 |
| Total interest and dividend income | 9,650 | 11,260 |
| | | |
| Interest Expense: | | |
| Interest on deposits | 2,527 | 3,582 |
| Interest on short-term borrowings | 236 | 484 |
| Interest on long-term borrowings | 131 | 126 |
| Interest on trust preferred capital notes | 343 | 343 |
| Total interest expense | 3,237 | 4,535 |
| | | |
| Net Interest Income | 6,413 | 6,725 |
| Provision for Loan Losses | 350 | 140 |
| | | |
| Net Interest Income After Provision for Loan Losses | 6,063 | 6,585 |
| | | |
| Noninterest Income: | | |
| Trust fees | 758 | 880 |
| Service charges on deposit accounts | 502 | 565 |
| Other fees and commissions | 242 | 203 |
| Mortgage banking income | 286 | 195 |
| Brokerage fees | 57 | 143 |
| Securities gains, net | - | 30 |
| Net loss on foreclosed real estate | (1,179) | (7) |
| Other | 68 | 126 |
| Total noninterest income | 734 | 2,135 |
| | | |
| Noninterest Expense: | | |
| Salaries | 2,531 | 2,469 |
| Employee benefits | 813 | 747 |
| Occupancy and equipment | 971 | 966 |
| FDIC assessment | 217 | 17 |
| Bank franchise tax | 163 | 177 |
| Core deposit intangible amortization | 94 | 94 |
| Other | 1,086 | 979 |

| | | | | |
|---|---|---|---|---|
| Total noninterest expense | | 5,875 | | 5,449 |
| Income Before Income Taxes | | 922 | | 3,271 |
| Income Taxes | | 154 | | 966 |
| Net Income | $ | 768 | $ | 2,305 |
| | | | | |
| Net Income Per Common Share: | | | | |
| Basic | $ | 0.13 | $ | 0.38 |
| Diluted | $ | 0.13 | $ | 0.38 |
| Average Common Shares Outstanding: | | | | |
| Basic | | 6,081,998 | | 6,107,832 |
| Diluted | | 6,085,457 | | 6,121,285 |
| | | | | |

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

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American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Three Months Ended March 31, 2009 and 2008
(Dollars in thousands) (Unaudited)

| | Common Stock | | Capital in Excess of | Retained | Accumulated Other Comprehensive Income | Total Shareholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | Par Value | Earnings | (Loss) | Equity |
| Balance, December 31, 2007 | 6,118,717 | $ 6,119 | $ 26,425 | $ 69,409 | $ (442) | $ 101,511 |
| Net income | - | - | - | 2,305 | - | 2,305 |
| Change in unrealized gains on securities available for sale, net of tax, $481 | - | - | - | - | 897 | |
| Less: Reclassification adjustment for gains on securities available for sale, net of tax, $(10) | - | - | - | - | (20) | |
| Other comprehensive income | | | | | 877 | 877 |
| Total comprehensive income | | | | | | 3,182 |
| Stock repurchased and retired | (28,800) | (29) | (124) | (446) | - | (599) |
| Stock options exercised | 10,268 | 10 | 171 | - | - | 181 |
| Cash dividends declared, $0.23 per share | - | - | - | (1,402) | - | (1,402) |
| Balance, March 31, 2008 | 6,100,185 | $ 6,100 | $ 26,472 | $ 69,866 | $ 435 | $ 102,873 |
| Balance, December 31, 2008 | 6,085,628 | $ 6,086 | $ 26,491 | $ 71,090 | $ (1,367) | $ 102,300 |
| Net income | - | - | - | 768 | - | 768 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Change in unrealized gains on securities available for sale, net of tax, $181 | - | - | - | - | 336 | |
| Other comprehensive income | | | | | 336 | 336 |
| Total comprehensive income | | | | | | 1,104 |
| Stock repurchased and retired | (7,600) | (8) | (33) | (80) | - | (121) |
| Stock options exercised | 1,133 | 1 | 15 | - | - | 16 |
| Stock option expense | | | 15 | | | 15 |
| Cash dividends declared, $0.23 per share | - | - | | (1,399) | - | (1,399) |
| Balance, March 31, 2009 | 6,079,161 | $ 6,079 | $ 26,488 | $ 70,379 | $ (1,031) | $ 101,915 |

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

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American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Three Months Ended March 31, 2009 and 2008
(Dollars in thousands) (Unaudited)

| | 2009 | 2008 |
|---|---|---|
| Cash Flows from Operating Activities: | | |
| Net income | $ 768 | $ 2,305 |
| Adjustments to reconcile net income to net | | |
| cash provided by operating activities: | | |
| Provision for loan losses | 350 | 140 |
| Depreciation | 338 | 353 |
| Core deposit intangible amortization | 94 | 94 |
| Net amortization (accretion) of bond premiums and discounts | (67) | (64) |
| Net gain on sale or call of securities | - | (30) |
| Gain on loans held for sale | (249) | (166) |
| Proceeds from sales of loans held for sale | 12,554 | 8,279 |
| Originations of loans held for sale | (13,323) | (8,426) |
| Net loss on foreclosed real estate | 1,179 | 7 |
| Stock-based compensation expense | 15 | - |
| Deferred income tax expense (benefit) | (423) | 13 |
| Net change in interest receivable | 12 | 223 |
| Net change in other assets | 325 | (292) |
| Net change in interest payable | 17 | (63) |
| Net change in other liabilities | 332 | 868 |
| Net cash provided by operating activities | 1,922 | 3,241 |
| | | |
| Cash Flows from Investing Activities: | | |
| Proceeds from maturities and calls of securities available for sale | 8,995 | 15,342 |
| Proceeds from maturities and calls of securities held to maturity | 311 | 952 |
| Purchases of securities available for sale | (42,699) | (18,377) |
| Net change in loans | 1,387 | (3,386) |
| Purchases of bank property and equipment | (1,189) | (397) |
| Proceeds from sales of foreclosed real estate | 169 | 75 |
| Net cash used in investing activities | (33,026) | (5,791) |
| | | |
| Cash Flows from Financing Activities: | | |
| Net change in demand, money market, and savings deposits | 995 | 4,696 |
| Net change in time deposits | 25,755 | (4,378) |
| Net change in repurchase agreements | 9,027 | 10,288 |
| Net change in short-term borrowings | 4,590 | (3,975) |

| | | | | |
|---|---|---|---|---|
| Net change in long-term borrowings | | (37) | | 3,963 |
| Cash dividends paid | | (1,399) | | (1,402) |
| Repurchase of stock | | (121) | | (599) |
| Proceeds from exercise of stock options | | 16 | | 181 |
| Net cash provided by financing activities | | 38,826 | | 8,774 |
| | | | | |
| Net Increase in Cash and Cash Equivalents | | 7,722 | | 6,224 |
| | | | | |
| Cash and Cash Equivalents at Beginning of Period | | 24,098 | | 18,304 |
| | | | | |
| Cash and Cash Equivalents at End of Period | $ | 31,820 | $ | 24,528 |

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 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.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of foreclosed real estate.

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 ("Community First") which occurred in April 2006. Refer to Note 9 for further details concerning this variable interest entity.

All significant inter-company transactions and accounts are eliminated in consolidation, with the exception of the Trust, as detailed in Note 9.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position as of March 31, 2009; the consolidated statements of income for the three months ended March 31, 2009 and 2008; the consolidated statements of changes in shareholders' equity for the three months ended March 31, 2009 and 2008; and the consolidated statements of cash flows for the three months ended March 31, 2009 and 2008. Operating results for the three month periods ended March 31, 2009 are not necessarily indicative of the results that may occur for the year ending December 31, 2009. Certain reclassifications have been made to prior period balances to conform to the current period presentation. These statements should be read in conjunction with the Notes to Financial Statements included in the Company's Form 10-K for the year ended December 31, 2008.

## Note 2 – Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141(R), "Business Combinations" ("SFAS 141(R)"). The Standard significantly changed the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.  SFAS 141(R) is effective for acquisition dates on or after the beginning of an entity's first year that begins after December 15, 2008.  The Company does not expect the implementation of SFAS 141(R) to have a material impact on its consolidated financial statements, at this time.

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In April 2009, the FASB issued Staff Position ("FSP") Financial Accounting Standards ("FAS") 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies." FSP FAS 141(R)-1 amends and clarifies SFAS 141(R) to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company does not expect the adoption of FSP FAS 141(R)-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. Earlier adoption is permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 157-4 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principals Board Opinion No. ("APB 28-1"), "Interim Disclosures about Fair Value of Financial Instruments." FSP FAS 107-1 and APB 28-1 amends SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. In addition, the FSP amends APB Opinion No. 28, "Interim Financial Reporting," to require those disclosures in summarized financial information at interim reporting periods. The FSP is effective for interim periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 107-1 and APB 28-1 to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." FSP FAS 115-2 and FAS 124-2 amends other-than-temporary impairment guidance for debt securities to make guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Company does not expect the adoption of FSP FAS 115-2 and FAS 124-2 to have a material impact on its consolidated financial statements.

In April 2009, the Securities and Exchange Commission (the"SEC") issued Staff Accounting Bulletin No. 111 ("SAB 111"). SAB 111 amends and replaces SAB Topic 5.M. in the SAB Series entitled "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities." SAB 111 maintains the SEC Staff's previous views related to equity securities and amends Topic 5.M. to exclude debt securities from its scope. The Company does not expect the implementation of SAB 111 to have a material impact on its consolidated financial statements.

Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2008 for previously announced accounting pronouncements.

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Note 3 – Securities

The amortized cost and estimated fair value of investments in debt and equity securities at March 31, 2009 and December 31, 2008 were as follows:

| | March 31, 2009 | | | |
|---|---|---|---|---|
| (in thousands) | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| Federal agencies | $ 74,216 | $ 1,963 | $ 2 | $ 76,177 |
| Mortgage-backed | 42,934 | 1,491 | 547 | 43,878 |
| State and municipal | 40,085 | 819 | 87 | 40,817 |
| Corporate | 2,980 | - | 6 | 2,974 |
| Equity securities: | | | | |
| FHLB stock – restricted | 2,598 | - | - | 2,598 |
| Federal Reserve stock – restricted | 1,429 | - | - | 1,429 |
| Other | 108 | - | - | 108 |
| Total securities available for sale | 164,350 | 4,273 | 642 | 167,981 |
| | | | | |
| Debt securities held to maturity: | | | | |
| Mortgage-backed | 243 | 13 | - | 256 |
| State and municipal | 6,568 | 254 | - | 6,822 |
| Total securities held to maturity | 6,811 | 267 | - | 7,078 |
| Total securities | $ 171,161 | $ 4,540 | $ 642 | $ 175,059 |

| | December 31, 2008 | | | |
|---|---|---|---|---|
| (in thousands) | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Securities available for sale: | | | | |
| Debt securities: | | | | |
| Federal agencies | $ 43,331 | $ 2,093 | $ 8 | $ 45,416 |
| Mortgage-backed | 45,139 | 1,040 | 496 | 45,683 |
| State and municipal | 36,726 | 653 | 74 | 37,305 |
| Corporate | 1,485 | 3 | 96 | 1,392 |
| Equity securities: | | | | |
| FHLB stock – restricted | 2,362 | - | - | 2,362 |
| Federal Reserve stock – restricted | 1,429 | - | - | 1,429 |
| Other | 108 | - | - | 108 |
| Total securities available for sale | 130,580 | 3,789 | 674 | 133,695 |
| | | | | |
| Debt securities held to maturity: | | | | |
| Mortgage-backed | 254 | 10 | - | 264 |
| State and municipal | 6,867 | 261 | 1 | 7,127 |
| Total securities held to maturity | 7,121 | 271 | 1 | 7,391 |
| Total securities | $ 137,701 | $ 4,060 | $ 675 | $ 141,086 |

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 March 31, 2009 and December 31, 2008.  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.

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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 March 31, 2009, the Company held 20 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 March 31, 2009.

March 31, 2009

| | Total | | Less than 12 Months | | 12 Months or More | |
|---|---|---|---|---|---|---|
| (in thousands) | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Federal agencies | $ 32,005 | $ 2 | $ 32,005 | $ 2 | $ - | $ - |
| Mortgage-backed | 3,162 | 547 | - | - | 3,162 | 547 |
| State and municipal | 3,201 | 87 | 3,201 | 87 | - | - |
| Corporate | 1,993 | 6 | 1,993 | 6 | - | - |
| Total | $ 40,361 | $ 642 | $ 37,199 | $ 95 | $ 3,162 | $ 547 |

December 31, 2008

| | Total | | Less than 12 Months | | 12 Months or More | |
|---|---|---|---|---|---|---|
| (in thousands) | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Federal agencies | $ 1,583 | $ 8 | $ 1,583 | $ 8 | $ - | $ - |
| Mortgage-backed | 4,484 | 496 | 3,468 | 472 | 1,016 | 24 |
| State and municipal | 3,581 | 75 | 3,581 | 75 | - | - |
| Corporate | 389 | 96 | - | - | 389 | 96 |
| Total | $ 10,037 | $ 675 | $ 8,632 | $ 555 | $ 1,405 | $ 120 |

Note 4 - Loans

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

| (in thousands) | March 31, 2009 | December 31, 2008 |
|---|---|---|
| Construction and land development | $ 53,579 | $ 63,361 |
| Commercial real estate | 213,508 | 207,160 |
| Residential real estate | 134,509 | 136,480 |
| Home equity | 61,458 | 57,170 |
| Total real estate | 463,054 | 464,171 |
| | | |
| Commercial and industrial | 97,261 | 98,546 |
| Consumer | 8,688 | 8,393 |

| | | | | |
|---|---|---|---|---|
| Total loans | $ | 569,003 | $ | 571,110 |

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

| (in thousands) | March 31, 2009 | December 31, 2008 |
|---|---|---|
| Impaired loans with a valuation allowance | $ 2,470 | $ 2,545 |
| Impaired loans without a valuation allowance | 1,426 | 647 |
| Total impaired loans | $ 3,896 | $ 3,192 |
| | | |
| Allowance provided for impaired loans, included in the allowance for loan losses | $ 1,121 | $ 1,164 |
| | | |
| Nonaccrual loans excluded from the impaired loan disclosure | $ 1,006 | $ 1,574 |

| (in thousands) | Three Months Ended March 31, 2009 | Three Months Ended March 31, 2008 |
|---|---|---|
| Average balance in impaired loans | $ 3,383 | $ 3,647 |
| Interest income recognized on impaired loans | $ 36 | $ 49 |
| Interest income recognized on nonaccrual loans | $ - | $ - |
| Interest on nonaccrual loans had they been accruing | $ 55 | $ 73 |
| Loans past due 90 days and still accruing interest | $ - | $ - |

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

Foreclosed real estate was $3,345,000 at March 31, 2009 and $4,311,000 December 31, 2008.

## 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 three months ended March 31, 2009 and 2008, and for the year ended December 31, 2008, are presented below:

| (in thousands) | Three Months Ended March 31, 2009 | Year Ended December 31, 2008 | Three Months Ended March 31, 2008 |
|---|---|---|---|
| Allowance for Loan Losses | | | |
| Balance, beginning of period | $ 7,824 | $ 7,395 | $ 7,395 |
| Provision for loan losses | 350 | 1,620 | 140 |
| Charge-offs | (376) | (1,564) | (170) |
| Recoveries | 38 | 373 | 60 |
| Balance, end of period | $ 7,836 | $ 7,824 | $ 7,425 |
| | | | |
| Reserve for unfunded lending commitments | | | |
| Balance, beginning of period | $ 475 | 151 | $ 151 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Provision for unfunded commitments | | 54 | | 324 | | 42 |
| Charge-offs | | ( 215) | | - | | - |
| Balance, end of period | $ | 314 | $ | 475 | $ | 193 |

The reserve for unfunded loan commitments in included in other liabilities.

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Note 6 – Goodwill and Other Intangible Assets

In January 2002, the Company adopted SFAS No. 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 2008 that determined the market value of the Company's shares exceeds 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 quarter ended March 31, 2009, are as follows (in thousands):

| | Amount |
|---|---|
| Balance as of December 31, 2008 | $ 22,468 |
| Goodwill recorded during the period | - |
| Impairment losses | - |
| Balance as of March 31, 2009 | $ 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. The net core deposit intangible at March 31, 2009 was $1,981,000.

Note 7 – Short-term Borrowings

Short-term borrowings consist of customer repurchase agreements, overnight borrowings from the Federal Home Loan Bank of Atlanta ("FHLB"), and Federal Funds purchased. Customer repurchase agreements are collateralized by securities of the U.S. Government or its agencies. They mature daily. The interest rates may be changed at the discretion of the Company. The securities underlying these agreements remain under the Company's control. FHLB overnight borrowings contain floating interest rates that may change daily at the discretion of the FHLB. Federal Funds purchased are unsecured overnight borrowings from other financial institutions. Short-term borrowings consisted of the following as of March 31, 2009 and December 31, 2008 (in thousands):

| | March 31, 2009 | December 31, 2008 |
|---|---|---|
| Customer repurchase agreements | $ 60,768 | $ 51,741 |
| FHLB overnight borrowings | 12,440 | 7,850 |
| | $ 73,208 | $ 59,591 |

Note 8 – Long-term Borrowings

Under the terms of its collateral agreement with the FHLB, the Company provides a blanket lien covering all of its residential first mortgage loans, second mortgage loans and home equity lines of credit. In addition, the Company pledges as collateral its capital stock in the FHLB and deposits with the FHLB. The Company has a line of credit with the FHLB equal to 30% of the Company's assets, subject to the amount of collateral pledged. As of March 31, 2009, $106,631,000 in 1-4 family residential mortgage loans and $62,161,000 in home equity lines of credit were pledged under the blanket floating lien agreement which covers both short-term and long-term borrowings. Long-term borrowings consisted of the following fixed rate, long term advances as of March 31, 2009 and December 31, 2008 (in thousands):

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| Due by March 31 | 2009 Advance Amount | Weighted Average Rate | Due by December 31 | 2008 Advance Amount | Weighted Average Rate |
|---|---|---|---|---|---|
| 2010 | $ 5,000 | 5.26% | 2009 | $ 5,000 | 5.26% |
| 2011 | 4,000 | 2.92 | 2011 | 8,000 | 2.93 |
| 2012 | 4,000 | 2.93 | 2014 | 787 | 3.78 |
| 2014 | 750 | 3.78 | | $ 13,787 | 3.82% |
| | $ 13,750 | 3.82% | | | |

Note 9 – Trust Preferred Capital Notes

On April 7, 2006, AMNB Statutory Trust I, a Delaware statutory trust and a newly formed, wholly owned subsidiary of the Company, issued $20,000,000 of preferred securities in a private placement pursuant to an applicable exemption from registration. The Trust Preferred Securities mature on June 30, 2036, but may be redeemed at the Company's option beginning on June 30, 2011. The securities require quarterly distributions by the Trust to the holder of the Trust Preferred Securities at a fixed rate of 6.66%. Effective June 30, 2011, the rate will reset quarterly at the three-month LIBOR plus 1.35%. Distributions are cumulative and will accrue from the date of original issuance, but may be deferred by the Company from time to time for up to twenty consecutive quarterly periods. The Company has guaranteed the payment of all required distributions on the Trust Preferred Securities.

The proceeds of the Trust Preferred Securities received by the Trust, along with proceeds of $619,000 received by the Trust from the issuance of common securities by the Trust to the Company, were used to purchase $20,619,000 of the Company's junior subordinated debt securities (the "Trust Preferred Capital Notes"), issued pursuant to a Junior Subordinated Indenture entered into between the Company and Wilmington Trust Company, as trustee. The proceeds of the Trust Preferred Capital Notes were used to fund the cash portion of the merger consideration to the former shareholders of Community First in connection with the Company's acquisition of that company, and for general corporate purposes. 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 AMNB Statutory Trust I. Instead, the Corporation reflected this equity investment in the "Accrued interest receivable and other assets" line item in the consolidated balance sheets.

Note 10 – Stock Based Compensation

A summary of stock option transactions for the three months ended March 31, 2009, is as follows:

| | Option Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Average Intrinsic Value ($000) |
|---|---|---|---|---|
| Outstanding at December 31, 2008 | 218,610 | $ 20.31 | | |
| Granted | - | - | | |
| Exercised | (1,133) | 14.29 | | |
| Forfeited | (10,000) | 22.94 | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Outstanding at March 31, 2009 | 207,477 | $ | 20.22 | 5.2 | $ | 47 |
| Exercisable at March 31, 2009 | 163,227 | $ | 21.09 | 3.9 | $ | 47 |

The total intrinsic value of options exercised during the three month period ended March 31, 2009 was $2,000.

There were 59,000 options granted in the fourth quarter of 2008, which resulted in $15,000 compensation expense in the first quarter of 2009. $161,000 remains to be expensed in future periods. No other options were granted in 2008 or 2007. There was no tax benefit associated with stock option activity during 2009, 2008, or 2007. Under SFAS No. 123R, “Share-Based Payment” a company may only recognize tax benefits for stock options that ordinarily will result in a tax deduction when the option is exercised (“non-statutory” options). The Company has no non-statutory stock options.

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Note 11 – Earnings Per Share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of potentially dilutive common stock. Potentially dilutive common stock had no effect on income available to common shareholders.

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | | | 2008 | | |
| | Shares | | Per Share Amount | Shares | | Per Share Amount |
| Basic | 6,081,998 | $ | .13 | 6,107,832 | $ | .38 |
| Effect of dilutive securities - stock options | 3,459 | | - | 13,453 | | - |
| Diluted | 6,085,457 | $ | .13 | 6,121,285 | $ | .38 |

Stock options on common stock which were not included in computing diluted earnings per share for the three month periods ended March 31, 2009 and 2008, because their effects were antidilutive, averaged 138,511 and 93,027, respectively.

Note 12 – Employee Benefit Plans

Following is information pertaining to the Company's non-contributory defined benefit pension plan.

| Components of Net Periodic Benefit Cost (in thousands) | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | | 2009 | | 2008 |
| Service cost | $ | 184 | $ | 181 |
| Interest cost | | 146 | | 128 |
| Expected return on plan assets | | (203) | | (164) |
| Recognized net actuarial loss | | 111 | | 28 |
| | | | | |
| Net periodic benefit cost | $ | 238 | $ | 173 |

The Company's anticipated contribution for 2009 is $481,000.

Note 13 – Segment and Related Information

In accordance with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, reportable segments include community banking and trust and investment services.

Community banking involves making loans to and generating deposits from individuals and businesses. All assets and liabilities of the Company are allocated to community banking. Investment income from securities is also allocated to the community banking segment. Loan fee income, service charges from deposit accounts, and non-deposit fees such as automatic teller machine fees and insurance commissions generate additional income for community banking.

Trust and investment services include estate planning, trust account administration, investment management, and retail brokerage. Investment management services include purchasing equity, fixed income, and mutual fund investments for customer accounts. The trust and investment services division receives fees for investment and administrative services. Fees are also received by this division for individual retirement accounts managed for the community banking segment.

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Amounts shown in the “Other” column include activities of American National Bankshares Inc. and its subsidiary, AMNB Statutory Trust I. Refer to Note 1 for additional information on the Trust. The “Other” column also includes corporate items, results of insignificant operations and, as it relates to segment profit (loss), income and expense not allocated to reportable segments. Intersegment eliminations primarily consist of American National Bankshares Inc.’s investment in American National Bank and Trust Company and related equity earnings.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. All intersegment sales prices are market based.

Segment information as of and for the three month periods ended March 31, 2009 and 2008, is shown in the following table.

Three Months Ended March 31, 2009

| (in thousands) | Community Banking | Trust and Investment Services | Other | Intersegment Eliminations | Total |
|---|---|---|---|---|---|
| Interest income | $ 9,650 | $ - | $ 80 | $ (80) | $ 9,650 |
| Interest expense | 2,974 | - | 343 | $ (80) | 3,237 |
| Noninterest income | (93) | 815 | 12 | - | 734 |
| Operating income before income taxes | 955 | 294 | (327) | - | 922 |
| Depreciation and amortization | 425 | 6 | 1 | - | 432 |
| Total assets | 828,714 | - | 764 | | 829,478 |
| Capital expenditures | 1,181 | 8 | - | - | 1,189 |

Three Months Ended March 31, 2008

| (in thousands) | Community Banking | Trust and Investment Services | Other | Intersegment Eliminations | Total |
|---|---|---|---|---|---|
| Interest income | $ 11,260 | $ - | $ - | $ - | $ 11,260 |
| Interest expense | 4,192 | - | 343 | - | 4,535 |
| Noninterest income | 1,096 | 1,023 | 16 | - | 2,135 |
| Operating income before income taxes | 3,111 | 566 | (406) | - | 3,271 |
| Depreciation and amortization | 440 | 6 | 1 | - | 447 |
| Total assets | 784,257 | - | 792 | | 785,049 |
| Capital expenditures | 397 | - | - | - | 397 |

Note 14 – Fair Value of Financial Instruments

The Company adopted SFAS No. 157, Fair Value Measurements, on January 1, 2008 to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. SFAS 157 clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

In October of 2008, the FASB issued FSP 157-3 to clarify the application of SFAS 157 in a market that is not active and to provide key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 was effective upon issuance, including prior periods for which financial statements were not issued.

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SFAS 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy under SFAS 157 based on these two types of inputs are as follows:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that considers observable market data (Level 2). Federal Reserve Bank and Federal Home Loan Bank stocks are carried at cost since no ready market exists and there is no quoted market value. The Company is required to own stock in these companies as long as it is a member. Therefore, they have been excluded from the table below.

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2009 (in thousands):

| | | Fair Value Measurements at March 31, 2009 Using | | |
|---|---|---|---|---|
| Description | Balance as of March 31, 2009 | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| Assets | | | | |
| Securities available for sale | $ 163,954 | $ - | $ 163,954 | $ - |
| Mortgage loan derivative contracts | (1) | - | (1) | - |

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans held for sale: Loans held for sale are carried at market value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during the quarter ended March 31, 2009. Gains and losses on the sale of loans are recorded within income from mortgage banking on the Consolidated Statements of Income.

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Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

The following table summarizes the Company's financial assets that were measured at fair value on a nonrecurring basis during the period (in thousands):

| | | Carrying Value at March 31, 2009 | | |
|---|---|---|---|---|
| Description | Balance as of March 31 2009 | Quoted Prices in Active Markets for Identical Assets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| Assets | | | | |
| Loans held for sale | $ 2,782 | $ - | $ 2,782 | $ - |
| Impaired loans, net of valuation allowance | 1,349 | - | 858 | 491 |

Note 15 – Supplemental Cash Flow Information

| | Three Months Ended March 31, 2009 | 2008 |
|---|---|---|
| Supplemental Schedule of Cash and Cash Equivalents: | | |
| Cash and due from banks | $ 13,632 | $ 20,310 |
| Interest-bearing deposits in other banks | 18,188 | 4,218 |
| | | |
| | $ 31,820 | $ 24,528 |
| | | |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash paid for: | | |
| Interest on deposits and borrowed funds | $ 3,286 | $ 4,598 |
| Income taxes | - | 72 |
| Noncash investing and financing activities: | | |

| | | |
|---|---|---|
| Transfer of loans to other real estate owned | 382 | - |
| Unrealized loss on securities available for sale | 517 | 1,349 |

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ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this discussion is to focus on important factors affecting the financial condition and results of operations of the Company.  The discussion and analysis should be read in conjunction with the Consolidated Financial Statements.

Forward-Looking Statements

This report contains forward-looking statements with respect to the financial condition, results of operations and business of American National Bankshares Inc. and its wholly owned subsidiary, American National Bank and Trust Company (the”Bank”) (collectively referred to as the “Company”).  These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Company and on information available to management at the time these statements and disclosures were prepared.  Forward-looking statements are subject to numerous assumptions, estimates, risks, and uncertainties that could cause actual conditions, events, or results to differ materially fro those stated or implied by such forward-looking statements.

A variety of factors may affect the operations, performance, business strategy, and results of the Company.  Those factors include but are not limited to the following:

- Financial market volatility including the level of interest rates could affect the values of financial instruments and the amount of net interest income earned;
- General economic or business conditions, either nationally or in the market areas in which the Company does business, may be less favorable than expected, resulting in deteriorating credit quality, reduced demand for credit, or a weakened ability to generate deposits;
- Competition among financial institutions may increase and competitors may have greater financial resources and develop products and technology that enable those competitors to compete more successfully than the Company;
- Businesses that the Company is engaged in may be adversely affected by legislative or regulatory changes, including changes in accounting standards;
- The ability to retain key personnel; and
- The failure of assumptions underlying the allowance for loan losses.

Reclassification

In certain circumstances, reclassifications have been made to prior period information to conform to the 2009 presentation.

Critical Accounting Policies

The accounting and reporting policies followed by the Company conform with U.S. generally accepted accounting principles (“GAAP”) and they conform to general practices within the banking industry.  The Company’s critical accounting policies, which are summarized below, relate to (1) the allowance for loan losses and (2) goodwill impairment.  A summary of the Company’s significant accounting policies is set forth in Note 1 to the Consolidated Financial Statements in the Company’s 2008 Annual Report on Form 10-K.

The financial information contained within the Company’s financial statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred.  A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset, or relieving a liability. In addition, GAAP itself may change from one previously acceptable method to another method.

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Allowance for Loan Losses and Reserve for Unfunded Loan Commitments

The allowance for loan losses is an estimate of the losses inherent in the loan portfolio at the balance sheet date. The allowance is based on two basic principles of accounting: (i) Statement of Financial Accounting Standards ("SFAS") 5, Accounting for Contingencies, which requires that losses be accrued when they are probable of occurring and estimable and (ii) SFAS 114, Accounting by Creditors for Impairment of a Loan, which requires that losses on impaired loans be accrued based on the differences between the value of collateral, present value of future cash flows, or values observable in the secondary market, and the loan balance.

The Company's allowance for loan losses has three basic components: the formula allowance, the specific allowance and the unallocated allowance. Each of these components is determined based upon estimates that can and do change. The formula allowance uses a historical loss view as an indicator of future losses along with various qualitative factors, including levels and trends in delinquencies, nonaccrual loans, charge-offs and recoveries; trends in volume and terms of loans; effects of changes in underwriting standards; experience of lending staff and economic conditions; and portfolio concentrations. In the formula allowance, the historical loss rate is combined with the qualitative factors, resulting in an adjusted loss factor for each risk-grade category of loans. The adjusted loss factor is multiplied by the period-end balances for each risk-grade category. The formula allowance is calculated for a range of outcomes. The specific allowance uses various techniques to arrive at an estimate of loss for specifically identified impaired loans. The unallocated allowance includes estimated losses whose impact on the portfolio has yet to be recognized in either the formula or specific allowance. The use of these values is inherently subjective and actual losses could be greater or less than the estimates.

The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance-sheet loan commitments at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included in other liabilities.

Goodwill Impairment

The Company tests goodwill on an annual basis or more frequently if events or circumstances indicate that there may have been impairment. If the carrying amount of goodwill exceeds its implied fair value, the Company would recognize an impairment loss in an amount equal to that excess. The goodwill impairment test requires management to make judgments in determining the assumptions used in the calculations. The goodwill impairment testing conducted by the Company in 2008 indicated that goodwill is not impaired and is properly recorded in the financial statements. No events or circumstances since December 31, 2008 have occurred that would question the impairment of goodwill.

Non-GAAP Presentations

The analysis of net interest income in this document is performed on a taxable equivalent basis to facilitate performance comparisons among various taxable and tax-exempt assets.

Internet Access to Corporate Documents

The Company provides access to its Securities and Exchange Commission ("SEC") filings through a link on the Investors Relations page of the Company's web site at www.amnb.com. Reports available include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after the reports are filed electronically with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

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## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income is the difference between interest income on earning assets, primarily loans and securities, and interest expense on interest bearing liabilities, primarily deposits and other funding sources. Fluctuations in interest rates as well as volume and mix changes in earning assets and interest bearing liabilities can materially impact net interest income. The following discussion of net interest income is presented on a taxable equivalent basis to facilitate performance comparisons among various taxable and tax-exempt assets, such as certain state and municipal securities. A tax rate of 35% was used in adjusting interest on tax-exempt assets to a fully taxable equivalent basis. Net interest income divided by average earning assets is referred to as the net interest margin. The net interest spread represents the difference between the average rate earned on earning assets and the average rate paid on interest bearing liabilities.

In comparison to the first quarter of 2008, net interest income on a taxable equivalent basis decreased $328,000, or 4.7%, for the first quarter of 2009. This decrease was due primarily to reductions in interest rates. Since September 2007, the Federal Open Market Committee of the Federal Reserve Board has reduced the intended federal funds rate ten times by a total of 5.00% and, as a result, rates earned on loans fell more quickly than rates paid on deposits. The Company's net interest margin, on a fully taxable equivalent basis, was 3.61% during the first quarter of 2009, compared to 3.88% during the same quarter of 2008.

The following presentation is an analysis of net interest income and related yields and rates, on a taxable equivalent basis, for the first quarter 2009 and 2008. Nonaccrual loans are included in average balances. Interest income on nonaccrual loans, if recognized, is recorded on a cash basis or when the loan returns to accrual status.

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Net Interest Income Analysis
For the Three Months Ended March 31, 2009 and 2008
(in thousands, except rates)

| | Average Balance | | Interest Income/Expense | | Yield/Rate | |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 |
| Loans: | | | | | | |
| Commercial | $ 96,097 | $ 85,632 | $ 1,100 | $ 1,454 | 4.58% | 6.79% |
| Real estate | 469,346 | 460,429 | 6,779 | 7,789 | 5.78 | 6.77 |
| Consumer | 7,895 | 9,524 | 178 | 217 | 9.02 | 9.11 |
| Total loans | 573,338 | 555,585 | 8,057 | 9,460 | 5.62 | 6.81 |
| Securities: | | | | | | |
| Federal agencies | 45,767 | 50,064 | 521 | 597 | 4.55 | 4.77 |
| Mortgage-backed | 44,560 | 47,405 | 562 | 603 | 5.04 | 5.09 |
| State and municipal | 42,726 | 47,847 | 604 | 656 | 5.65 | 5.48 |
| Other | 5,014 | 6,383 | 33 | 99 | 2.63 | 6.20 |
| Total securities | 138,067 | 151,699 | 1,720 | 1,955 | 4.98 | 5.15 |
| Deposits in other banks | 23,575 | 10,224 | 88 | 76 | 1.49 | 2.97 |
| Total interest earning assets | 734,980 | 717,508 | 9,865 | 11,491 | 5.37 | 6.41 |
| Nonearning assets | 68,226 | 62,696 | | | | |
| Total assets | $ 803,206 | $ 780,204 | | | | |
| Deposits: | | | | | | |
| Demand | $ 112,459 | $ 107,994 | 190 | 225 | 0.68 | 0.83 |
| Money market | 64,648 | 51,320 | 198 | 294 | 1.23 | 2.29 |
| Savings | 61,289 | 63,184 | 40 | 116 | 0.26 | 0.73 |
| Time | 272,425 | 263,700 | 2,099 | 2,947 | 3.08 | 4.47 |
| Total deposits | 510,821 | 486,198 | 2,527 | 3,582 | 1.98 | 2.95 |
| Customer repurchase agreements | 56,051 | 54,624 | 233 | 451 | 1.66 | 3.30 |
| Other short-term borrowings | 2,071 | 3,091 | 3 | 33 | 0.58 | 4.27 |
| Long-term borrowings | 34,398 | 30,779 | 474 | 469 | 5.51 | 6.10 |
| Total interest bearing liabilities | 603,341 | 574,692 | 3,237 | 4,535 | 2.15 | 3.16 |
| Noninterest bearing | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| demand deposits | 93,181 | 97,212 | | | | |
| Other liabilities | 3,839 | 5,958 | | | | |
| Shareholders' equity | 102,845 | 102,342 | | | | |
| Total liabilities and shareholders' equity | $ 803,206 | $ 780,204 | | | | |
| | | | | | | |
| Interest rate spread | | | | | 3.22% | 3.25% |
| Net interest margin | | | | | 3.61% | 3.88% |
| | | | | | | |
| Net interest income (taxable equivalent basis) | | | 6,628 | 6,956 | | |
| Less: Taxable equivalent adjustment | | | 215 | 231 | | |
| Net interest income | | | $ 6,413 | $ 6,725 | | |

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Changes in Net Interest Income (Rate/Volume Analysis)
(in thousands)

| | Three months ended March 31 2009 vs. 2008 | | |
|---|---|---|---|
| | | Change Attributable to | |
| Interest income | Increase (Decrease) | Rate | Volume |
| Loans: | | | |
| Commercial | $ (354) | $ (516) | $ 162 |
| Real estate | (1,010) | (1,158) | 148 |
| Consumer | (39) | (2) | (37) |
| Total loans | (1,403) | (1,676) | 273 |
| Securities: | | | |
| Federal agencies | (76) | (26) | (50) |
| Mortgage-backed | (41) | (5) | (36) |
| State and municipal | (52) | 20 | (72) |
| Other securities | (66) | (48) | (18) |
| Total securities | (235) | (59) | (176) |
| Deposits in other banks | 12 | (51) | 63 |
| Total interest income | (1,626) | (1,786) | 160 |
| | | | |
| Interest expense | | | |
| Deposits: | | | |
| Demand | (35) | (44) | 9 |
| Money market | (96) | (160) | 64 |
| Savings | (76) | (73) | (3) |
| Time | (848) | (943) | 95 |
| Total deposits | (1,055) | (1,220) | 165 |
| Customer repurchase agreements | (218) | (229) | 11 |
| Other borrowings | (25) | (62) | 37 |
| Total interest expense | (1,298) | (1,511) | 213 |
| Net interest income | $ (328) | $ (275) | $ (53) |

Noninterest Income

Noninterest income decreased 65.6% to $734,000 in the first quarter of 2009 from $2,135,000 in the first quarter of 2008, due primarily to a $1.2 million valuation adjustment on foreclosed real estate assets. This property represents one relationship, an acquisition and development credit in the North Carolina Triad area, and constitutes over 60% of the Bank's other real estate owned.

Fees from the management of trusts, estates, and asset management accounts decreased to $758,000 in the first quarter of 2009 from $880,000 for the same period in 2008. Volatility in the financial markets negatively impacted account asset values, which offset the income from new account activity. A substantial portion of Trust fees are earned based on account values.

Service charges on deposit accounts were $502,000, a decline of $63,000 or 11.1% from the first quarter of 2008, primarily due to a drop in customer overdraft activity.

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Mortgage banking income was $286,000 in the first quarter of 2009, compared to $195,000 for the same period in 2008, an increase of $91,000 or 46.7%. This income improvement reflects the impact of historically low mortgage rates and increased refinancing activity.

Brokerage fees decreased 60.1% to $57,000 in the first quarter of 2009, from $143,000 in the first quarter of 2008, due to decreased retail investment activity.

Noninterest income

| (in thousands) | Three Months Ended March 31, 2009 | 2008 |
|---|---|---|
| Trust fees | $ 758 | $ 880 |
| Service charges on deposit accounts | 502 | 565 |
| Other fees and commissions | 242 | 203 |
| Mortgage banking income | 286 | 195 |
| Brokerage fees | 57 | 143 |
| Securities gains (losses), net | - | 30 |
| Net loss on foreclosed real estate | (1,179) | (7) |
| Bank owned life insurance | 34 | 33 |
| Check order charges | 28 | 29 |
| Investment in insurance companies | 2 | 6 |
| VISA Incentive | - | 39 |
| Other | 4 | 19 |
| | $ 734 | $ 2,135 |

Noninterest Expense

Noninterest expense was $5,875,000 for the first quarter of 2009 compared to $5,449,000 for the same period in 2008, an increase of $426,000 or 7.8%.

Salaries increased $62,000 or 2.5% in the first quarter of 2009 compared to the same period in 2008, due primarily to limited salary increases.

Employee benefits increased $66,000 or 8.8% in the first quarter of 2009 over the same period last year primarily due to increases in employee insurance expenses.

The Federal Deposit Insurance Corporation (“FDIC”) insurance assessment increased $200,000 in the first quarter of 2009 over the same period in 2008. This increase reflected the expiration of an assessment credit and the impact of industry-wide premium increases.

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Noninterest expense

| (in thousands) | Three Months Ended March 31, 2009 | 2008 |
|---|---|---|
| Salaries | $ 2,531 | $ 2,469 |
| Employee benefits | 813 | 747 |
| Occupancy and equipment | 971 | 966 |
| FDIC assessment | 217 | 17 |
| Bank franchise tax | 163 | 177 |
| Core deposit intangible amortization | 94 | 94 |
| Telephone | 115 | 101 |
| Stationery and printing supplies | 104 | 71 |
| Director fees | 65 | 49 |
| Postage | 58 | 76 |
| Provision for unfunded lending commitments | 55 | 42 |
| ATM and VISA network fees | 55 | 74 |
| Trust services contracted | 51 | 50 |
| Internet banking fees | 51 | 49 |
| Legal | 49 | 34 |
| Regulatory assessments | 46 | 44 |
| Advertising and marketing | 43 | 47 |
| Auditing | 40 | 38 |
| Other | 354 | 304 |
| | $ 5,875 | $ 5,449 |

Income Taxes

The effective tax rate for the first quarter of 2009 was 16.7% compared to 29.5% for the same period of 2008. The effective tax rate is lower than the statutory rate primarily due to income that is not taxable for Federal income tax purposes. The primary non-taxable income is that of state and municipal securities and industrial revenue bonds or loans.

Impact of Inflation and Changing Prices

The majority of assets and liabilities of a financial institution are monetary in nature and therefore differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. The most significant effect of inflation is on noninterest expense that tend to rise during periods of inflation. Changes in interest rates have a greater impact on a financial institution’s profitability than do the effects of higher costs for goods and services. Through its balance sheet management practices, the Company has the ability to react to those changes and measure and monitor its interest rate and liquidity risk.

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BALANCE SHEET ANALYSIS

Securities

The securities portfolio generates income, plays a major role in the management of interest rate sensitivity, provides a source of liquidity, and is used to meet collateral requirements. The portfolio consists primarily of high quality, investment-grade securities. Federal agency, mortgage-backed, and state and municipal securities comprise the majority of the portfolio.

The available for sale securities portfolio increased to $167,981,000 at March 31, 2009 from $133,695,000 at December 31, 2008. The held to maturity securities portfolio decreased to $6,811,000 at March 31, 2009 from $7,121,000 at December 31, 2008.

At March 31, 2009, the available for sale portfolio had an estimated fair value of $167,981,000 and an amortized cost of $164,350,000, resulting in a net unrealized gain of $3,631,000.At the same date, the held to maturity portfolio had an estimated fair value of $7,078,000 and an amortized cost of $6,811,000, resulting in a net unrealized gain of $267,000.

At March 31, 2009, mortgage-backed securities consist principally of obligations of U.S. Government agencies and sponsored entities. Mortgage-backed securities issued by non-U.S. Government agencies and sponsored entities as of March 31, 2009, had an amortized cost of $3,039,000 and an estimated fair value of $2,500,000; resulting in an estimated net unrealized loss of $539,000.

Loans

The loan portfolio consists primarily of commercial and residential real estate loans, commercial loans, construction and land development loans, and home equity loans. Loans decreased to $569,003,000 at March 31, 2009 from $571,110,000 at December 31, 2008, a decline of $2,107,000 or 0.37%.

Allowance for Loan Losses, Asset Quality, and Credit Risk Management

The allowance for loan losses was virtually unchanged at $7,836,000 at March 31, 2009 compared to $7,824,000 at December 31, 2008. The allowance was 1.38% of loans at the end of the first quarter 2009 compared to 1.37% at year-end. Annualized net charge-offs represented 0.24% of total loans during the first quarter of 2009.

Nonperforming loans include loans on which interest is no longer accrued, accruing loans that are contractually past due 90 days or more as to principal and interest payments, and any loans classified as troubled debt restructurings. Nonperforming assets include nonperforming loans and foreclosed real estate. Nonperforming loans represented 0.50% of total loans at March 31, 2009 and December 31, 2008. There were no troubled debt restructurings at March 31, 2009 or December 31, 2008.

The following table summarizes nonperforming assets (in thousands):

| | March 31, 2009 | December 31, 2008 |
|---|---|---|
| Loans 90 days or more past due | $ - | $ - |
| Nonaccrual loans | 2,821 | 2,845 |
| Nonperforming loans | 2,821 | 2,845 |

| | | | | |
|---|---|---|---|---|
| Foreclosed real estate | | 3,345 | | 4,311 |
| Nonperforming assets | $ | 6,166 | $ | 7,156 |

Deposits

The Company's deposits consist primarily of checking, money market, savings, and consumer time deposits. Deposits increased to $615,888,000 at March 31, 2009 from $589,138,000 at December 31, 2008, an increase of $26,750,000 or 4.5%. Of this increase approximately $21.6 million represents brokered deposits obtained in mid-quarter. $5 million of the proceeds were used to pay off an advance from the Federal Home Loan Bank of Atlanta; the remaining funds were used for general liquidity purposes. Management anticipates that three quarters of these funds will mature by year end and the Bank does not plan for them to be renewed. Core deposit growth continues to be an ongoing challenge for the community banking industry.

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Shareholders' Equity

The Company's capital management strategy is to be classified as "well capitalized" under regulatory capital ratios and provide as high as possible total return to our shareholders.

Shareholders' equity decreased to $101,915,000 at March 31, 2009 from $102,300,000 at December 31, 2008. The decrease was largely the result of dividends paid during the quarter being larger than net income during the quarter. In the first quarter of 2009, the Company declared and paid a quarterly cash dividend of $.23 per share.

Banking regulators have defined minimum regulatory capital ratios that the Company and its banking subsidiary are required to maintain. These ratios take into account risk factors identified by those regulatory authorities associated with the assets and off-balance sheet activities of financial institutions. The guidelines require percentages, or "risk weights," be applied to those assets and off-balance sheet assets in relation to their perceived risk. Under the guidelines, capital strength is measured in two tiers. Tier I capital consists primarily of shareholders' equity and trust preferred capital notes, while Tier II capital consists of qualifying allowance for loan losses. "Total" capital is the combination of Tier I and Tier II capital. Another regulatory indicator of capital adequacy is the leverage ratio, which is computed by dividing Tier I capital by average quarterly assets less intangible assets.

The regulatory guidelines require that minimum total capital (Tier I plus Tier II) of 8% be held against total risk-adjusted assets, at least half of which (4%) must be Tier I capital. At March 31, 2009, the Company's Tier I and total capital ratios were 16.23% and 17.48%, respectively. At December 31, 2008, these ratios were 16.67% and 17.92%, respectively. The ratios for both periods were in excess of the regulatory requirements. The Company's leverage ratio was 12.66% and 13.04% at March 31, 2009 and December 31, 2008, respectively. The leverage ratio has a regulatory minimum of 4%, with most institutions required to maintain a ratio of 4-5%, depending upon risk profiles and other factors.

As mandated by bank regulations, the following five capital categories are identified for insured depository institutions: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." These regulations require the federal banking regulators to take prompt corrective action with respect to insured depository institutions that do not meet minimum capital requirements. Under the regulations, well capitalized institutions must have Tier I risk-based capital ratios of at least 6%, total risk-based capital ratios of at least 10%, and leverage ratios of at least 5%, and not be subject to capital directive orders. Management believes, as of March 31, 2009, that the Company met the requirements to be considered "well capitalized

Off-Balance-Sheet Activities

The Company enters into certain financial transactions in the ordinary course of performing traditional banking services that result in off-balance sheet transactions. Other than AMNB Statutory Trust I, formed in 2006 to issue Trust Preferred Securities, the Company does not have any off-balance sheet subsidiaries. Off-balance sheet transactions were as follows (in thousands):

| | March 31, 2009 | December 31, 2008 |
|---|---|---|
| Commitments to extend credit | $ 145,667 | $ 146,399 |
| Standby letters of credit | 2,565 | 2,858 |
| Mortgage loan rate-lock commitments | 2,783 | 2,031 |

Commitments to extend credit to customers represent legally binding agreements with fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future funding requirements. Standby letters of credit are conditional commitments issued by the Company guaranteeing the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk Management

Effectively managing market risk is essential to achieving the Company’s financial objectives. Market risk reflects the risk of economic loss resulting from changes in interest rates and market prices. The Company is not subject to currency exchange risk or commodity price risk. The Company’s primary market risk exposure is interest rate risk; however, market risk also includes liquidity risk. Both are discussed below.

Interest Rate Risk Management

Interest rate risk and its impact on net interest income is a primary market risk exposure. The Company manages its exposure to fluctuations in interest rates through policies approved by its Asset/Liability Investment Committee (“ALCO”) and Board of Directors, both of which receive and review periodic reports of the Company’s interest rate risk position.

The Company uses simulation analysis to measure the sensitivity of projected earnings to changes in interest rates. Simulation takes into account current balance sheet volumes and the scheduled repricing dates and maturities of assets and liabilities. It incorporates numerous assumptions including growth, changes in the mix of assets and liabilities, prepayments, and average rates earned and paid. Based on this information, management uses the model to project net interest income under multiple interest rate scenarios.

A balance sheet is considered asset sensitive when its earning assets (loans and securities) reprice fastert than its liabilities (deposits and borrowings). An asset sensitive balance sheet will produce more net interest income when interest rates rise and less net interest income when they decline. Based on the Company’s simulation analysis, management believes the Company’s interest sensitivity position is asset sensitive.

Liquidity Risk Management

Liquidity is the ability of the Company to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining the Company’s ability to meet the daily cash flow requirements of its customers, whether they are borrowers requiring funds to meet their credit needs or depositors desiring to withdraw funds. Additionally, the parent company requires cash for various operating needs including dividends to shareholders, stock repurchases, the servicing of debt, and the payment of general corporate expenses. The Company manages its exposure to fluctuations in interest rates through policies approved by the ALCO and Board of Directors, both of which receive periodic reports of the Company’s interest rate risk position. The Company uses a simulation and budget model to manage the future liquidity needs of the Company.

Liquidity sources include cash and amounts due from banks, deposits in other banks, loan repayments, increases in deposits, lines of credit from the Federal Home Loan Bank of Atlanta (“FHLB”) and the Federal Reserve Bank’s discount window, federal funds lines of credit from two correspondent banks, and maturities and sales of securities. Management believes that these sources provide sufficient and timely liquidity.

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The Company has a line of credit with the FHLB, equal to 30% of the Company's assets, subject to the amount of collateral pledged. Under the terms of its collateral agreement with the FHLB, the Company provides a blanket lien covering all of its residential first mortgage loans and home equity lines of credit. In addition, the Company pledges as collateral its capital stock in and deposits with the FHLB. At March 31, 2009, principal obligations to the FHLB consisted of $12,440,000 in floating-rate, overnight borrowings and $13,750,000 in fixed-rate, long-term advances. FHLB borrowings were $21,637,000 at December 31, 2008, consisting of $7,850,000 in floating-rate, overnight borrowings and $13,787,000 in fixed-rate, long-term advances.

The Company had fixed-rate term borrowing contracts with the FHLB as of March 31, 2009, with the following final maturities (in thousands):

| Amount | Expiration Date |
|---|---|
| $ 5,000,000 | April 2009 |
| 4,000,000 | March 2011 |
| 4,000,000 | April 2011 |
| 750,000 | March 2014 |
| $ 13,750,000 | |

The Company has federal funds lines of credit established with two other banks in the amounts of $15,000,000 and $10,000,000, and has access to the Federal Reserve Bank's discount window. There were no amounts outstanding under these facilities at March 31, 2009.

There have been no material changes to market risk as disclosed in the Company's 2008 Annual Report on Form 10-K. Refer to those disclosures for further information.

## ITEM 4. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

The Company's management, including the Chief Executive Officer and Chief Financial Officer, evaluated the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934), as amended (the "Exchange Act") as of March 31, 2009. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms. There were no significant changes in the Company's internal controls over financial reporting that occurred during the quarter ended March 31, 2009 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

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PART II

OTHER INFORMATION

Item:

1. Legal Proceedings

The nature of the business of the Company ordinarily results in a certain amount of litigation. The Company is involved in various legal proceedings, all of which are considered incidental to the normal conduct of business. Management believes that these proceedings will not have a material adverse effect on the consolidated financial position or consolidated results of operations of the Company.

1A. Risk Factors

There have been no material changes to the risk factors disclosed in the Company's 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2009.

2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchases Made for the Quarter Ended March 31, 2009

| Dates | Total Number of Shares Purchased | Average Price Paid Per share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Number of Shares that May Yet Be Purchased Under the Program |
|---|---|---|---|---|
| January 1–31 | 2,500 | $ 16.25 | 2,500 | 87,250 |
| February 1-28 | 2,600 | 15.76 | 2,600 | 84,650 |
| March 1-31 | 2,500 | 15.75 | 2,500 | 82,150 |

On August 19, 2008, the Company's board of directors approved the extension of its stock repurchase plan, begun in 2000, to include the repurchase of up to 100,000 shares of the Company's common stock between August 20, 2008 and August 18, 2009. The stock may be purchased in the open market or in privately negotiated transactions as management determines to be in the best interest of the Company.

3. Defaults Upon Senior Securities

None

4. Submission of Matters to a Vote of Security Holders

None

5. Other Information

(a) Required 8-K disclosures

None

(b) Changes in Nominating Process

None

6. Exhibits

| | |
|---|---|
| 11. | Refer to EPS calculation in the Notes to Financial Statements |
| 31.1 | Section 302 Certification of Charles H. Majors, President and Chief Executive Officer |
| 31.2 | Section 302 Certification of William W. Traynham, Senior Vice President and Chief Financial Officer |
| 32.1 | Section 906 Certification of Charles H. Majors, President and Chief Executive Officer |
| 32.2 | Section 906 Certification of William W. Traynham, Senior Vice President and Chief Financial Officer |

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AMERICAN NATIONAL BANKSHARES INC.

| | |
|---|---|
| | /s/ Charles H. Majors<br>Charles H. Majors |
| Date – May 8, 2009 | President and Chief Executive Officer |
| | /s/ William W. Traynham<br>William W. Traynham<br>Senior Vice President and |
| Date – May 8, 2009 | Chief Financial Officer |