

AMERICAN NATIONAL BANKSHARES INC
Form 10-Q
November 08, 2007

**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 **September 30, 2007.**

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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

At November 7, 2007, the Company had 6,115,125 shares Common Stock outstanding, \$1 par value.

AMERICAN NATIONAL BANKSHARES INC.

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American National Bankshares Inc. and Subsidiary
Consolidated Balance Sheets
(Dollars in thousands)

	(Unaudited) September 30 2007	(Audited) December 31 2006
ASSETS		
Cash and due from banks	\$ 20,016	\$ 24,375
Interest bearing deposits in other banks	24	1,749
Securities available for sale, at fair value	136,270	148,748
Securities held to maturity (fair value of \$12,220 in 2007 and \$14,131 in 2006)	12,009	13,873
Total securities	148,279	162,621
Loans held for sale	375	1,662
Loans, net of unearned income	554,002	542,228
Less allowance for loan losses	(7,334)	(7,264)
Net loans	546,668	534,964
Bank premises and equipment, at cost, less accumulated depreciation of \$15,592 in 2007 and \$14,755 in 2006	13,197	12,438
Goodwill	22,468	22,468
Core deposit intangibles, net	2,546	2,829
Accrued interest receivable and other assets	13,981	14,614
Total assets	\$ 767,554	\$ 777,720
LIABILITIES and SHAREHOLDERS' EQUITY		
Liabilities:		
Demand deposits -- noninterest bearing	\$ 105,014	\$ 106,885
Demand deposits -- interest bearing	105,004	107,170
Money market deposits	52,271	50,948
Savings deposits	63,565	69,517
Time deposits	260,300	274,008
Total deposits	586,154	608,528
Repurchase agreements	48,665	33,368
FHLB borrowings	8,975	15,087
Trust preferred capital notes	20,619	20,619
Accrued interest payable and other liabilities	3,807	5,126
Total liabilities	668,220	682,728

Shareholders' equity:		
Preferred stock, \$5 par, 200,000 shares authorized, none outstanding	-	-
Common stock, \$1 par, 10,000,000 shares authorized, 6,121,325 shares outstanding at September 30, 2007 and 6,161,865 shares outstanding at December 31, 2006	6,121	6,162
Capital in excess of par value	26,364	26,414
Retained earnings	68,188	64,584
Accumulated other comprehensive income (loss), net	(1,339)	(2,168)
Total shareholders' equity	99,334	94,992
Total liabilities and shareholders' equity	\$ 767,554	\$ 777,720

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

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

	Three Months Ended September 30	
	2007	2006
Interest Income:		
Interest and fees on loans	\$ 10,506	\$ 10,210
Interest and dividends on securities:		
Taxable	1,060	1,314
Tax-exempt	416	432
Dividends	75	84
Other interest income	236	111
Total interest income	12,293	12,151
Interest Expense:		
Interest on deposits	4,004	3,699
Interest on repurchase agreements	478	376
Interest on trust preferred capital notes	343	344
Interest on other borrowings	122	226
Total interest expense	4,947	4,645
Net Interest Income	7,346	7,506
Provision for loan losses	-	125
Net Interest Income After Provision for Loan Losses	7,346	7,381
Noninterest Income:		
Trust fees	861	843
Service charges on deposit accounts	631	696
Mortgage banking income	240	172
Brokerage fees	191	93
Other fees and commissions	193	194
Securities gains, net	45	9
Other	115	131
Total noninterest income	2,276	2,138
Noninterest Expense:		
Salaries	2,380	2,355
Pension and other employee benefits	779	649
Occupancy and equipment	881	775
Bank franchise tax	165	171
Other	1,174	1,167
Total noninterest expense	5,379	5,117
Income Before Income Tax Provision	4,243	4,402
Income Tax Provision	1,309	1,301
Net Income	\$ 2,934	\$ 3,101
Net Income Per Common Share:		
Basic	\$ 0.48	\$ 0.50

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Diluted	\$	0.48	\$	0.50
Average Common Shares Outstanding:				
Basic		6,132,288		6,165,268
Diluted		6,151,750		6,195,972

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

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

	Nine Months Ended September 30	
	2007	2006
Interest Income:		
Interest and fees on loans	\$ 30,993	\$ 27,255
Interest and dividends on securities:		
Taxable	3,224	3,824
Tax-exempt	1,259	1,313
Dividends	246	219
Other interest income	575	534
Total interest income	36,297	33,145
Interest Expense:		
Interest on deposits	11,647	9,544
Interest on repurchase agreements	1,353	1,020
Interest on trust preferred capital notes	1,030	664
Interest on other borrowings	498	681
Total interest expense	14,528	11,909
Net Interest Income	21,769	21,236
Provision for loan losses	303	605
Net Interest Income After Provision for Loan Losses	21,466	20,631
Noninterest Income:		
Trust fees	2,664	2,483
Service charges on deposit accounts	1,878	2,004
Mortgage banking income	759	508
Brokerage fees	439	327
Other fees and commissions	591	561
Securities gains, net	134	47
Other	454	376
Total noninterest income	6,919	6,306
Noninterest Expense:		
Salaries	7,284	6,866
Pension and other employee benefits	2,164	1,971
Occupancy and equipment	2,560	2,165
Bank franchise tax	498	481
Other	3,491	3,373
Total noninterest expense	15,997	14,856
Income Before Income Tax Provision	12,388	12,081
Income Tax Provision	3,719	3,572
Net Income	\$ 8,669	\$ 8,509
Net Income Per Common Share:		
Basic	\$ 1.41	\$ 1.44

Diluted	\$	1.40	\$	1.43
Average Common Shares Outstanding:				
Basic		6,146,349		5,926,599
Diluted		6,171,243		5,960,556

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

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American National Bankshares Inc. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
 Nine Months Ended September 30, 2007 and 2006
 (Unaudited) (Dollars in thousands)

	Common Stock		Capital in Excess of Par Value	Retained Earnings	Accumulated	
	Shares	Amount			Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2005	5,441,758	\$ 5,442	\$ 9,588	\$ 59,109	\$ (720)	\$ 73,419
Net income	-	-	-	8,509	-	8,509
Change in unrealized losses on securities available for sale, net of tax of \$ (53)	-	-	-	-	(65)	
Less: Reclassification adjustment for gains on securities available for sale, net of tax of \$ (16)	-	-	-	-	(31)	
Other comprehensive income (loss)					(96)	(96)
Total comprehensive income						8,413
Merger acquisition	746,944	747	16,799			17,546
Stock repurchased and retired	(34,200)	(34)	(111)	(652)	-	(797)
Stock options exercised	11,548	11	150	-	-	161
Cash dividends declared (\$.65 per share)	-	-	-	(3,854)	-	(3,854)
Balance, September 30, 2006	6,166,050	\$ 6,166	\$ 26,426	\$ 63,112	\$ (816)	\$ 94,888
	6,161,865	\$ 6,162	\$ 26,414	\$ 64,584	\$ (2,168)	94,992

Balance, December 31, 2006						
Net income	-	-	-	8,669	-	8,669
Change in unrealized gains on securities available for sale, net of tax of \$ 494	-	-	-	-	916	
Less: Reclassification adjustment for gains on securities available for sale, net of tax of \$ (47)	-	-	-	-	(87)	
Other comprehensive income (loss)					829	829
Total comprehensive income						9,498
Stock repurchased and retired	(53,200)	(53)	(228)	(887)	-	(1,168)
Stock options exercised	12,660	12	178	-	-	190
Cash dividends declared (\$.68 per share)	-	-	-	(4,178)	-	(4,178)
Balance, September 30, 2007	6,121,325	\$ 6,121	\$ 26,364	\$ 68,188	\$ (1,339)	\$ 99,334

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

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American National Bankshares Inc. and Subsidiary
Consolidated Statements of Cash Flows
 Nine Months Ended September 30, 2007 and 2006
 (Dollars in thousands) (Unaudited)

	2007	2006
Cash Flows from Operating Activities:		
Net income	\$ 8,669	\$ 8,509
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	303	605
Depreciation	855	709
Core deposit intangible amortization	283	307
Accretion of purchase accounting adjustments	-	(200)
Net (accretion) of bond premiums and discounts	(118)	(7)
Net gain on sale or call of securities	(134)	(47)
Gain on loans held for sale	(583)	(306)
Proceeds from sales of loans held for sale	28,202	12,264
Originations of loans held for sale	(26,332)	(12,402)
Net gain on foreclosed real estate	(6)	(10)
Change in valuation allowance for foreclosed real estate	-	9
Gain on sale of premises and equipment	(9)	-
Deferred income tax expense	52	19
Change in interest receivable	(257)	(904)
Change in other assets	924	(938)
Change in interest payable	(51)	337
Change in other liabilities	(1,268)	(1,452)
Net cash provided by operating activities	10,530	6,493
Cash Flows from Investing Activities:		
Proceeds from sales of securities available for sale	1,061	460
Proceeds from maturities and calls of securities available for sale	39,934	43,828
Proceeds from maturities and calls of securities held to maturity	1,864	4,162
Purchases of securities available for sale	(26,989)	(44,531)
Net change in loans	(12,505)	3,676
Proceeds from sale of bank property and equipment	25	-
Purchases of bank property and equipment	(1,630)	(634)
Proceeds from sales of foreclosed real estate	30	212
Increase in foreclosed real estate	(59)	-
Net cash paid in merger acquisition	-	(14,634)
Net cash provided by (used in) investing activities	1,731	(7,461)
Cash Flows from Financing Activities:		
Net change in demand, money market, and savings deposits	(8,666)	(9,235)
Net change in time deposits	(13,708)	(21,134)

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Net change in repurchase agreements	15,297	(51)
Net change in borrowings	(6,112)	33,381
Cash dividends paid	(4,178)	(3,854)
Repurchase of stock	(1,168)	(797)
Proceeds from exercise of stock options	190	161
Net cash used in financing activities	(18,345)	(1,529)
Net Decrease in Cash and Cash Equivalents	(6,084)	(2,497)
Cash and Cash Equivalents at Beginning of Period	26,124	27,354
Cash and Cash Equivalents at End of Period	\$ 20,040	\$ 24,857

Supplemental Schedule of Cash and Cash Equivalents:

Cash and due from banks	\$ 20,016	\$ 24,390
Interest bearing deposits in other banks	24	467
	\$ 20,040	\$ 24,857

Supplemental Disclosure of Cash Flow Information:

Interest paid	\$ 14,578	\$ 10,589
Income taxes paid	2,379	2,651
Transfer of loans to other real estate owned	498	115
Unrealized gain (loss) on securities available for sale	1,276	(165)

Merger acquisition		
Fair value of assets acquired	-	175,423
Fair value of common stock issued	-	(17,546)
Cash paid	-	(17,087)
Liabilities assumed	-	140,790

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

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**AMERICAN NATIONAL BANKSHARES INC. AND SUBSIDIARY
NOTES TO FINANCIAL STATEMENTS**

Note 1 – Basis of Presentation

The consolidated financial statements include the amounts and results of operations of American National Bankshares Inc. and its wholly owned subsidiary, American National Bank and Trust Company (collectively referred to as the “Company”).

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 September 30, 2007; the consolidated statements of income for the three months and nine months ended September 30, 2007 and 2006; the consolidated statements of changes in shareholders’ equity for the nine months ended September 30, 2007 and 2006; and the consolidated statements of cash flows for the nine months ended September 30, 2007 and 2006. Operating results for the nine month period ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. Certain reclassifications have been made to prior period balances to conform to the current period presentation. The 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, 2006.

Note 2 - Securities

The amortized cost and estimated fair value of investments in debt and equity securities at September 30, 2007 and December 31, 2006 were as follows:

(in thousands)	September 30, 2007			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Debt securities:				
Federal agencies	\$ 67,898	\$ 401	\$ 147	\$ 68,152
Mortgage-backed	27,034	215	173	27,076
State and municipal	34,569	152	336	34,385
Corporate	1,485	-	54	1,431
Equity securities:				
FHLB stock – restricted	1,851	-	-	1,851
Federal Reserve stock - restricted	1,429	-	-	1,429
FNMA and FHLMC preferred stock	1,716	136	-	1,852
Other	94	-	-	94
Total securities available for sale	136,076	904	710	136,270
Securities held to maturity:				
Mortgage-backed	328	8	-	336
State and municipal	11,681	224	21	11,884

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Total securities held to maturity	12,009	232	21	12,220
Total securities	\$ 148,085	\$ 1,136	\$ 731	\$ 148,490
December 31, 2006				
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Debt securities:				
Federal agencies	\$ 88,106	\$ 40	\$ 819	\$ 87,327
Mortgage-backed	19,225	104	353	18,976
State and municipal	33,608	168	423	33,353
Corporate	2,490	3	56	2,437
Equity securities:				
FHLB stock - restricted	2,248	-	-	2,248
Federal Reserve stock - restricted	1,429	-	-	1,429
FNMA and FHLMC preferred stock	2,643	254	-	2,897
Other	81	-	-	81
Total securities available for sale	149,830	569	1,651	148,748
Securities held to maturity:				
Federal agencies	1,001	-	12	989
Mortgage-backed	385	9	-	394
State and municipal	12,487	291	30	12,748
Total securities held to maturity	13,873	300	42	14,131
Total securities	\$ 163,703	\$ 869	\$ 1,693	\$ 162,879

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The following table shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2007.

(in thousands)	Total		Less than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Federal agencies	\$ 29,826	\$ 147	\$ 4,994	\$ -	\$ 24,832	\$ 147
Mortgage-backed	8,206	173	60	1	8,146	172
State and municipal	25,827	357	1,581	8	24,246	349
Corporate	1,431	54	-	-	1,431	54
Total	\$ 65,290	\$ 731	\$ 6,635	\$ 9	\$ 58,655	\$ 722

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 any anticipated recovery in fair value. The unrealized losses are attributable to interest rate changes and not credit concerns of the issuer. The Company has the intent and ability to hold these securities for the time necessary to recover the amortized cost. As of September 30, 2007, the Company held 110 securities that had been in a continuous unrealized loss position for twelve months or more.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities had been in a continuous unrealized loss position at December 31, 2006.

(in thousands)	Total		Less than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Federal agencies	\$ 72,091	\$ 831	\$ 21,439	\$ 113	\$ 50,652	\$ 718
Mortgage-backed	11,091	353	242	2	10,849	351
State and municipal	25,310	453	3,784	51	21,526	402
Corporate	1,429	56	-	-	1,429	56
Total	\$ 109,921	\$ 1,693	\$ 25,465	\$ 166	\$ 84,456	\$ 1,527

Note 3 - Loans

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

(in thousands)	September 30, 2007	December 31, 2006
Construction and land development	\$ 69,476	\$ 69,404
Commercial real estate	205,048	186,639

Residential real estate	133,476	131,126
Home equity	46,671	52,531
Total real estate	454,671	439,700

Commercial and industrial	88,638	91,511
Consumer	10,693	11,017
Total loans	\$ 554,002	\$ 542,228

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

(in thousands)	September 30, 2007	December 31, 2006
Impaired loans without a valuation allowance	\$ 1,301	\$ 472
Impaired loans with a valuation allowance	1,754	904
Total impaired loans	\$ 3,055	\$ 1,376
Allowance provided for impaired loans, included in the allowance for loan losses	\$ 1,159	\$ 241
Nonaccrual loans excluded from the impaired loan disclosure	\$ 1,152	\$ 2,311

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(in thousands)	As of and for the Three Months Ended September 30 2007	As of and for the Nine Months Ended September 30 2007	As of and for the Three Months Ended September 30 2006	As of and for the Nine Months Ended September 30 2006
Average balance in impaired loans	\$ 3,821	\$ 2,566	\$ 1,896	\$ 2,871
Interest income recognized on impaired loans	\$ 64	\$ 171	\$ 5	\$ 36
Interest income recognized on nonaccrual loans	\$ -	\$ -	\$ -	\$ 49
Interest on nonaccrual loans had they been accruing	\$ 28	\$ 176	\$ -	\$ 251
Loans past due 90 days and still accruing interest	\$ 157	\$ 157	\$ 1,276	\$ 1,276

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

Foreclosed real estate was \$632,000 at September 30, 2007 and \$99,000 at December 31, 2006, and is included in other assets on the Consolidated Balance Sheets.

Note 4 – 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 nine months ended September 30, 2007 and 2006, and for the year ended December 31, 2006 are presented below:

(in thousands)	Nine Months Ended September 30, 2007	Year Ended December 31, 2006	Nine Months Ended September 30, 2006
Allowance for Loan Losses			
Balance, beginning of period	\$ 7,264	\$ 6,109	\$ 6,109
Allowance acquired in merger	-	1,598	1,598
Provision for loan losses	303	58	605
Charge-offs	(431)	(913)	(465)
Recoveries	198	412	323
Balance, end of period	\$ 7,334	\$ 7,264	\$ 8,170

**Reserve for unfunded
lending commitments**

Balance, beginning of period	\$	128	-	\$	-
Provision for unfunded commitments		(20)	123		-
Balance, end of period	\$	108	\$	123	\$

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

Note 5 – Goodwill and Other Intangible Assets

In January 2002, the Company adopted Statement of Financial Accounting Standard (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-based test. A fair value-based test was performed during the third quarter of 2007 that determined the market value of the company 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 September 30, 2007, are as follows (in thousands):

Balance as of January 1, 2007	\$ 22,468
Goodwill recorded during the period	-
Impairment losses	-
Balance as of September 30, 2007	\$ 22,468

Core deposit intangibles resulting from the acquisition of Community First Financial Corporation on April 1, 2006 were \$3,112,000 and are being amortized over 99 months.

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On April 7, 2006, AMNB Statutory Trust I, a Delaware statutory trust (the “Trust”) and a newly formed, wholly owned subsidiary of the Company, issued \$20,000,000 of preferred securities (the “Trust 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 Trust Preferred 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 (the “Trust 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 (the “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 Financial Corporation in connection with the Company’s acquisition of that company, and for general corporate purposes.

Note 7 – Stock Based Compensation

The Company maintained a stock option plan until its expiration on December 31, 2006, which provided for the granting of incentive and non-statutory options to employees on a periodic basis. The existing stock options are still covered by the plan although the plan expired at the end of 2006. The Company’s stock options had an exercise price equal to the fair value of the stock on the date of grant. Effective January 1, 2006, the Company adopted SFAS 123R, *Share Based Payment*, using the modified prospective method and as such, results for prior periods have not been restated. SFAS 123R requires public companies to recognize compensation expense related to stock based compensation awards, such as stock options and restricted stock, in their income statements over the period during which an employee is required to provide service in exchange for such award. SFAS 123R eliminated the choice to account for employee stock options under Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*.

Prior to the implementation of SFAS 123R, the Company applied APB 25 and related interpretations in accounting for stock options. Under APB 25, no stock based compensation expense was recorded, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. There have been no stock options granted since 2004 and all options were fully vested at December 31, 2004.

There were no tax benefits associated with stock option activity during the first nine months of 2007 or 2006. Under SFAS 123R, 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.

Stock option plan activity for the nine months ended September 30, 2007 is summarized below:

Shares	Weighted Average Exercise Price	Average Remaining Contractual Life (in	Average Intrinsic Value
--------	--	---	-------------------------------

			years)	(in thousands)
Options outstanding, January 1	201,849	\$	20.36	
Granted	-		-	
Exercised	(12,660)		15.00	
Forfeited	(8,226)		14.00	
Outstanding at September 30	180,963	\$	21.02	4.5 \$ 481
Exercisable September 30	180,963		21.02	4.5 481

The total intrinsic value of options exercised during the three month and nine month periods ended September 30, 2007 was \$87,841 and \$195,991, respectively.

Index**Note 8 – 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 potential dilutive common stock. Potential dilutive common stock had no effect on income available to common shareholders.

	Three Months Ended September 30			
	2007		2006	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	6,132,288	\$.48	6,165,268	\$.50
Effect of dilutive securities (stock options)	19,462	-	30,704	-
Diluted earnings per share	6,151,750	\$.48	6,195,972	\$.50

	Nine Months Ended September 30			
	2007		2006	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	6,146,349	\$ 1.41	5,926,599	\$ 1.44
Effect of dilutive securities (stock options)	24,894	(.01)	33,957	(.01)
Diluted earnings per share	6,171,243	\$ 1.40	5,960,556	\$ 1.43

Stock options on common stock which were not included in computing diluted earnings per share for the nine month periods ended September 30, 2007 and 2006 because their effects were antidilutive averaged 88,027 and 88,227, respectively.

Note 9 – Defined Benefit Plan

Components of Net Periodic Benefit Cost (in thousands)	Three Months Ended September 30				Nine Months Ended September 30			
	2007		2006		2007		2006	
Service cost	\$	164	\$	165	\$	492	\$	456
Interest cost		104		88		314		264
Expected return on plan assets		(141)		(130)		(424)		(391)
		-		(6)		(1)		(18)

Amortization of prior service cost				
Recognized net actuarial loss	37	52	113	158
Net periodic benefit cost	\$ 164	\$ 169	\$ 494	\$ 469

The Company does not expect to make a cash contribution to the plan during 2007.

Note 10 – Segment and Related Information

In accordance with SFAS 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, and investment management. 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.

Amounts shown in the “Other” column include activities of American National Bankshares Inc. and its subsidiary, AMNB Statutory Trust I, which issued \$20,000,000 of preferred securities in 2006. Refer to Note 6 for additional information on the preferred securities. 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.

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Segment information for the three month and nine month periods ended September 30, 2007 and 2006 is shown in the following table.

Three Months Ended September 30, 2007					
	Community	Trust and		Intersegment	
	Banking	Investment	Other	Eliminations	Total
Interest income	\$ 12,293	\$ -	\$ -	\$ -	\$ 12,293
Interest expense	4,604	-	343	-	4,947
Noninterest income	1,208	1,052	16	-	2,276
Operating income before income taxes	4,117	500	(374)	-	4,243
Depreciation and amortization	379	6	1	-	386
Total assets	766,786	-	768	-	767,554
Capital expenditures	614	-	-	-	614
Three Months Ended September 30, 2006					
	Community	Trust and		Intersegment	
	Banking	Investment	Other	Eliminations	Total
Interest income	\$ 12,151	\$ -	\$ -	\$ -	\$ 12,151
Interest expense	4,645	-	-	-	4,645
Noninterest income	1,151	938	49	-	2,138
Operating income before income taxes	4,287	494	(379)	-	4,402
Depreciation and amortization	386	5	1	-	392
Total assets	791,882	-	752	-	792,634
Capital expenditures	229	-	-	-	229
Nine Months Ended September 30, 2007					
	Community	Trust and		Intersegment	
	Banking	Investment	Other	Eliminations	Total
Interest income	\$ 36,297	\$ -	\$ -	\$ -	\$ 36,297
Interest expense	13,498	-	1,030	-	14,528
Noninterest income	3,745	3,103	71	-	6,919
Operating income before income taxes	11,868	1,671	(1,151)	-	12,388
Depreciation and amortization	1,119	-	-	-	1,119