AMERICAN NATIONAL BANKSHARES INC.
Form 10-Q
May 09, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 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, 2016.

o 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 | 54-1284688 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| 628 Main Street<br>Danville, Virginia | 24541 |
|---|---|
| (Address of principal executive offices) | (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.

YesxNoo

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.

YesxNoo

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 (Do not check if a smaller reporting company)
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)
YesoNox

At May 5, 2016, the Company had 8,612,658 shares of Common Stock outstanding, $1 par value.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
American National Bankshares Inc.
Consolidated Balance Sheets
(Dollars in thousands, except per share data)

| Assets | (Unaudited) March 31, 2016 | (*) December 31, 2015 |
|---|---|---|
| Cash and due from banks | $26,345 | $19,352 |
| Interest-bearing deposits in other banks | 61,186 | 75,985 |
| | | |
| Securities available for sale, at fair value | 356,998 | 340,349 |
| Restricted stock, at cost | 5,355 | 5,312 |
| Loans held for sale | 785 | 3,266 |
| | | |
| Loans, net of unearned income | 1,034,564 | 1,005,525 |
| Less allowance for loan losses | (12,675) | (12,601) |
| Net loans | 1,021,889 | 992,924 |
| | | |
| Premises and equipment, net | 23,241 | 23,567 |
| Other real estate owned, net of valuation allowance $137 in 2016 and $329 in 2015 | 1,493 | 2,184 |
| Goodwill | 43,872 | 43,872 |
| Core deposit intangibles, net | 2,395 | 2,683 |
| Bank owned life insurance | 17,773 | 17,658 |
| Accrued interest receivable and other assets | 21,222 | 20,447 |
| Total assets | $1,582,554 | $1,547,599 |
| | | |
| Liabilities | | |
| Demand deposits -- noninterest bearing | $321,599 | $322,442 |
| Demand deposits -- interest bearing | 231,970 | 227,030 |
| Money market deposits | 218,543 | 200,495 |
| Savings deposits | 119,286 | 115,383 |
| Time deposits | 401,033 | 397,310 |
| Total deposits | 1,292,431 | 1,262,660 |
| | | |
| Customer repurchase agreements | 42,184 | 40,611 |
| Long-term borrowings | 9,963 | 9,958 |
| Junior subordinated debt | 27,648 | 27,622 |
| Accrued interest payable and other liabilities | 9,885 | 8,913 |
| Total liabilities | 1,382,111 | 1,349,764 |
| | | |
| Shareholders' equity | | |
| Preferred stock, $5 par, 2,000,000 shares authorized, none outstanding | — | — |
| Common stock, $1 par, 20,000,000 shares authorized, 8,612,658 shares outstanding at March 31, 2016 and 8,622,007 shares outstanding at December 31, 2015 | 8,575 | 8,605 |
| Capital in excess of par value | 74,744 | 75,375 |
| Retained earnings | 113,628 | 111,565 |

| | | |
|---|---|---|
| Accumulated other comprehensive income, net | 3,496 | 2,290 |
| Total shareholders' equity | 200,443 | 197,835 |
| Total liabilities and shareholders' equity | $1,582,554 | $1,547,599 |

(*) - Derived from audited consolidated financial statements.

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

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Interest and Dividend Income: | | |
| Interest and fees on loans | $12,115 | $ 11,770 |
| Interest on federal funds sold | — | 4 |
| Interest and dividends on securities: | | |
| Taxable | 1,084 | 975 |
| Tax-exempt | 823 | 960 |
| Dividends | 91 | 82 |
| Other interest income | 58 | 48 |
| Total interest and dividend income | 14,171 | 13,839 |
| Interest Expense: | | |
| Interest on deposits | 1,297 | 1,194 |
| Interest on short-term borrowings | 1 | 3 |
| Interest on long-term borrowings | 81 | 80 |
| Interest on junior subordinated debt | 208 | 184 |
| Total interest expense | 1,587 | 1,461 |
| Net Interest Income | 12,584 | 12,378 |
| Provision for Loan Losses | 50 | 600 |
| Net Interest Income After Provision for Loan Losses | 12,534 | 11,778 |
| Noninterest Income: | | |
| Trust fees | 930 | 952 |
| Service charges on deposit accounts | 492 | 497 |
| Other fees and commissions | 672 | 588 |
| Mortgage banking income | 292 | 222 |
| Securities gains, net | 366 | 310 |
| Brokerage fees | 204 | 215 |
| Income from Small Business Investment Companies | 166 | 234 |
| Other | 175 | 138 |
| Total noninterest income | 3,297 | 3,156 |
| Noninterest Expense: | | |
| Salaries | 4,215 | 4,147 |
| Employee benefits | 1,114 | 1,075 |
| Occupancy and equipment | 1,099 | 1,172 |
| FDIC assessment | 188 | 185 |
| Bank franchise tax | 256 | 235 |
| Core deposit intangible amortization | 288 | 301 |
| Data processing | 444 | 462 |
| Software | 297 | 283 |
| Other real estate owned, net | 104 | 53 |
| Merger related expense | — | 359 |
| Other | 1,913 | 1,775 |
| Total noninterest expense | 9,918 | 10,047 |
| Income Before Income Taxes | 5,913 | 4,887 |

| | | |
|---|---|---|
| Income Taxes | 1,785 | 1,372 |
| Net Income | $4,128 | $ 3,515 |
| | | |
| Net Income Per Common Share: | | |
| Basic | $0.48 | $ 0.40 |
| Diluted | $0.48 | $ 0.40 |
| Average Common Shares Outstanding: | | |
| Basic | 8,611,840 | 8,723,633 |
| Diluted | 8,617,008 | 8,732,679 |

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

American National Bankshares Inc.
Consolidated Statements of Comprehensive Income
(Dollars in thousands) (Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Net income | $4,128 | $3,515 |
| Other comprehensive income: | | |
| Unrealized gains on securities available for sale | 2,222 | 1,234 |
| Tax effect | (778 ) | (432 ) |
| Reclassification adjustment for gains on sales of securities | (366 ) | (310 ) |
| Tax effect | 128 | 109 |
| Other comprehensive income | 1,206 | 601 |
| Comprehensive income | $5,334 | $4,116 |

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

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American National Bankshares Inc.
Consolidated Statements of Changes in Shareholders' Equity
(Dollars in thousands, except per share data) (Unaudited)

| | Common Stock | Capital in Excess of Par Value | Retained Earnings | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|---|---|---|---|---|---|
| Balance, December 31, 2014 | $ 7,872 | $ 57,650 | $ 104,594 | $ 3,664 | $ 173,780 |
| Net income | — | — | 3,515 | — | 3,515 |
| Other comprehensive income | — | — | — | 601 | 601 |
| Issuance of common stock (825,586 shares) | 826 | 19,657 | — | — | 20,483 |
| Stock options exercised (9,175 shares) | 9 | 153 | — | — | 162 |
| Equity based compensation (19,461 shares) | 3 | 152 | — | — | 155 |
| Cash dividends paid, $0.23 per share | — | — | (2,007 ) | — | (2,007 ) |
| Balance, March 31, 2015 | $ 8,710 | $ 77,612 | $ 106,102 | $ 4,265 | $ 196,689 |
| Balance, December 31, 2015 | $ 8,605 | $ 75,375 | $ 111,565 | $ 2,290 | $ 197,835 |
| Net income | — | — | 4,128 | — | 4,128 |
| Other comprehensive income | — | — | — | 1,206 | 1,206 |
| Stock repurchased (38,887 shares) | (39 ) | (925 ) | — | — | (964 ) |
| Stock options exercised (2,484 shares) | 2 | 57 | — | — | 59 |
| Vesting of restricted stock (3,046 shares) | 3 | (3 ) | — | — | — |
| Equity based compensation (27,054 shares) | 4 | 240 | — | — | 244 |
| Cash dividends paid, $0.24 per share | — | — | (2,065 ) | — | (2,065 ) |
| Balance, March 31, 2016 | $ 8,575 | $ 74,744 | $ 113,628 | $ 3,496 | $ 200,443 |

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

American National Bankshares Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands) (Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Cash Flows from Operating Activities: | | |
| Net income | $4,128 | $3,515 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 50 | 600 |
| Depreciation | 475 | 440 |
| Net accretion of acquisition accounting adjustments | (1,001 ) | (1,113 ) |
| Core deposit intangible amortization | 288 | 301 |
| Net amortization of securities | 686 | 680 |
| Net gains on sale or call of securities | (366 ) | (310 ) |
| Gain on sale of loans held for sale | (233 ) | (166 ) |
| Proceeds from sales of loans held for sale | 14,131 | 9,329 |
| Originations of loans held for sale | (11,417 ) | (10,483 ) |
| Net gain (loss) on other real estate owned | 50 | (27 ) |
| Valuation allowance on other real estate owned | 53 | 22 |
| Net gain on sale of premises and equipment | (1 ) | (5 ) |
| Equity based compensation expense | 244 | 155 |
| Net change in bank owned life insurance | (115 ) | (113 ) |
| Deferred income tax benefit | (1,716 ) | (143 ) |
| Net change in interest receivable | (592 ) | 219 |
| Net change in other assets | 883 | (56 ) |
| Net change in interest payable | 8 | (1 ) |
| Net change in other liabilities | 964 | 569 |
| Net cash provided by operating activities | 6,519 | 3,413 |
| | | |
| Cash Flows from Investing Activities: | | |
| Proceeds from sales of securities available for sale | 12,867 | 3,820 |
| Proceeds from maturities, calls and paydowns of securities available for sale | 26,127 | 24,979 |
| Purchases of securities available for sale | (54,107 ) | (16,936 ) |
| Net change in restricted stock | (43 ) | (25 ) |
| Net increase in loans | (28,080 ) | (9,865 ) |
| Proceeds from sale of premises and equipment | 1 | 42 |
| Purchases of premises and equipment | (149 ) | (348 ) |
| Proceeds from sales of other real estate owned | 685 | 316 |
| Cash paid in bank acquisition | — | (5,935 ) |
| Cash acquired in bank acquisition | — | 18,173 |
| Net cash (used in) provided by investing activities | (42,699 ) | 14,221 |
| | | |
| Cash Flows from Financing Activities: | | |
| Net change in demand, money market, and savings deposits | 26,048 | 37,878 |
| Net change in time deposits | 3,723 | (8,289 ) |
| Net change in customer repurchase agreements | 1,573 | 184 |
| Net change in long-term borrowings | — | — |
| Common stock dividends paid | (2,065 ) | (2,007 ) |

| | | |
|---|---|---|
| Repurchase of common stock | (964 ) | — |
| Proceeds from exercise of stock options | 59 | 162 |
| Net cash provided by financing activities | 28,374 | 27,928 |
| | | |
| Net Increase (Decrease) in Cash and Cash Equivalents | (7,806 ) | 45,562 |
| | | |
| Cash and Cash Equivalents at Beginning of Period | 95,337 | 67,303 |
| | | |
| Cash and Cash Equivalents at End of Period | $87,531 | $112,865 |

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

AMERICAN NATIONAL BANKSHARES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Note 1 – Accounting Policies

The consolidated financial statements include the accounts of American National Bankshares Inc. (the "Company") and its wholly owned subsidiary, American National Bank and Trust Company (the "Bank"). The 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 ("GAAP") 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, goodwill and intangible assets, other than temporary impairment, the valuation of deferred tax assets and liabilities, and the valuation of foreclosed real estate.

All significant inter-company transactions and accounts are eliminated in consolidation, with the exception of the AMNB Trust and the MidCarolina Trusts, 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 results of the interim periods. The results of operations for the interim periods are not necessarily indicative of the results that may occur for any other period. Certain reclassifications have been made to prior period balances to conform to the current period presentation. These reclassifications did not have an impact on net income and were considered immaterial. These statements should be read in conjunction with the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." This update is intended to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management is required under the new guidance to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued when preparing financial statements for each interim and annual reporting period. If conditions or events are identified, the ASU specifies the process that must be followed by management and also clarifies the timing and content of going concern footnote disclosures in order to reduce diversity in practice. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have a material impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things: (1) requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (2) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); and (4) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently assessing the impact that ASU 2016-01 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606,

Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements.

During March 2016, the FASB issued ASU No. 2016-05, "Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships." The amendments in this ASU clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria remain intact. The amendments are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company does not expect the adoption of ASU 2016-05 to have a material impact on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-07, "Investments - Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting." The amendments in this ASU eliminate the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. In addition, the amendments in this ASU require that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Early adoption is permitted. The Company does not expect the adoption of ASU 2016-07 to have a material impact on its consolidated financial statements.

During March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Shares-Based Payment Accounting." The amendments in this ASU simplify several aspects of the accounting for share-based payment award transactions including: (1) income tax consequences; (2) classification of awards as either equity or liabilities; and (3 classification on the statement of cash flows. The amendments are effective for public companies for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company is currently assessing the impact that ASU 2016-09 will have on its consolidated financial statements.

Note 2 – Acquisition of MainStreet BankShares, Inc.

On January 1, 2015, the Company completed its acquisition of MainStreet BankShares, Inc. ("MainStreet"). The merger of MainStreet with and into the Company was effected pursuant to the terms and conditions of the Agreement and Plan of Reorganization, dated as of August 24, 2014, between the Company and MainStreet, and a related Plan of Merger. Immediately after the merger, Franklin Community Bank, N.A., MainStreet's wholly owned bank subsidiary, merged with and into the Bank.

Pursuant to the MainStreet merger agreement, the former holders of shares of MainStreet common stock received $3.46 in cash and 0.482 shares of the Company's common stock for each share of MainStreet common stock held immediately prior to the effective date of the merger, plus cash in lieu of fractional shares. Each option to purchase

shares of MainStreet common stock that was outstanding immediately prior to the effective date of the merger vested upon the merger and was converted into an option to purchase shares of the Company's common stock, adjusted based on a 0.643 exchange ratio. Each share of the Company's common stock outstanding immediately prior to the merger remained outstanding and was unaffected by the merger. The cash portion of the merger consideration was funded through a cash dividend of $6,000,000 from the Bank to the Company, and no borrowing was incurred by the Company or the Bank in connection with the merger. Replacement stock option awards representing 43,086 shares of the Company's common stock were granted in conjunction with the MainStreet acquisition.

MainStreet was the holding company for Franklin Community Bank, N.A.  As of January 1, 2015, MainStreet had net loans of approximately $122,000,000, total assets of approximately $164,000,000, and total deposits of approximately

$137,000,000. Franklin Community Bank, N.A. provided banking services to its customers from three banking offices located in Rocky Mount, Hardy, and Union Hall, Virginia, which are now branch offices of the Bank.
The net impact of the amortization and accretion of premiums and discounts associated with the Company's acquisition accounting adjustments related to the Mainstreet acquisition had the following impact on the Consolidated Statements of Income during the three months ended March 31, 2016 and 2015 (dollars in thousands):

| | Three Months Ended | |
|---|---|---|
| | March 31, 2016 | March 31, 2015 |
| Acquired performing loans | $49 | $636 |
| Purchase acquired impaired loans | 263 | (7 ) |
| CD valuation | — | 72 |
| Brokered CD valuation | — | 2 |
| Amortization of core deposit intangible | (62 ) | (75 ) |
| Net impact to income before taxes | $250 | $628 |

Note 3 – Securities
The amortized cost and fair value of investments in debt securities at March 31, 2016 and December 31, 2015 were as follows (dollars in thousands):

| | March 31, 2016 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Securities available for sale: | | | | |
| Federal agencies and GSEs | $98,584 | $ 504 | $ 5 | $99,083 |
| Mortgage-backed and CMOs | 75,299 | 1,171 | 41 | 76,429 |
| State and municipal | 163,327 | 5,915 | 15 | 169,227 |
| Corporate | 10,557 | 160 | — | 10,717 |
| Equity securities | 1,034 | 508 | — | 1,542 |
| Total securities available for sale | $348,801 | $ 8,258 | $ 61 | $356,998 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Securities available for sale: | | | | |
| Federal agencies and GSEs | $81,601 | $ 170 | $ 319 | $81,452 |
| Mortgage-backed and CMOs | 70,520 | 799 | 389 | 70,930 |
| State and municipal | 170,268 | 5,659 | 36 | 175,891 |
| Corporate | 10,619 | 28 | 57 | 10,590 |
| Equity securities | 1,000 | 486 | — | 1,486 |
| Total securities available for sale | $334,008 | $ 7,142 | $ 801 | $340,349 |

Restricted Stock

Due to restrictions placed upon the Bank's common stock investment in the Federal Reserve Bank of Richmond ("FRB") and Federal Home Loan Bank of Atlanta ("FHLB"), these securities have been classified as restricted equity securities and carried at cost. The restricted securities are not subject to the investment security classification and are included as a separate line item on the Company's Consolidated Balance Sheet. The FRB requires the Bank to maintain stock with a par value equal to 3.0% of its outstanding capital and an additional 3.0% is on call. The FHLB requires the Bank to maintain stock in an amount equal to 4.5% of outstanding borrowings and a specific percentage of the Bank's total assets. The cost of restricted stock at March 31, 2016 and December 31, 2015 was as follows (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| FRB stock | $ 1,815 | $ 3,535 |
| FHLB stock | 3,540 | 1,777 |
| Total restricted stock | $ 5,355 | $ 5,312 |

Temporarily Impaired Securities

The following table shows 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, 2016. 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. Available for sale securities that have been in a continuous unrealized loss position are as follows (dollars 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 and GSEs | $5,001 | $ 5 | $5,001 | $ 5 | $— | $ — |
| Mortgage-backed and CMOs | 9,031 | 41 | 6,522 | 28 | 2,509 | 13 |
| State and municipal | 6,702 | 15 | 5,880 | 14 | 822 | 1 |
| Total | $20,734 | $ 61 | $17,403 | $ 47 | $3,331 | $ 14 |

GSE debt securities: The unrealized loss on the Company's investment in one government sponsored entity ("GSE") was caused by interest rate increases. The contractual terms of this investment does not permit the issuer to settle the security at a price less than the amortized cost basis of the investment. Because the Company does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of their amortized cost basis, which may be maturity, the Company does not consider this investment to be other-than-temporarily impaired at March 31, 2016.

Mortgage-backed securities and CMOs: The unrealized losses on the Company's investment in eight GSE mortgage-backed securities and collateralized mortgage obligations ("CMOs") were caused by interest rate increases. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of its amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2016.

State and municipal securities: The unrealized losses on 12 state and municipal securities were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2016.

Corporate securities: The Company had zero investments with unrealized losses in corporate securities. In prior periods when unrealized losses were shown they were caused by interest rate increases. The contractual terms of those investments did not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company

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did not intend to sell the investments and it was not more likely than not that the Company would be required to sell the investments before recovery of their amortized cost basis, which may have been maturity, the Company did not consider those investments to be other-than-temporarily impaired at March 31, 2016.

Restricted stock: When evaluating restricted stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Company does not consider restricted stock to be other-than-temporarily impaired at March 31, 2016, and no impairment has been recognized.

The table below shows estimated fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities had been in a continuous unrealized loss position, at December 31, 2015 (dollars 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 and GSEs | $57,711 | $ 319 | $57,711 | $ 319 | $— | $ — |
| Mortgage-backed and CMOs | 37,368 | 389 | 35,424 | 346 | 1,944 | 43 |
| State and municipal | 13,540 | 36 | 12,716 | 34 | 824 | 2 |
| Corporate | 5,107 | 57 | 3,530 | 29 | 1,577 | 28 |
| Total | $113,726 | $ 801 | $109,381 | $ 728 | $4,345 | $ 73 |

Other-Than-Temporary-Impaired Securities

As of March 31, 2016 and December 31, 2015, there were no securities classified as other-than-temporary impaired.

Note 4 – Loans

Loans, excluding loans held for sale, at March 31, 2016 and December 31, 2015, were comprised of the following (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Commercial | $196,110 | $ 177,481 |
| Commercial real estate: | | |
| Construction and land development | 82,711 | 72,968 |
| Commercial real estate | 427,824 | 430,186 |
| Residential real estate: | | |
| Residential | 222,451 | 220,434 |
| Home equity | 100,019 | 98,449 |
| Consumer | 5,449 | 6,007 |
| Total loans | $1,034,564 | $ 1,005,525 |

Acquired Loans

The outstanding principal balance and the carrying amount of these loans included in the consolidated balance sheets at March 31, 2016 and December 31, 2015 are as follows (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Outstanding principal balance | $133,918 | $ 145,380 |
| Carrying amount | 124,804 | 135,254 |

The outstanding principal balance and related carrying amount of acquired impaired loans, for which the Company applies FASB Accounting Standards Codification ("ASC") 310-30 to account for interest earned, as of the indicated dates are as follows (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Outstanding principal balance | $ 38,316 | $ 40,951 |
| Carrying amount | 31,999 | 33,878 |

The following table presents changes in the accretable yield on acquired impaired loans, for which the Company applies FASB ASC 310-30, at March 31, 2016 and December 31, 2015 (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Balance at January 1 | $7,299 | $ 1,440 |
| Additions from merger with MainStreet | — | 7,140 |
| Accretion | (1,249 ) | (4,313 ) |
| Other changes, net | 490 | 3,032 |
| | $6,540 | $ 7,299 |

Past Due Loans

The following table shows an analysis by portfolio segment of the Company's past due loans at March 31, 2016 (dollars in thousands):

| | 30- 59 Days Past Due | 60-89 Days Past Due | 90 Days + Past Due and Still Accruing | Non-Accrual Loans | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|---|
| Commercial | $18 | $ — | $ — | $118 | $136 | $195,974 | $196,110 |
| Commercial real estate: | | | | | | | |
| Construction and land development | 52 | — | — | 105 | 157 | 82,554 | 82,711 |
| Commercial real estate | 4 | — | — | 2,287 | 2,291 | 425,533 | 427,824 |
| Residential: | | | | | | | |
| Residential | 610 | 28 | — | 2,155 | 2,793 | 219,658 | 222,451 |
| Home equity | 388 | — | — | 576 | 964 | 99,055 | 100,019 |
| Consumer | 40 | — | — | 35 | 75 | 5,374 | 5,449 |
| Total | $1,112 | $ 28 | $ — | $5,276 | $6,416 | $1,028,148 | $1,034,564 |

The following table shows an analysis by portfolio segment of the Company's past due loans at December 31, 2015 (dollars in thousands):

| | 30- 59 Days Past Due | 60-89 Days Past Due | 90 Days + Past Due and Still Accruing | Non-Accrual Loans | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|---|
| Commercial | $137 | $— | $ — | $90 | $227 | $177,254 | $177,481 |
| Commercial real estate: | | | | | | | |
| Construction and land development | — | — | — | 258 | 258 | 72,710 | 72,968 |
| Commercial real estate | 135 | 182 | — | 2,497 | 2,814 | 427,372 | 430,186 |
| Residential: | | | | | | | |
| Residential | 913 | 398 | — | 1,731 | 3,042 | 217,392 | 220,434 |
| Home equity | 140 | 12 | — | 620 | 772 | 97,677 | 98,449 |
| Consumer | 53 | 1 | — | 9 | 63 | 5,944 | 6,007 |
| Total | $1,378 | $593 | $ — | $5,205 | $7,176 | $998,349 | $1,005,525 |

Impaired Loans

The following table presents the Company's impaired loan balances by portfolio segment, excluding acquired impaired loans, at March 31, 2016 (dollars in thousands):

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Commercial | $ 3 | $ 3 | $ — | $ 3 | $ — |
| Commercial real estate: | | | | | |
| Construction and land development | — | — | — | — | — |
| Commercial real estate | 843 | 843 | — | 856 | 12 |
| Residential: | | | | | |
| Residential | — | — | — | — | — |
| Home equity | 170 | 170 | — | 172 | 2 |
| Consumer | 11 | 11 | — | 12 | — |
| | $ 1,027 | $ 1,027 | $ — | $ 1,043 | $ 14 |
| With a related allowance recorded: | | | | | |
| Commercial | 118 | 118 | — | 104 | 4 |
| Commercial real estate: | | | | | |
| Construction and land development | 490 | 491 | 5 | 469 | 6 |
| Commercial real estate | 464 | 465 | 4 | 427 | — |
| Residential | | | | | |
| Residential | 1,811 | 1,971 | 23 | 1,675 | 4 |
| Home equity | 356 | 767 | — | 377 | 1 |
| Consumer | 35 | 183 | — | 21 | — |
| | $ 3,274 | $ 3,995 | $ 32 | $ 3,073 | $ 15 |
| Total: | | | | | |
| Commercial | $ 121 | $ 121 | $ — | $ 107 | $ 4 |
| Commercial real estate: | | | | | |
| Construction and land development | 490 | 491 | 5 | 469 | 6 |
| Commercial real estate | 1,307 | 1,308 | 4 | 1,283 | 12 |
| Residential: | | | | | |
| Residential | 1,811 | 1,971 | 23 | 1,675 | 4 |
| Home equity | 526 | 937 | — | 549 | 3 |
| Consumer | 46 | 194 | — | 33 | — |
| | $ 4,301 | $ 5,022 | $ 32 | $ 4,116 | $ 29 |

The following table presents the Company's impaired loan balances by portfolio segment, excluding acquired impaired loans, at December 31, 2015 (dollars in thousands):

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Commercial | $ 4 | $ 4 | $ — | $ 47 | $ — |
| Commercial real estate: | | | | | |
| Construction and land development | 205 | 205 | — | 220 | — |
| Commercial real estate | 1,202 | 1,206 | — | 1,504 | 1 |
| Residential: | | | | | |
| Residential | 127 | 124 | — | 126 | — |
| Home equity | 173 | 173 | — | 305 | — |
| Consumer | 13 | 13 | — | 14 | — |
| | $ 1,724 | $ 1,725 | $ — | $ 2,216 | $ 1 |
| With a related allowance recorded: | | | | | |
| Commercial | $ 91 | $ 91 | $ — | $ 99 | $ — |
| Commercial real estate: | | | | | |
| Construction and land development | 448 | 449 | 6 | 563 | 26 |
| Commercial real estate | 390 | 391 | 3 | 353 | 17 |
| Residential: | | | | | |
| Residential | 1,649 | 1,690 | — | 1,034 | 22 |
| Home equity | 397 | 396 | 25 | 327 | — |
| Consumer | 8 | 9 | 1 | 11 | — |
| | $ 2,983 | $ 3,026 | $ 35 | $ 2,387 | $ 65 |
| Total: | | | | | |
| Commercial | $ 95 | $ 95 | $ — | $ 146 | $ — |
| Commercial real estate: | | | | | |
| Construction and land development | 653 | 654 | 6 | 783 | 26 |
| Commercial real estate | 1,592 | 1,597 | 3 | 1,857 | 18 |
| Residential: | | | | | |
| Residential | 1,776 | 1,814 | — | 1,160 | 22 |
| Home equity | 570 | 569 | 25 | 632 | — |
| Consumer | 21 | 22 | 1 | 25 | — |
| | $ 4,707 | $ 4,751 | $ 35 | $ 4,603 | $ 66 |

The following tables show the detail of loans modified as troubled debt restructurings ("TDRs") during the three months ended March 31, 2016 and 2015 included in the impaired loan balances (dollars in thousands):

| | Loans Modified as a TDR for the Three Months Ended March 31, 2016 | | |
|---|---|---|---|
| Loan Type | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial | — | $ — | $ — |
| Commercial real estate | 1 | 68 | 66 |
| Construction and land development | — | — | — |
| Home Equity | — | — | — |
| Residential real estate | — | — | — |
| Consumer | — | — | — |
| Total | 1 | $ 68 | $ 66 |

| | Loans Modified as a TDR for the Three Months Ended March 31, 2015 | | |
|---|---|---|---|
| Loan Type | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial | — | $ — | $ — |
| Commercial real estate | 1 | 8 | 8 |
| Construction and land development | — | — | — |
| Home Equity | 2 | 341 | 341 |
| Residential real estate | — | — | — |
| Consumer | — | — | — |
| Total | 3 | $ 349 | $ 349 |

During the three months ended March 31, 2016 and 2015, the Company had no loans that subsequently defaulted within twelve months of modification. The Company defines defaults as one or more payments that occur more than 90 days past the due date, charge-off or foreclosure subsequent to modification.

Residential Real Estate in Process of Foreclosure

The Company had $670,000 in residential real estate loans in the process of foreclosure at March 31, 2016.

Risk Grades

The following table shows the Company's loan portfolio broken down by internal risk grading as of March 31, 2016 (dollars in thousands):

Commercial and Consumer Credit Exposure

Credit Risk Profile by Internally Assigned Grade

| | Commercial | Construction and Land Development | Commercial Real Estate Other | Residential | Home Equity |
|---|---|---|---|---|---|
| Pass | $ 194,574 | $ 78,822 | $ 417,017 | $ 203,392 | $ 97,411 |
| Special Mention | 1,303 | 1,176 | 5,520 | 13,558 | 1,630 |
| Substandard | 233 | 2,713 | 5,287 | 5,501 | 978 |
| Doubtful | — | — | — | — | — |
| Total | $ 196,110 | $ 82,711 | $ 427,824 | $ 222,451 | $ 100,019 |

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

| | Consumer |
|---|---|
| Performing | $ 5,204 |
| Nonperforming | 245 |
| Total | $ 5,449 |

The following table shows the Company's loan portfolio broken down by internal risk grading as of December 31, 2015 (dollars in thousands):

Commercial and Consumer Credit Exposure

Credit Risk Profile by Internally Assigned Grade

| | Commercial | Construction and Land Development | Commercial Real Estate Other | Residential | Home Equity |
|---|---|---|---|---|---|
| Pass | $ 175,963 | $ 68,853 | $ 418,719 | $ 200,008 | $ 96,142 |
| Special Mention | 1,364 | 1,210 | 5,860 | 14,638 | 1,314 |
| Substandard | 154 | 2,905 | 5,607 | 5,788 | 993 |
| Doubtful | — | — | — | — | — |
| Total | $ 177,481 | $ 72,968 | $ 430,186 | $ 220,434 | $ 98,449 |

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

| | Consumer |
|---|---|
| Performing | $ 5,999 |
| Nonperforming | 8 |
| Total | $ 6,007 |

Loans classified in the Pass category typically are fundamentally sound and risk factors are reasonable and acceptable. Loans classified in the Special Mention category typically have been criticized internally, by loan review or the loan officer, or by external regulators under the current credit policy regarding risk grades.

Loans classified in the Substandard category typically have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are typically characterized by the possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans classified in the Doubtful category typically have all the weaknesses inherent in loans classified as substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. However, these loans are not yet rated as loss because certain events may occur that may salvage the debt.

Consumer loans are classified as performing or nonperforming. A loan is nonperforming when payments of interest and principal are past due 90 days or more, or payments are less than 90 days past due, but there are other good reasons to doubt that payment will be made in full.

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 as of the indicated dates and periods are presented below (dollars in thousands):

| | Three Months Ended March 31, 2016 | Year Ended December 31, 2015 | Three Months Ended March 31, 2015 |
|---|---|---|---|
| Allowance for Loan Losses | | | |
| Balance, beginning of period | $12,601 | $ 12,427 | $12,427 |
| Provision for loan losses | 50 | 950 | 600 |
| Charge-offs | (40) | (1,200) | (309) |
| Recoveries | 64 | 424 | 126 |
| Balance, end of period | $12,675 | $ 12,601 | $12,844 |
| | | | |
| Reserve for Unfunded Lending Commitments | | | |
| Balance, beginning of period | $184 | $ 163 | $163 |
| Provision for unfunded commitments | 4 | 21 | 6 |
| Charge-offs | — | — | — |
| Balance, end of period | $188 | $ 184 | $169 |

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

The following table presents changes in the Company's allowance for loan losses by portfolio segment and the related loan balance total by segment at and for the three months ended March 31, 2016 (dollars in thousands):

| | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Total |
|---|---|---|---|---|---|
| Allowance for Loan Losses | | | | | |
| Balance at December 31, 2015: | $ 2,065 | $ 6,930 | $ 3,546 | $ 60 | $ 12,601 |
| Charge-offs | — | — | — | (40) | (40) |
| Recoveries | 8 | 7 | 19 | 30 | 64 |
| Provision for loan losses | 130 | (91) | 7 | 4 | 50 |
| Balance at March 31, 2016: | $ 2,203 | $ 6,846 | $ 3,572 | $ 54 | $ 12,675 |
| | | | | | |
| Balance at March 31, 2016: | | | | | |
| | | | | | |
| Allowance for Loan Losses | | | | | |
| Individually evaluated for impairment | $ — | $ 9 | $ 23 | $ — | $ 32 |
| Collectively evaluated for impairment | 2,182 | 6,702 | 3,291 | 53 | 12,228 |
| Acquired impaired loans | 21 | 135 | 258 | 1 | 415 |
| Total | $ 2,203 | $ 6,846 | $ 3,572 | $ 54 | $ 12,675 |
| | | | | | |
| Loans | | | | | |
| Individually evaluated for impairment | $ 121 | $ 1,797 | $ 2,337 | $ 46 | $ 4,301 |
| Collectively evaluated for impairment | 195,360 | 494,635 | 303,058 | 5,211 | 998,264 |
| Acquired impaired loans | 629 | 14,103 | 17,075 | 192 | 31,999 |
| Total | $ 196,110 | $ 510,535 | $ 322,470 | $ 5,449 | $ 1,034,564 |

The following table presents changes in the Company's allowance for loan losses by portfolio segment and the related loan balance total by segment at and for the year ended December 31, 2015 (dollars in thousands):

| | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Total |
|---|---|---|---|---|---|
| Allowance for Loan Losses | | | | | |
| Balance at December 31, 2014: | $ 1,818 | $ 6,814 | $ 3,715 | $ 80 | $ 12,427 |
| Charge-offs | (175 ) | (482 ) | (323 ) | (220 ) | (1,200 ) |
| Recoveries | 32 | 124 | 139 | 129 | 424 |
| Provision for loan losses | 390 | 474 | 15 | 71 | 950 |
| Balance at December 31, 2015: | $ 2,065 | $ 6,930 | $ 3,546 | $ 60 | $ 12,601 |
| | | | | | |
| Balance at December 31, 2015: | | | | | |
| | | | | | |
| Allowance for Loan Losses | | | | | |
| Individually evaluated for impairment | $ — | $ 9 | $ 26 | $ — | $ 35 |
| Collectively evaluated for impairment | 2,065 | 6,750 | 3,284 | 60 | 12,159 |
| Acquired impaired loans | — | 171 | 236 | — | 407 |
| Total | $ 2,065 | $ 6,930 | $ 3,546 | $ 60 | $ 12,601 |
| | | | | | |
| Loans | | | | | |
| Individually evaluated for impairment | $ 95 | $ 2,245 | $ 2,346 | $ 21 | $ 4,707 |
| Collectively evaluated for impairment | 176,798 | 487,177 | 297,281 | 5,684 | 966,940 |
| Acquired impaired loans | 588 | 13,732 | 19,256 | 302 | 33,878 |
| Total | $ 177,481 | $ 503,154 | $ 318,883 | $ 6,007 | $ 1,005,525 |

The allowance for loan losses is allocated to loan segments based upon historical loss factors, risk grades on individual loans, portfolio analysis of smaller balance homogenous loans, and qualitative factors. Qualitative factors include trends in delinquencies, nonaccrual loans, and loss rates; trends in volume and terms of loans, effects of changes in risk selection, underwriting standards, and lending policies; experience of lending officers, other lending staff and loan review; national, regional, and local economic trends and conditions; legal, regulatory and collateral factors; and concentrations of credit.

Note 6 – Goodwill and Other Intangible Assets

The Company records as goodwill the excess of the purchase price over the fair value of the identifiable net assets acquired. Impairment testing is performed annually, as well as when an event triggering impairment may have occurred. The Company performs its annual analysis as of June 30 each fiscal year. Accounting guidance permits preliminary assessment of qualitative factors to determine whether more substantial impairment testing is required. The Company chose to bypass the preliminary assessment and utilized a two-step process for impairment testing of goodwill. The first step tests for impairment, while the second step, if necessary, measures the impairment. No indicators of impairment were identified as of June 30, 2016.

Core deposit intangibles resulting from the acquisition of MidCarolina Financial Corporation ("MidCarolina") in July 2011 were $6,556,000 and are being amortized on an accelerated basis over 108 months. Core deposit intangibles resulting from the MainStreet acquisition in January 2015 were $1,839,000 and are being amortized on an accelerated basis over 120 months.

The changes in the carrying amount of goodwill and intangibles for the three months ended March 31, 2016, are as follows (dollars in thousands):

| | Goodwill | Intangibles |
|---|---|---|
| Balance at December 31, 2015 | $ 43,872 | $ 2,683 |
| Additions | — | — |
| Amortization | — | (288 ) |
| Impairment | — | — |
| Balance at March 31, 2016 | $ 43,872 | $ 2,395 |

Note 7 – Short-term Borrowings

Short-term borrowings consist of customer repurchase agreements, overnight borrowings from the FHLB, and Federal Funds purchased. The Company has federal funds lines of credit established with two correspondent banks in the amounts of $15,000,000, each, and, additionally, has access to the FRB's discount window. Customer repurchase agreements are collateralized by securities of the U.S. Government or its agencies or GSEs. 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 solely of customer repurchase agreements at March 31, 2016 and December 31, 2015 (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Customer repurchase agreements | $ 42,184 | $ 40,611 |
| | $ 42,184 | $ 40,611 |

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, home equity lines of credit, and commercial real estate loans. 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, 2016, $431,561,000 in eligible collateral was 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, 2016 and December 31, 2015 (dollars in thousands):

| March 31, 2016 | | | December 31, 2015 | | |
|---|---|---|---|---|---|
| Due by | Advance Amount | Weighted Average Rate | Due by | Advance Amount | Weighted Average Rate |
| November 30, 2017 | 9,963 | 2.98 % | November 30, 2017 | 9,958 | 2.98 % |

The advance due in November 2017 is net of a fair value discount of $37,000. The original discount recorded on July 1, 2011, was a result of the merger with MidCarolina. The adjustment to the face value is being amortized into interest expense over the life of the borrowing. There were no long-term borrowings acquired in the MainStreet acquisition and no borrowings were incurred to fund the acquisition.

In the regular course of conducting its business, the Company takes deposits from political subdivisions of the states of Virginia and North Carolina. At March 31, 2016, the Bank's public deposits totaled $140,762,000. The Company is required to provide collateral to secure the deposits that exceed the insurance coverage provided by the Federal Deposit Insurance Corporation. This collateral can be provided in the form of certain types of government or agency bonds or letters of credit from the FHLB. At March 31, 2016, the Company had $70,000,000 in letters of credit with the FHLB outstanding, as well as $124,212,000 in agency, state, and municipal securities pledged to provide collateral for such deposits.

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Note 9 – Junior Subordinated Debt

On April 7, 2006, AMNB Statutory Trust I, a Delaware statutory trust and a 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 September 30, 2011. Initially, the securities required quarterly distributions by the trust to the holder of the Trust Preferred Securities at a fixed rate of 6.66%. Effective September 30, 2011, the rate resets 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 20 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 "Junior Subordinated Debt"), issued pursuant to junior subordinated debentures entered into between the Company and Wilmington Trust Company, as trustee. The proceeds of the Junior Subordinated Debt 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 in 2006, and for general corporate purposes.

On July 1, 2011, in connection with the MidCarolina merger, the Company assumed $8,764,000 in junior subordinated debt to MidCarolina Trust I and MidCarolina Trust II, two separate Delaware statutory trusts (the "MidCarolina Trusts"), to fully and unconditionally guarantee the preferred securities issued by the MidCarolina Trusts. These long-term obligations, which currently qualify as Tier 1 capital, constitute a full and unconditional guarantee by the Company of the MidCarolina Trusts' obligations. The MidCarolina Trusts were consolidated in the Company's financial statements.

In accordance with ASC 810-10-15-14, "Consolidation - Overall - Scope and Scope Exceptions," the Company did not eliminate through consolidation the Company's $619,000 equity investment in AMNB Statutory Trust I or the $264,000 equity investment in the MidCarolina Trusts. Instead, the Company reflected this equity investment in the "Accrued interest receivable and other assets" line item in the consolidated balance sheets.

A description of the junior subordinated debt securities outstanding payable to the trusts is shown below as of March 31, 2016 and December 31, 2015 (dollars in thousands):

| Issuing Entity | Date Issued | Interest Rate | Maturity Date | Principal Amount March 31, 2016 | Principal Amount December 31, 2015 |
|---|---|---|---|---|---|
| AMNB Trust I | 4/7/2006 | Libor plus 1.35% | 6/30/2036 | $20,619 | $ 20,619 |
| MidCarolina Trust I | 10/29/2002 | Libor plus 3.45% | 11/7/2032 | 4,224 | 4,209 |
| MidCarolina Trust II | 12/3/2003 | Libor plus 2.95% | 10/7/2033 | 2,805 | 2,794 |
| | | | | $27,648 | $ 27,622 |

The principal amounts reflected above for the MidCarolina Trusts are net of fair value adjustments of $931,000 and $804,000, respectively at March 31, 2016. The original fair value adjustments of $1,197,000 and $1,021,000 were recorded as a result of the acquisition of MidCarolina on July 1, 2011, and are being amortized into interest expense over the remaining lives of the respective borrowings.

Note 10 – Stock Based Compensation

The Company's 2008 Stock Incentive Plan ("2008 Plan") was adopted by the Board of Directors of the Company on February 19, 2008, and approved by shareholders on April 22, 2008, at the Company's 2008 Annual Meeting of Shareholders. The 2008 Plan provides for the granting of restricted stock awards and incentive and non-statutory options to employees and directors on a periodic basis, at the discretion of the Board of Directors or a Board designated committee. The 2008 Plan authorizes the issuance of up to 500,000 shares of common stock. The 2008 Plan replaced the Company's stock option plan that was approved by the shareholders at the 1997 Annual Meeting,

which expired in 2006.

Stock Options

Accounting guidance requires that compensation cost relating to share-based payment transactions be recognized in the financial statements with measurement based upon the fair value of the equity or liability instruments issued.

A summary of stock option transactions for the three months ended March 31, 2016 is as follows:

| | Option Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value ($000) |
|---|---|---|---|---|
| Outstanding at December 31, 2015 | 67,871 | $ 24.47 | | |
| Acquired in acquisition | — | — | | |
| Granted | — | — | | |
| Exercised | 2,484 | 23.33 | | |
| Forfeited | — | — | | |
| Expired | — | — | | |
| Outstanding at March 31, 2016 | 65,387 | $ 24.51 | 2.39 years | $ 102 |
| Exercisable at March 31, 2016 | 65,387 | $ 24.51 | 2.39 years | $ 102 |

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and expensed over the options' vesting period. As of March 31, 2016, there was no unrecognized compensation expenses related to nonvested stock option grants.

Restricted Stock

The Company from time-to-time grants shares of restricted stock to key employees and non-employee directors. These awards help align the interests of these employees and directors with the interests of the shareholders of the Company by providing economic value directly related to increases in the value of the Company's common stock. The value of the stock awarded is established as the fair value of the stock at the time of the grant. The Company recognizes expense, equal to the total value of such awards, ratably over the vesting period of the stock grants. Restricted stock granted in 2016 cliff vests at the end of a 36 month period beginning on the date of the grant.

Nonvested restricted stock activity for the three months ended March 31, 2016 is summarized in the following table.

| Restricted Stock | Shares | Weighted Average Grant Date Value |
|---|---|---|
| Nonvested at December 31, 2015 | 41,563 | $ 22.15 |
| Granted | 24,091 | 22.77 |
| Vested | 18,782 | 21.44 |
| Forfeited | 547 | 21.98 |
| Nonvested at March 31, 2016 | 46,325 | $ 22.77 |

As of March 31, 2016 and December 31, 2015, there was $735,000 and $594,000, respectively, in unrecognized compensation cost related to nonvested restricted stock granted under the 2008 Plan. The weighted average period over which this cost is expected to be recognized is 1.96 years. The share based compensation expense for nonvested restricted stock was $153,000 and $93,000 during the first three months of 2016 and 2015, respectively.

Starting in 2010, the Company began offering its outside directors alternatives with respect to director compensation. The regular monthly board retainer can be received in the form of either (a) $1,667 in cash or (b) shares of immediately vested, but restricted stock with a market value of $2,083. Monthly meeting fees can also be received as $725 per meeting in cash or $900 in immediately vested, but restricted stock. For 2016, all 13 outside directors have elected to receive stock in lieu of cash for either all or part of their monthly retainer board fees. Only outside directors receive board fees. The Company issued 3,510 and 2,812 shares and recognized share based compensation expense of $91,000 and $62,000 during the first three months of 2016 and 2015, respectively.

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Note 11 – Earnings Per Common Share

The following shows the weighted average number of shares used in computing earnings per common 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. Nonvested restricted shares are included in the computation of basic earnings per share as the holder is entitled to full shareholder benefits during the vesting period including voting rights and sharing in nonforfeitable dividends. The following tables present basic and diluted earnings per share for the three months period ended March 31, 2016 and 2015.

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| | Shares | Per Share Amount | Shares | Per Share Amount |
| Basic earnings per share | 8,611,840 | $ 0.48 | 8,723,633 | $ 0.40 |
| Effect of dilutive securities - stock options | 5,168 | — | 9,046 | — |
| Diluted earnings per share | 8,617,008 | $ 0.48 | 8,732,679 | $ 0.40 |

Outstanding stock options on common stock were not included in computing diluted earnings per share for the three month periods ended March 31, 2016 and 2015 because their effects were anti-dilutive, averaged 35,026 and 79,726 shares, respectively.

Note 12 – Employee Benefit Plans

The following information for the three months ended March 31, 2016 and 2015 pertains to the Company's non-contributory defined benefit pension plan which was frozen in 2009. If lump sum payments exceed the service cost plus interest cost, an additional settlement charge will apply (dollars in thousands):

| Components of Net Periodic Benefit Cost | Three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Service cost | $— | $— |
| Interest cost | 67 | 74 |
| Expected return on plan assets | (96 ) | (115 ) |
| Recognized net actuarial loss | 57 | 154 |
| Net periodic cost | $28 | $113 |

Note 13 – Fair Value of Financial Instruments

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the fair value measurements and disclosures topic of FASB ASC 820, the fair value of an instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the

asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts



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and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

| | |
|---|---|
| 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 financial 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 consider observable market data (Level 2). If no observable market data is available, valuations are based upon third party model based techniques (Level 3).

The following table presents the balances of financial assets measured at fair value on a recurring basis at the dates indicated (dollars in thousands):

| | Fair Value Measurements at March 31, 2016 Using | | | |
|---|---|---|---|---|
| | Balance at March 31, | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| Description | 2016 | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Securities available for sale: | | | | |
| Federal agencies and GSEs | $99,083 | $ — | $ 99,083 | $ — |
| Mortgage-backed and CMOs | 76,429 | — | 76,429 | — |
| State and municipal | 169,227 | — | 169,227 | — |
| Corporate | 10,717 | — | 10,717 | — |
| Equity securities | 1,542 | — | — | 1,542 |
| Total | $356,998 | $ — | $ 355,456 | $ 1,542 |

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| | Fair Value Measurements at December 31, 2015 Using | | | |
|---|---|---|---|---|
| Description | Balance at December 31, 2015 | 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: | | | | |
| Federal agencies and GSEs | $81,452 | $ — | $ 81,452 | $ — |
| Mortgage-backed and CMOs | 70,930 | — | 70,930 | — |
| State and municipal | 175,891 | — | 175,891 | — |
| Corporate | 10,590 | — | 10,590 | — |
| Equity securities | 1,486 | — | — | 1,486 |
| Total | $340,349 | $ — | $ 338,863 | $ 1,486 |

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | | | | | |
|---|---|---|---|---|---|---|
| | | Total Realized / Unrealized Gains (Losses) Included in | | | | |
| | Balances as of January 1, 2016 | Net Income | Other Comprehensive Income | Purchases, Sales, Issuances and Settlements, Net | Transfer In (Out) of Level 3 | Balances as of March 31, 2016 |
| Securities available for sale: | | | | | | |
| Equity | $1,486 | $ — | $ 56 | $ — | $ — | $ 1,542 |

Certain 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 assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans held for sale: Loans held for sale are carried at fair 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 three month period ended March 31, 2016 or the year ended December 31, 2015. Gains and losses on the sale of loans are recorded within income from mortgage banking on the Consolidated Statements of Income.

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 agreements will not be collected when due. The measurement of the loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable.  The vast majority of the Company's collateral is real estate.  The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of

one year or less, conducted by an independent, licensed appraiser 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 property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable 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.

Other real estate owned: Measurement for fair values for other real estate owned are the same as impaired loans. Any fair value adjustments are recorded in the period incurred as a valuation allowance against other real estate owned with the associated expense included in other real estate owned expense, net on the Consolidated Statements of Income.

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

| | Fair Value Measurements at March 31, 2016 Using | | | |
|---|---|---|---|---|
| | Balance at March 31, | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| Description | 2016 | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Loans held for sale | $785 | $ — | $ 785 | $ — |
| Impaired loans, net of valuation allowance | 3,242 | — | — | 3,242 |
| Other real estate owned, net | 1,493 | — | — | 1,493 |

| | Fair Value Measurements at December 31, 2015 Using | | | |
|---|---|---|---|---|
| | Balance at December 31, | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| Description | 2015 | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Loans held for sale | $3,266 | $ — | $ 3,266 | $ — |
| Impaired loans, net of valuation allowance | 2,948 | — | — | 2,948 |
| Other real estate owned, net | 2,184 | — | — | 2,184 |

The following tables summarize the Company's quantitative information about Level 3 fair value measurements at the dates indicated:

Quantitative Information About Level 3 Fair Value Measurements at March 31, 2016

| Assets | Valuation Technique | Unobservable Input | Weighted Rate | |
|---|---|---|---|---|
| Securities available for sale | Third party model based techniques | Stock price in different rate environments | 30 | % |
| Impaired loans | Discounted appraised value | Selling cost | 8 | % |
| Other real estate owned, net | Discounted appraised value | Selling cost | 6 | % |

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Quantitative Information About Level 3 Fair Value Measurements at December 31, 2015

| Assets | Valuation Technique | Unobservable Input | Weighted Rate | |
|---|---|---|---|---|
| Securities available for sale | Third party model based techniques | Stock price in different rate environments | 49 | % |
| Impaired loans | Discounted appraised value | Selling cost | 6 | % |
| | Discounted cash flow analysis | Market rate for borrower (discount rate) | 4 | % |
| Other real estate owned, net | Discounted appraised value | Selling cost | 6 | % |

The carrying values and estimated fair values of the Company's financial instruments at March 31, 2016 are as follows (dollars in thousands):

| | | Fair Value Measurements at March 31, 2016 Using | | | |
|---|---|---|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | Fair Value |
| | Carrying Value | Level 1 | Level 2 | Level 3 | Balance |
| Financial Assets: | | | | | |
| Cash and cash equivalents | $87,531 | $87,531 | $— | $— | $87,531 |
| Securities available for sale | 356,998 | — | 355,456 | 1,542 | 356,998 |
| Restricted stock | 5,355 | — | 5,355 | — | 5,355 |
| Loans held for sale | 785 | — | 785 | — | 785 |
| Loans, net of allowance | 1,021,889 | — | — | 1,019,070 | 1,019,070 |
| Bank owned life insurance | 17,773 | — | 17,773 | — | 17,773 |
| Accrued interest receivable | 4,708 | — | 4,708 | — | 4,708 |
| Financial Liabilities: | | | | | |
| Deposits | $1,292,431 | $— | $891,383 | $402,487 | $1,293,870 |
| Repurchase agreements | 42,184 | — | 42,184 | — | 42,184 |
| Other borrowings | 9,963 | — | — | 10,317 | 10,317 |
| Junior subordinated debt | 27,648 | — | — | 24,863 | 24,863 |
| Accrued interest payable | 663 | — | 663 | — | 663 |

The carrying values and estimated fair values of the Company's financial instruments at December 31, 2015 are as follows (dollars in thousands):

| | Fair Value Measurements at December 31, 2015 Using | | | | |
|---|---|---|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | Fair Value |
| | Carrying Value | Level 1 | Level 2 | Level 3 | Balance |
| Financial Assets: | | | | | |
| Cash and cash equivalents | $95,337 | $95,337 | $— | $ — | $95,337 |
| Securities available for sale | 340,349 | — | 338,863 | 1,486 | 340,349 |
| Restricted stock | 5,312 | — | 5,312 | — | 5,312 |
| Loans held for sale | 3,266 | — | 3,266 | — | 3,266 |
| Loans, net of allowance | 992,924 | — | — | 994,808 | 994,808 |
| Bank owned life insurance | 17,658 | — | 17,658 | — | 17,658 |
| Accrued interest receivable | 4,116 | — | 4,116 | — | 4,116 |
| | | | | | |
| Financial Liabilities: | | | | | |
| Deposits | $1,262,660 | $— | $ 865,350 | $ 396,551 | $1,261,901 |
| Repurchase agreements | 40,611 | — | 40,611 | — | 40,611 |
| Other borrowings | 9,958 | — | — | 10,293 | 10,293 |
| Junior subordinated debt | 27,622 | — | — | 22,940 | 22,940 |
| Accrued interest payable | 655 | — | 655 | — | 655 |

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and cash equivalents. The carrying amount is a reasonable estimate of fair value.

Securities. Fair values are based on quoted market prices or dealer quotes.

Restricted stock. The carrying value of restricted stock approximates fair value based on the redemption provisions of the respective entity.

Loans held for sale. The carrying amount is a reasonable estimate of fair value.

Loans. For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate loans are estimated based upon discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable.

Bank owned life insurance. Bank owned life insurance represents insurance policies on officers, directors, and past directors of the Company. The cash values of the policies are estimates using information provided by insurance carriers. These policies are carried at their cash surrender value, which approximates the fair value.

Accrued interest receivable. The carrying amount is a reasonable estimate of fair value.

Deposits. The fair value of demand deposits, savings deposits, and money market deposits equals the carrying value. The fair value of fixed-rate certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposit instruments would be offered to depositors for the same remaining maturities.

Repurchase agreements. The carrying amount is a reasonable estimate of fair value.

Other borrowings. The fair values of other borrowings are estimated using discounted cash flow analysis based on the interest rates for similar types of borrowing arrangements.

Junior subordinated debt. Fair value is calculated by discounting the future cash flows using the estimated current interest rates at which similar securities would be issued.

Accrued interest payable. The carrying amount is a reasonable estimate of fair value.

Off-balance sheet instruments. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At March 31, 2016 and December 31, 2015, the fair value of off-balance sheet instruments was deemed immaterial, and therefore was not included in the previous table.

The Company assumes interest rate risk (the risk that interest rates will change) in its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rates change and that change may be either favorable or unfavorable to the Company.

Note 14 – Segment and Related Information

The Company has two reportable segments, 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 automated teller machine fees and insurance commissions generate additional income for the community banking segment.

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 segment receives fees for investment and administrative services.

Amounts shown in the "Other" column includes activities of the Company which are primarily debt service on trust preferred securities and corporate items. Intersegment eliminations primarily consist of the Company's interest income on deposits held by the Bank.

Segment information as of and for the three months ended March 31, 2016 and 2015 (unaudited), is shown in the following tables (dollars in thousands):

| | Three Months Ended March 31, 2016 | | | | |
|---|---|---|---|---|---|
| | Community Banking | Trust and Investment Services | Other | Intersegment Eliminations | Total |
| Interest income | $ 14,156 | $ — | $ 15 | $ — | $ 14,171 |
| Interest expense | 1,379 | — | 208 | — | 1,587 |
| Noninterest income | 2,158 | 1,134 | 5 | — | 3,297 |
| Income before income taxes | 5,616 | 655 | (358 ) | — | 5,913 |
| Net income | 3,907 | 457 | (236 ) | — | 4,128 |
| Depreciation and amortization | 760 | 3 | — | — | 763 |
| Total assets | 1,580,264 | — | 224,313 | (222,023 ) | 1,582,554 |
| Goodwill | 43,872 | — | — | — | 43,872 |
| Capital expenditures | 149 | — | — | — | 149 |

| | Three Months Ended March 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Community Banking | Trust and Investment Services | Other | Intersegment Eliminations | Total |
| Interest income | $ 13,824 | $ — | $ 15 | $ — | $ 13,839 |
| Interest expense | 1,277 | — | 184 | — | 1,461 |
| Noninterest income | 1,983 | 1,168 | 5 | — | 3,156 |
| Income (loss) before income taxes | 4,507 | 650 | (270 ) | — | 4,887 |
| Net income (loss) | 3,225 | 468 | (178 ) | — | 3,515 |
| Depreciation and amortization | 738 | 3 | — | — | 741 |
| Total assets | 1,537,939 | — | 224,313 | (222,154 ) | 1,540,098 |
| Goodwill | 44,210 | — | — | — | 44,210 |
| Capital expenditures | 348 | — | — | — | 348 |

Note 15 – Supplemental Cash Flow Information

| | Three Months Ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Supplemental Schedule of Cash and Cash Equivalents: | | |
| Cash and due from banks | $26,345 | $23,995 |
| Interest-bearing deposits in other banks | 61,186 | 75,254 |
| Federal funds sold | — | 13,616 |
| Cash and Cash Equivalents | $87,531 | $112,865 |
| | | |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash paid for: | | |
| Interest on deposits and borrowed funds | $1,580 | $1,410 |
| Income taxes | — | — |
| Noncash investing and financing activities: | | |
| Transfer of loans to other real estate owned | (97) | (677) |
| Unrealized gains on securities available for sale | 1,856 | 924 |
| | | |
| Non-cash transactions related to acquisitions: | | |
| | | |
| Assets acquired: | | |
| Investment securities | — | 18,173 |
| Restricted stock | — | 587 |
| Loans | — | 114,884 |
| Premises and equipment | — | 1,245 |
| Deferred income taxes | — | 3,056 |
| Core deposit intangible | — | 1,839 |
| Other real estate owned | — | 168 |
| Bank owned life insurance | — | 1,955 |
| Other assets | — | 1,236 |
| | | |
| Liabilities assumed: | | |
| Deposits | — | 137,323 |
| Other liabilities | — | 3,076 |
| | | |
| Consideration: | | |
| Issuance of common stock | — | 20,483 |

Note 16 – Accumulated Other Comprehensive Income

Changes in each component of accumulated other comprehensive income ("AOCI") for the three months ended March 31, 2016 and 2015 (unaudited) were as follows (dollars in thousands):

| For the Three Months Ended | Net Unrealized Gains (Losses) on Securities | Adjustments Related to Pension Benefits | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|
| Balance at December 31, 2014 | $ 5,845 | $ (2,181 ) | $ 3,664 |
| Net unrealized gains on securities available for sale, net of tax, $432 | 802 | — | 802 |
| Reclassification adjustment for gains on securities, net of tax, $(109) | (201 ) | — | (201 ) |
| Balance at March 31, 2015 | $ 6,446 | $ (2,181 ) | $ 4,265 |
| Balance at December 31, 2015 | $ 4,122 | $ (1,832 ) | $ 2,290 |
| Net unrealized gains on securities available for sale, net of tax, $778 | 1,444 | — | 1,444 |
| Reclassification adjustment for gains on securities, net of tax, $(128) | (238 ) | — | (238 ) |
| Balance at March 31, 2016 | $ 5,328 | $ (1,832 ) | $ 3,496 |

Reclassifications Out of Accumulated Other Comprehensive Income
For the three months ended March 31, 2016 and 2015
(dollars in thousands)

| For the Three Months Ended March 31, 2016 | Amount Reclassified from AOCI | Affected Line Item in the Statement of Where Net Income is Presented |
|---|---|---|
| Details about AOCI Components | | |
| Available for sale securities: | | |
| Realized gain on sale of securities | $ 366 | Securities gains, net |
| | (128 ) | Income taxes |
| Total reclassifications | $ 238 | Net of tax |

| For the Three Months Ended March 31, 2015 | Amount Reclassified from AOCI | Affected Line Item in the Statement of Where Net Income is Presented |
|---|---|---|
| Details about AOCI Components | | |
| Available for sale securities: | | |
| Realized gain on sale of securities | $ 310 | Securities gains, net |
| | (109 ) | Income taxes |
| Total reclassifications | $ 201 | Net of tax |

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. (the "Company") and its wholly owned subsidiary, American National Bank and Trust Company (the "Bank"). 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 from those stated or implied by such forward-looking statements.

A variety of factors, some of which are discussed in more detail in Item 1A – Risk Factors of the Company's Annual Report on Form 10-K for the year ended December 31, 2015, 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;
- The failure of assumptions underlying the allowance for loan losses; and
- Risks associated with mergers and other acquisitions and other expansion activities.

Reclassification

In certain circumstances, reclassifications have been made to prior period information to conform to the 2015 presentation. There were no material reclassifications.

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, (2) mergers and acquisitions, (3) acquired loans with specific credit-related deterioration and (4) goodwill impairment. A summary of the Company's significant accounting policies is set forth in Note 1 to the Consolidated Financial Statements contained in the Form 10-K for the year ended December 31, 2015.

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.

Allowance for Loan Losses

The purpose of the allowance for loan losses ("ALLL") is to provide for probable losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses and by recoveries of previously charged-off loans. Loan charge-offs decrease the allowance.

The goal of the Company is to maintain an appropriate, systematic, and consistently applied process to determine the amounts of the ALLL and the provision for loan loss expense.

The Company uses certain practices to manage its credit risk. These practices include (1) appropriate lending limits for loan officers, (2) a loan approval process, (3) careful underwriting of loan requests, including analysis of borrowers, cash flows, collateral, and market risks, (4) regular monitoring of the portfolio, including diversification by type and geography, (5) review of loans by the Loan Review department, which operates independently of loan

production, (6) regular meetings of the Credit

Committee to discuss portfolio and policy changes and make decisions on large or unusual loan requests, and (7) regular meetings of the Asset Quality Committee which reviews the status of individual loans.

Risk grades are assigned as part of the loan origination process. From time to time, risk grades may be modified as warranted by the facts and circumstances surrounding the credit.

Calculation and analysis of the ALLL is prepared quarterly by the Finance Department. The Company's Credit Committee, Capital Management Committee, Audit Committee, and the Board of Directors review the allowance for adequacy.

The Company's ALLL has two basic components: the formula allowance and the specific allowance. Each of these components is determined based upon estimates and judgments.

The formula allowance uses historical loss experience 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, economic conditions, portfolio concentrations, regulatory, legal, competition, quality of loan review system, and value of underlying collateral. In the formula allowance for commercial and commercial real estate loans, the historical loss rate is combined with the qualitative factors, resulting in an adjusted loss factor for each risk-grade category of loans. The period-end balances for each loan risk-grade category are multiplied by the adjusted loss factor. Allowance calculations for residential real estate and consumer loans are calculated based on historical losses for each product category without regard to risk grade. This loss rate is combined with qualitative factors resulting in an adjusted loss factor for each product category.

The specific allowance uses various techniques to arrive at an estimate of loss for specifically identified impaired loans. These include:

- The present value of expected future cash flows discounted at the loan's effective interest rate. The effective interest rate on a loan is the rate of return implicit in the loan (that is, the contractual interest rate adjusted for any net deferred loan fees or costs and any premium or discount existing at the origination or acquisition of the loan);
- The loan's observable market price, or
- The fair value of the collateral, net of estimated costs to dispose, if the loan is collateral dependent. The use of these computed values is inherently subjective and actual losses could be greater or less than the estimates.

No single statistic, formula, or measurement determines the adequacy of the allowance. Management makes subjective and complex judgments about matters that are inherently uncertain, and different amounts would be reported under different conditions or using different assumptions. For analytical purposes, management allocates a portion of the allowance to specific loan categories and specific loans. However, the entire allowance is used to absorb credit losses inherent in the loan portfolio, including identified and unidentified losses.

The relationships and ratios used in calculating the allowance, including the qualitative factors, may change from period to period as facts and circumstances evolve. Furthermore, management cannot provide assurance that in any particular period the Bank will not have sizable credit losses in relation to the amount reserved. Management may find it necessary to significantly adjust the allowance, considering current factors at the time.

Mergers and Acquisitions

Business combinations are accounted for under the Financial Accounting Standards Board (the "FASB") Accounting Standards Codification ("ASC") 805, Business Combinations, using the acquisition method of accounting. The acquisition method of accounting requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date. To determine the fair values, the Company will rely on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analysis or other valuation techniques. Under the acquisition method of accounting, the Company will identify the acquirer and the closing date and apply applicable recognition principles and conditions.

Acquisition-related costs are costs the Company incurs to effect a business combination. Those costs include advisory, legal, accounting, valuation, and other professional or consulting fees. Some other examples of costs to the Company include systems conversions, integration planning consultants and advertising costs. The Company will account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities will be recognized in accordance with other applicable

GAAP. These acquisition-related costs have been and will be included within the Consolidated Statements of Income classified within the noninterest expense caption.

Acquired Loans with Specific Credit-Related Deterioration

Acquired loans with specific credit deterioration are accounted for by the Company in accordance with FASB ASC 310-30, Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality. Certain acquired loans, those for which specific credit-related deterioration, since origination, is identified, are recorded at fair value reflecting the present value of the amounts expected to be collected. Income recognition on these loans is based on a reasonable expectation about the timing and amount of cash flows to be collected. Acquired loans deemed impaired and considered collateral dependent, with the timing of the sale of loan collateral indeterminate, remain on non-accrual status and have no accretable yield.

Goodwill Impairment

The Company performs its annual analysis as of June 30 each fiscal year. Accounting guidance permits preliminary assessment of qualitative factors to determine whether more substantial impairment testing is required. The Company chose to bypass the preliminary assessment and utilized a two-step process for impairment testing of goodwill. The first step tests for impairment, while the second step, if necessary, measures the impairment. No indicators of impairment were identified during the years ended December 31, 2015, 2014, and 2013.

Non-GAAP Presentations

Non-GAAP presentations are provided because the Company believes these may be valuable to investors. These include (1) the analysis of net interest income presented on a taxable equivalent basis to facilitate performance comparisons among various taxable and tax-exempt assets and (2) the impact to net interest income and pretax income from accretable and amortizable fair value adjustments attributable to the merger with MidCarolina Financial Corporation ("MidCarolina") in July 2011 and the merger with MainStreet BankShares, Inc. ("MainStreet") in January 2015.

Internet Access to Corporate Documents

The Company provides access to its Securities and Exchange Commission ("SEC") filings through a link on the Investor Relations page of the Company's web site at www.amnb.com. Reports available include annual reports 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 information on the Company's website is not incorporated into this report or any other filing the Company makes 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.

RESULTS OF OPERATIONS

Earnings Performance

Three months ended March 31, 2016 and 2015

For the quarter ended March 31, 2016, the Company reported net income of $4,128,000 compared to $3,515,000 for the comparable quarter in 2015. The $613,000 or 17.4% increase in earnings was primarily due to the large increase in earning assets related to the January 2015 acquisition of MainStreet and the reduced provision expense in 2016. Provision expense in the 2015 quarter was unusually large and was related to the results of the quarterly review of expected cash flows from certain purchased credit impaired loans. Nonrecurring merger related expenses recognized in the first quarter 2015 are the primary contributor to the decrease in noninterest expenses for the quarterly period.

SUMMARY INCOME STATEMENT

(Dollars in thousands)

| Three Months Ended March 31, | 2016 | 2015 | $ Change | % Change |
|---|---|---|---|---|
| Interest income | $14,171 | $13,839 | $ 332 | 2.4 % |
| Interest expense | (1,587 ) | (1,461 ) | (126 ) | 8.6 |
| Net interest income | 12,584 | 12,378 | 206 | 1.7 |
| Provision for loan losses | (50 ) | (600 ) | 550 | (91.7) |
| Noninterest income | 3,297 | 3,156 | 141 | 4.5 |
| Noninterest expense | (9,918 ) | (10,047 ) | 129 | (1.3 ) |
| Income tax expense | (1,785 ) | (1,372 ) | (413 ) | 30.1 |
| Net income | $4,128 | $3,515 | $ 613 | 17.4 |

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.

Three months ended March 31, 2016 and 2015

Net interest income on a taxable equivalent basis increased $179,000 or 1.4%, for the first quarter of 2016 compared to the same quarter of 2015.  This change was driven by an increase in average interest-earning assets of $41,991,000 or 3.0%, primarily related to the increase in loans.

For the first quarter of 2016, the Company's yield on interest-earning assets was 4.12%, compared to 4.16% for the first quarter of 2015.  The cost of interest-bearing liabilities was 0.62% compared to 0.57%, primarily related to a 12 basis point increase in the cost of time deposits. The cost of time deposits in the first quarter of 2016 was adversely impacted by the expiration of acquisition accounting discount from the MainStreet transaction which expired at the end of 2015. The interest rate spread was 3.50% compared to 3.59%.  The net interest margin, on a fully taxable equivalent basis, was 3.67% compared to 3.73%, a decrease of six basis points (0.06%).

The following presentation is an analysis of net interest income and related yields and rates, on a taxable equivalent basis, for the three months ended March 31, 2016 and 2015. 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.

Net Interest Income Analysis (in thousands, except rates)
Three Months Ended March 31,

| | Average Balance | | Income/Expense | | Yield/Rate | |
|---|---|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Loans: | | | | | | |
| Commercial | $188,275 | $139,120 | $1,855 | $1,826 | 3.96 % | 5.32% |
| Real estate | 824,970 | 801,373 | 10,090 | 9,719 | 4.89 | 4.85 |
| Consumer | 5,506 | 15,328 | 231 | 240 | 16.87 | 6.35 |
| Total loans | 1,018,751 | 955,821 | 12,176 | 11,785 | 4.79 | 4.94 |
| | | | | | | |
| Securities: | | | | | | |
| Federal agencies & GSEs | 88,283 | 74,850 | 378 | 245 | 1.71 | 1.31 |
| Mortgage-backed & CMOs | 75,891 | 65,558 | 400 | 378 | 2.11 | 2.31 |
| State and municipal | 166,187 | 190,216 | 1,493 | 1,763 | 3.59 | 3.71 |
| Other | 16,929 | 15,176 | 146 | 123 | 3.45 | 3.24 |
| Total securities | 347,290 | 345,800 | 2,417 | 2,509 | 2.78 | 2.90 |
| | | | | | | |
| Federal funds sold | — | 14,580 | — | 4 | — | 0.11 |
| Deposits in other banks | 58,767 | 66,616 | 58 | 48 | 0.40 | 0.29 |
| | | | | | | |
| Total interest-earning assets | 1,424,808 | 1,382,817 | 14,651 | 14,346 | 4.12 | 4.16 |
| | | | | | | |
| Non-earning assets | 126,316 | 135,632 | | | | |
| | | | | | | |
| Total assets | $1,551,124 | $1,518,449 | | | | |
| | | | | | | |
| Deposits: | | | | | | |
| Demand | $231,368 | $212,673 | 36 | 18 | 0.06 | 0.03 |
| Money market | 205,274 | 202,935 | 76 | 71 | 0.15 | 0.14 |
| Savings | 117,650 | 107,683 | 14 | 12 | 0.05 | 0.05 |
| Time | 395,979 | 414,773 | 1,171 | 1,093 | 1.19 | 1.07 |
| Total deposits | 950,271 | 938,064 | 1,297 | 1,194 | 0.55 | 0.52 |
| | | | | | | |
| Customer repurchase agreements | 44,412 | 53,181 | 1 | 3 | 0.01 | 0.02 |
| Long-term borrowings | 37,593 | 37,469 | 289 | 264 | 3.08 | 2.82 |
| Total interest-bearing liabilities | 1,032,276 | 1,028,714 | 1,587 | 1,461 | 0.62 | 0.57 |
| | | | | | | |
| Noninterest bearing demand deposits | 310,263 | 282,973 | | | | |
| Other liabilities | 9,060 | 10,676 | | | | |
| Shareholders' equity | 199,525 | 196,086 | | | | |
| Total liabilities and shareholders' equity | $1,551,124 | $1,518,449 | | | | |

| | | | | |
|---|---|---|---|---|
| Interest rate spread | | | 3.50 % | 3.59 % |
| Net interest margin | | | 3.67 % | 3.73 % |
| | | | | |
| Net interest income (taxable equivalent basis) | 13,064 | 12,885 | | |
| Less: Taxable equivalent adjustment | 480 | 507 | | |
| Net interest income | $12,584 | $12,378 | | |

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

| | Three Months Ended March 31, 2016 vs. 2015 | | |
|---|---|---|---|
| | | Change Attributable to | |
| Interest income | Increase (Decrease) | Rate | Volume |
| Loans: | | | |
| Commercial | $29 | $(522) | $ 551 |
| Real estate | 371 | 83 | 288 |
| Consumer | (9) | 216 | (225) |
| Total loans | 391 | (223) | 614 |
| Securities: | | | |
| Federal agencies | 133 | 84 | 49 |
| Mortgage-backed | 22 | (34) | 56 |
| State and municipal | (270) | (53) | (217) |
| Other securities | 23 | 8 | 15 |
| Total securities | (92) | 5 | (97) |
| Federal funds sold | (4) | — | (4) |
| Deposits in other banks | 10 | 16 | (6) |
| Total interest income | 305 | (202) | 507 |
| | | | |
| Interest expense | | | |
| Deposits: | | | |
| Demand | 18 | 16 | 2 |
| Money market | 5 | 4 | 1 |
| Savings | 2 | 1 | 1 |
| Time | 78 | 129 | (51) |
| Total deposits | 103 | 150 | (47) |
| Customer repurchase agreements | (2) | (2) | — |
| Other borrowings | 25 | 24 | 1 |
| Total interest expense | 126 | 172 | (46) |
| Net interest income (taxable equivalent basis) | $179 | $(374) | $ 553 |

Noninterest Income, three months ended March 31, 2016 and 2015

For the the quarter ended March 31, 2016, noninterest income increased $141,000 or 4.5% compared to the comparable 2015 quarter. Details of individual accounts are shown in the table below.

| | Three Months Ended March 31, (Dollars in thousands) | | | |
|---|---|---|---|---|
| | 2016 | 2015 | $ Change | % Change |
| Noninterest income: | | | | |
| Trust fees | $930 | $952 | $ (22 ) | (2.3 )% |
| Service charges on deposit accounts | 492 | 497 | (5 ) | (1.0 ) |
| Other fees and commissions | 672 | 588 | 84 | 14.3 |
| Mortgage banking income | 292 | 222 | 70 | 31.5 |
| Securities gains, net | 366 | 310 | 56 | 18.1 |
| Brokerage fees | 204 | 215 | (11 ) | (5.1 ) |
| Income from Small Business Investment Companies (SBICs) | 166 | 234 | (68 ) | (29.1) |
| Other | 175 | 138 | 37 | 26.8 |
| Total noninterest income | $3,297 | $3,156 | $ 141 | 4.5 |

Trust income decreased slightly due to volatility in the equity markets. Service charge income was virtually unchanged for the 2016 quarter compared to the 2015 quarter. Mortgage banking income increased in the 2016 quarter, based on greater loan demand volume in existing markets. Securities gains increased in the 2016 quarter related to actions resulting from asset/liability strategy decisions. Income from Small Business Investment Companies (SBICs) reflected a $68,000 decrease compared to the 2015 quarter; this category of income is highly unpredictable.

Noninterest Expense, three months ended March 31, 2016 and 2015

For the three months ended March 31, 2016, noninterest expense decreased $129,000 or 1.3%. Details of individual accounts are shown in the table below.

| | Three Months Ended March 31, (Dollars in thousands) | | | |
|---|---|---|---|---|
| | 2016 | 2015 | $ Change | % Change |
| Noninterest Expense | | | | |
| Salaries | $4,215 | $4,147 | $ 68 | 1.6 % |
| Employee benefits | 1,114 | 1,075 | 39 | 3.6 |
| Occupancy and equipment | 1,099 | 1,172 | (73 ) | (6.2 ) |
| FDIC assessment | 188 | 185 | 3 | 1.6 |
| Bank franchise tax | 256 | 235 | 21 | 8.9 |
| Core deposit intangible amortization | 288 | 301 | (13 ) | (4.3 ) |
| Data processing | 444 | 462 | (18 ) | (3.9 ) |
| Software | 297 | 283 | 14 | 4.9 |
| Other real estate, net | 104 | 53 | 51 | 96.2 |
| Merger related expenses | — | 359 | (359 ) | (100.0) |
| Other | 1,913 | 1,775 | 138 | 7.8 |
| Total noninterest expense | $9,918 | $10,047 | $ (129 ) | (1.3 ) |

Salaries and employee benefits expense increased in the 2016 quarter as compared to 2015 quarter due to normal annual increases. Foreclosed real estate expenses increased during the 2016 quarter primarily due to a loss of $50,000 on the sale of one foreclosed property. The first quarter of 2015 noninterest expenses reflected nonrecurring merger related expenses.

The efficiency ratio for the 2016 quarter was 61.36% compared to 63.90% for the 2015 quarter. The Company expects continued improvement in this ratio in coming quarters.

Income Taxes

The effective tax rate for the first quarter of 2016 was 30.19% compared to 28.07% for the first quarter of 2015. The effective tax rate is lower than the statutory rate of 35% 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 loans. The increase in the effective tax rate of 2.12% is related to a lower level of tax exempt municipal securities income.

Fair Value Impact to Net Income

The following table presents the impact for the three month period ended March 31, 2016 of the accretable and amortizable fair value adjustments attributable to the July 2011 acquisition of MidCarolina and the January 2015 acquisition of MainStreet on net interest income and pretax income (dollars in thousands):

| | | | March 31, 2016 | |
|---|---|---|---|---|
| | Income Statement Effect | Premium (Discount) Balance on December 31, 2015 | Three Months Ended | Remaining Premium (Discount) Balance |
| Interest income/(expense): | | | | |
| Acquired performing loans | Income | $ (3,061) | $ 257 | $ (2,804) |
| Purchase acquired impaired loans | Income | (7,066) | 775 | (6,291) |
| FHLB advances | Expense | 42 | (5) | 37 |
| Junior subordinated debt | Expense | 1,761 | (26) | 1,735 |
| Net Interest Income | | | 1,001 | |
| | | | | |
| Non-interest (expense) | | | | |
| Amortization of core deposit intangible | Expense | $ 2,683 | (288) | $ 2,395 |
| Net non-interest expense | | | (288) | |
| | | | | |
| Change in pretax income | | | $ 713 | |

The following table presents the impact for the three month period ended March 31, 2015 of the accretable and amortizable fair value adjustments attributable to the two acquisitions mentioned above on net interest income and pretax income (dollars in thousands):

| | | | March 31, 2015 | | |
|---|---|---|---|---|---|
| | Income Statement Effect | Premium (Discount) Balance on December 31, 2014 | Additions | Three Months Ended | Remaining Premium (Discount) Balance |
| Interest income/(expense): | | | | | |
| Acquired performing loans | Income | $ (3,358) | $ (4,270) | $ 907 | $ (6,721) |
| Purchase acquired impaired loans | Income | (1,440) | (1,208) | 163 | (2,485) |
| FHLB Advances | Expense | 65 | — | (6) | 59 |
| Trust preferred securities | Expense | 1,862 | — | (25) | 1,837 |
| CD valuation | Expense | — | (288) | 72 | (216) |
| Brokered CD valuation | Expense | — | (2) | 2 | — |
| Net Interest Income | | | (5,768) | 1,113 | |
| | | | | | |
| Non-interest (expense) | | | | | |
| Amortization of core deposit intangible | Expense | $ 2,045 | 1,839 | (301) | $ 3,583 |
| Net non-interest expense | | | 1,839 | (301) | |
| | | | | | |
| Change in pretax income | | | $ (3,929) | $ 812 | |

During the first quarter 2016, the Company received two substantial payoffs of purchase acquired impaired loans from our MidCarolina acquisition that resulted in $460,000 in current quarter cash-basis accretion income. Of the $460,000, approximately $117,000 related to a consumer purpose loan. This is a relatively small segment of our loan portfolio and the additional accretion had a material and favorable impact on the segment's yield for the quarter, which was 16.87% compared to 6.35% for the prior year quarter. In addition, the 2016 quarter was negatively impacted by the completed amortization of a time deposit valuation adjustment related to the MainStreet acquisition of $72,000, which increased interest expense.

Generally accepted accounting principles for business combinations require the acquired balance sheet to be valued at fair value at the time of the merger. In the context of acquiring a commercial bank, most of the balance sheet is interest rate sensitive and this can generate significant discounts or premiums to contractual values. These discounts or premiums will have a potentially significant impact to net interest income and to net income.

The table below summarizes the impact of the fair value acquisition related accounting impact to net interest income and total pretax income of the MidCarolina ("MC" for the table below only) and MainStreet ("MS" for the table below only) acquisitions for the three month periods indicated (dollars in thousands):

| Three Months Ended March 31, | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | MC | MS | Total | MC | MS | Total |
| Net interest income | $689 | $312 | $1,001 | $410 | 703 | $1,113 |
| Core deposit amortization | (226) | (62) | (288) | (226) | (75) | (301) |
| Total pretax income | $463 | $250 | $713 | $184 | 628 | $812 |

The MidCarolina acquisition was effective July 1, 2011 and the MainStreet acquisition was effective January 1, 2015. Management expects that the acquisition accounting financial impact will continue to decline in subsequent quarters.

### 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, which tends 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. During the reported periods, inflation and interest rates have been low.

## CHANGES IN FINANCIAL POSITION

## 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, is used to meet collateral requirements for public deposits, and facilitates commercial customers' repurchase agreements. The portfolio consists primarily of high credit quality, very liquid securities. Federal agency and U. S. government sponsored enterprises, mortgage-backed securities, state and municipal securities, and corporates comprise the portfolio.

The available for sale securities portfolio was $356,998,000 at March 31, 2016, compared to $340,349,000 at December 31, 2015, an increase of $16,649,000 or 4.9%. At March 31, 2016, the available for sale portfolio had an amortized cost of $348,801,000, resulting in a net unrealized gain of $8,197,000. At December 31, 2015, the available for sale portfolio had an amortized cost of $334,008,000, resulting in a net unrealized gain of $6,341,000.

The Company is cognizant of the continuing historically low and recently volatile interest rate environment and has elected to maintain a defensive asset liability strategy of purchasing high quality taxable securities of relatively short duration and somewhat longer-term tax exempt securities, whose market values are not as volatile in rising rate environments as similar termed taxable investments.

The Company manages its investment portfolio on an aggregate portfolio basis for purposes of monitoring and controlling average life and duration. Accordingly, some individual purchases may fall outside these overall guidelines. The Company will continue to deploy its cash to the maximum extent practical and prudent, consistent with its liquidity and asset liability strategies, and regulatory requirements.

### Loans

The loan portfolio consists primarily of commercial and residential real estate loans, commercial loans to small and medium-sized businesses, construction and land development loans, and home equity loans.

Total loans were $1,034,564,000 at March 31, 2016, compared to $1,005,525,000 at December 31, 2015, an increase of $29,039,000 or 2.9%. The increase is a result of organic growth in North Carolina and Virginia.

Loans held for sale totaled $785,000 at March 31, 2016 and $3,266,000 at December 31, 2015. Loan production volume was $10,500,000 for the three month period ending March 31, 2016 and $59,030,000 for the year ended December 31, 2015. These loans were approximately 60% purchase and 40% refinancing.

Management of the loan portfolio is organized around segments. Each segment is comprised of various loan types that are reflective of operational and regulatory management and reporting requirements. The following table presents the Company's loan portfolio by segment as of March 31, 2016 and December 31, 2015 (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Commercial | $196,110 | $177,481 |
| Commercial real estate: | | |
| Construction and land development | 82,711 | 72,968 |
| Commercial real estate | 427,824 | 430,186 |
| Residential real estate: | | |
| Residential | 222,451 | 220,434 |
| Home equity | 100,019 | 98,449 |
| Consumer | 5,449 | 6,007 |
| Total loans | $1,034,564 | $1,005,525 |

Provision for Loan Losses

Provision for loan losses was $50,000 for the three month period ended March 31, 2016, compared to $600,000 for the same period ended March 31, 2015. The need for additional provision in the three month period ended March 31, 2016 was mitigated by improvement in various qualitative factors used in the determination of the allowance, notably asset quality and local economic conditions, Provision expense in the 2015 quarter was unusually large as a result of the quarterly review of expected cash flows from certain purchased credit impaired loans.

Allowance for Loan Losses ("ALLL")

The purpose of the ALLL is to provide for probable losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses and by recoveries of previously charged-off loans. Loan charge-offs decrease the allowance.

At March 31, 2016, the ALLL was $12,675,000 compared to $12,601,000 at December 31, 2015. The ALLL as a percentage of total loans was 1.23% and 1.25%, respectively.

As part of the Company's methodology to evaluate the adequacy of its ALLL, the Company computes its ASC 450 loan balance by reducing total loans by acquired loans and loans that were evaluated for impairment individually or smaller balance nonaccrual loans evaluated for impairment in homogeneous pools. The FASB ASC 450 loan loss reserve balance is the total ALLL reduced by allowances associated with these other pools of loans.

The general allowance, ASC 450 (FAS 5) reserves to FASB ASC 450 loans, was 1.35% at March 31, 2016, compared to 1.40% at December 31, 2015. On a dollar basis, the reserve was $12,227,000 at March 31, 2016, compared to $12,159,000 at December 31, 2015. The percentage of the reserve to total loans has declined due to improving local economic conditions and continued improvement in asset quality. This segment of the allowance represents by far the largest portion of the loan portfolio and the largest aggregate risk.

The specific allowance, ASC 310-40 (FAS 114) reserves to FASB ASC 310-40 loans, was 0.75% at March 31, 2016, compared to 0.74% at December 31, 2015. On a dollar basis, the reserve was $32,000 at March 31, 2016, compared to $35,000 at December 31, 2015. There is ongoing turnover in the composition of the impaired loan population, which decreased by a net $406,000 over December 31, 2015. Newly evaluated impaired loans did not have an impact on the overall impairment allowance.

The specific allowance does not include reserves related to acquired loans with deteriorated credit quality. This reserve was $415,000 at March 31, 2016 compared to $407,000 at December 31, 2015. This is the only portion of the reserve related to acquired loans. Cash flow expectations for these loans are reviewed on a quarterly basis and unfavorable changes in those estimates relative to the initial estimates can result in the need for additional loan loss provision. The decrease in this impairment for the current period is related to the recasting of expected cash flows during the third quarter, which utilized lifetime default probabilities and loss given default estimates. This recast also incorporated an upward migration in risk grades for loans in the acquired portfolio. The following table presents the Company's loan loss and recovery experience for the periods indicated (dollars in thousands):

Summary of Loan Loss Experience

| | Three Months Ended March 31, 2016 | Year Ended December 31, 2015 |
|---|---|---|
| Balance at beginning of period | $12,601 | $ 12,427 |
| | | |
| Charge-offs: | | |
| Construction and land development | — | 20 |
| Commercial real estate | — | 462 |
| Residential real estate | — | 15 |
| Home equity | — | 308 |
| Total real estate | — | 805 |
| Commercial and industrial | — | 175 |
| Consumer | 40 | 220 |
| Total charge-offs | 40 | 1,200 |
| | | |
| Recoveries: | | |
| Construction and land development | 3 | 81 |
| Commercial real estate | 4 | 43 |
| Residential real estate | 15 | 121 |
| Home equity | 4 | 18 |
| Total real estate | 26 | 263 |
| Commercial and industrial | 8 | 32 |
| Consumer | 30 | 129 |
| Total recoveries | 64 | 424 |
| | | |
| Net charge-offs (recoveries) | (24 ) | 776 |
| Provision for loan losses | 50 | 950 |
| Balance at end of period | $12,675 | $ 12,601 |

Asset Quality Indicators

The following table provides qualitative indicators relevant to the Company's loan portfolio for the three month period and year indicated below.

Asset Quality Ratios

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Allowance to loans | 1.23 % | 1.25 % |
| ASC 450 (FAS 5) ALLL | 1.35 | 1.40 |
| Net charge-offs (recoveries) to allowance (1) | (0.76 ) | 6.16 |
| Net charge-offs (recoveries) to average loans (1) | (0.01 ) | 0.08 |
| Nonperforming assets to total assets | 0.43 | 0.48 |
| Nonperforming loans to loans | 0.51 | 0.52 |
| Provision to net charge-offs (recoveries) (1) | (208.33 ) | 122.42 |
| Provision to average loans (1) | — | 0.10 |
| Allowance to nonperforming loans | 240.24 | 242.09 |

(1) - annualized.

Nonperforming Assets (Loans and Other Real Estate Owned)

Nonperforming loans include loans on which interest is no longer accrued and accruing loans that are contractually past due 90 days or more. Nonperforming loans include loans originated and loans acquired.

Nonperforming loans to total loans were 0.51% at March 31, 2016 and 0.52% at December 31, 2015.

Nonperforming assets include nonperforming loans and other real estate owned ("OREO"). Nonperforming assets represented 0.43% of total assets at March 31, 2016, down from 0.48% at December 31, 2015. This decrease was related primarily to the decreases in OREO and net charge-offs.

In most cases, it is the policy of the Company that any loan that becomes 90 days past due will automatically be placed on nonaccrual loan status, accrued interest reversed out of income, and further interest accrual ceased. Any payments received on such loans will be credited to principal. In some cases a loan in process of renewal may become 90 days past due. In these instances the loan may still be accruing because of a delayed renewal process in which the customer has not been billed.

Loans will only be restored to full accrual status after six consecutive months of payments that were each less than 30 days delinquent. The Company strictly adheres with this policy before restoring a loan to normal accrual status.

The following table presents the Company's nonperforming assets as of March 31, 2016 and December 31, 2015 (dollars in thousands):

Nonperforming Assets

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Nonaccrual loans: | | |
| Real estate | $ 5,123 | $ 5,106 |
| Commercial | 118 | 90 |
| Consumer | 35 | 9 |
| Total nonaccrual loans | 5,276 | 5,205 |
| Loans past due 90 days and accruing interest: | — | — |
| Total nonperforming loans | 5,276 | 5,205 |
| Other real estate owned | 1,493 | 2,184 |
| Total nonperforming assets | $ 6,769 | $ 7,389 |

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The following table shows loans that were considered impaired, exclusive of acquired impaired loans as of March 31, 2016 and December 31, 2015 (dollars in thousands):

Impaired Loans

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Accruing | $ 1,046 | $ 1,171 |
| Nonaccruing | 3,255 | 3,536 |
| Total impaired loans | $ 4,301 | $ 4,707 |

Troubled Debt Restructurings ("TDRs")

TDRs exist whenever the Company makes a concession to a customer based on the customer's financial distress that would not have otherwise been made in the normal course of business.

There was $1,806,000 in TDRs at March 31, 2016 compared to $1,958,000 at December 31, 2015.

Other Real Estate Owned

Other real estate owned was $1,493,000 and $2,184,000 as of March 31, 2016 and December 31, 2015, respectively. OREO is initially recorded at fair value, less estimated costs to sell, at the date of foreclosure. Loan losses resulting from foreclosure are charged against the ALLL at that time. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the new cost basis or fair value, less estimated costs to sell with any additional write-downs charged against earnings. For significant assets, these valuations are typically outside annual appraisals. The following table shows the Company's OREO as of March 31, 2016 and December 31, 2015 (dollars in thousands):

Other Real Estate Owned

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Construction and land development | $ 159 | $ 886 |
| 1-4 family residential | 718 | 643 |
| Commercial real estate | 616 | 655 |
| | $ 1,493 | $ 2,184 |

Deposits

The Company's deposits consist primarily of checking, money market, savings, and consumer time deposits. Total deposits were $1,292,431,000 at March 31, 2016 compared to $1,262,660,000 at December 31, 2015, an increase of $29,771,000 or 2.4%.

The Company's primary focus on the liability side of the balance sheet is growing core deposits and their affiliated relationships. The challenge in this ongoing low rate environment is to fund the Bank in a cost effective and competitive manner. The Company's cost of deposits for the first quarter of 2016 was 0.55%, up from 0.52% for the first quarter of 2015.

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 shareholders.

Shareholders' equity was $200,443,000 at March 31, 2016 compared to $197,835,000 at December 31, 2015, an increase of $2,608,000 or 1.3%.

The Company paid cash dividends of $0.24 per share during the first three months of 2016 while the aggregate basic and diluted earnings per share for the same period was $0.48 per share.

In July 2013, the Board of Governors of the Federal Reserve System issued final rules that make technical changes to its capital rules to align them with the Basel III regulatory capital framework and meet certain requirements of the Dodd-Frank Act. The final rules maintain the general structure of the prompt corrective action framework in effect at such time while incorporating certain increased minimum requirements. Effective January 1, 2015, the final rules require the Company and the Bank to comply with the following minimum capital ratios: (i) a new common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6.0% of risk-weighted assets (increased from the prior requirement of 4.0%); (iii) a total capital ratio of 8.0% of risk-weighted assets (unchanged from the prior requirement); and (iv) a leverage ratio of 4.0% of total assets (unchanged from the prior requirement). These are the initial capital requirements, which will be phased in over a four-year period. When fully phased in on January 1, 2019, the rules will require the Company and the Bank to maintain such minimum ratios plus a 2.5% "capital conservation buffer" (other than for the leverage ratio). The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing by the same amount each year until fully implemented at 2.5% on January 1, 2019. Management believes the Company and the Bank will be compliant with the fully phased-in requirements when they become effective January 1, 2019.

The following table provides information on the regulatory capital ratios for the Company and the Bank at March 31, 2016 and December 31, 2015. Management believes, as of March 31, 2016, that the Company and the Bank more than satisfy all capital adequacy requirements to which they are subject.

| | Percentage At March 31, 2016 | | Percentage At December 31, 2015 | |
|---|---|---|---|---|
| Risk-Based Capital Ratios: | Company | Bank | Company | Bank |
| Common equity tier 1 capital ratio | 12.57 | 14.29 | 12.88 | 14.58 |
| Tier 1 capital ratio | 14.87 | 14.29 | 15.23 | 14.58 |
| Total capital ratio | 15.95 | 15.36 | 16.34 | 15.67 |
| Leverage Capital Ratio: | | | | |
| Tier 1 leverage ratio | 11.96 | 11.50 | 12.05 | 11.54 |

Stock Repurchase Plan

On November 19, 2015, the Company filed a Form 8-K with the SEC to announce the approval by its Board of Directors of a stock repurchase program. The plan authorizes the repurchase of up to 300,000 shares of the Company's common shares over a two year period. The share purchase limit was established at such number to equal to approximately 3.5% of the 8,622,000 shares then outstanding at the time the Board approved the program.

In the three month period ended March 31, 2016, the Company repurchased 38,887 shares at an average cost of $24.78 per share, for a total cost of $964,000. No shares were repurchased during the same period in 2015.

Liquidity

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 in a timely manner. Liquidity management involves maintaining the Company's ability to meet the daily cash flow requirements of its customers, whether they are borrowers requiring funds or depositors desiring to withdraw funds. Additionally, the Company requires cash for various operating needs including dividends to shareholders, 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 Asset Liability Committee ("ALCO") and Board of Directors, both of which receive periodic reports of the Company's interest rate risk and liquidity position. The Company uses a computer simulation model to assist in the management of the future liquidity needs of the Company.

Liquidity sources include on balance sheet and off balance sheet sources.

Balance sheet liquidity sources include cash, amounts due from banks, loan repayments, and increases in deposits. The Company also maintains a large, high quality, very liquid bond portfolio, which is generally 50% to 60% unpledged and would, accordingly, be available for sale if necessary.

Off balance sheet sources include lines of credit from the Federal Home Loan Bank of Atlanta ("FHLB"), federal funds lines of credit, and access to the Federal Reserve Bank of Richmond's discount window.

The Company has a line of credit with the FHLB, equal to 30% of the Bank'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, second mortgage loans, home equity lines of credit, and commercial real estate loans. In addition, the Company pledges as collateral its capital stock in and deposits with the FHLB. At March 31, 2016, principal advance obligations to the FHLB consisted of $9,963,000 in fixed-rate, long-term advances compared to $9,958,000 in fixed-rate, long-term advances at December 31, 2015. The Company also had outstanding $70,700,000 in letters of credit at March 31, 2016 and at December 31, 2015. The letters of credit provide the Bank with alternate collateral for securing public entity deposits above Federal Deposit Insurance Company ("FDIC") insurance levels, thereby providing less need for collateral pledging from the securities portfolio, and thereby maximizing on balance sheet liquidity.

Short-term borrowings are discussed in Note 7 and long-term borrowings are discussed in Note 8 in the Consolidated Financial Statements included in this report.

The Company has federal funds lines of credit established with two correspondent banks in the amounts of $15,000,000 each, and has access to the Federal Reserve Bank's discount window. There were no amounts outstanding under these facilities at March 31, 2016.

The Company has a relationship with Promontory Network, the sponsoring entity for the Certificate of Deposit Account Registry Service® ("CDARS"). Through CDARS, the Company is able to provide deposit customers with access to aggregate FDIC insurance in amounts exceeding $250,000. This gives the Company the ability, as and when needed, to attract and retain large deposits from insurance conscious customers. CDARS are classified as brokered deposits; however, they are generally derived from customers with whom the Company has or wishes to have a direct and ongoing relationship. As a result, management considers these deposits functionally, though not technically, core deposits. With CDARS, the Company has the option to keep deposits on balance sheet or sell them to other members of the network. Additionally, subject to certain limits, the Bank can use CDARS to purchase cost-effective funding without collateralization and in lieu of generating funds through traditional brokered CDs or the FHLB. In this manner, CDARS can provide the Company with another funding option. Thus, CDARS serves as a deposit-gathering tool and an additional liquidity management tool. Deposits through the CDARS program as of March 31, 2016 and December 31, 2015, were $26,622,000 and $23,633,000, respectively.

Management believes that these sources provide sufficient and timely liquidity, both on and off the balance sheet.

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 subsidiaries to issue trust preferred securities, the Company does not have any off-balance sheet subsidiaries. Off-balance sheet transactions at March 31, 2016 and at December 31, 2015 were as follows (dollars in thousands):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Commitments to extend credit | $308,864 | $ 301,360 |
| Standby letters of credit | 4,005 | 4,286 |
| Mortgage loan rate-lock commitments | 7,695 | 5,365 |

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.

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 generally 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 in the following sections.

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 the ALCO and Board of Directors, both of which receive and review periodic reports of the Company's interest rate risk position.

The Company uses computer 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 instrument level optionality, 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 faster or to a greater extent than its liabilities (deposits and borrowings). An asset sensitive balance sheet will produce relatively 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 at March 31, 2016 is asset sensitive. As of early 2016, management expects that the general direction of market interest rates will be stable to up, though volatility, sometimes substantial, is anticipated in the short-term.

Earnings Simulation

The following tables shows the estimated impact of changes in interest rates on net interest income as of March 31, 2016 (dollars in thousands), assuming gradual and parallel changes in interest rates, and consistent levels of assets and liabilities. Net interest income for the following twelve months is projected to increase when interest rates are higher than current rates.

Estimated Changes in Net Interest Income

| | March 31, 2016 Change in Net Interest Income | |
|---|---|---|
| Change in interest rates | Amount | Percent |
| Up 4.00% | $7,533 | 15.5 % |
| Up 3.00% | 5,740 | 11.8 |
| Up 2.00% | 3,872 | 8.0 |
| Up 1.00% | 1,947 | 11.8 |
| Flat | — | — |
| Down 0.25% | (672 ) | 11.8 |
| Down 0.50% | (1,413 ) | (3.0 ) |

Management cannot predict future interest rates or their exact effect on net interest income. Computations of future effects of hypothetical interest rate changes are based on numerous assumptions and should not be relied upon as indicative of actual results. Certain limitations are inherent in such computations. Assets and liabilities may react differently than projected to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while rates on other types of assets and liabilities may lag changes in market interest rates. Interest rate shifts may not be parallel.

Changes in interest rates can cause substantial changes in the amount of prepayments of loans and mortgage-backed securities, which may in turn affect the Company's interest rate sensitivity position. Additionally, credit risk may rise if an interest rate increase adversely affects the ability of borrowers to service their debt.

Economic Value Simulation

Economic value simulation is used to calculate the estimated fair value of assets and liabilities over different interest rate environments. Economic values are calculated based on discounted cash flow analysis. The net economic value of equity is the economic value of all assets minus the economic value of all liabilities. The change in net economic value over different rate environments is an indication of the longer-term earnings capability of the balance sheet. The same assumptions are used in the economic value simulation as in the earnings simulation. The economic value simulation uses instantaneous rate shocks to the balance sheet.

The following table reflects the estimated change in net economic value over different rate environments using economic value simulation for the balances at the quarterly period ended March 31, 2016 (dollars in thousands):

Estimated Changes in Economic Value of Equity

| | March 31, 2016 | | |
|---|---|---|---|
| Change in interest rates | Amount | $ Change | % Change |
| Up 4.00% | $274,676 | $65,561 | 31.4 % |
| Up 3.00% | 269,169 | 60,054 | 11.8 |
| Up 2.00% | 258,986 | 49,871 | 23.8 |
| Up 1.00% | 239,668 | 30,553 | 11.8 |
| Flat | 209,115 | — | — |
| Down 0.25% | 199,138 | (9,977 ) | 11.8 |
| Down 0.50% | 188,656 | (20,459 ) | (9.8 ) |

Due to the current low interest rate environment, no measurement was considered necessary for a further decline in interest rates. There have been no material changes to market risk as disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. 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, 2016. 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, 2016, that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

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.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 15, 2016.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On November 19, 2015, the Company's Board of Directors authorized a share repurchase program of up to 300,000 shares of the Company's outstanding common stock for a period of two years. Repurchases may be made through open market purchases or in privately negotiated transactions, and shares repurchased will be returned to the status of authorized and unissued shares of common stock. The actual timing, number, and value of shares repurchased under the program will be determined by management.

Shares of the Company's common stock were repurchased during the three months ended March 31, 2016, as detailed below. Under the share repurchase program, the Company has the remaining authority to repurchase up to 247,412 shares of the Company's common stock as of March 31, 2016.

| Period Beginning on First Day of Month Ended | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under Plans or Programs |
|---|---|---|---|---|
| January 31, 2016 | 30,166 | $ 24.90 | 30,166 | 256,133 |
| February 29, 2016 | 8,721 | 24.37 | 8,721 | 247,412 |
| March 31, 2016 | — | — | — | 247,412 |
| Total | 38,887 | $ 24.78 | 38,887 | |

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

(a) Required 8-K disclosures

None

(b) Changes in Nominating Process

None

ITEM 6. EXHIBITS

| | |
|---|---|
| 11.0 | Refer to EPS calculation in the Notes to Financial Statements |
| 31.1 | Section 302 Certification of Jeffrey V. Haley, President and Chief Executive Officer |
| 31.2 | Section 302 Certification of William W. Traynham, Executive Vice President and Chief Financial Officer |
| 32.1 | Section 906 Certification of Jeffrey V. Haley, President and Chief Executive Officer |
| 32.2 | Section 906 Certification of William W. Traynham, Executive Vice President and Chief Financial Officer |
| 101 | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of March 31, 2016 and December 31, 2015, (ii) the Consolidated Statements of Income for the three months ended March 31, 2016 and March 31, 2015, (iii) the Consolidated Statements of Comprehensive Income for the three months ended March 31, 2016 and March 31, 2015, (iv) the Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2016 and March 31, 2015, (v) the Consolidated Statements of Cash Flows for the three months ended March 31, 2016 and March 31, 2015 and (vi) the Notes to the Consolidated Financial Statements (furnished herewith). |

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/ Jeffrey V. Haley<br>Jeffrey V. Haley<br>President and Chief Executive Officer |
| Date - May 9, 2016 | (principal executive officer) |
| | /s/ William W. Traynham<br>William W. Traynham<br>Executive Vice President and |
| Date - May 9, 2016 | (principal financial officer) |
| | /s/ Cathy W. Liles<br>Cathy W. Liles<br>Senior Vice President and |
| Date - May 9, 2016 | (principal accounting officer) |