AMERICAN NATIONAL BANKSHARES INC.
Form 10-Q
August 08, 2014

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 June 30, 2014.

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	
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
Smaller reporting company -

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

YesoNox

At August 6, 2014, the Company had 7,840,132 shares of Common Stock outstanding, $1 par value.

AMERICAN NATIONAL BANKSHARES INC.

Index

2

Index
Part I. Financial Information
Item 1. Financial Statements

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

	(Unaudited) June 30, 2014	(Audited) December 31, 2013
Assets		
Cash and due from banks	$21,295	$19,808
Interest-bearing deposits in other banks	22,948	47,873
Securities available for sale, at fair value	349,719	346,124
Restricted stock, at cost	5,064	4,889
Loans held for sale	118	2,760
Loans, net of unearned income	813,057	794,671
Less allowance for loan losses	(12,763)	(12,600)
Net loans	800,294	782,071
Premises and equipment, net	23,083	23,674
Other real estate owned, net	2,622	3,422
Goodwill	39,043	39,043
Core deposit intangibles, net	2,498	3,159
Bank owned life insurance	14,945	14,746
Accrued interest receivable and other assets	19,019	19,943
Total assets	$1,300,648	$1,307,512
Liabilities		
Liabilities:		
Demand deposits -- noninterest bearing	$228,588	$229,347
Demand deposits -- interest bearing	189,700	167,736
Money market deposits	165,090	185,270
Savings deposits	88,539	85,724
Time deposits	363,883	389,598
Total deposits	1,035,800	1,057,675
Short-term borrowings:		
Customer repurchase agreements	38,420	39,478
Other short-term borrowings	12,000	-
Long-term borrowings	9,924	9,951
Trust preferred capital notes	27,470	27,419
Accrued interest payable and other liabilities	4,951	5,438
Total liabilities	1,128,565	1,139,961
Shareholders' equity		

Preferred stock, $5 par, 2,000,000 shares authorized, none outstanding	-	-
Common stock, $1 par, 20,000,000 shares authorized, 7,840,132 shares outstanding at June 30, 2014 and 7,890,697 shares outstanding at December 31, 2013	7,840	7,891
Capital in excess of par value	56,944	58,050
Retained earnings	102,152	99,090
Accumulated other comprehensive income, net	5,147	2,520
Total shareholders' equity	172,083	167,551
Total liabilities and shareholders' equity	$ 1,300,648	$ 1,307,512

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

3

Index

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

	Three Months Ended June 30	
	2014	2013
Interest and Dividend Income:		
Interest and fees on loans	$9,687	$11,358
Interest and dividends on securities:		
Taxable	968	851
Tax-exempt	1,016	1,045
Dividends	74	54
Other interest income	35	39
Total interest and dividend income	11,780	13,347
Interest Expense:		
Interest on deposits	1,161	1,369
Interest on short-term borrowings	2	14
Interest on long-term borrowings	81	82
Interest on trust preferred capital notes	185	189
Total interest expense	1,429	1,654
Net Interest Income	10,351	11,693
Provision for Loan Losses	150	-
Net Interest Income After Provision for Loan Losses	10,201	11,693
Noninterest Income:		
Trust fees	1,017	944
Service charges on deposit accounts	431	429
Other fees and commissions	493	463
Mortgage banking income	275	531
Securities gains, net	150	1
Other	334	318
Total noninterest income	2,700	2,686
Noninterest Expense:		
Salaries	3,638	3,503
Employee benefits	847	867
Occupancy and equipment	910	872
FDIC assessment	165	161
Bank franchise tax	231	185
Core deposit intangible amortization	330	421
Data processing	345	310
Software	235	249
Foreclosed real estate, net	(9)	193

Other	1,673	1,667
Total noninterest expense	8,365	8,428
Income Before Income Taxes	4,536	5,951
Income Taxes	1,303	1,741
Net Income	$3,233	$4,210
Net Income Per Common Share:		
Basic	$0.41	$0.54
Diluted	$0.41	$0.53
Average Common Shares Outstanding:		
Basic	7,872,079	7,867,222
Diluted	7,879,854	7,876,969

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

Index

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

	Six Months Ended June 30	
	2014	2013
Interest and Dividend Income:		
Interest and fees on loans	$19,534	$22,753
Interest and dividends on securities:		
Taxable	1,932	1,729
Tax-exempt	2,051	2,097
Dividends	149	109
Other interest income	68	68
Total interest and dividend income	23,734	26,756
Interest Expense:		
Interest on deposits	2,390	2,805
Interest on short-term borrowings	4	35
Interest on long-term borrowings	161	164
Interest on trust preferred capital notes	369	377
Total interest expense	2,924	3,381
Net Interest Income	20,810	23,375
Provision for Loan Losses	150	294
Net Interest Income After Provision for Loan Losses	20,660	23,081
Noninterest Income:		
Trust fees	2,139	1,532
Service charges on deposit accounts	844	838
Other fees and commissions	937	922
Mortgage banking income	538	1,249
Securities gains, net	189	199
Other	756	716
Total noninterest income	5,403	5,456
Noninterest Expense:		
Salaries	7,176	6,942
Employee benefits	1,822	1,766
Occupancy and equipment	1,846	1,788
FDIC assessment	329	322
Bank franchise tax	453	372
Core deposit intangible amortization	661	841
Data processing	693	587
Software	497	461
Foreclosed real estate, net	7	436
Other	3,304	3,231
Total noninterest expense	16,788	16,746
Income Before Income Taxes	9,275	11,791

Income Taxes	2,592	3,430
Net Income	$6,683	$8,361
Net Income Per Common Share:		
Basic	$0.85	$1.06
Diluted	$0.85	$1.06
Average Common Shares Outstanding:		
Basic	7,886,232	7,862,719
Diluted	7,896,541	7,872,351

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

5

Index

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

	Three Months Ended June 30	
	2014	2013
Net income	$3,233	$4,210
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	2,422	(7,299)
Income tax (expense) benefit	(848)	2,554
Reclassification adjustment for gains on securities	(150)	(1)
Income tax expense	52	1
Other comprehensive income (loss)	1,476	(4,745)
Comprehensive income (loss)	$4,709	$(535)

	Six Months Ended June	
	2014	2013
Net income	$6,683	$8,361
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	4,231	(8,181)
Income tax (expense) benefit	(1,481)	2,863
Reclassification adjustment for gains on securities	(189)	(199)
Income tax expense	66	70
Other comprehensive income (loss)	2,627	(5,447)
Comprehensive income	$9,310	$2,914

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

Index

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Six Months Ended June 30, 2014 and 2013
(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, 2012	$ 7,847	$ 57,211	$ 90,591	$ 7,597	$ 163,246
Net income	-	-	8,361	-	8,361
Other comprehensive loss	-	-	-	(5,447)	(5,447)
Stock options exercised	6	96	-	-	102
Equity based compensation	19	274	-	-	293
Cash dividends declared, $0.46 per share	-	-	(3,619)	-	(3,619)
Balance, June 30, 2013	$ 7,872	$ 57,581	$ 95,333	$ 2,150	$ 162,936
Balance, December 31, 2013	$ 7,891	$ 58,050	$ 99,090	$ 2,520	$ 167,551
Net income	-	-	6,683	-	6,683
Other comprehensive income	-	-	-	2,627	2,627
Stock repurchased and retired	(70)	(1,430)	-	-	(1,500)
Equity based compensation	19	324	-	-	343
Cash dividends declared, $0.46 per share	-	-	(3,621)	-	(3,621)
Balance, June 30, 2014	$ 7,840	$ 56,944	$ 102,152	$ 5,147	$ 172,083

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

Index

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Six Months Ended June 30, 2014 and 2013
(Dollars in thousands) (Unaudited)

	2014	2013
Cash Flows from Operating Activities:		
Net income	$6,683	$8,361
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	150	294
Depreciation	857	854
Net accretion of acquisition accounting adjustments	(1,500)	(4,050)
Core deposit intangible amortization	661	841
Net amortization (accretion) of securities	1,303	1,617
Net gain on sale or call of securities	(189)	(199)
Gain on sale of loans held for sale	(426)	(1,099)
Proceeds from sales of loans held for sale	34,344	58,268
Originations of loans held for sale	(31,276)	(47,415)
Net gain on foreclosed real estate	(152)	(139)
Valuation allowance on foreclosed real estate	46	294
Equity based compensation expense	343	293
Deferred income tax expense (benefit)	212	(1,874)
Net change in interest receivable	168	(99)
Net change in other assets	(1,070)	1,619
Net change in interest payable	(20)	(51)
Net change in other liabilities	(467)	(53)
Net cash provided by operating activities	9,667	17,462
Cash Flows from Investing Activities:		
Proceeds from sales of securities available for sale	6,477	2,627
Proceeds from maturities, calls and paydowns of securities available for sale	35,795	32,216
Purchases of securities available for sale	(42,939)	(49,530)
Net change in restricted stock	(175)	407
Net increase in loans	(17,197)	(2,222)
Purchases of premises and equipment	(266)	(580)
Proceeds from sales of foreclosed real estate	1,292	1,518
Net cash used in investing activities	(17,013)	(15,564)
Cash Flows from Financing Activities:		
Net change in demand, money market, and savings deposits	3,840	22,413
Net change in time deposits	(25,715)	(3,477)
Net change in customer repurchase agreements	(1,058)	(7,970)
Net change in other short-term borrowings	12,000	-
Net change in long-term borrowings	(38)	(75)
Common stock dividends paid	(3,621)	(3,619)
Repurchase of stock	(1,500)	-
Proceeds from exercise of stock options	-	102
Net cash (used in) provided by financing activities	(16,092)	7,374

Net (Decrease) Increase in Cash and Cash Equivalents	(23,438)	9,272
Cash and Cash Equivalents at Beginning of Period	67,681	47,442
Cash and Cash Equivalents at End of Period	$44,243	$56,714

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

Index

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

Note 1 – Basis of Presentation

The consolidated financial statements include the accounts of American National Bankshares Inc. (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, the valuation of foreclosed real estate, goodwill and intangible assets, the valuation of deferred tax assets, other-than-temporary impairments of securities, and acquired loans with specific credit-related deterioration.

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 the year ending December 31, 2014. 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, 2013.

Note 2 – Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2014-01, "Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company is currently assessing the impact that ASU 2014-01 will have on its consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, "Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company is currently assessing the impact that ASU 2014-04 will have on its consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." The amendments in this ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results and include disposals of a major geographic area, a major line of business, or a major equity method investment. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. Additionally, the new guidance requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-08 to have a material impact on its consolidated financial statements.

Index

In June 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606". This ASU applies to any entity using GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition", most industry-specific guidance, and some cost guidance included in Subtopic 605-35, "Revenue Recognition—Construction-Type and Production-Type Contracts". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-09 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-10, "Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation". The amendments in this ASU remove all incremental financial reporting requirements from GAAP for development stage entities, including the removal of Topic 915, "Development Stage Entities", from the FASB Accounting Standards Codification. In addition, this ASU adds an example disclosure and removes an exception provided to development stage entities in Topic 810, "Consolidation", for determining whether an entity is a variable interest entity. The presentation and disclosure requirements in Topic 915 will no longer be required for the first annual period beginning after December 15, 2014. The revised consolidation standards are effective for annual periods beginning after December 15, 2015. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-10 to have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures". This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-11 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period". The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in "Compensation

– Stock Compensation (Topic 718)", should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Company is currently assessing the impact that ASU 2014-12 will have on its consolidated financial statements.

Note 3 – Securities

The amortized cost and estimated fair value of investments in debt and equity securities at June 30, 2014 and December 31, 2013 were as follows:

	June 30, 2014			
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Federal agencies and GSEs	$80,585	$ 233	$ 149	$80,669
Mortgage-backed and CMOs	59,920	1,323	229	61,014
State and municipal	189,003	8,373	133	197,243
Corporate	9,664	69	58	9,675
Equity securities	1,000	118	-	1,118
Total securities available for sale	$340,172	$ 10,116	$ 569	$349,719

	December 31, 2013			
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Federal agencies and GSEs	$66,241	$ 126	$ 486	$65,881
Mortgage-backed and CMOs	69,168	1,085	645	69,608
State and municipal	193,251	5,999	517	198,733
Corporate	10,959	4	164	10,799
Equity securities	1,000	103	-	1,103
Total securities available for sale	$340,619	$ 7,317	$ 1,812	$346,124

Index

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 balance sheet. The FRB requires the Bank to maintain stock with a par value equal to 6.0% of its common stock and paid-in surplus. One-half of this amount is paid to the Federal Reserve Bank and the remaining half is subject to call when deemed necessary by the Board of Governors of the Federal Reserve System. The FHLB requires the Bank to maintain stock in an amount equal to a specific percentage of the Bank's total assets and 4.5% of outstanding borrowings. The Bank also owns common stock in CBB Financial Corporation, a Community Bankers Bank located in Richmond, Virginia which provides services to community banks that was inherited from the merger with Community First Financial Corporation in 2006 and common stock in Danville Community Development Corporation, a corporation formed by local banks in the Danville, Virginia area that restores dilapidated properties for resale. The cost of restricted stock at June 30, 2014 and December 31, 2013 were as follows:

(in thousands)	June 30, 2014	December 31, 2013
FRB stock	$2,165	$ 2,722
FHLB stock	2,732	2,000
CBB Financial Corporation stock	101	101
Danville Community Development Corporation stock	66	66
Total restricted stock	$5,064	$ 4,889

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 June 30, 2014. 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.

	Total		Less than 12 Months		12 Months or More	
(in thousands)	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Federal agencies and GSEs	$33,328	$ 149	$13,801	$ 32	$19,527	$ 117
Mortgage-backed and CMOs	12,015	229	1,907	1	10,108	228
State and municipal	14,985	133	7,825	76	7,160	57
Corporate	2,783	58	-	-	2,783	58
Total	$63,111	$ 569	$23,533	$ 109	$39,578	$ 460

GSE debt securities: The unrealized losses on the Company's investment in 16 government sponsored entities ("GSE") 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 June 30, 2014.

Mortgage-backed securities and CMOs: The unrealized losses on the Company's investment in 10 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 their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2014.

State and municipal securities: The unrealized losses on 18 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 June 30, 2014.

Corporate securities: The unrealized losses on three investments in corporate 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 June 30, 2014.

Restricted stock: When evaluating restricted stock for impairment, its value is based on the ultimate recoverablity of the par value rather than by recognizing temporary declines is value. The company does not consider restricted stock to be other-than-temorailly impaired at June 30, 2014, and no impairment has been recognized.

Index

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities had been in a continuous unrealized loss position, at December 31, 2013.

(in thousands)	Total Estimated Fair Value	Unrealized Loss	Less than 12 Months Estimated Fair Value	Unrealized Loss	12 Months or More Estimated Fair Value	Unrealized Loss
Federal agencies and GSEs	$41,586	$ 486	$41,586	$ 486	$-	$ -
Mortgage-backed and CMOs	23,916	645	19,042	577	4,874	68
State and municipal	33,192	517	29,732	462	3,460	55
Corporate	7,347	164	7,347	164	-	-
Total	$106,041	$ 1,812	$97,707	$ 1,689	$8,334	$ 123

Other-Than-Temporary-Impaired Securities

As of June 30, 2014 and December 31, 2013, there were no securities classified as having other-than-temporary impairment.

Note 4 - Loans

Segments

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

(in thousands)	June 30, 2014	December 31, 2013
Commercial	$125,163	$122,553
Commercial real estate:		
Construction and land development	50,856	41,822
Commercial real estate	366,722	364,616
Residential real estate:		
Residential	175,387	171,917
Home equity	89,725	87,797
Consumer	5,204	5,966
Total loans	$813,057	$794,671

Acquired Loans

Interest income, including accretion, on loans acquired from MidCarolina Financial Corporation ("MidCarolina") in connection with the Company's acquisition of MidCarolina for the six months ended June 30, 2014 was approximately $6.1 million. This included $1.6 million in accretion income of which $88,000 was related to loan payoffs and renewals and $410,000 related to recoveries of loans charged off prior to the merger. The outstanding principal balance and the carrying amount of these loans included in the consolidated balance sheets at June 30, 2014 and December 31, 2013 are as follows:

(in thousands)	June 30, 2014	December 31, 2013
Outstanding principal balance	$101,006	$134,099

Carrying amount	93,053	124,828

The outstanding principal balance and related carrying amount of acquired impaired loans, for which the Company applies Accounting Standards Codification ("ASC") 310-30, to account for interest earned, at June 30, 2014 and December 31, 2013 are as follows:

(in thousands)	June 30, 2014	December 31, 2013
Outstanding principal balance	$ 19,241	$ 21,014
Carrying amount	15,372	16,644

The following table presents changes in the accretable discount on acquired impaired loans, for which the Company applies ASC 310-30, for the six months ended June 30, 2014. The accretion reflected below includes $88,000 related to loan payoffs.

(in thousands)	Accretable Discount
Balance at December 31, 2013	$ 2,046
Accretion	(676)
Reclassification from nonaccretable difference	462
Balance at June 30, 2014	$ 1,832

Index

Past Due Loans

The following table shows an analysis by portfolio segment of the Company's past due loans at June 30, 2014.

(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	$ 2	$ 20	$ -	$ 17	$ 39	$ 125,124	$ 125,163
Commercial real estate:							
Construction and land development	-	120	-	306	426	50,430	50,856
Commercial real estate	-	-	-	3,417	3,417	363,305	366,722
Residential:							
Residential	395	58	-	1,039	1,492	173,895	175,387
Home equity	-	-	-	440	440	89,285	89,725
Consumer	6	-	-	5	11	5,193	5,204
Total	$ 403	$ 198	$ -	$ 5,224	$ 5,825	$ 807,232	$ 813,057

The following table shows an analysis by portfolio segment of the Company's past due loans at December 31, 2013.

(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	$ 27	$ -	$ -	$ 11	$ 38	$ 122,515	$ 122,553
Commercial real estate:							
Construction and land development	-	51	-	877	928	40,894	41,822
Commercial real estate	667	-	-	2,879	3,546	361,070	364,616
Residential:							
Residential	642	202	-	880	1,724	170,193	171,917
Home equity	109	18	-	424	551	87,246	87,797
Consumer	21	1	-	-	22	5,944	5,966
Total	$ 1,466	$ 272	$ -	$ 5,071	$ 6,809	$ 787,862	$ 794,671

Index

Impaired Loans

The following table presents the Company's impaired loan balances by portfolio segment, excluding loans acquired with deteriorated credit quality, at June 30, 2014.

(in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 24	$ 24	$ -	$ 16	$ 1
Commercial real estate:					
Construction and land development	298	338	-	609	-
Commercial real estate	1,005	1,036	-	884	4
Residential:					
Residential	880	889	-	891	-
Home equity	434	434	-	421	-
Consumer	5	5	-	4	-
	$ 2,646	$ 2,726	$ -	$ 2,825	$ 5
With a related allowance recorded:					
Commercial	-	-	-	-	-
Commercial real estate:					
Construction and land development	600	600	22	604	16
Commercial real estate	2,204	2,224	616	2,228	4
Residential					
Residential	4	4	1	4	-
Home equity	-	-	-	-	-
Consumer	17	17	3	17	1
	$ 2,825	$ 2,845	$ 642	$ 2,853	$ 21
Total:					
Commercial	$ 24	$ 24	$ -	$ 16	$ 1
Commercial real estate:					
Construction and land development	898	938	22	1,213	16
Commercial real estate	3,209	3,260	616	3,112	8
Residential:					
Residential	884	893	1	895	-
Home equity	434	434	-	421	-
Consumer	22	22	3	21	1
	$ 5,471	$ 5,571	$ 642	$ 5,678	$ 26

Index

The following table presents the Company's impaired loan balances by portfolio segment, excluding loans acquired with deteriorated credit quality, at December 31, 2013.

(in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 19	$ 19	$ -	$ 20	$ 1
Commercial real estate:					
Construction and land development	18	18	-	261	4
Commercial real estate	936	936	-	950	13
Residential:					
Residential	880	888	-	1,200	11
Home equity	424	424	-	433	-
Consumer	-	-	-	-	-
	$ 2,277	$ 2,285	$ -	$ 2,864	$ 29
With a related allowance recorded:					
Commercial	$ -	$ -	$ -	$ -	$ -
Commercial real estate:					
Construction and land development	1,468	1,507	68	1,551	33
Commercial real estate	2,266	2,264	488	1,198	7
Residential:					
Residential	1,198	-	-	-	-
Home equity	-	-	-	-	-
Consumer	18	18	3	19	1
	$ 3,752	$ 3,789	$ 559	$ 2,768	$ 41
Total:					
Commercial	$ 19	$ 19	$ -	$ 20	$ 1
Commercial real estate:					
Construction and land development	1,486	1,525	68	1,812	37
Commercial real estate	3,202	3,200	488	2,148	20
Residential:					
Residential	880	888	-	1,200	11
Home equity	424	424	-	433	-
Consumer	18	18	3	19	1
	$ 6,029	$ 6,074	$ 559	$ 5,632	$ 70

The following table shows the detail of loans modified as troubled debt restructurings ("TDRs") during the three and six months ended June 30, 2014 included in the impaired loan balances. There were no loans modified as TDRs for the three and six months ended June 30, 2013.

	Loans Modified as a TDR for the Three Months Ended June 30, 2014		
(dollars in thousands)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment

Commercial	-	$	-		$	-
Commercial real estate	1		182			182
Construction and land development	-		-			-
Home Equity	1		8			8
Residential real estate	2		117			117
Consumer	1		4			4
Total	5	$	311		$	311

	Loans Modified as a TDR for the Six Months Ended June 30, 2014					
(dollars in thousands)	Number of Contracts		Pre-Modification Outstanding Recorded Investment			Post-Modification Outstanding Recorded Investment
Commercial	-	$	-		$	-
Commercial real estate	1		182			182
Construction and land development	-		-			-
Home Equity	1		8			8
Residential real estate	2		117			117
Consumer	1		4			4
Total	5	$	311		$	311

During the three and six months ended June 30, 2014 and 2013, the Company had no loans that subsequently defaulted within twelve months of modification.

Index
Risk Grades

The following table shows the Company's loan portfolio broken down by internal risk grading as of June 30, 2014.

(in thousands)
Commercial and Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Commercial	Commercial Real Estate Construction	Commercial Real Estate Other	Residential	Home Equity
Pass	$ 123,824	$ 45,033	$ 357,138	$ 163,897	$ 87,613
Special Mention	1,294	826	4,526	8,103	1,414
Substandard	45	4,997	5,058	3,387	698
Doubtful	-	-	-	-	-
Total	$ 125,163	$ 50,856	$ 366,722	$ 175,387	$ 89,725

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer
Performing	$ 5,199
Nonperforming	5
Total	$ 5,204

The following table shows the Company's loan portfolio broken down by internal risk grading as of December 31, 2013.

(in thousands)
Commercial and Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

	Commercial	Commercial Real Estate Construction	Commercial Real Estate Other	Residential	Home Equity
Pass	$ 121,033	$ 35,563	$ 351,801	$ 158,478	$ 85,163
Special Mention	1,500	1,005	6,795	8,242	1,650
Substandard	20	5,254	6,020	5,197	984
Doubtful	-	-	-	-	-
Total	$ 122,553	$ 41,822	$ 364,616	$ 171,917	$ 87,797

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer
Performing	$ 5,966

Nonperforming	-
Total	$ 5,966

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:

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

Index

(in thousands)	Six Months Ended June 30, 2014	Year Ended December 31, 2013	Six Months Ended June 30, 2013
Allowance for Loan Losses			
Balance, beginning of period	$12,600	$ 12,118	$12,118
Provision for loan losses	150	294	294
Charge-offs			