AMERICAN NATIONAL BANKSHARES INC.
Form 10-Q
August 08, 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 June 30, 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	
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.

Yes x No o

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

Yes x No o

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)
Yes o No x

At August 4, 2016, the Company had 8,609,160 shares of Common Stock outstanding, $1 par value.

AMERICAN NATIONAL BANKSHARES INC.
Index

		Page
Part I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements	
	Consolidated Balance Sheets as of June 30, 2016 (unaudited) and December 31, 2015	3
	Consolidated Statements of Income for the three and six months ended June 30, 2016 and 2015 (unaudited)	4
	Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2016 and 2015 (unaudited)	5
	Consolidated Statements of Changes in Shareholders' Equity for the three and six months ended June 30, 2016 and 2015 (unaudited)	6
	Consolidated Statements of Cash Flows for the six months ended June 30, 2016 and 2015 (unaudited)	7
	Notes to Consolidated Financial Statements (unaudited)	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	35
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	58
Item 4.	Controls and Procedures	60
Part II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	61
Item 1A.	Risk Factors	61
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	61
Item 3.	Defaults Upon Senior Securities	61
Item 4.	Mine Safety Disclosures	61
Item 5.	Other Information	61
Item 6.	Exhibits	62
SIGNATURES		63

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

Assets	(Unaudited) June 30, 2016	(*) December 31, 2015
Cash and due from banks	$21,625	$19,352
Interest-bearing deposits in other banks	51,716	75,985
Securities available for sale, at fair value	362,800	340,349
Restricted stock, at cost	5,362	5,312
Loans held for sale	4,692	3,266
Loans, net of unearned income	1,057,959	1,005,525
Less allowance for loan losses	(12,674)	(12,601)
Net loans	1,045,285	992,924
Premises and equipment, net	22,878	23,567
Other real estate owned, net of valuation allowance $134 in 2016 and $329 in 2015	1,289	2,184
Goodwill	43,872	43,872
Core deposit intangibles, net	2,107	2,683
Bank owned life insurance	17,885	17,658
Accrued interest receivable and other assets	22,140	20,447
Total assets	$1,601,651	$1,547,599
Liabilities		
Demand deposits -- noninterest bearing	$321,442	$322,442
Demand deposits -- interest bearing	205,440	227,030
Money market deposits	252,118	200,495
Savings deposits	116,047	115,383
Time deposits	403,338	397,310
Total deposits	1,298,385	1,262,660
Customer repurchase agreements	53,369	40,611
Long-term borrowings	9,969	9,958
Junior subordinated debt	27,673	27,622
Accrued interest payable and other liabilities	9,551	8,913
Total liabilities	1,398,947	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, 8,609,160 shares outstanding at June 30, 2016 and 8,622,007 shares outstanding at December 31, 2015	8,572	8,605
Capital in excess of par value	74,753	75,375
Retained earnings	115,648	111,565

Accumulated other comprehensive income, net	3,731	2,290
Total shareholders' equity	202,704	197,835
Total liabilities and shareholders' equity	$1,601,651	$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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest and Dividend Income:				
Interest and fees on loans	$11,642	$ 11,767	$23,757	$ 23,537
Interest on federal funds sold	—	1	—	5
Interest and dividends on securities:				
Taxable	1,150	994	2,234	1,969
Tax-exempt	817	940	1,640	1,900
Dividends	93	85	184	167
Other interest income	67	50	125	98
Total interest and dividend income	13,769	13,837	27,940	27,676
Interest Expense:				
Interest on deposits	1,314	1,184	2,611	2,378
Interest on short-term borrowings	1	2	2	5
Interest on long-term borrowings	81	81	162	161
Interest on junior subordinated debt	213	188	421	372
Total interest expense	1,609	1,455	3,196	2,916
Net Interest Income	12,160	12,382	24,744	24,760
Provision for Loan Losses	50	100	100	700
Net Interest Income After Provision for Loan Losses	12,110	12,282	24,644	24,060
Noninterest Income:				
Trust fees	961	1,005	1,891	1,957
Service charges on deposit accounts	514	525	1,006	1,022
Other fees and commissions	656	607	1,328	1,195
Mortgage banking income	365	389	657	611
Securities gains, net	222	237	588	547
Brokerage fees	223	211	427	426
Income from Small Business Investment Companies	72	94	238	328
Other	354	190	529	328
Total noninterest income	3,367	3,258	6,664	6,414
Noninterest Expense:				
Salaries	4,031	4,308	8,246	8,455
Employee benefits	1,055	1,111	2,169	2,186
Occupancy and equipment	1,059	1,024	2,158	2,196
FDIC assessment	193	195	381	380
Bank franchise tax	256	220	512	455
Core deposit intangible amortization	288	300	576	601
Data processing	459	483	903	945
Software	274	277	571	560
Other real estate owned, net	76	133	209	186
Merger related expense	—	1,502	—	1,861
Other	1,965	2,089	3,849	3,864
Total noninterest expense	9,656	11,642	19,574	21,689
Income Before Income Taxes	5,821	3,898	11,734	8,785

Income Taxes	1,733	1,018	3,518	2,390
Net Income	$4,088	$ 2,880	$8,216	$ 6,395
Net Income Per Common Share:				
Basic	$0.47	$ 0.33	$0.95	$ 0.73
Diluted	$0.47	$ 0.33	$0.95	$ 0.73
Average Common Shares Outstanding:				
Basic	8,610,156	8,707,504	8,610,998	8,713,528
Diluted	8,619,833	8,715,934	8,616,873	8,722,266

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

4

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

	Three Months Ended June 30,	
	2016	2015
Net income	$4,088	$2,880
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	583	(2,628)
Tax effect	(204)	920
Reclassification adjustment for gains on sales of securities	(222)	(237)
Tax effect	78	82
Other comprehensive income (loss)	235	(1,863)
Comprehensive income	$4,323	$1,017

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

	Six Months Ended June 30,	
	2016	2015
Net income	$8,216	$6,395
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	2,805	(1,394)
Tax effect	(982)	488
Reclassification adjustment for gains on sales of securities	(588)	(547)
Tax effect	206	191
Other comprehensive income (loss)	1,441	(1,262)
Comprehensive income	$9,657	$5,133

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

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	—	—	6,395	—	6,395
Other comprehensive income (loss)	—	—	—	(1,262)	(1,262)
Issuance of common stock (825,586 shares)	826	19,657	—	—	20,483
Stock repurchased (51,982 shares)	(52)	(1,123)	—	—	(1,175)
Stock options exercised (14,642 shares)	15	250	—	—	265
Equity based compensation (26,760 shares)	10	392	—	—	402
Cash dividends paid, $0.46 per share	—	—	(4,005)	—	(4,005)
Balance, June 30, 2015	$ 8,671	$ 76,826	$ 106,984	$ 2,402	$ 194,883
Balance, December 31, 2015	$ 8,605	$ 75,375	$ 111,565	$ 2,290	$ 197,835
Net income	—	—	8,216	—	8,216
Other comprehensive income	—	—	—	1,441	1,441
Stock repurchased (47,976 shares)	(48)	(1,155)	—	—	(1,203)
Stock options exercised (4,134 shares)	4	97	—	—	101
Vesting of restricted stock (3,046 shares)	3	(3)	—	—	—
Equity based compensation (30,995 shares)	8	439	—	—	447
Cash dividends paid, $0.48 per share	—	—	(4,133)	—	(4,133)
Balance, June 30, 2016	$ 8,572	$ 74,753	$ 115,648	$ 3,731	$ 202,704

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)

	Six Months Ended June 30,	
	2016	2015
Cash Flows from Operating Activities:		
Net income	$8,216	$6,395
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	100	700
Depreciation	949	882
Net accretion of acquisition accounting adjustments	(1,353)	(1,957)
Core deposit intangible amortization	576	601
Net amortization of securities	1,356	1,369
Net gains on sale or call of securities	(588)	(547)
Gain on sale of loans held for sale	(514)	(481)
Proceeds from sales of loans held for sale	30,465	25,601
Originations of loans held for sale	(31,377)	(27,224)
Net loss (gain) on other real estate owned	64	(10)
Valuation allowance on other real estate owned	76	63
Net loss (gain) on sale of premises and equipment	8	(5)
Equity based compensation expense	447	402
Net change in bank owned life insurance	(227)	(228)
Deferred income tax (benefit) expense	(1,763)	83
Net change in interest receivable	(858)	391
Net change in other assets	151	(350)
Net change in interest payable	13	(40)
Net change in other liabilities	625	(1,161)
Net cash provided by operating activities	6,366	4,484
Cash Flows from Investing Activities:		
Proceeds from sales of securities available for sale	9,317	7,429
Proceeds from maturities, calls and paydowns of securities available for sale	63,183	57,846
Purchases of securities available for sale	(93,501)	(60,117)
Net change in restricted stock	(50)	(224)
Net increase in loans	(51,143)	(26,465)
Proceeds from sale of premises and equipment	1	42
Purchases of premises and equipment	(269)	(601)
Proceeds from sales of other real estate owned	852	1,047
Cash paid in bank acquisition	—	(5,935)
Cash acquired in bank acquisition	—	18,173
Net cash used in investing activities	(71,610)	(8,805)
Cash Flows from Financing Activities:		
Net change in demand, money market, and savings deposits	29,697	39,984
Net change in time deposits	6,028	(18,980)
Net change in customer repurchase agreements	12,758	(3,357)
Common stock dividends paid	(4,133)	(4,005)
Repurchase of common stock	(1,203)	(1,175)
Proceeds from exercise of stock options	101	265

Net cash provided by financing activities	43,248	12,732
Net (Decrease) Increase in Cash and Cash Equivalents	(21,996)	8,411
Cash and Cash Equivalents at Beginning of Period	95,337	67,303
Cash and Cash Equivalents at End of Period	$73,341	$75,714

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 other real estate owned (OREO).
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.

During June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for Securities and Exchange Commission ("SEC") filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. For public companies that are not SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Company is currently assessing the impact that ASU 2016-13 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 six months ended June 30, 2016 and 2015 (dollars in thousands):

	Six Months Ended	
	June 30, 2016	June 30, 2015
Acquired performing loans	$115	$216
Purchase acquired impaired loans	370	803
CD valuation	—	—
Brokered CD valuation	—	—
Amortization of core deposit intangible	(124)	(147)
Net impact to income before taxes	$361	$872

Note 3 – Securities

The amortized cost and fair value of investments in debt and equity securities at June 30, 2016 and December 31, 2015 were as follows (dollars in thousands):

	June 30, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
Federal agencies and GSEs	$100,348	$ 381	$ 1	$100,728
Mortgage-backed and CMOs	80,948	1,467	19	82,396
State and municipal	162,905	6,037	7	168,935
Corporate	8,752	87	—	8,839
Equity securities	1,288	614	—	1,902
Total securities available for sale	$354,241	$ 8,586	$ 27	$362,800

	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 June 30, 2016 and December 31, 2015 was as follows (dollars in thousands):

	June 30, 2016	December 31, 2015
FRB stock	$ 3,547	$ 3,535
FHLB stock	1,815	1,777
Total restricted stock	$ 5,362	$ 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 June 30, 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	$8,505	$ 1	$8,505	$ 1	$—	$ —
Mortgage-backed and CMOs	2,589	19	648	1	1,941	18
State and municipal	5,064	7	4,244	7	820	—
Total	$16,158	$ 27	$13,397	$ 9	$2,761	$ 18

GSE debt securities: The unrealized loss on the Company's investment in two government sponsored entity ("GSE") securities was 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, 2016.

Mortgage-backed securities and CMOs: The unrealized losses on the Company's investment in six 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, 2016.

State and municipal securities: The unrealized losses on seven 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, 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 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 June 30, 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 June 30, 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 June 30, 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 June 30, 2016 and December 31, 2015, were comprised of the following (dollars in thousands):

	June 30, 2016	December 31, 2015
Commercial	$201,381	$ 177,481
Commercial real estate:		
Construction and land development	89,451	72,968
Commercial real estate	438,164	430,186
Residential real estate:		
Residential	216,857	220,434
Home equity	107,007	98,449
Consumer	5,099	6,007
Total loans	$1,057,959	$ 1,005,525

Acquired Loans

The outstanding principal balance and the carrying amount of these loans included in the consolidated balance sheets at June 30, 2016 and December 31, 2015 are as follows (dollars in thousands):

	June 30, 2016	December 31, 2015
Outstanding principal balance	$123,770	$ 145,380
Carrying amount	115,084	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):

	June 30, 2016	December 31, 2015
Outstanding principal balance	$36,401	$ 40,951
Carrying amount	30,302	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 June 30, 2016 and December 31, 2015 (dollars in thousands):

	June 30, 2016	December 31, 2015
Balance at January 1	$7,299	$ 1,440
Additions from merger with MainStreet	—	7,140
Accretion	(1,902)	(4,313)
Other changes, net	645	3,032
	$6,042	$ 7,299

Past Due Loans

The following table shows an analysis by portfolio segment of the Company's past due loans at June 30, 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	$—	$3	$—	$74	$77	$201,304	$201,381
Commercial real estate:							
Construction and land development	—	28	—	86	114	89,337	89,451
Commercial real estate	1	—	—	933	934	437,230	438,164
Residential:							
Residential	548	258	—	1,688	2,494	214,363	216,857
Home equity	191	57	—	628	876	106,131	107,007
Consumer	29	9	—	3	41	5,058	5,099
Total	$769	$355	$—	$3,412	$4,536	$1,053,423	$1,057,959

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 June 30, 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	1,577	1,577	—	1,096	40
Residential:					
Residential	2	3	—	1	2
Home equity	6	6	—	117	1
Consumer	10	10	—	11	—
	$ 1,598	$ 1,599	$ —	$ 1,228	$ 43
With a related allowance recorded:					
Commercial *	98	98	—	102	1
Commercial real estate:					
Construction and land development	291	291	4	410	10
Commercial real estate	384	384	2	413	7
Residential					
Residential	1,415	1,420	22	1,588	9
Home equity*	271	270	—	341	2
Consumer*	1	1	—	15	—
	$ 2,460	$ 2,464	$ 28	$ 2,869	$ 29
Total:					
Commercial	$ 101	$ 101	$ —	$ 105	$ 1
Commercial real estate:					
Construction and land development	291	291	4	410	10
Commercial real estate	1,961	1,961	2	1,509	47
Residential:					
Residential	1,417	1,423	22	1,589	11
Home equity	277	276	—	458	3
Consumer	11	11	—	26	—
	$ 4,058	$ 4,063	$ 28	$ 4,097	$ 72

*Allowance is reported as zero in the table due to presentation in thousands and rounding.

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

*Allowance is reported as zero in the table due to presentation in thousands and rounding.

The following tables show the detail of loans modified as troubled debt restructurings ("TDRs") during the three and six months ended June 30, 2016 included in the impaired loan balances (dollars in thousands):

Loan Type	Loans Modified as a TDR for the Three Months Ended June 30, 2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	1	$ 24	$ 24
Commercial real estate	1	937	937
Construction and land development	—	—	—
Home Equity	—	—	—
Residential real estate	1	2	1
Consumer	—	—	—
Total	3	$ 963	$ 962

Loan Type	Loans Modified as a TDR for the Six Months Ended June 30, 2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	1	$ 24	$ 24
Commercial real estate	2	1,005	1,003
Construction and land development	—	—	—
Home Equity	—	—	—
Residential real estate	1	2	1
Consumer	—	—	—
Total	4	$ 1,031	$ 1,028

The following tables show the detail of loans modified as TDRs during the three and six months ended June 30, 2015 included in the impaired loan balances (dollars in thousands):

Loan Type	Loans Modified as a TDR for the Three Months Ended June 30, 2015		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	—	$ —	$ —
Commercial real estate	2	249	249
Construction and land development	—	—	—
Home Equity	—	—	—
Residential real estate	2	51	51
Consumer	—	—	—
Total	4	$ 300	$ 300

	Loans Modified as a TDR for the Six Months Ended June 30, 2015		
Loan Type	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	—	$ —	$ —
Commercial real estate	3	256	255
Construction and land development	—	—	—
Home Equity	—	—	—
Residential real estate	4	394	389
Consumer	—	—	—
Total	7	$ 650	$ 644

During the three and six months ended June 30, 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 $1,208,000 in residential real estate loans in the process of foreclosure at June 30, 2016 and $533,000 and $643,000 in residential other real estate owned at June 30, 2016 and December 31, 2015, respectively.

Risk Grades

The following table shows the Company's loan portfolio broken down by internal risk grading as of June 30, 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	$ 200,609	$ 86,580	$ 426,666	$ 199,337	$ 104,426
Special Mention	683	818	6,811	12,517	1,548
Substandard	89	2,053	4,687	5,003	1,033
Doubtful	—	—	—	—	—
Total	$ 201,381	$ 89,451	$ 438,164	$ 216,857	$ 107,007

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

	Consumer
Performing	$ 5,061
Nonperforming	38
Total	$ 5,099

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):

	Six Months Ended June 30, 2016	Year Ended December 31, 2015	Six Months Ended June 30, 2015
Allowance for Loan Losses			
Balance, beginning of period	$12,601	$ 12,427	$12,427
Provision for loan losses	100	950	700
Charge-offs	(158)	(1,200)	(630)
Recoveries	131	424	296
Balance, end of period	$12,674	$ 12,601	$12,793
Reserve for Unfunded Lending Commitments			
Balance, beginning of period	$184	$ 163	$163
Provision for unfunded commitments	12	21	13
Charge-offs	—	—	—
Balance, end of period	$196	$ 184	$176

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 six months ended June 30, 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)	(78)	(158)
Recoveries	12	16	36	67	131
Provision for loan losses	184	(55)	(32)	3	100
Balance at June 30, 2016:	$ 2,221	$ 6,891	$ 3,510	$ 52	$ 12,674
Balance at June 30, 2016:					
Allowance for Loan Losses					
Individually evaluated for impairment	$ —	$ 6	$ 22	$ —	$ 28
Collectively evaluated for impairment	2,216	6,760	3,253	52	12,281
Acquired impaired loans	5	125	235	—	365
Total	$ 2,221	$ 6,891	$ 3,510	$ 52	$ 12,674
Loans					
Individually evaluated for impairment	$ 101	$ 2,252	$ 1,694	$ 11	$ 4,058
Collectively evaluated for impairment	200,730	511,742	306,055	5,072	1,023,599
Acquired impaired loans	550	13,621	16,115	16	30,302
Total	$ 201,381	$ 527,615	$ 323,864	$ 5,099	$ 1,057,959

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 six months ended June 30, 2016, are as follows (dollars in thousands):

	Goodwill	Intangibles
Balance at December 31, 2015	$ 43,872	$ 2,683
Additions	—	—
Amortization	—	(576)
Impairment	—	—
Balance at June 30, 2016	$ 43,872	$ 2,107

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 June 30, 2016 and December 31, 2015 (dollars in thousands):

	June 30, 2016	December 31, 2015
Customer repurchase agreements	$ 53,369	$ 40,611
	$ 53,369	$ 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 June 30, 2016, $424,116,000 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 June 30, 2016 and December 31, 2015 (dollars in thousands):

June 30, 2016			December 31, 2015		
Due by	Advance Amount	Weighted Average Rate	Due by	Advance Amount	Weighted Average Rate
November 30, 2017	$ 9,969	2.98 %	November 30, 2017	$ 9,958	2.98 %

The advance due in November 2017 is net of a fair value discount of $31,000. 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 June 30, 2016, the Bank's public deposits totaled $160,185,000. 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 June 30, 2016, the Company had $70,000,000 in letters of credit with the FHLB outstanding, as well as $142,438,000 in agency, state, and municipal securities pledged to provide collateral for such deposits.

22

Note 9 – Junior Subordinated Debt

On April 7, 2006, AMNB Statutory Trust I, a Delaware statutory trust and a wholly owned unconsolidated 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 not 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 June 30, 2016 and December 31, 2015 (dollars in thousands):

				Principal Amount	
Issuing Entity	Date Issued	Interest Rate	Maturity Date	June 30, 2016	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	4,237	4,209
MidCarolina Trust II	12/3/2003	Libor plus 2.95%	10/7/2033	2,817	2,794
				$27,673	$ 27,622

The principal amounts reflected above for the MidCarolina Trusts are net of fair value adjustments of $918,000 and $946,000, respectively at June 30, 2016 and December 31, 2015. 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 six months ended June 30, 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	(4,134)	24.30		
Forfeited	—	—		
Expired	—	—		
Outstanding at June 30, 2016	63,737	$ 24.48	2.14 years	$ 97
Exercisable at June 30, 2016	63,737	$ 24.48	2.14 years	$ 97

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 June 30, 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 six months ended June 30, 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	(19,219)	21.47
Forfeited	(547)	21.98
Nonvested at June 30, 2016	45,888	$ 22.76

As of June 30, 2016 and December 31, 2015, there was $640,000 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 1.71 years. The share based compensation expense for nonvested restricted stock was $249,000 and $173,000 during the first six 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 7,451 and 5,953 shares and recognized share based compensation expense of $198,000 and $135,000 during the first six months of 2016 and 2015, respectively.

24

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 and six month periods ended June 30, 2016 and 2015.

	Three Months Ended June 30,			
	2016		2015	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	8,610,156	$ 0.47	8,707,504	$ 0.33
Effect of dilutive securities - stock options	9,677	—	8,430	—
Diluted earnings per share	8,619,833	$ 0.47	8,715,934	$ 0.33

	Six Months Ended June 30,			
	2016		2015	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	8,610,998	$ 0.95	8,713,528	$ 0.73
Effect of dilutive securities - stock options	5,875	—	8,738	—
Diluted earnings per share	8,616,873	$ 0.95	8,722,266	$ 0.73

Outstanding stock options on common stock that were not included in computing diluted earnings per share for the six month periods ended June 30, 2016 and 2015 because their effects were anti-dilutive, averaged 30,571 and 79,726 shares, respectively.

Note 12 – Employee Benefit Plans

The following information for the six months ended June 30, 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	Six months ended June 30,	
	2016	2015
Service cost	$—	$—
Interest cost	134	148
Expected return on plan assets	(192)	(230)
Recognized net actuarial loss	114	308
Net periodic cost	$56	$226

25

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 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 June 30, 2016 Using			
Description	Balance at June 30, 2016	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	$100,728	$ —	$ 100,728	$ —
Mortgage-backed and CMOs	82,396	—	82,396	—
State and municipal	168,935	—	168,935	—
Corporate	8,839	—	8,839	—
Equity securities	1,902	—	1,902	—
Total	$362,800	$ —	$ 362,800	$ —

	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 June 30, 2016

Securities available for sale:					
Equity	$1,486	$ —	$ 93	$ —	$(1,579)	$ —

The Company's investment in preferred securities ,a level 3 input, was converted into common stock, a level 1 input, at June 29, 2016.

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 six month period ended June 30, 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 June 30, 2016 Using			
	Balance at June 30,	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	$4,692	$ —	$ 4,692	$ —
Impaired loans, net of valuation allowance	2,432	—	—	2,432
Other real estate owned, net	1,289	—	—	1,289

	Fair Value Measurements at December 31, 2015 Using			
	Balance at	Quoted Prices in	Significant Other	Significant Unobservable

Description	December 31, 2015	Active Markets for Identical Assets Level 1	Observable Inputs Level 2	Inputs 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

28

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 June 30, 2016

Assets	Valuation Technique	Unobservable Input	Weighted Rate	
Impaired loans	Discounted appraised value	Selling cost	8	%
Other real estate owned, net	Discounted appraised value	Selling cost	6	%

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 June 30, 2016 are as follows (dollars in thousands):

		Fair Value Measurements at June 30, 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	$73,341	$73,341	$—	$—	$73,341
Securities available for sale	362,800		362,477	—	362,477
Restricted stock	5,362	—	5,362	—	5,362
Loans held for sale	4,692	—	4,692	—	4,692
Loans, net of allowance	1,045,285	—	—	1,048,001	1,048,001
Bank owned life insurance	17,885	—	17,885	—	17,885
Accrued interest receivable	4,974	—	4,974	—	4,974
Financial Liabilities:					
Deposits	$1,298,385	$—	$ 895,047	$ 405,688	$1,300,735
Repurchase agreements	53,369	—	53,369	—	53,369
Other borrowings	9,969	—	—	10,285	10,285
Junior subordinated debt	27,673	—	—	26,856	26,856
Accrued interest payable	668	—	668	—	668

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 June 30, 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.

Segment information as of and for the three and six months ended June 30, 2016 and 2015 (unaudited), is shown in the following tables (dollars in thousands):

	Three Months Ended June 30, 2016				
	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$13,754	$ —	$ 15	$ —	$ 13,769
Interest expense	1,396	—	213	—	1,609
Noninterest income	2,177	1,184	6	—	3,367
Income (loss) before income taxes	5,566	679	(424)	—	5,821
Net income (loss)	3,891	477	(280)	—	4,088
Depreciation and amortization	759	3	—	—	762
Total assets	1,597,722	—	230,456	(226,527)	1,601,651
Goodwill	43,872	—	—	—	43,872
Capital expenditures	120	—	—	—	120

	Three Months Ended June 30, 2015				
	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$13,822	$ —	$ 15	$ —	$ 13,837
Interest expense	1,267	—	188	—	1,455
Noninterest income	2,038	1,215	5	—	3,258
Income (loss) before income taxes	3,647	573	(322)	—	3,898
Net income (loss)	2,671	422	(213)	—	2,880
Depreciation and amortization	739	3	—	—	742
Total assets	1,522,208	—	222,526	(220,378)	1,524,356
Goodwill	44,210	—	—	—	44,210
Capital expenditures	232	21	—	—	253

	Six Months Ended June 30, 2016				
	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$27,910	$ —	$ 30	$ —	$ 27,940
Interest expense	2,775	—	421	—	3,196
Noninterest income	4,335	2,318	11	—	6,664
Income (loss) before income taxes	11,182	1,334	(782)	—	11,734
Net income (loss)	7,798	934	(516)	—	8,216
Depreciation and amortization	1,519	6	—	—	1,525
Total assets	1,597,722	—	230,456	(226,527)	1,601,651
Goodwill	43,872	—	—	—	43,872
Capital expenditures	269	—	—	—	269

	Six Months Ended June 30, 2015				
	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$27,646	$ —	$ 30	$ —	$ 27,676
Interest expense	2,544	—	372	—	2,916
Noninterest income	4,021	2,383	10	—	6,414
Income (loss) before income taxes	8,154	1,223	(592)	—	8,785
Net income (loss)	5,896	890	(391)	—	6,395
Depreciation and amortization	1,477	6	—	—	1,483
Total assets	1,522,208	—	222,526	(220,378)	1,524,356
Goodwill	44,210	—	—	—	44,210
Capital expenditures	580	21	—	—	601

Note 15 – Supplemental Cash Flow Information

	Six Months Ended June 30,	
	2016	2015
Supplemental Schedule of Cash and Cash Equivalents:		
Cash and due from banks	$21,625	$24,548
Interest-bearing deposits in other banks	51,716	50,758
Federal funds sold	—	408
Cash and Cash Equivalents	$73,341	$75,714
Supplemental Disclosure of Cash Flow Information:		
Cash paid for:		
Interest on deposits and borrowed funds	$3,183	$2,905
Income taxes	3,397	2,415
Noncash investing and financing activities:		
Transfer of loans to other real estate owned	97	1,047
Unrealized gains on securities available for sale	2,217	(1,941)
Non-cash transactions related to acquisitions:		
Assets acquired:		
Investment securities	—	18,800
Restricted stock	—	738
Loans	—	114,902
Premises and equipment	—	1,475
Deferred income taxes	—	2,683
Core deposit intangible	—	1,839
Other real estate owned	—	168
Bank owned life insurance	—	1,955
Other assets	—	917
Liabilities assumed:		
Deposits	—	137,323
Other liabilities	—	3,076

Consideration:		
Issuance of common stock	—	20,483

33

Note 16 – Accumulated Other Comprehensive Income

Changes in each component of accumulated other comprehensive income ("AOCI") for the three and six months ended June 30, 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 March 31, 2015	$ 6,446	$ (2,181)	$ 4,265
Net unrealized gains on securities available for sale, net of tax, $(920)	(1,708)	—	(1,708)
Reclassification adjustment for gains on securities, net of tax, $(82)	(155)	—	(155)
Balance at June 30, 2015	$ 4,583	$ (2,181)	$ 2,402
Balance at March 31, 2016	$ 5,328	$ (1,832)	$ 3,496
Net unrealized gains on securities available for sale, net of tax, $204	379	—	379
Reclassification adjustment for gains on securities, net of tax, $(78)	(144)	—	(144)
Balance at June 30, 2016	$ 5,563	$ (1,832)	$ 3,731

For the Six 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, $(488)	(906)	—	(906)
Reclassification adjustment for gains on securities, net of tax, $(191)	(356)	—	(356)
Balance at June 30, 2015	$ 4,583	$ (2,181)	$ 2,402
Balance at December 31, 2015	$ 4,122	$ (1,832)	$ 2,290
Net unrealized losses on securities available for sale, net of tax, $982	1,823	—	1,823
Reclassification adjustment for gains on securities, net of tax, $(206)	(382)	—	(382)
Balance at June 30, 2016	$ 5,563	$ (1,832)	$ 3,731

Reclassifications Out of Accumulated Other Comprehensive Income
For the three and six months ended June 30, 2016 and 2015
(dollars in thousands)

For the Three Months Ended June 30, 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	$ 222	Securities gains, net
	(78)	Income taxes
Total reclassifications	$ 144	Net of tax

For the Three Months Ended June 30, 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	$ 237	Securities gains, net
	(82)	Income taxes
Total reclassifications	$ 155	Net of tax

For the Six Months Ended June 30, 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	$ 588	Securities gains, net
	(206)	Income taxes
Total reclassifications	$ 382	Net of tax

For the Six Months Ended June 30, 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	$ 547	Securities gains, net
	(191)	Income taxes
Total reclassifications	$ 356	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, Risk and Compliance 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 June 30, 2016 and 2015

For the quarter ended June 30, 2016, the Company reported net income of $4,088,000 compared to $2,880,000 for the comparable quarter in 2015. The $1,208,000 or 41.9% increase was primarily related to non-recurring MainStreet acquisition expenses, which totaled $1,502,000 for the second quarter of 2015.

SUMMARY INCOME STATEMENT
(Dollars in thousands)

Three Months Ended June 30,	2016	2015	$ Change	% Change
Interest income	$13,769	$13,837	$(68)	(0.5)%
Interest expense	(1,609)	(1,455)	(154)	10.6
Net interest income	12,160	12,382	(222)	(1.8)
Provision for loan losses	(50)	(100)	50	(50.0)
Noninterest income	3,367	3,258	109	3.3
Noninterest expense	(9,656)	(11,642)	1,986	(17.1)
Income tax expense	(1,733)	(1,018)	(715)	70.2
Net income	$4,088	$2,880	$1,208	41.9

Six months ended June 30, 2016 and 2015

For the six month period ended June 30, 2016, the Company reported net income of $8,216,000 compared to $6,395,000 for the comparable period in 2015. The $1,821,000 or 28.5% increase in earnings was primarily related to non-recurring MainStreet acquisition expenses, which totaled $1,861,000 for the first half of 2015.

SUMMARY INCOME STATEMENT
(Dollars in thousands)

Six months ended June 30,	2016	2015	$ Change	% Change
Interest income	$27,940	$27,676	$264	1.0 %
Interest expense	(3,196)	(2,916)	(280)	9.6
Net interest income	24,744	24,760	(16)	(0.1)
Provision for loan losses	(100)	(700)	600	(85.7)
Noninterest income	6,664	6,414	250	3.9
Noninterest expense	(19,574)	(21,689)	2,115	(9.8)
Income tax expense	(3,518)	(2,390)	(1,128)	47.2
Net income	$8,216	$6,395	$1,821	28.5

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 June 30, 2016 and 2015

Net interest income on a taxable equivalent basis decreased $268,000 or 2.1%, for the second quarter of 2016 compared to the same quarter of 2015. The decrease was a result of the decline in accretion income but was offset by increased average loans, securities and time deposits in the 2016 quarter compared to the 2015 quarter.

For the second quarter of 2016, the Company's yield on interest-earning assets was 3.89%, compared to 4.11% for the second quarter of 2015. The cost of interest-bearing liabilities was 0.61% compared to 0.56%, primarily related to an eight basis point increase in the cost of time deposits. The interest rate spread was 3.28% compared to 3.55%. The net interest margin, on a fully taxable equivalent basis, was 3.45% compared to 3.69%, a decrease of twenty-four basis points (0.24%).

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 June 30, 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 June 30,

	Average Balance		Income/Expense		Yield/Rate	
	2016	2015	2016	2015	2016	2015
Loans:						
Commercial	$200,000	$155,752	$1,976	$1,760	3.97 %	4.53%
Real estate	844,914	807,605	9,591	9,841	4.54	4.87
Consumer	5,166	11,562	140	205	10.90	7.11
Total loans	1,050,080	974,919	11,707	11,806	4.46	4.85
Securities:						
Federal agencies & GSEs	100,205	86,815	446	324	1.78	1.49
Mortgage-backed & CMOs	81,379	61,738	425	334	2.09	2.16
State and municipal	164,788	185,848	1,472	1,720	3.57	3.70
Other	14,692	15,412	130	125	3.54	3.24
Total securities	361,064	349,813	2,473	2,503	2.74	2.86
Federal funds sold	—	6,480	—	1	—	0.06
Deposits in other banks	53,548	66,236	67	50	0.50	0.30
Total interest-earning assets	1,464,692	1,397,448	14,247	14,360	3.89	4.11
Non-earning assets	127,569	133,419				
Total assets	$1,592,261	$1,530,867				
Deposits:						
Demand	$229,639	$237,102	43	22	0.08	0.04
Money market	221,508	195,578	91	61	0.17	0.13
Savings	117,408	109,397	14	14	0.05	0.05
Time	403,830	403,854	1,166	1,087	1.16	1.08
Total deposits	972,385	945,931	1,314	1,184	0.54	0.50
Customer repurchase agreements	47,607	51,417	1	2	0.01	0.02
Long-term borrowings	37,624	37,499	294	269	3.13	2.87
Total interest-bearing liabilities	1,057,616	1,034,847	1,609	1,455	0.61	0.56
Noninterest bearing demand deposits	323,135	290,695				
Other liabilities	9,825	8,662				
Shareholders' equity	201,685	196,663				
Total liabilities and shareholders' equity	$1,592,261	$1,530,867				
Interest rate spread					3.28 %	3.55%

Net interest margin			3.45 %	3.69 %
Net interest income (taxable equivalent basis)	12,638	12,905		
Less: Taxable equivalent adjustment	478	523		
Net interest income	$12,160	$12,382		

41

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

	Three Months Ended June 30, 2016 vs. 2015		
		Change Attributable to	
Interest income	Increase (Decrease)	Rate	Volume
Loans:			
Commercial	$216	$(240)	$ 456
Real estate	(250)	(692)	442
Consumer	(65)	79	(144)
Total loans	(99)	(853)	754
Securities:			
Federal agencies	122	68	54
Mortgage-backed	91	(12)	103
State and municipal	(248)	(58)	(190)
Other securities	5	11	(6)
Total securities	(30)	9	(39)
Federal funds sold	(1)	(1)	—
Deposits in other banks	16	27	(11)
Total interest income	(114)	(818)	704
Interest expense			
Deposits:			
Demand	21	22	(1)
Money market	30	21	9
Savings	—	(1)	1
Time	79	79	—
Total deposits	130	121	9
Customer repurchase agreements	(1)	(1)	—
Other borrowings	25	24	1
Total interest expense	154	144	10
Net interest income (taxable equivalent basis)	$(268)	$(962)	$ 694

Six months ended June 30, 2016 and 2015

Net interest income on a taxable equivalent basis decreased $88,000 or 0.34%, for the six months ended June 30, 2016 compared to the same period of 2015. This change was primarily driven by a decrease in accretion income but was positively impacted by increased average loans, securities and time deposits during the 2016 period.

For the first six months of 2016, the Company's yield on interest-earning assets was 4.01%, compared to 4.13% for the same period of 2015. The cost of interest-bearing liabilities was 0.62% compared to 0.57%, mostly related to an eleven basis point increase in the cost of time deposits. The interest rate spread was 3.39% compared to 3.56%. The net interest margin, on a fully taxable equivalent basis, was 3.56% compared to 3.71%, a decrease of fifteen basis points (0.15%).

Net interest income for the first six months of 2016 and 2015 was positively impacted by acquisition related accretion income. For the 2016 period, acquisition related accretion income was $1,353,000 or 5.5% of total net interest income. For the 2015 period, acquisition related accretion income was $1,957,000 or 7.9% of net interest income.

The following presentation is an analysis of net interest income and related yields and rates, on a taxable equivalent basis, for the six months ended June 30, 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)
Six Months Ended June 30,

	Average Balance		Income/Expense		Yield/Rate	
	2016	2015	2016	2015	2016	2015
Loans:						
Commercial	$194,137	$147,482	$3,830	$3,586	3.99 %	4.90%
Real estate	834,943	804,507	19,681	19,560	4.71	4.86
Consumer	5,336	13,434	371	445	14.06	6.68
Total loans	1,034,416	965,423	23,882	23,591	4.63	4.89
Securities:						
Federal agencies & GSEs	94,244	80,866	824	569	1.75	1.41
Mortgage-backed & CMOs	78,635	63,637	825	712	2.10	2.24
State and municipal	165,349	188,020	2,964	3,483	3.59	3.70
Other	15,810	15,293	278	248	3.52	3.24
Total securities	354,038	347,816	4,891	5,012	2.76	2.88
Federal funds sold	—	10,508	—	5	—	0.10
Deposits in other banks	56,157	66,425	125	98	0.45	0.30
Total interest-earning assets	1,444,611	1,390,172	28,898	28,706	4.01	4.13
Non-earning assets	127,081	134,521				
Total assets	$1,571,692	$1,524,693				
Deposits:						
Demand	$230,504	$224,955	80	40	0.07	0.04
Money market	213,391	199,236	166	132	0.16	0.13
Savings	117,529	108,545	28	26	0.05	0.05
Time	399,904	409,283	2,337	2,180	1.18	1.07
Total deposits	961,328	942,019	2,611	2,378	0.55	0.51
Customer repurchase agreements	46,008	52,294	2	5	0.01	0.02
Long-term borrowings	37,609	37,484	583	533	3.10	2.84
Total interest-bearing liabilities	1,044,945	1,031,797	3,196	2,916	0.62	0.57
Noninterest bearing demand deposits	316,699	286,855				
Other liabilities	9,443	9,665				
Shareholders' equity	200,605	196,376				
Total liabilities and shareholders' equity	$1,571,692	$1,524,693				
Interest rate spread					3.39 %	3.56%

Net interest margin			3.56 %	3.71%
Net interest income (taxable equivalent basis)	25,702	25,790		
Less: Taxable equivalent adjustment	958	1,030		
Net interest income	$24,744	$24,760		

43

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

	Six Months Ended June 30, 2016 vs. 2015		
		Change Attributable to	
Interest income	Increase (Decrease)	Rate	Volume
Loans:			
Commercial	$244	$(756)	$1,000
Real estate	121	(606)	727
Consumer	(74)	299	(373)
Total loans	291	(1,063)	1,354
Securities:			
Federal agencies	255	152	103
Mortgage-backed	113	(47)	160
State and municipal	(519)	(110)	(409)
Other securities	30	21	9
Total securities	(121)	16	(137)
Federal funds sold	(5)	(3)	(2)
Deposits in other banks	27	44	(17)
Total interest income	192	(1,006)	1,198
Interest expense			
Deposits:			
Demand	40	39	1
Money market	34	24	10
Savings	2	—	2
Time	157	208	(51)
Total deposits	233	271	(38)
Customer repurchase agreements	(3)	(2)	(1)
Other borrowings	50	48	2
Total interest expense	280	317	(37)
Net interest income (taxable equivalent basis)	$(88)	$(1,323)	$1,235

Noninterest Income, three months ended June 30, 2016 and 2015

For the quarter ended June 30, 2016, noninterest income increased $109,000 or 3.3% compared to the comparable 2015 quarter. Details of individual accounts are shown in the table below.

	Three Months Ended June 30, (Dollars in thousands)			
	2016	2015	$ Change	% Change
Noninterest income:				
Trust fees	$961	$1,005	$ (44)	(4.4)%
Service charges on deposit accounts	514	525	(11)	(2.1)
Other fees and commissions	656	607	49	8.1
Mortgage banking income	365	389	(24)	(6.2)
Securities gains, net	222	237	(15)	(6.3)
Brokerage fees	223	211	12	5.7
Income from Small Business Investment Companies (SBICs)	72	94	(22)	(23.4)
Other	354	190	164	86.3
Total noninterest income	$3,367	$3,258	$ 109	3.3

Trust income decreased slightly due to volatility early in the year in the equity markets. Service charge income was virtually unchanged for the 2016 quarter compared to the 2015 quarter. Other fees and commissions were positively impacted by higher levels of debit card transaction volume. Mortgage banking income and securities gains decreased slightly in the 2016 quarter. Income from Small Business Investment Companies ("SBICs") reflected a $22,000 decrease compared to the 2015 quarter; this category of income is highly unpredictable. Other income increased $164,000 compared to the same quarter of 2015 primarily from additional income from investments in limited partnerships.

Noninterest Income, six months ended June 30, 2016 and 2015

For the six months ended June 30, 2016, noninterest income increased $250,000 or 3.9% compared to the comparable 2015 period. Details of individual accounts are shown in the table below.

	Six Months Ended June 30, (Dollars in thousands)			
	2016	2015	$ Change	% Change
Noninterest income:				
Trust fees	$1,891	$1,957	$ (66)	(3.4)%
Service charges on deposit accounts	1,006	1,022	(16)	(1.6)
Other fees and commissions	1,328	1,195	133	11.1
Mortgage banking income	657	611	46	7.5
Securities gains, net	588	547	41	7.5
Brokerage fees	427	426	1	0.2
Income from Small Business Investment Companies (SBICs)	238	328	(90)	(27.4)
Other	529	328	201	61.3
Total noninterest income	$6,664	$6,414	$ 250	3.9

Trust income decreased slightly for the 2016 period compared to the 2015 period primarily due to volatility early in the year in the equity markets. Other fees and commissions was positively impacted by higher levels of debit card transaction volume. Mortgage banking income was higher in the 2016 period, based on greater loan demand in existing markets and the impact of the MainStreet acquisition. Income from SBICs reflected a $90,000 decrease compared to the 2015 period; this category of income is highly unpredictable. Other income increased $201,000 compared to the 2015 period primarily due to the additional income from investments in limited partnerships during the three months ended June 30, 2016.

Noninterest Expense, three months ended June 30, 2016 and 2015

For the three months ended June 30, 2016, noninterest expense decreased $1,986,000 or 17.1%. Details of individual accounts are shown in the table below.

	Three Months Ended June 30, (Dollars in thousands)			
	2016	2015	$ Change	% Change
Noninterest Expense				
Salaries	$4,031	$4,308	$(277)	(6.4)%
Employee benefits	1,055	1,111	(56)	(5.0)
Occupancy and equipment	1,059	1,024	35	3.4
FDIC assessment	193	195	(2)	(1.0)
Bank franchise tax	256	220	36	16.4
Core deposit intangible amortization	288	300	(12)	(4.0)
Data processing	459	483	(24)	(5.0)
Software	274	277	(3)	(1.1)
Other real estate owned, net	76	133	(57)	(42.9)
Merger related expenses	—	1,502	(1,502)	(100.0)
Other	1,965	2,089	(124)	(5.9)
Total noninterest expense	$9,656	$11,642	$(1,986)	(17.1)

Salaries and employee benefits expense decreased in the 2016 quarter as compared to 2015 quarter due to a decrease in full-time equivalent employees related to the integration of the MainStreet acquisition. Full time equivalent employees at the end of the 2016 quarter were 302, down from 322 for the prior year quarter. Other real estate owned expenses decreased during the 2016 quarter as a result of a reduction in the number of foreclosed properties. The largest component of the decrease in expense was the second quarter of 2015 nonrecurring merger related expenses of $1.5 million, which was 75.6% of the overall reduction.

Noninterest Expense, six months ended June 30, 2016 and 2015
For the six months ended June 30, 2016, noninterest expense decreased $2,115,000 or 9.8%. Details of individual accounts are shown in the table below.

	Six months ended June 30, (Dollars in thousands)			
	2016	2015	$ Change	% Change
Noninterest Expense				
Salaries	$8,246	$8,455	$(209)	(2.5)%
Employee benefits	2,169	2,186	(17)	(0.8)
Occupancy and equipment	2,158	2,196	(38)	(1.7)
FDIC assessment	381	380	1	0.3
Bank franchise tax	512	455	57	12.5
Core deposit intangible amortization	576	601	(25)	(4.2)
Data processing	903	945	(42)	(4.4)
Software	571	560	11	2.0
Other real estate owned, net	209	186	23	12.4
Merger related expenses	—	1,861	(1,861)	(100.0)
Other	3,849	3,864	(15)	(0.4)
Total noninterest expense	$19,574	$21,689	$(2,115)	(9.8)

Salaries and employee benefits expense decreased in the 2016 period as compared to the 2015 period due to a decrease in full-time equivalent employees related to the integration of the MainStreet acquisition. The largest component of the decrease in expense was the 2015 nonrecurring merger related expenses of $1.9 million, which was 88.0% of the overall reduction.

Non-GAAP Financial Measures

The efficiency ratio is calculated by dividing noninterest expense excluding gains or losses on the sale of OREO by net interest income including tax equivalent income on nontaxable loans and securities and noninterest income and excluding (i) gains or losses on securities and (ii) gains or losses on sale of premises and equipment. The efficiency ratio for the 2016 quarter was 60.91% compared to 72.76% for the 2015 quarter. The Company expects continued improvement in this ratio in coming quarters. This is a non-GAAP financial measure that the Company believes provides investors with important information regarding operational efficiency. Such information is not prepared in accordance with U.S. GAAP and should not be construed as such. Management believes, however, such financial information is meaningful to the reader in understanding operating performance, but cautions that such information not be viewed as a substitute for GAAP. The Company, in referring to its net income, is referring to income under GAAP. The components of the efficiency ratio calculation are summarized in the following table (dollars in thousands):

	Three Months Ended June 30,	
	2016	2015
Efficiency Ratio		
Noninterest expense	$9,656	$11,642
Subtract: loss on sale OREO	(37)	$(58)
	$9,619	$11,584
Net interest income	$12,160	$12,382
Tax equivalent adjustment	479	$523
Noninterest income	3,367	$3,258
Subtract: gain on securities	(222)	$(237)
Add/Subtract: (gain)/loss on sale of fixed assets	8	$(5)
	$15,792	$15,921
Efficiency ratio	60.91 %	72.76 %

Net interest margin is calculated by dividing tax equivalent net interest income by total average earning assets. Because a portion of interest income earned by the Company is nontaxable, the tax equivalent net interest income is considered in the calculation of this ratio. Tax equivalent net interest income is calculated by adding the tax benefit realized from interest income that is nontaxable to total interest income then subtracting total interest expense. The tax rate utilized in calculating the tax benefit for both 2016 and 2015 is 35%. The reconciliation of tax equivalent net interest income, which is not a measurement under GAAP, to net interest income, is reflected in the table below (in thousands):

	Three Months Ended June 30,	
	2016	2015
Reconciliation of Net Interest Income to Tax-Equivalent Net Interest Income		
GAAP measures:		
Interest income - loans	$ 11,707	$ 11,806
Interest income - investments and other	2,540	2,554
Interest expense - deposits	(1,314)	(1,184)
Interest expense - other borrowings	(1)	(2)

Interest expense - junior subordinated debt	(294		)	(269		)
Total net interest income	$	12,638		$	12,905	
Less non-GAAP measures:						
Tax benefit realized on non-taxable interest income - loans	$	(65	)	$	(21	)
Tax benefit realized on non-taxable interest income - municipal securities	(413		)	(502		)
Total benefit realized on non-taxable interest income	$	(478	)	$	(523	)

48

Income Taxes

The effective tax rate for the second quarter of 2016 was 29.77% compared to 26.12% for the second 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 3.65% is primarily related to a lower level of tax exempt municipal securities income.

The effective tax rate for the first six months of 2016 was 29.98% compared to 27.21% for the same period of 2015.

Fair Value Impact to Net Income

The following table presents the impact for the three and six month periods ended June 30, 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):

			June 30, 2016		
	Income Statement Effect	Premium (Discount) Balance on December 31, 2015	Three Months Ended	Six Months Ended	Remaining Premium (Discount) Balance
Interest income/(expense):					
Acquired performing loans	Income	$ (3,061)	$ 216	$ 473	$ (2,588)
Purchase acquired impaired loans	Income	(7,066)	167	942	(6,124)
FHLB advances	Expense	42	(6)	(11)	31
Junior subordinated debt	Expense	1,761	(25)	(51)	1,710
Net interest income			352	1,353	
Non-interest (expense)					
Amortization of core deposit intangible	Expense	$ 2,683	(288)	(576)	$ 2,107
Net non-interest expense			(288)	(576)	
Change in pretax income			$ 64	$ 777	

The following table presents the impact for the three and six month periods ended June 30, 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):

			June 30, 2015			
	Income Statement Effect	Premium (Discount) Balance on December 31, 2014	Additions	Three Months Ended	Six Months Ended	Remaining Premium (Discount) Balance
Interest income/(expense):						
Acquired performing loans	Income	$ (3,358)	$(4,270)	$ 807	$1,714	$ (5,914)
Purchase acquired impaired loans	Income	(1,440)	(1,208)	(4)	159	(2,489)
FHLB Advances	Expense	65	—	(5)	(11)	54
Junior subordinated debt	Expense	1,862	—	(26)	(51)	1,811
CD valuation	Expense	—	(288)	72	144	(144)
Brokered CD valuation	Expense	—	(2)	—	2	—
Net interest income			(5,768)	844	1,957	
Non-interest (expense)						
Amortization of core deposit intangible	Expense	$ 2,045	1,839	(300)	$(601)	$ 3,283
Net non-interest expense			1,839	(300)	(601)	
Change in pretax income						