AMERICAN NATIONAL BANKSHARES INC.
Form 10-Q
May 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2014.

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO_____ .

Commission file number: 0-12820

AMERICAN NATIONAL BANKSHARES INC.
(Exact name of registrant as specified in its charter)

VIRGINIA	54-1284688
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
628 Main Street	
Danville, Virginia	24541
(Address of principal executive offices)	(Zip Code)

(434) 792-5111
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YesxNoo

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

YesxNoo

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

YesoNox

At April 30, 2014, the Company had 7,905,243 shares of Common Stock outstanding, $1 par value.

AMERICAN NATIONAL BANKSHARES INC.

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Part I. Financial Information
Item 1. Financial Statements

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

	(Unaudited) March 31, 2014	(Audited) December 31, 2013
Assets		
Cash and due from banks	$25,880	$19,808
Interest-bearing deposits in other banks	45,466	47,873
Securities available for sale, at fair value	349,123	346,124
Restricted stock, at cost	4,529	4,889
Loans held for sale	1,389	2,760
Loans, net of unearned income	783,369	794,671
Less allowance for loan losses	(12,614)	(12,600)
Net loans	770,755	782,071
Premises and equipment, net	23,359	23,674
Other real estate owned, net	3,233	3,422
Goodwill	39,043	39,043
Core deposit intangibles, net	2,828	3,159
Bank owned life insurance	14,845	14,746
Accrued interest receivable and other assets	19,352	19,943
Total assets	$1,299,802	$1,307,512
Liabilities		
Liabilities:		
Demand deposits -- noninterest bearing	$218,795	$229,347
Demand deposits -- interest bearing	170,894	167,736
Money market deposits	194,528	185,270
Savings deposits	89,024	85,724
Time deposits	378,008	389,598
Total deposits	1,051,249	1,057,675
Customer repurchase agreements	34,153	39,478
Long-term borrowings	9,919	9,951
Trust preferred capital notes	27,444	27,419
Accrued interest payable and other liabilities	6,538	5,438
Total liabilities	1,129,303	1,139,961
Shareholders' equity		
Preferred stock, $5 par, 2,000,000 shares authorized, none outstanding	-	-
Common stock, $1 par, 20,000,000 shares authorized, 7,905,243 shares outstanding at March 31, 2014 and 7,890,697 shares outstanding at December 31, 2013	7,905	7,891
Capital in excess of par value	58,202	58,050
Retained earnings	100,721	99,090

Accumulated other comprehensive income, net	3,671	2,520
Total shareholders' equity	170,499	167,551
Total liabilities and shareholders' equity	$ 1,299,802	$ 1,307,512

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

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

	Three Months Ended March 31	
	2014	2013
Interest and Dividend Income:		
Interest and fees on loans	$9,847	$11,395
Interest and dividends on securities:		
Taxable	964	878
Tax-exempt	1,035	1,052
Dividends	75	55
Other interest income	33	29
Total interest and dividend income	11,954	13,409
Interest Expense:		
Interest on deposits	1,229	1,436
Interest on short-term borrowings	2	21
Interest on long-term borrowings	80	82
Interest on trust preferred capital notes	184	188
Total interest expense	1,495	1,727
Net Interest Income	10,459	11,682
Provision for Loan Losses	-	294
Net Interest Income After Provision for Loan Losses	10,459	11,388
Noninterest Income:		
Trust fees	1,122	588
Service charges on deposit accounts	413	409
Other fees and commissions	444	459
Mortgage banking income	263	718
Securities gains, net	39	198
Other	422	398
Total noninterest income	2,703	2,770
Noninterest Expense:		
Salaries	3,538	3,439
Employee benefits	975	899
Occupancy and equipment	936	916
FDIC assessment	164	161
Bank franchise tax	222	187
Core deposit intangible amortization	331	420
Data processing	348	277
Software	262	212
Foreclosed real estate, net	16	243

Other	1,631	1,564
Total noninterest expense	8,423	8,318
Income Before Income Taxes	4,739	5,840
Income Taxes	1,289	1,689
Net Income	$3,450	$4,151
Net Income Per Common Share:		
Basic	$0.44	$0.53
Diluted	$0.44	$0.53
Average Common Shares Outstanding:		
Basic	7,904,759	7,861,991
Diluted	7,917,601	7,871,508

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

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

	Three Months Ended March 31	
	2014	2013
Net income	$3,450	$4,151
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	1,809	(882)
Income tax (expense) benefit	(633)	309
Reclassification adjustment for gains on securities	(39)	(198)
Income tax expense	14	69
Other comprehensive income (loss)	1,151	(702)
Comprehensive income	$4,601	$3,449

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

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American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Three Months Ended March 31, 2014 and 2013
(Dollars in thousands except per share data) (Unaudited)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, December 31, 2012	$ 7,847	$ 57,211	$ 90,591	$ 7,597	$ 163,246
Net income	-	-	4,151	-	4,151
Other comprehensive loss	-	-	-	(702)	(702)
Equity based compensation	16	130	-	-	146
Cash dividends declared, $0.23 per share	-	-	(1,809)	-	(1,809)
Balance, March 31, 2013	$ 7,863	$ 57,341	$ 92,933	$ 6,895	$ 165,032
Balance, December 31, 2013	$ 7,891	$ 58,050	$ 99,090	$ 2,520	$ 167,551
Net income	-	-	3,450	-	3,450
Other comprehensive income	-	-	-	1,151	1,151
Equity based compensation	14	152	-	-	166
Cash dividends declared, $0.23 per share	-	-	(1,819)	-	(1,819)
Balance, March 31, 2014	$ 7,905	$ 58,202	$ 100,721	$ 3,671	$ 170,499

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

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American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Three Months Ended March 31, 2014 and 2013
(Dollars in thousands) (Unaudited)

	2014			2013		
Cash Flows from Operating Activities:						
Net income	$	3,450		$	4,151	
Adjustments to reconcile net income to net cash provided by operating activities:						
Provision for loan losses		-			294	
Depreciation		434			424	
Net accretion of purchase accounting adjustments		(896	)		(1,983	)
Core deposit intangible amortization		331			420	
Net amortization (accretion) of securities		668			788	
Net gain on sale or call of securities		(39	)		(198	)
Gain on sale of loans held for sale		(215	)		(650	)
Proceeds from sales of loans held for sale		13,745			33,782	
Originations of loans held for sale		(12,159	)		(23,675	)
Net gain on foreclosed real estate		(49	)		(14	)
Valuation allowance on foreclosed real estate		24			70	
Equity based compensation expense		166			146	
Deferred income tax expense (benefit)		94			(43	)
Net change in interest receivable		344			175	
		(565	)		(1,504	)

Net change in other assets				
Net change in interest payable	(43	)	(23	)
Net change in other liabilities	1,143		1,813	
Net cash provided by operating activities	6,433		13,973	
Cash Flows from Investing Activities:				
Proceeds from sales of securities available for sale	2,061		2,627	
Proceeds from maturities, calls and paydowns of securities available for sale	22,540		9,329	
Purchases of securities available for sale	(26,459	)	(19,555	)
Net change in restricted stock	360		411	
Net decrease (increase) in loans	12,225		(2,112	)
Purchases of premises and equipment	(119	)	(178	)
Proceeds from sales of foreclosed real estate	232		645	
Net cash provided by (used in) investing activities	10,840		(8,833	)
Cash Flows from Financing Activities:				
Net change in demand, money market, and savings deposits	5,164		4,199	
Net change in time deposits	(11,590	)	5,986	
Net change in customer repurchase agreements	(5,325	)	(3,276	)
Net change in long-term borrowings	(38	)	(37	)
Common stock dividends paid	(1,819	)	(1,809	)
	(13,608	)	5,063	

Net cash (used in) provided by financing activities				
Net Increase in Cash and Cash Equivalents		3,665		10,203
Cash and Cash Equivalents at Beginning of Period		67,681		47,442
Cash and Cash Equivalents at End of Period	$	71,346	$	57,645

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

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

Note 1 – Basis of Presentation

The consolidated financial statements include the accounts of American National Bankshares Inc. (the "Company") and its wholly owned subsidiary, American National Bank and Trust Company (the "Bank"). The Bank offers a wide variety of retail, commercial, secondary market mortgage lending, and trust and investment services which also include non-deposit products such as mutual funds and insurance policies.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of foreclosed real estate, goodwill and intangible assets, the valuation of deferred tax assets, other-than-temporary impairments of securities, and acquired loans with specific credit-related deterioration.

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

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the results of the interim periods. The results of operations for the interim periods are not necessarily indicative of the results that may occur for the year ending December 31, 2014. Certain reclassifications have been made to prior period balances to conform to the current period presentation. These statements should be read in conjunction with the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Note 2 – Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (the"FASB") issued Accounting Standards Update ("ASU") 2014-01, "Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-01 to have a material impact on its consolidated financial statements.

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

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

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Note 3 – Securities

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

	March 31, 2014			
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Federal agencies and GSEs	$72,872	$ 107	$ 394	$72,585
Mortgage-backed and CMOs	64,129	940	398	64,671
State and municipal	194,114	7,178	287	201,005
Corporate	9,733	13	115	9,631
Equity securities	1,000	231	-	1,231
Total securities available for sale	$341,848	$ 8,469	$ 1,194	$349,123

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

Restricted Stock

Due to restrictions placed upon the Bank's common stock investment in the Federal Reserve Bank of Richmond ("FRB") and Federal Home Loan Bank of Atlanta ("FHLB"), these securities have been classified as restricted equity securities and carried at cost. The restricted securities are not subject to the investment security classification and are included as a separate line item on the Company's balance sheet. The Federal Reserve Bank of Richmond requires the Bank to maintain stock with a par value equal to 4.5% of its outstanding capital. The FHLB requires the Bank to maintain stock in an amount equal to 6% of outstanding borrowings and a specific percentage of the Bank's total assets. The Bank also owns common stock in CBB Financial Corporation, a Community Bankers Bank located in Richmond, Virginia which provides services to community banks that was inherited from the merger with Community First Financial Corporation in 2006 and common stock in Danville Community Development Corporation, a corporation formed by local banks in the Danville, Virginia area that restores dilapidated properties for resale. The cost of restricted stock at March 31, 2014 and December 31, 2013 were as follows:

(in thousands)	March 31, 2014	December 31, 2013
FRB stock	$2,727	$ 2,722
FHLB stock	1,635	2,000
CBB Financial Corporation stock	101	101
Danville Community Development Corporation stock	66	66

Total restricted stock	$4,529	$ 4,889

Temporarily Impaired Securities

The following table shows estimated fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2014. The reference point for determining when securities are in an unrealized loss position is month-end. Therefore, it is possible that a security's market value exceeded its amortized cost on other days during the past twelve-month period.

	Total		Less than 12 Months		12 Months or More	
(in thousands)	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Federal agencies and GSEs	$52,841	$ 394	$52,841	$ 394	$-	$ -
Mortgage-backed and CMOs	21,655	398	19,001	354	2,654	44
State and municipal	25,232	287	20,672	215	4,560	72
Corporate	6,212	115	6,212	115	-	-
Total	$105,940	$ 1,194	$98,726	$ 1,078	$7,214	$ 116

GSE debt securities: The unrealized losses on the Company's investment in 26 government sponsored entities ("GSE") were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2014.

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Mortgage-backed securities and CMOs: The unrealized losses on the Company's investment in 16 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 March 31, 2014.

State and municipal securities: The unrealized losses on 28 state and municipal securities were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2014.

Corporate securities: The unrealized losses on six investments in corporate securities were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2014.

Restricted stock: When evaluating restricted stock for impairment, its value is based on the ultimate recoverablity of the par value rather than by recognizing temporary declines is value. The company does not consider restricted stock to be other-than-temoraily impaired at March 31, 2014, and no impairment has been recognized.

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

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

Other-Than-Temporary-Impaired Securities

As of March 31, 2014 and December 31, 2013, there were securities classified as having other-than-temporary impairment.

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Note 4 - Loans

Segments

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

(in thousands)	March 31, 2014	December 31, 2013
Commercial	$119,042	$122,553
Commercial real estate:		
Construction and land development	40,458	41,822
Commercial real estate	358,362	364,616
Residential real estate:		
Residential	170,517	171,917
Home equity	89,081	87,797
Consumer	5,909	5,966
Total loans	$783,369	$794,671

Acquired Loans

Interest income, including accretion, on loans acquired from MidCarolina Financial Corporation ("MidCarolina") in connection with the Company's acquisition of MidCarolina for the three months ended March 31, 2014 was approximately $3.4 million. This included $1.1 million in accretion income of which $88,000 was related to loan payoffs and renewals and $410,000 related to recoveries of loans charged off prior to the merger. The outstanding principal balance and the carrying amount of these loans included in the consolidated balance sheets at March 31, 2014 and December 31, 2013 are as follows:

(in thousands)	March 31, 2014	December 31, 2013
Outstanding principal balance	$110,702	$134,099
Carrying amount	102,133	124,828

The outstanding principal balance and related carrying amount of acquired impaired loans, for which the Company applies Accounting Standards Codification ("ASC") 310-30 (formerly Statement of Position ("SOP") 03-3), to account for interest earned, at March 31, 2014 and December 31, 2013 are as follows:

(in thousands)	March 31, 2014	December 31, 2013
Outstanding principal balance	$19,958	$21,014
Carrying amount	15,909	16,644

The following table presents changes in the accretable discount on acquired impaired loans, for which the Company applies ASC 310-30 (formerly SOP 03-3), for the three months ended March 31, 2014. The accretion reflected below includes $88,000 related to loan payoffs.

(in thousands)	Accretable Discount

Balance at December 31, 2013	$ 2,046
Accretion	(440)
Reclassification from nonaccretable difference	236
Balance at March 31, 2014	$ 1,842

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Past Due Loans

The following table shows an analysis by portfolio segment of the Company's past due loans at March 31, 2014.

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days + Past Due and Still Accruing	Non-Accrual Loans	Total Past Due	Current	Total Loans
Commercial	$ 69	$ -	$ -	$ 9	$ 78	$ 118,964	$ 119,042
Commercial real estate:							
Construction and land development	-	-	-	909	909	39,549	40,458
Commercial real estate	-	312	-	3,296	3,608	354,754	358,362
Residential:							
Residential	201	147	-	931	1,279	169,238	170,517
Home equity	109	432	-	409	950	88,131	89,081
Consumer	3	-	-	3	6	5,903	5,909
Total	$ 382	$ 891	$ -	$ 5,557	$ 6,830	$ 776,539	$ 783,369

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

(in thousands)	30- 59 Days Past Due	60-89 Days Past Due	90 Days + Past Due and Still Accruing	Non-Accrual Loans	Total Past Due	Current	Total Loans
Commercial	$ 27	$ -	$ -	$ 11	$ 38	$ 122,515	$ 122,553
Commercial real estate:							
Construction and land development	-	51	-	877	928	40,894	41,822
Commercial real estate	667	-	-	2,879	3,546	361,070	364,616
Residential:							
Residential	642	202	-	880	1,724	170,193	171,917
Home equity	109	18	-	424	551	87,246	87,797
Consumer	21	1	-	-	22	5,944	5,966
Total	$ 1,466	$ 272	$ -	$ 5,071	$ 6,809	$ 787,862	$ 794,671

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Impaired Loans

The following table presents the Company's impaired loan balances by portfolio segment, excluding loans acquired with deteriorated credit quality, at March 31, 2014.

(in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 16	$ 16	$ -	$ 14	$ -
Commercial real estate:					
Construction and land development	63	63	-	64	-
Commercial real estate	1,942	1,955	-	2,063	1
Residential:					
Residential	932	936	-	956	-
Home equity	409	409	-	413	-
Consumer	3	3	-	3	-
	$ 3,365	$ 3,382	$ -	$ 3,513	$ 1
With a related allowance recorded:					
Commercial	-	-	-	-	-
Commercial real estate:					
Construction and land development	1,453	1,496	88	1,456	8
Commercial real estate	2,231	2,239	483	2,246	2
Residential					
Residential	4	-	-	-	-
Home equity	-	-	-	-	-
Consumer	17	17	3	18	-
	$ 3,705	$ 3,752	$ 574	$ 3,720	$ 10
Total:					
Commercial	$ 16	$ 16	$ -	$ 14	$ -
Commercial real estate:					
Construction and land development	1,516	1,559	88	1,520	8
Commercial real estate	4,173	4,194	483	4,309	3
Residential:					
Residential	936	936	-	956	-
Home equity	409	409	-	413	-
Consumer	20	20	3	21	-
	$ 7,070	$ 7,134	$ 574	$ 7,233	$ 11

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

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

There were no loans modified as a troubled debt restructuring ("TDR") for the three months ended March 31, 2014 and 2013.

None of the loans modified as a TDR within the previous twelve months have subsequently defaulted during the three month periods ending March 31, 2014 and 2013.

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Risk Grades

The following table shows the Company's loan portfolio broken down by internal risk grading as of March 31, 2014.

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

	Commercial	Commercial Real Estate Construction	Commercial Real Estate Other	Residential	Home Equity
Pass	$ 117,576	$ 33,911	$ 347,780	$ 158,722	$ 86,519
Special Mention	1,450	887	5,345	8,265	1,788
Substandard	16	5,660	5,237	3,530	774
Doubtful	-	-	-	-	-
Total	$ 119,042	$ 40,458	$ 358,362	$ 170,517	$ 89,081

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer
Performing	$ 5,906
Nonperforming	3
Total	$ 5,909

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

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

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

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer
Performing	$ 5,966

Nonperforming	-
Total	$ 5,966

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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.

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Note 5 – Allowance for Loan Losses and Reserve for Unfunded Lending Commitments

Changes in the allowance for loan losses and the reserve for unfunded lending commitments as of the indicated dates and periods are presented below:

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

(in thousands)	Three Months Ended March 31, 2014	Year Ended December 31, 2013	Three Months Ended March 31, 2013
Allowance for Loan Losses			
Balance, beginning of period	$12,600	$ 12,118	$12,118
Provision for loan losses	-	294	294
Charge-offs	(73)	(837)	(287)
Recoveries	87	1,025	403
Balance, end of period	$12,614	$ 12,600	$12,528
Reserve for Unfunded Lending Commitments			
Balance, beginning of period	$210	$ 201	$201
Provision for loan losses	7	9	10
Charge-offs	-	-	-
Balance, end of period	$217	$ 210	$211

The following table presents the Company's allowance for loan losses by portfolio segment and the related loan balance total by segment at March 31, 2014.

(in thousands)	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for Loan Losses						
Balance as of December 31, 2013	$ 1,810	$ 6,819	$ 3,690	$ 99	$ 182	$12,600
Charge-offs	-	-	(53)	(20)	-	(73)
Recoveries	8	14	43	22	-	87
Provision for loan losses	(30)	113	126	(27)	(182)	-
Balance as of March 31, 2014	$ 1,788	$ 6,946	$ 3,806	$ 74	$ -	$12,614
Balance as of March 31, 2014:						
Allowance for Loan Losses						
Individually evaluated for impairment	$ -	$ 571	$ -	$ 3	$ -	$574
Collectively evaluated for impairment	1,785	6,110	3,615	71	-	11,581
Loans acquired with deteriorated credit quality	3	265	191	-	-	459

Total	$ 1,788	$ 6,946	$ 3,806	$ 74	$ -	$ 12,614
Loans						
Individually evaluated for impairment	$ 16	$ 5,689	$ 1,345	$ 20	$ -	$ 7,070
Collectively evaluated for impairment	118,906	384,693	250,902	5,889	-	760,390
Loans acquired with deteriorated credit quality	120	8,438	7,351	-	-	15,909
Total	$ 119,042	$ 398,820	$ 259,598	$ 5,909	$ -	$ 783,369

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The following table presents the Company's allowance for loan losses by portfolio segment and the related loan balance total by segment at December 31, 2013.

(in thousands)	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for Loan Losses						
Balance as of December 31, 2012	$ 1,450	$ 6,822	$ 3,638	$ 208	$ -	$ 12,118
Charge-offs	(129)	(164)	(369)	(175)	-	(837)
Recoveries	335	323	244	123	-	1,025
Provision for loan losses	154	(162)	177	(57)	182	294
Balance as of December 31, 2013	$ 1,810	$ 6,819	$ 3,690	$ 99	$ 182	$ 12,600
Balance as of December 31, 2013:						
Allowance for Loan Losses						
Individually evaluated for impairment	$ -	$ 556	$ -	$ 3	$ -	$ 559
Collectively evaluated for impairment	1,810	6,039	3,483	96	182	11,610
Loans acquired with deteriorated credit quality	-	224	207	-	-	431
Total	$ 1,810	$ 6,819	$ 3,690	$ 99	$ 182	$ 12,600
Loans						
Individually evaluated for impairment	$ 19	$ 4,688	$ 1,304	$ 18	$ -	$ 6,029
Collectively evaluated for impairment	122,424	392,720	250,906	5,948	-	771,998
Loans acquired with deteriorated credit quality	110	9,030	7,504	-	-	16,644
Total	$ 122,553	$ 406,438	$ 259,714	$ 5,966	$ -	$ 794,671

The allowance for loan losses is allocated to loan segments based upon historical loss factors, risk grades on individual loans, portfolio analyses 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 and other lending staff; 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 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, 2013.

Core deposit intangibles resulting from the acquisition of Community First Financial Corporation ("Community First") in April 2006 were $3,112,000 and are being amortized over 99 months. Core deposit intangibles resulting from the MidCarolina acquisition in July 2011 were $6,556,000 and are being amortized on an accelerated basis over 108 months.

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The changes in the carrying amount of goodwill and intangibles for the three months ended March 31, 2014, are as follows (in thousands):

	Goodwill	Intangibles
Balance as of December 31, 2013	$ 39,043	$ 3,159
Additions	-	-
Amortization	-	(331)
Impairment	-	-
Balance as of March 31, 2014	$ 39,043	$ 2,828

Note 7 – Short-term Borrowings

Short-term borrowings consist of customer repurchase agreements, overnight borrowings from the FHLB, and Federal Funds purchased. 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 soley of customer repurchase agreements at March 31, 2014 and December 31, 2013 (in thousands):

	March 31, 2014	December 31, 2013
Customer repurchase agreements	$ 34,153	$ 39,478

Note 8 – Long-term Borrowings

Under the terms of its collateral agreement with the FHLB, the Company provides a blanket lien covering all of its residential first mortgage loans, second mortgage loans, home equity lines of credit, and commercial real estate loans. In addition, the Company pledges as collateral its capital stock in the FHLB and deposits with the FHLB. The Company has a line of credit with the FHLB equal to 30% of the Company's assets, subject to the amount of collateral pledged. As of March 31, 2014, $409,241,000 in eligible collateral was pledged under the blanket floating lien agreement which covers both short-term and long-term borrowings. Long-term borrowings consisted of the following fixed rate, long-term advances as of March 31, 2014 and December 31, 2013 (dollars in thousands):

March 31, 2014			December 31, 2013		
Due by	Advance Amount	Weighted Average Rate	Due by	Advance Amount	Weighted Average Rate
			March 2014	$ 38	3.78 %
November 2017	$ 9,919	2.98 %	November 2017	9,913	2.98
	$ 9,919	2.98 %		$ 9,951	3.01 %

The advance due in November 2017 is net of a valuation allowance of $81,000. The original valuation allowance recorded on July 1, 2011, was a result of the merger with MidCarolina. The adjustment to the face value will be amortized into interest expense over the life of the borrowing.

In the regular course of conducting its business, the Company takes deposits from political subdivisions of the states of Virginia and North Carolina. At March 31, 2014, the Bank's public deposits totaled $138,237,000. The Company is required to provide collateral to secure the deposits that exceed the insurance coverage provided by the Federal Deposit Insurance Corporation. This collateral can be provided in the form of certain types of government or agency bonds or letters of credit from the FHLB. At March 31, 2014, the Company had $72,000,000 in letters of credit with the FHLB outstanding, as well as $108,947,000 in agency, state, and municipal securities to provide collateral for such deposits.

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Note 9 – Trust Preferred Capital Notes

On April 7, 2006, AMNB Statutory Trust I (the "AMNB Trust I"), a Delaware statutory trust and a wholly owned subsidiary of the Company, issued $20,000,000 of preferred securities (the "Trust Preferred Securities") in a private placement pursuant to an applicable exemption from registration. The Trust Preferred Securities mature on September 30, 2036, but may be redeemed at the Company's option (which option became effective beginning on September 30, 2011). Initially, the securities required quarterly distributions by the AMNB Trust I 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 AMNB Trust, along with proceeds of $619,000 received by the trust from the issuance of common securities by the trust to the Company, were used to purchase $20,619,000 of the Company's junior subordinated debt securities (the "Trust Preferred Capital Notes"), issued pursuant to junior subordinated debentures entered into between the Company and Wilmington Trust Company, as trustee. The proceeds of the Trust Preferred Capital Notes were used to fund the cash portion of the merger consideration to the former shareholders of Community First in connection with the Company's acquisition of that company, and for general corporate purposes.

On July 1, 2011, in connection with the MidCarolina merger, the Company assumed $8,764,000 in junior subordinated debentures to MidCarolina Trust I and MidCarolinia Trust II, two separate Delaware statutory tursts (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 are not consolidated in the Company's financial statements.

In accordance with FASB ASC 810-10-15-14, the Company did not eliminate through consolidation the Company's $619,000 equity investment in AMNB 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:

				(Amounts in thousands) Principal Amount	
Issuing Entity	Date Issued	Interest Rate	Maturity Date	March 31, 2014	December 31, 2013
AMNB Trust I	04-07-06	Libor plus 1.35 %	06-30-36	$20,619	$ 20,619
MidCarolina Trust I	10-29-02	Libor plus 3.45 %	11-07-32	4,111	4,098
MidCarolina Trust II	12-03-03		10-07-33	2,714	2,702

Libor plus 2.95 %			
		$27,444	$ 27,419

The principal amounts reflected for the MidCarolina Trusts are net of valuation allowances of $1,044,000 and $895,000, respectively. The original valuation allowances of $1,197,000 and $1,021,000 were recorded as a result of the merger with MidCarolina on July 1, 2011, and are being amortized into interest expense over the remaining lives of the respective borrowings.

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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. The prior stock option plan was terminated in 2006.

Stock Options

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

A summary of stock option transactions for the three months ended March 31, 2014 is as follows:

	Option Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at December 31, 2013	176,747	$ 24.39		
Granted	-	-		
Exercised	-	-		
Forfeited	-	-		
Expired	-	-		
Outstanding at March 31, 2014	176,747	$ 24.39	3.09 years	$ 289
Exercisable at March 31, 2014	176,747	$ 24.39	3.09 years	$ 289

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and expensed over the options' vesting period. As of March 31, 2014, 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 market 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 cliff vests over 24 to 36 months based on the term of the award.

Nonvested restricted stock activity for the three months ended March 31, 2014 is summarized in the following table.

Restricted Stock	Shares	Weighted Average Grant Date

		Value
Nonvested at January 1, 2014	33,350	$ 19.77
Granted	11,544	24.49
Vested	-	-
Forfeited	-	-
Nonvested at March 31, 2014	44,894	$ 20.98

As of March 31, 2014 and December 31, 2013, there was $523,000 and $337,000 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 1.55 years. The share based compensation expense for nonvested restricted stock was $96,000 and $70,000 during the first three months of 2014 and 2013, respectively.

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Starting in 2010, the Company began offering its outside directors alternatives with respect to director compensation. The regular quarterly board retainer can be received in the form of either (i) $3,000 in cash or (ii) shares of immediately vested, but restricted stock with a market value of $4,688. Monthly meeting fees can also be received as $600 per meeting in cash or $750 in immediately vested, but restricted stock. For 2014, all 13 outside directors have elected to receive stock in lieu of cash for either all or part of their quarterly retainer or meeting fees. Only outside directors receive board fees. The Company issued 3,002 and 3,668 shares and recognized share based compensation expense of $70,000 and $76,000 during the first three months of 2014 and 2013, respectively.

Note 11 – Earnings Per 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.

	Three Months Ended March 31,			
	2014		2013	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic	7,904,759	$ 0.44	7,861,991	$ 0.53
Effect of dilutive securities - stock options	12,842	-	9,517	-
Diluted	7,917,601	$ 0.44	7,871,508	$ 0.53

Stock options on common stock which were not included in computing diluted earnings per share for the three month periods ended March, 2014 and 2013, because their effects were antidilutive, averaged 110,542 and 188,517 shares, respectively.

Note 12 – Employee Benefit Plans

The following information 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.

Components of Net Periodic Benefit Cost (in thousands)	Three Months Ended March 31,	
	2014	2013
Service cost	$-	$-
Interest cost	76	72
Expected return on plan assets	(117)	(128)
Recognized net actuarial loss	18	69
Net periodic (benefit) cost	$(23)	$13

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Note 13 – Segment and Related Information

The Company has two reportable segments, community banking and trust and investment services.

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

Trust and investment services include estate planning, trust account administration, investment management, and retail brokerage. Investment management services include purchasing equity, fixed income, and mutual fund investments for customer accounts. The trust and investment services segment receives fees for investment and administrative services.

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

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Segment information as of and for the three months ended March 31, 2014 and 2013, is shown in the following table.

(in thousands)	Three Months Ended March 31, 2014 Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$ 11,939	$ -	$ 15	$ -	$ 11,954
Interest expense	1,311	-	184	-	1,495
Noninterest income	1,431	1,267	5	-	2,703
Income (loss) before income taxes	4,071	874	(206)	-	4,739
Net income (loss)	2,949	637	(136)	-	3,450
Depreciation and amortization	762	3	-	-	765
Total assets	1,297,729	-	198,011	(195,938)	1,299,802
Capital expenditures	119	-	-	-	119

	Three Months Ended March 31, 2013 Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$ 13,409	$ -	$ -	$ -	$ 13,409
Interest expense	1,539	-	188	-	1,727
Noninterest income	2,078	687	5	-	2,770
Income (loss) before income taxes	5,771	296	(227)	-	5,840
Net income (loss)	4,091	210	(150)	-	4,151
Depreciation and amortization	840	4	-	-	844
Total assets	1,293,145	-	195,040	(194,122)	1,294,063
Capital expenditures	178	-	-	-	178

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Note 14 – 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, "Fair Value Measurement and Disclosures", 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 assets and 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 assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). If no observable market data is available, valuations are based upon third party model based techniques (Level 3). Federal Reserve Bank of Richmond and FHLB stocks are carried at cost since no ready market exists and there is no quoted market value. The Company is required to own stock in these entities as long as it is a member. Therefore, they have been excluded from the following table.

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The following table presents the balances of assets and liabilities measured at fair value on a recurring basis during the period (in thousands):

	Fair Value Measurements at March 31, 2014 Using			
Description	Balance as of March 31, 2014	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	$ 72,585	$ 3,998	$ 68,587	$ -
Mortgage-backed and CMOs	64,671	-	64,671	-
State and municipal	201,005	-	201,005	-
Corporate	9,631	-	9,631	-
Equity	1,231	-	-	1,231
Total	$ 349,123	$ 3,998	$ 343,894	$ 1,231

	Fair Value Measurements at December 31, 2013 Using			
Description	Balance as of December 31, 2013	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	$ 65,881	$ -	$ 65,881	$ -
Mortgage-backed and CMOs	69,608	-	69,608	-
State and municipal	198,733	-	198,733	-
Corporate	10,799	-	10,799	-
Equity	1,103	-	-	1,103
Total	$ 346,124	$ -	$ 345,021	$ 1,103

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
	Total Realized / Unrealized Gains (Losses) Included in				
Balance as of	Net Income	Other Comprehensive	Purchases, Sales,	Transfer In (Out)	Balances as of

	January 1, 2014		Income	Issuances and Settlements, Net	of Level 3	March 31, 2014
Securities available for sale:						
Equity	$1,103	$ -	$ 128	$ -	$ -	$ 1,231

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 estimated fair value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during the three month period ended March 31, 2014 or the year ended December 31, 2013. Gains and losses on the sale of loans are recorded within income from mortgage banking on the Consolidated Statements of Income.

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Impaired loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected. In addition, the impairment of a loan may be measured using a present value of future cash flows analysis (Level 3). 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 receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Other real estate owned: Measurement for fair values for other real estate owned are the same as real estate collateral discussed with impaired loans.

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

	Fair Value Measurements at March 31, 2014 Using			
Description	Balance as of March 31, 2014	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Loans held for sale	$1,389	$ -	$ 1,389	$ -
Impaired loans, net of valuation allowance	3,131	-	-	3,131
Other real estate owned	3,233	-	-	3,233

	Fair Value Measurements at December 31, 2013 Using			
Description	Balance as of December 31, 2013	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3

Assets:				
Loans held for sale	$2,760	$ -	$ 2,760	$ -
Impaired loans, net of valuation allowance	3,193	-	-	3,193
Other real estate owned	3,422	-	-	3,422

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Quantitative Information About Level 3 Fair Value Measurements for March 31, 2014

Assets	Valuation Technique	Unobservable Input	Weighted Rate
Securities available for sale	Consideration of equity conversion options	Stock price in different rate environments	11%
Impaired loans	Discounted appraised value	Selling cost	6%
	Discounted cash flows	Market rate for borrower (discount rate)	6%
Other real estate owned	Discounted appraised value	Discount for lack of marketability and age of appraisal	6%

Quantitative Information About Level 3 Fair Value Measurements for December 31, 2013

Assets	Valuation Technique	Unobservable Input	Weighted Rate
Securities available for sale	Consideration of equity conversion options	Stock price in different rate environments	11%
Impaired loans	Discounted appraised value	Selling cost	6%
Other real estate owned	Discounted appraised value	Selling cost	6%
Other real estate owned	Discounted appraised value	Discount for lack of marketability and age of appraisal	9%

The carrying values and estimated fair values of the Company's financial instruments at March 31, 2014 are as follows (in thousands):

	Fair Value Measurements at March 31, 2014 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	$71,346	$ -	$ 71,346	$ -	$71,346
Securities available for sale	349,123	3,998	343,894	1,231	349,123
Restricted stock	4,529	-	4,529	-	4,529
Loans held for sale	1,389	-	1,389	-	1,389
Loans, net of allowance	770,755	-	-	777,005	777,005
Bank owned life insurance	14,845	-	14,845	-	14,845

Accrued interest receivable	4,397	-	4,397	-	4,397
Financial Liabilities:					
Deposits	$1,051,249	$ -	$ 673,241	$ 380,938	$1,054,179
Repurchase agreements	34,153	-	34,153	-	34,153
Other borrowings	9,919	-	-	10,508	10,508
Trust preferred capital notes	27,444	-	-	19,707	19,707
Accrued interest payable	567	-	567	-	567

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The carrying values and estimated fair values of the Company's financial instruments at December 31, 2013 are as follows (in thousands):

		Fair Value Measurements at December 31, 2013 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	$67,681	$ -	$ 67,681	$ -	$67,681
Securities available for sale	346,124	-	345,021	1,103	346,124
Restricted stock	4,889	-	4,889	-	4,889
Loans held for sale	2,760	-	2,760	-	2,760
Loans, net of allowance	782,071	-	-	783,825	783,825
Bank owned life insurance	14,746	-	14,746	-	14,746
Accrued interest receivable	4,741	-	4,741	-	4,741
Financial Liabilities:					
Deposits	$1,057,675	$ -	$ 668,077	$ 392,991	$1,061,068
Repurchase agreements	39,478	-	39,478	-	39,478
Other borrowings	9,951	-	-	10,560	10,560
Trust preferred capital notes	27,419	-	-	18,162	18,162
Accrued interest payable	610	-	610	-	610

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.

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 analyses, 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 analyses 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 analyses based on the interest rates for similar types of borrowing arrangements.

Trust preferred capital notes. Fair value is calculated by discounting the future cash flows using the estimated current interest rates at which similar securities would be issued.

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

Off-balance sheet instruments. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At March 31, 2014 and December 31, 2013, 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 15 – Supplemental Cash Flow Information

	Three Months Ended March 31,	
	2014	2013
Supplemental Schedule of Cash and Cash Equivalents:		
Cash and due from banks	$25,880	$15,365
Interest-bearing deposits in other banks	45,466	42,280
	$71,346	$57,645
Supplemental Disclosure of Cash Flow Information:		
Cash paid for:		
Interest on deposits and borrowed funds	$1,538	$1,750
Income taxes	-	-
Noncash investing and financing activities:		
Transfer of loans to other real estate owned	18	331
Unrealized gains (losses) on securities available for sale	1,770	(1,080)

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Note 16 – Accumulated Other Comprehensive Income

Changes in each component of accumulated other comprehensive income ("AOCI") for the three months ended March 31, 2014 and 2013 were as follows (in thousands):

For the Three Month Period	Net Unrealized Gains (Losses) on Securities	Adjustments Related to Pension Benefits	Accumulated Other Comprehensive Income
Balance at December 31, 2012	$ 9,800	$ (2,203)	$ 7,597
Net unrealized losses on securities available for sale, net of tax, $(309)	(573)	-	(573)
Reclassification adjustment for gains on securities, net of tax, $(69)	(129)	-	(129)
Balance at March 31, 2013	$ 9,098	$ (2,203)	$ 6,895
Balance at December 31, 2013	$ 3,578	$ (1,058)	$ 2,520
Net unrealized gains on securities available for sale, net of tax, $633	1,176	-	1,176
Reclassification adjustment for gains on securities, net of tax, $(14)	(25)	-	(25)
Balance at March 31, 2014	$ 4,729	$ (1,058)	$ 3,671

Reclassifications Out of Accumulated Other Comprehensive Income
For the three month periods ending March 31, 2014 and 2013
(in thousands)

For the Three Month Period Ended March 31, 2013 Details about AOCI Components	Amount Reclassified from AOCI	Affected Line Item in the Statement of Where Net Income is Presented
Available for sale securities:		
Realized gain on sale of securities	$ 198	Securities gains, net
	(69)	Income tax expense
Total reclassifications	$ 129	Net of tax

For the Three Month Period Ended March 31, 2014 Details about AOCI Components	Amount Reclassified from AOCI	Affected Line Item in the Statement of Where Net Income is Presented
Available for sale securities:		
Realized gain on sale of securities	$ 39	Securities gains, net
	(14)	Income tax expense
Total reclassifications	$ 25	Net of tax

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

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

Forward-Looking Statements

This report contains forward-looking statements with respect to the financial condition, results of operations and business of American National Bankshares Inc. (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, 2013, 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 2014 presentation. These reclassifications did not have an impact on net income and were considered immaterial.

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, 2013.

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 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.

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The Company uses certain practices to manage its credit risk. These practices include (a) appropriate lending limits for loan officers, (b) a loan approval process, (c) careful underwriting of loan requests, including analysis of borrowers, cash flows, collateral, and market risks, (d) regular monitoring of the portfolio, including diversification by type and geography, (e) review of loans by the Loan Review department, which operates independently of loan production, (f) regular meetings of the Credit Committees to discuss portfolio and policy changes and make decisions on large or unusual loan requests, and (g) 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, 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 underwr