

AMERICAN COMMUNITY BANCSHARES INC

Form 10-K

March 30, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2008

OR

**.. 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 000-30517

**AMERICAN COMMUNITY BANCSHARES, INC.**

(Exact name of registrant as specified in its charter)

**NORTH CAROLINA**  
(State or Other Jurisdiction of

**56-2179531**  
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

**4500 Cameron Valley Parkway, Suite 150**

**Charlotte, North Carolina**  
(Address of Principal Executive Offices)

**28211**  
(Zip Code)

Registrant's Telephone number, including area code: (704) 225-8444

**Securities registered pursuant to Section 12(b) of the Act**

**NONE**

**Securities registered pursuant to Section 12(g) of the Act**

**COMMON STOCK, PAR VALUE \$1.00 PER SHARE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. \$41,935,000

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date. 6,651,295 shares of Common Stock outstanding as of March 24, 2009:

**Documents Incorporated by Reference.**

Portions of the registrant's definitive proxy statement as filed with the Federal Deposit Insurance Corporation in connection with its 2009 annual meeting are incorporated into Part III of this report.

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**PART 1**

**ITEM 1 BUSINESS**

**Who We Are**

American Community Bancshares, Inc. ( Bancshares ) is a bank holding company that owns all of the common stock of American Community Bank ( American Community or the Bank ) a state-chartered commercial bank that is insured by the Deposit Insurance Fund of the FDIC. Bancshares was incorporated on February 16, 2000 as a North Carolina-chartered corporation and became the holding company for American Community on April 28, 2000. To become American Community s holding company, Bancshares received approval of the Federal Reserve Board as well as American Community s shareholders. Upon receiving such approvals, each share of the common stock of American Community was exchanged on a one-for-one basis for shares of the common stock of Bancshares. Bancshares acquired FNB Bancshares, Inc. and its subsidiary bank First National Bank of the Carolinas ( First National ) based in Gaffney, South Carolina on April 15, 2004. First National was merged into American Community on April 1, 2005.

On September 9, 2008, the Company entered into a definitive agreement to be acquired, subject to shareholder approval, by Yadkin Valley Financial Corporation ( Yadkin Valley ). The Bank will become a wholly-owned division of Yadkin Valley operating under its current name. Pursuant to the agreement, the Company will merge with and into Yadkin Valley and each of the Company s shareholders will be entitled to receive in exchange for each share of the Company s common stock one of the following: (i) .8517 shares of Yadkin Valley common stock, (ii) \$12.35 in cash, or (iii) a combination of both stock and cash. In total, the merger consideration will be allocated as follows: 80.5% of the Company s outstanding shares of common stock will be exchanged for shares of Yadkin Valley common stock and 19.5% of the Company s outstanding shares of common stock will be exchanged for cash. The parties have received all regulatory approvals required for consummation of the merger, including approval of the Board of Governors of the Federal Reserve System, the North Carolina Commission of Banks and the Federal Deposit Insurance Corporation. The parties anticipate closing of the transaction during the second quarter of 2009.

The Bank operates for the primary purpose of serving the banking needs of individuals, and small to medium-sized businesses in our market areas. While numerous banks in our market have chosen to focus on the affluent and high net worth individuals, we have chosen to focus on middle income households and the entrepreneurial segment of our market. We offer a wide range of banking services including checking, certificates of deposit and savings accounts, commercial, consumer and personal loans, mortgage and other associated financial services.

**Our Market Area**

We consider our primary market area to be the Southern Piedmont area of North Carolina, including Union, Mecklenburg and adjoining counties. In South Carolina our primary markets include Cherokee and York Counties. The Bank serves our market area through thirteen full service branch locations with nine located in Union and Mecklenburg County in North Carolina. The Bank also offers four convenient locations throughout York and Cherokee Counties of South Carolina. The Bank s customers may access various banking services through ATMs owned by the Bank and ATMs owned by others, through debit cards, and through the Bank s automated telephone and online banking products.

Union County had an estimated 2008 population of 191,000 and Mecklenburg County has an estimated 2008 population of 887,000. Both counties have a balanced and diversified economy. Monroe, with a population of approximately 36,000, is the largest city in Union County. Union County is currently one of the fastest growing counties in North Carolina and also one of the fastest growing counties in the country. The population of Union County has grown 42% since 2000. Charlotte, which is ranked 21<sup>st</sup> in U.S. population, is Mecklenburg County s and North Carolina s largest city and has consistently been one of the fastest growing areas of the Southeast. The population of Charlotte and Mecklenburg County had a growth rate of 19% between 2000 and 2006. The most recent unemployment rate was 8.1% for Union County and 8.3% for Mecklenburg County; both of which approximate the North Carolina state rate of 8.1%. Cherokee County, previous headquarters for the First National Bank of the Carolinas, has an estimated population of 54,000 and an estimated growth rate of 3%. York County, South Carolina is the one of the region s fastest growing county and has an estimated population of 213,000. York County also averaged a 21% growth rate between 2000 and 2006, ranking 4<sup>th</sup> in per capita income in South Carolina.

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### **Strategy**

American Community has expanded significantly since opening for business in November 1998. Because of its strong capital position created during its incorporation stage, American Community had the requisite capital needed to permit it to immediately establish branch offices. American Community's branching strategy is opportunistic. It has established nine branch offices in growing areas within Union and Mecklenburg Counties, North Carolina. The Bank also offers four full-service banking offices located in York and Cherokee Counties, South Carolina. The Bank seeks markets where there are opportunities to hire successful local bankers who have a loyal following of deposit and loan customers. To date we have centered each of our branch offices on such a local and experienced banker. Management also believes it is important in the early formation years to build branches that will provide convenience and efficiencies in its operational infrastructure. The Charlotte region is a highly competitive banking market with many competitors including money center, super-regional and community banks. American Community's strategy is to develop a branch network to take advantage of opportunities that present themselves in both new geographic and new product markets. We will continue to search for opportunities, either for de novo branching, branch purchase or whole bank acquisitions that we believe will add long term enhanced value for our shareholders. The acquisition of First National Bank of the Carolinas in 2004 provided us the opportunity to expand across the South Carolina state line into York County, one of the fastest growing counties in South Carolina. We are one of a handful of banks in North Carolina that has expansion ability across the South Carolina state line. We believe this adds to the long term franchise value of our Company since it is hard to replicate due to the regulatory restrictions that prohibit most banks from branching into South Carolina. In addition, we will remain open to opportunistic expansion through acquisition of additional whole banks in other growing metropolitan areas of North Carolina and South Carolina if the acquisition enhances shareholder value and there exists synergies of operations and compatible corporate culture (i.e. a community bank serving a community's needs).

### **Lending Activities**

*General.* The Bank provides to its customers a full range of short- to medium-term commercial, agricultural, Small Business Administration guaranteed, mortgage, construction and personal loans, both secured and unsecured. The Bank also makes real estate mortgage and construction loans. Variable rate loans accounted for 63% of the loan balances outstanding at December 31, 2008 while fixed rate loans accounted for 37% of the balances.

The Bank's loan policies and procedures establish the basic guidelines governing its lending operations. Generally, the guidelines address the types of loans that the Bank seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to the Bank, including the indebtedness of any guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Bank. The Bank supplements its own supervision of the loan underwriting and approval process with periodic loan audits by external loan examiners experienced in loan review work. The Bank has focused its portfolio lending activities on typically higher yielding commercial, construction and consumer loans.

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*Loan Composition.* The following table sets forth at December 31 for the dates indicated the Bank's loan portfolio composition by type of loan:

|   | 2008              |                | 2007              |                | 2006              |                | 2005              |                | 2004              |                |
|---|-------------------|----------------|-------------------|----------------|-------------------|----------------|-------------------|----------------|-------------------|----------------|
|   | Amount            | Percent        | Amount            | Percent        | Amount            | Percent        | Amount            | Percent        | Amount            | Percent        |
| (Dollars in Thousands)                        |                   |                |                   |                |                   |                |                   |                |                   |                |
| Real estate mortgage loans:                   |                   |                |                   |                |                   |                |                   |                |                   |                |
| 1-4 family                                    | \$ 43,431         | 10.16%         | \$ 35,680         | 9.08%          | \$ 32,414         | 8.75%          | \$ 28,933         | 8.70%          | \$ 27,161         | 8.82%          |
| Commercial mortgage                           | 105,464           | 24.66%         | 104,209           | 26.51%         | 96,946            | 26.16%         | 84,694            | 25.45%         | 84,621            | 27.47%         |
| Construction/development                      | 157,230           | 36.76%         | 136,531           | 34.73%         | 93,643            | 25.27%         | 44,037            | 13.24%         | 39,844            | 12.93%         |
| Home equity lines of credit                   | 43,777            | 10.24%         | 34,784            | 8.85%          | 24,388            | 6.58%          | 27,732            | 8.33%          | 24,575            | 7.98%          |
| Commercial and industrial loans               | 60,017            | 14.03%         | 57,958            | 14.74%         | 78,086            | 21.07%         | 97,197            | 29.21%         | 85,911            | 27.88%         |
| Loans to individuals                          | 15,844            | 3.70%          | 20,010            | 5.09%          | 36,782            | 9.93%          | 35,941            | 10.80%         | 30,813            | 10.00%         |
| Lease financing, net                          | 1,901             | 0.45%          | 3,941             | 1.00%          | 8,316             | 2.24%          | 14,193            | 4.27%          | 15,177            | 4.92%          |
| <b>Subtotal</b>                               | <b>427,664</b>    | <b>100.00%</b> | <b>393,113</b>    | <b>100.00%</b> | <b>370,575</b>    | <b>100.00%</b> | <b>332,727</b>    | <b>100.00%</b> | <b>308,102</b>    | <b>100.00%</b> |
| Less: allowance for loan losses               | (9,124)           |                | (5,740)           |                | (5,628)           |                | (4,331)           |                | (3,488)           |                |
| Plus: net unamortized deferred fees and costs | (172)             |                | (154)             |                | (144)             |                | (19)              |                | (114)             |                |
| <b>Total</b>                                  | <b>\$ 418,368</b> |                | <b>\$ 387,219</b> |                | <b>\$ 364,803</b> |                | <b>\$ 328,377</b> |                | <b>\$ 304,500</b> |                |

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The following table sets forth the contractual maturity of loans at December 31, 2008:

|                                 | One Year<br>Or Less | Greater than<br>One Year<br>Through 5<br>Years | More Than<br>5 Years | Total             |
|---------------------------------|---------------------|--|----------------------|-------------------|
| (Dollars in thousands)          |                     |  |                      |                   |
| Real estate mortgage loans:     |                     |  |                      |                   |
| 1-4 family                      | \$ 14,650           | \$ 27,670                                      | \$ 1,111             | \$ 43,431         |
| Commercial mortgage             | 28,504              | 72,182   | 4,778                | 105,464           |
| Construction/development        | 116,867             | 38,287   | 2,076                | 157,230           |
| Home equity lines of credit     | 3,774               | 4,127  | 35,876               | 43,777            |
| Commercial and industrial loans | 39,506              | 19,293   | 1,218                | 60,017            |
| Loans to individuals            | 7,502               | 8,029  | 313                  | 15,844            |
| Lease financing, net            | 374                 | 1,527  |                      | 1,901             |
| <b>Total</b>                    | <b>\$ 211,177</b>   | <b>\$ 171,115</b>                              | <b>\$ 45,372</b>     | <b>\$ 427,664</b> |

The following table sets forth loans with fixed and variable rates having contractual maturities greater than one year at December 31, 2008:

|                                 | Fixed<br>Rate | Variable<br>Rate | Total      |
|---------------------------------|---------------|------------------|------------|
| (Dollars in thousands)          |               |                  |            |
| Real estate mortgage loans      | \$ 110,895    | \$ 35,209        | \$ 146,104 |
| Home equity lines of credit     | 120           | 39,883           | 40,003     |
| Commercial and industrial loans | 11,131        | 9,380            | 20,511     |
| Loans to individuals            | 7,314         | 1,028            | 8,342      |
| Lease financing, net            | 1,527         |                  | 1,527      |
|                                 | \$ 130,987    | \$ 85,500        | \$ 216,487 |

*Real Estate Loans.* Real estate loans are made for purchasing, constructing and refinancing one-to-four family, five or more family and commercial properties. The Bank offers fixed and adjustable rate options, but typically limits the maximum fixed rate term to five years. The Bank provides customers access to long-term conventional real estate loans through its mortgage loan department, which makes loans for the account of third parties.

Residential one-to-four family loans amounted to \$43.4 million at December 31, 2008. The Bank's residential mortgage loans are typically construction loans that convert into permanent financing and are secured by properties located within the Bank's market areas. Most of the permanent one-to-four family residential mortgage loans that the Bank originates are for the account of third parties. Such loans are closed by the third party and therefore are not shown in the Bank's financial statements. The Bank receives a fee for each such loan originated, with such fees aggregating \$259,000 for the year ended December 31, 2008. The Bank anticipates that it will continue to be an active originator of residential loans for the account of third parties.

The Bank has made, and anticipates continuing to make, commercial real estate loans. Commercial real estate loans totaled \$105.5 million at December 31, 2008. This lending has involved loans secured principally by owner occupied commercial buildings for office, storage and warehouse space. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

Another lending focus for the Bank is construction/development lending with balances outstanding as of December 31, 2008 of \$157.2 million. The \$157.2 million is principally comprised of \$42.4 million in loans secured by land, \$28.4 million in acquisition and development loans, \$32.7

in non pre-sold construction loans, \$22.5 million in 1-4



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family pre-sold construction loans, \$15.6 million in commercial construction loans and \$15.6 million in miscellaneous other construction loans. The Bank originates one to four family residential construction loans for the construction of custom homes (where the home buyer is the borrower) and provides financing to builders and consumers for the construction of pre-sold homes. The Bank generally receives a pre-arranged permanent financing commitment from an outside banking entity prior to financing the construction of pre-sold homes. The Bank is active in the construction market and makes construction loans to builders of homes that are not pre-sold, but limits the number of speculative loans to any one builder. This type of lending is only done with local, well established builders and not with large or national tract builders. The Bank lends to builders who have demonstrated a favorable record of performance and profitable operations and who are building in markets that management believes it understands. The Bank also makes commercial real estate construction loans, primarily for owner-occupied properties. The Bank further endeavors to limit its construction lending risk through adherence to established underwriting procedures. The Bank generally requires documentation of all draw requests and utilizes third party appraisers to inspect the project prior to paying any draw requests from the builder. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment on construction loans.

*Commercial Loans.* Commercial business lending is also a focus of the Bank's lending activities. At December 31, 2008, the Bank's commercial loan portfolio totaled \$60.0 million. Commercial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans generally are secured by accounts receivable, inventory and/or equipment. The Bank also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment. Commercial loans generally provide greater yields and reprice more frequently than other types of loans, such as real estate loans. More frequent repricing means that yields on our commercial loans adjust with changes in interest rates.

*Loans to Individuals and Home Equity Lines of Credit.* Loans to individuals (consumer loans) include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous secured and unsecured personal loans and totaled \$59.6 million at December 31, 2008. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. Consumer loan collections are sensitive to job loss, illness and other personal factors. The Bank attempts to manage the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

*Leasing.* At December 31, 2008 the Bank's lease portfolio totaled \$1.9 million. This type of lease financing is generally limited to heavy machinery, manufacturing equipment, and specific vehicles. The leasing division also requires personal guarantees on the majority of our leases. In 2006, the Bank determined that the leasing business had become extremely competitive and was dominated by a few large players. The Bank felt that leasing was not the best use of its capital and has contracted with a third party leasing company to liquidate the remaining leases in our portfolio. The bank no longer originates leases and is allowing the portfolio to pay down.

*Other Loan Products.* The Bank is an active home mortgage originator and several of our offices have trained lending personnel to originate home mortgage loans for the account of third parties. We currently have four lending relationships to which we sell all home mortgages to enable us to satisfy special lending requests of our borrowing customers. The Bank offers a credit card on an agency basis as an accommodation to its customers. The Bank assumes none of the underwriting risk associated with credit card accounts established through this agency arrangement.

*Loan Approvals.* The Bank's loan policies and procedures establish the basic guidelines governing its lending operations. Generally, the guidelines address the type of loans that the Bank seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to the Bank, including any indebtedness as a guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Bank. The Bank supplements its own supervision of the loan underwriting and approval process with periodic loan audits by independent, outside professionals experienced in loan review. Responsibility for loan review and loan underwriting resides with the Chief Credit Officer position. This position is responsible for loan processing, loan underwriting and approval. In 2008, the Chief Credit Officer position was vacated by the incumbent. The Chief Executive Officer, Chief Banking Officer along with two senior credit officers assumed joint responsibility for loan review and loan underwriting

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while aggressively pursuing a search process to replace the Chief Credit Officer (hiring a Chief Credit Officer was delayed due to the pending merger with Yadkin Valley). On an annual basis, the Board of Directors of the Bank determines the President's and other officers' lending authority. Authorities may include loans, letters of credit, overdrafts, uncollected funds and such other authorities as determined by the Board of Directors.

The President of American Community, and the Chief Credit Officer (currently vacant) each have the authority to approve loans up to the lending limits set by the Board of Directors, which were \$2,000,000 and \$1,500,000, respectively, at December 31, 2008. These limits are based upon the total credit exposure in a relationship and not based on loan transaction size. The President and Chief Credit Officer together can approve up to \$3,000,000 of total customer credit exposure with the following exceptions. Any acquisition and development loan over \$1,500,000, speculative construction loans over \$1,500,000, land acquisition and hold transactions greater than \$1,000,000 and any loans to non-profit organizations greater than \$1,000,000 must be approved by the Loan Committee. All loans above the lending limit of the President and Chief Credit Officer are reviewed and approved by the Loan Committee, which consists of the President, the South Carolina Regional Executive, and six outside directors. In addition, the Chief Credit Officer serves as a non-voting member of this committee. A Senior Credit Committee consisting of the Chief Banking Officer, and the Bank's two Senior Credit Officers was approved by the Bank's Board of Directors due to the absence of the Chief Credit Officer in 2008. The Senior Credit Committee was granted the authority by the Board of Directors to approve loans up to \$1,500,000 with unanimous concurrence of all three members. The President of American Community and the unanimous concurrence of the Senior Credit Committee were granted the authority by the Board of Directors to approve loans up to \$3,000,000 secured and \$1,000,000 unsecured at December 31, 2008. At December 31, 2008, the Loan Committee had the authority to approve loans up to the Bank's legal lending limit. The Bank's legal lending limit was \$7.9 million at December 31, 2008. The Bank seldom makes loans approaching its legal lending limit. All loans made to executive officers and directors must be approved by the full Board of Directors.

**Non-performing Assets**

The table sets forth, for the periods indicated, information about our non-accrual loans, restructured loans, total non-performing loans (non-accrual loans plus restructured loans), and total non-performing assets.

|   | At December 31,        |                 |                 |                 |                 |
|---|------------------------|-----------------|-----------------|-----------------|-----------------|
|   | 2008                   | 2007            | 2006            | 2005            | 2004            |
|   | (Dollars in thousands) |                 |                 |                 |                 |
| Non-accrual loans                                   | \$ 6,599               | \$ 866          | \$ 563          | \$ 469          | \$ 881          |
| Non-accrual leases                                  | 414                    | 345             | 1,246           | 482             |                 |
| Restructured loans                                  | 745                    | 511             |                 |                 |                 |
| <b>Total non-performing loans</b>                   | <b>7,758</b>           | <b>1,722</b>    | <b>1,809</b>    | <b>951</b>      | <b>881</b>      |
| Foreclosed real estate and other repossessed assets |                        | 9               | 201             | 479             | 311             |
| <b>Total non-performing assets</b>                  | <b>\$ 7,758</b>        | <b>\$ 1,731</b> | <b>\$ 2,010</b> | <b>\$ 1,430</b> | <b>\$ 1,192</b> |
| Accruing loans past due 90 days or more             | \$ 26                  | \$              | \$ 291          | \$ 1,402        | \$ 1,117        |
| Allowance for loan losses                           | 9,124                  | 5,740           | 5,628           | 4,331           | 3,488           |
| Non-performing loans to period end loans            | 1.82%                  | 0.44%           | 0.49%           | 0.29%           | 0.29%           |
| Allowance for loan losses to period end loans       | 2.13%                  | 1.46%           | 1.52%           | 1.30%           | 1.13%           |
| Allowance for loan losses to non-performing loans   | 118%                   | 333%            | 311%            | 455%            | 396%            |
| Non-performing assets to total assets               | 1.45%                  | 0.34%           | 0.41%           | 0.33%           | 0.30%           |

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The financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on loans, unless a loan is placed on non-accrual basis. Loans are accounted for on a non-accrual basis when there are serious doubts about the collectibility of principal or interest. Loans are placed on non-accrual status in cases where there is uncertainty as to whether the borrower can satisfy the contractual terms of the loan agreement. Amounts received on non-accrual loans generally are applied first to principal and then to interest only after all principal has been collected. At December 31, 2008, the Bank had \$7.0 million in non-accrual loans and leases. Interest foregone on non-accrual loans and leases was approximately \$272,000 for the year ended December 31, 2008 and \$44,000 for the year ended December 31, 2007.

Restructured loans are those for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal have been granted due to the borrower's weakened financial condition. Interest on restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur. In 2008, the Bank had five troubled debt restructured loans for \$745,000. Due to the borrower's inability to make the payments required under the original loan terms, the Bank modified the terms by granting a longer amortized repayment structure in exchange for obtaining real estate as collateral. Potential problem loans are loans which are currently performing and are not included in non-accrual or restructured loans above, but about which we have serious doubts as to the borrower's ability to comply with present repayment terms. These loans are likely to be included later in non-accrual, past due or restructured loans, so they are considered by management in assessing the adequacy of the allowance for loan losses. At December 31, 2008, there were approximately \$11.0 million in loans that had been identified as potential problem loans. All of these loans were still accruing interest at year end. There were eight leases totaling \$305,000 that had been identified as potential problem leases as of December 31, 2008.

The following table presents for the periods indicated a breakdown of non-performing loans and leases by type, which include non-accrual loans and leases and restructured loans:

|                             | 2008            |                  | 2007            |                  | 2006            |                  | 2005          |                  | 2004          |                  |
|-----------------------------|-----------------|------------------|-----------------|------------------|-----------------|------------------|---------------|------------------|---------------|------------------|
|                             | Balance         | % of Total Loans | Balance         | % of Total Loans | Balance         | % of Total Loans | Balance       | % of Total Loans | Balance       | % of Total Loans |
| Real estate mortgage loans: |                 |                  |                 |                  |                 |                  |               |                  |               |                  |
| 1-4 Family                  | 1,373           | 0.32%            | 557             | 0.14%            | \$ 74           | 0.02%            | \$ 106        | 0.03%            | \$ 54         | 0.02%            |
| Construction/development    | 4,246           | 1.00%            |                 | 0.00%            | 151             | 0.04%            | 67            | 0.02%            | 54            | 0.02%            |
| Commercial mortgage         | 914             | 0.22%            | 262             | 0.07%            | 77              | 0.02%            | 11            | 0.01%            |               | 0.00%            |
| Home equity line of credit  | 175             | 0.04%            | 111             | 0.03%            | 29              | 0.01%            | 10            | 0.01%            | 10            | 0.00%            |
| Commercial & Industrial     | 303             | 0.07%            | 341             | 0.09%            | 110             | 0.03%            | 140           | 0.04%            | 261           | 0.08%            |
| Personal Loans              | 186             | 0.04%            | 106             | 0.03%            | 49              | 0.01%            | 56            | 0.02%            | 488           | 0.16%            |
| Leases, net                 | 414             | 0.10%            | 345             | 0.08%            | 1,246           | 0.34%            | 482           | 0.14%            |               | 0.00%            |
| Other                       | 147             | 0.03%            |                 | 0.00%            | 73              | 0.02%            | 79            | 0.02%            | 14            | 0.01%            |
| <b>Total</b>                | <b>\$ 7,758</b> | <b>1.82%</b>     | <b>\$ 1,722</b> | <b>0.44%</b>     | <b>\$ 1,809</b> | <b>0.49%</b>     | <b>\$ 951</b> | <b>0.29%</b>     | <b>\$ 881</b> | <b>0.29%</b>     |

Other real estate owned consists of foreclosed properties. At December 31, 2008, foreclosed real estate and other repossessed assets totaled \$1,000 or less than .01% of total assets, and consisted of equipment. At December 31, 2007, foreclosed real estate and other repossessed assets totaled \$9,000 or .01% of total assets, and consisted of equipment and one vehicle.

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### **Analysis of Allowance for Loan Losses**

The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. The allowance for loan losses is increased by provisions charged to operations and by recoveries of amounts previously charged off, and reduced by loans charged off. The adequacy of the allowance is evaluated monthly. In evaluating the adequacy of the allowance, the growth, composition and industry diversification of the portfolio, historical loan loss experience, current delinquency levels, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral, prevailing economic conditions and other relevant factors are all considered. In addition, regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and may require adjustments to the allowance for loan losses based upon judgments different from those of management.

The Bank uses a risk grading program to facilitate the evaluation of probable inherent loan losses and the adequacy of the allowance for loan losses. In this program, risk grades are initially assigned by loan officers, reviewed by Credit Administration, and reviewed by a third party on a test basis. The Bank strives to maintain the loan portfolio in accordance with conservative loan underwriting policies that result in loans specifically tailored to the needs of the Bank's market area. Every effort is made to identify and minimize the credit risks associated with such lending strategies. The Bank has no foreign loans and does not engage in highly leveraged transactions.

The Bank follows a loan review program designed to evaluate the credit risk in the loan portfolio. Through this loan review process, an internally classified watch list that helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses is maintained. In establishing the appropriate classification for specific assets, management considers, among other factors, the estimated value of the underlying collateral, the borrower's ability to repay, the borrower's payment history and the current delinquency status. As a result of this process, certain loans are categorized as substandard, doubtful or loss and reserves are allocated based on management's judgment and historical experience.

Loans classified as substandard are those loans with clear and defined weaknesses such as unfavorable financial ratios, uncertain repayment sources or poor financial condition that may jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some losses if the deficiencies are not corrected. Loans classified as doubtful are those loans that have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable. Loans classified as loss are considered uncollectible and of such little value that their continuance as assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be achieved in the future. As a practical matter, when loans are identified as loss they are charged off against the allowance for loan losses. In addition to the above classification categories, loans are also categorized based upon risk grade and loan type, assigning an allowance allocation based upon each category.

The increase in the allowance for loan losses and the resultant provision for loan losses necessary to provide for the increase includes growth in loans outstanding, the volume of net charge-offs experienced during the year and the current level of nonperforming loans. Loan growth has been spread among the major loan categories, with the concentrations of major loan categories being relatively consistent in recent years. For the five years ended December 31, 2008, the range of each major category of loans as a percentage of total loans outstanding is as follows: 1-4 family mortgage loans 8% to 10%, commercial mortgage loans 24% to 27%, construction/development real estate loans 13% to 37%; home equity loans 6% to 10%; commercial and industrial loans 14% to 29%; loans to individuals 4% to 11%; and lease financing 1% to 5%. For all full fiscal years through 2008, loan loss experience was similar to that of other banks our age, with net loan charge-offs in each year no greater than 0.40% of average loans outstanding. Non-performing loans and leases, as discussed in the previous section titled Non-performing assets, were \$7.8 million at December 31, 2008 as compared to \$1.7 million at December 31, 2007. The allowance for loan losses at December 31, 2008 of \$9.1 million represents 2.13% of total loans and 118% of non-performing loans.

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The allowance for loan losses represents management's estimate of an amount adequate to provide for known and inherent losses in the loan portfolio in the normal course of business. Specific allowances are made that are allocated to certain individual loans and pools of loans based on risk characteristics. While management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while the Bank believes it has established the allowance for loan losses in conformity with generally accepted accounting principles, there can be no assurance that regulators, in reviewing the portfolio, will not require adjustments to the allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed herein. Any material increase in the allowance for loan losses may adversely affect the financial condition and results of operations of Bancshares.

The following table describes the allocation of the allowance for loan losses among various categories of loans and certain other information for the dates indicated. The allocation is made for analytical purposes only and is not necessarily indicative of the categories in which future losses may occur.

|                                 | 2008     |                         | 2007     |                         | At December 31,<br>2006 |                         | 2005     |                         | 2004     |                         |
|---------------------------------|----------|-------------------------|----------|-------------------------|-------------------------|-------------------------|----------|-------------------------|----------|-------------------------|
|                                 | Amount   | % of Total<br>Loans (1) | Amount   | % of Total<br>Loans (1) | Amount                  | % of Total<br>Loans (1) | Amount   | % of Total<br>Loans (1) | Amount   | % of Total<br>Loans (1) |
| Real estate loans               | \$ 6,631 | 72.68%                  | \$ 3,450 | 60.10%                  | \$ 2,340                | 41.58%                  | \$ 2,155 | 49.76%                  | \$ 2,149 | 61.61%                  |
| Home equity lines of credit     | 332      | 3.64%                   | 177      | 3.08%                   | 130                     | 2.31%                   | 137      | 3.16%                   | 72       | 2.06%                   |
| Commercial and industrial loans | 1,375    | 15.07%                  | 1,121    | 19.53%                  | 1,132                   | 20.11%                  | 929      | 21.45%                  | 731      | 20.96%                  |
| Loans to individuals            | 310      | 3.40%                   | 340      | 5.92%                   | 405                     | 7.20%                   | 215      | 4.96%                   | 232      | 6.65%                   |
| Lease financing, net            | 476      | 5.21%                   | 652      | 11.36%                  | 1,621                   | 28.80%                  | 895      | 20.67%                  | 304      | 8.72%                   |
| Total                           | \$ 9,124 | 100.00%                 | \$ 5,740 | 100.00%                 | \$ 5,628                | 100.00%                 | \$ 4,331 | 100.00%                 | \$ 3,488 | 100.00%                 |

(1) Represents total of all outstanding loans in each category as a percent of total loans outstanding.

The recent economic recession and downturn in the real estate market has resulted in increased loan delinquencies, and in some cases defaults and foreclosures in our real estate portfolio. This downturn has resulted in impairment of the value of the collateral used to secure these loans and the ability to sell the collateral upon foreclosure. In response to this deterioration in real estate loan quality, management is aggressively monitoring its classified loans and is continuing to monitor credits with material weaknesses.

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The following table presents for the periods indicated information regarding changes in the allowance for loan losses:

|   | 2008                   | At or for the Years Ended December 31, |            |            | 2004       |
|---|------------------------|--|------------|------------|------------|
|   |                        | 2007                                   | 2006       | 2005       |            |
|   | (Dollars in thousands) |  |            |            |            |
| Balance at beginning of period  | \$ 5,740               | \$ 5,628                               | \$ 4,331   | \$ 3,488   | \$ 2,529   |
| Charge-offs:  |                        |  |            |            |            |
| Real estate loans   | 228                    | 19                                     | 10         |            | 51         |
| Home equity lines of credit   | 600                    |  | 43         |            |            |
| Commercial and industrial loans   | 385                    | 180                                    | 64         | 8          | 211        |
| Lease financing, net  | 112                    | 728                                    | 1,183      | 28         | 24         |
| Loans to individuals  | 315                    | 108                                    | 50         | 45         | 54         |
| Total charge-offs   | 1,640                  | 1,035                                  | 1,350      | 81         | 340        |
| Recoveries:   |                        |  |            |            |            |
| Real estate loans   | 1                      |  |            |            | 1          |
| Home equity lines of credit   |                        |  |            |            |            |
| Commercial and industrial loans   | 9                      | 5                                      | 1          | 100        | 12         |
| Lease financing, net  | 8                      | 91                                     | 26         | 4          |            |
| Loans to individuals  | 7                      | 18                                     | 8          | 11         | 27         |
| Total recoveries  | 25                     | 114                                    | 35         | 115        | 40         |
| Net charge-offs (recoveries)  | 1,615                  | 921                                    | 1,315      | (34)       | 300        |
| Allowance acquired from First National merger                           |                        |  |            |            | 685        |
| Provision for loan losses   | 4,999                  | 1,033                                  | 2,612      | 809        | 574        |
| Balance at end of period  | \$ 9,124               | \$ 5,740                               | \$ 5,628   | \$ 4,331   | \$ 3,488   |
| Total loans outstanding   | \$ 427,492             | \$ 392,959                             | \$ 370,431 | \$ 332,708 | \$ 307,988 |
| Average loans outstanding   | \$ 403,626             | \$ 370,832                             | \$ 351,401 | \$ 317,986 | \$ 275,011 |
| Allowance for loan losses to total loans outstanding                    | 2.13%                  | 1.46%                                  | 1.52%      | 1.30%      | 1.13%      |
| Ratio of net loan charge-offs (recoveries) to average loans outstanding | 0.40%                  | 0.25%                                  | 0.37%      | -0.01%     | 0.11%      |

**Table of Contents****Investment Activities**

Bancshares' portfolio of investment securities, most of which are available for sale, consists of U.S. Government agency, mortgage-backed securities, municipal bonds and other marketable equity securities.

Securities to be held for indefinite periods of time and not intended to be held to maturity are classified as available for sale and carried at fair value with any unrealized gains or losses reflected as an adjustment to stockholders' equity. Securities held for indefinite periods of time include securities that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates and/or significant prepayment risks.

The following table summarizes the amortized costs, gross unrealized gains and losses and the resulting market value of investment securities:

|  | Amortized<br>Cost | 2008   |                               | Fair<br>Value    |
|--|-------------------|--|-------------------------------|------------------|
|  |                   | Gross<br>Unrealized<br>Gains<br>(Dollars in thousands) | Gross<br>Unrealized<br>Losses |                  |
| <b>Securities available for sale:</b>      |                   |  |                               |                  |
| U. S. Government agencies                  | \$ 9,635          | \$ 211   | \$ 5                          | \$ 9,841         |
| Mortgage-backed securities                 | 47,232            | 1,238  | 6                             | 48,464           |
| State and municipal bonds                  | 12,143            | 42   | 202                           | 11,983           |
|  | 69,010            | 1,491  | 213                           | 70,288           |
| Marketable equity securities               | 974               |  |                               | 974              |
| <b>Total securities available for sale</b> | <b>\$ 69,984</b>  | <b>\$ 1,491</b>  | <b>\$ 213</b>                 | <b>\$ 71,262</b> |

|  | Amortized<br>Cost | 2007   |                               | Fair<br>Value   |
|--|-------------------|--|-------------------------------|-----------------|
|  |                   | Gross<br>Unrealized<br>Gains<br>(Dollars in thousands) | Gross<br>Unrealized<br>Losses |                 |
| <b>Securities held to maturity:</b>      |                   |  |                               |                 |
| State and municipal bonds                | \$ 1,768          | \$   | \$ 8                          | \$ 1,760        |
| <b>Total securities held to maturity</b> | <b>\$ 1,768</b>   | <b>\$</b>  | <b>\$ 8</b>                   | <b>\$ 1,760</b> |

|  | Amortized<br>Cost | 2007   |                               | Fair<br>Value    |
|--|-------------------|--|-------------------------------|------------------|
|  |                   | Gross<br>Unrealized<br>Gains<br>(Dollars in thousands) | Gross<br>Unrealized<br>Losses |                  |
| <b>Securities available for sale:</b>      |                   |  |                               |                  |
| U. S. Government agencies                  | \$ 13,635         | \$ 341   | \$ 10                         | \$ 13,966        |
| Mortgage-backed securities                 | 49,116            | 385  | 196                           | 49,305           |
| State and municipal bonds                  | 10,762            | 109  | 44                            | 10,827           |
|  | 73,513            | 835  | 250                           | 74,098           |
| Marketable equity securities               | 907               | 7  |                               | 914              |
| <b>Total securities available for sale</b> | <b>\$ 74,420</b>  | <b>\$ 842</b>  | <b>\$ 250</b>                 | <b>\$ 75,012</b> |

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|                                   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains<br>(Dollars in thousands) | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-----------------------------------|-------------------|--|-------------------------------|---------------|
| Securities held to maturity:      |                   |  |                               |               |
| State and municipal bonds         | \$ 1,770          | \$ 34  | \$                            | \$ 1,804      |
| Total securities held to maturity | \$ 1,770          | \$ 34  | \$                            | \$ 1,804      |



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The following table summarizes the amortized cost and recorded market values of investment securities (excluding marketable equity securities) at December 31, 2008, by contractual maturity groups:

|   | Amortized<br>Cost      | Fair<br>Value | Book<br>Yield (1) |
|---|------------------------|---------------|-------------------|
|   | (Dollars in thousands) |               |                   |
| <b>Securities available for sale and held to maturity</b> |                        |               |                   |
| U. S. Government agencies                                 |                        |               |                   |
| Due after one but within five years                       | \$ 2,497               | \$ 2,534      | 5.28%             |
| Due after five but within ten years                       | 7,137                  | 7,307         | 5.77%             |
|   | 9,634                  | 9,841         | 5.64%             |
| <b>Mortgage-backed securities</b>                         |                        |               |                   |
| Due after one but within five years                       | 3,812                  | 3,879         | 4.34%             |
| Due after five but within ten years                       | 6,485                  | 6,611         | 4.54%             |
| Due after ten years                                       | 36,936                 | 37,975        | 5.56%             |
|   | 47,233                 | 48,465        | 5.32%             |
| <b>Municipal bonds</b>                                    |                        |               |                   |
| Due after one but within five years                       | 1,315                  | 1,336         | 3.51%             |
| Due after five but within ten years                       | 3,628                  | 3,622         | 3.93%             |
| Due after ten years                                       | 8,968                  | 8,785         | 4.17%             |
|   | 13,911                 | 13,743        | 5.70%             |
| <b>Total investment securities</b>                        |                        |               |                   |
| Due after one but within five years                       | 7,625                  | 7,749         | 4.50%             |
| Due after five but within ten years                       | 17,249                 | 17,540        | 4.93%             |
| Due after ten years                                       | 45,904                 | 46,759        | 5.30%             |
|   | \$ 70,778              | \$ 72,048     | 5.44%             |

(1) Yields on tax-exempt investments have been adjusted to tax equivalent basis using an assumed tax rate of 34% for 2008.

**Table of Contents****Deposit Activities**

The Bank provides a range of deposit services, including non-interest bearing checking accounts, interest bearing checking and savings accounts, money market accounts and certificates of deposit. These accounts generally earn interest at rates established by management based on competitive market factors and the desire to increase or decrease certain types or maturities of deposits.

The Bank periodically uses brokered deposits consistent with asset and liability management policies. At December 31, 2008 the Bank had \$36.1 million in brokered deposits. We rarely bid on political funds for municipalities as such deposits are extremely rate sensitive and due to fiduciary pressures on government officials, not as stable as regular corporate and individual customers.

The Bank offers a variety of deposit programs to individuals and to small-to-medium size businesses and other organizations at interest rates generally competitive with local market conditions. For some of our corporate customers who require such a service, we provide a courier service for non-cash deposit pickup. The following table sets forth the average balances and rates for each of the deposit categories for the periods indicated:

|  | 2008                   |                 | Year Ended December 31,<br>2007 |                 | 2006               |                 |
|--|------------------------|-----------------|---------------------------------|-----------------|--------------------|-----------------|
|  | Average<br>Balance     | Average<br>Rate | Average<br>Balance              | Average<br>Rate | Average<br>Balance | Average<br>Rate |
|  | (Dollars in thousands) |                 |                                 |                 |                    |                 |
| Interest bearing NOW, savings, and money market accounts | \$ 87,785              | 1.17%           | \$ 100,047                      | 2.24%           | \$ 91,792          | 1.78%           |
| Other time deposits                                      | 139,295                | 4.20%           | 128,382                         | 4.84%           | 102,697            | 3.76%           |
| Time deposits greater than \$100,000                     | 137,334                | 4.21%           | 112,416                         | 5.05%           | 120,443            | 4.78%           |
| Total interest bearing deposits                          | 364,414                | 3.49%           | 340,845                         | 4.15%           | 314,932            | 3.57%           |
| Demand and other non-interest bearing deposits           | 52,653                 |                 | 59,376                          |                 | 58,705             |                 |
| Total average deposits                                   | \$ 417,067             | 3.04%           | \$ 400,221                      | 3.53%           | \$ 373,637         | 3.01%           |

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The following table indicates the amount of the Bank's certificates of deposit by interest rate and by time remaining until maturity as of December 31, 2008.

|                                     | Three months or less   |              | More than three months to six months |              | More than six months to one year |              | More than one year |              | Total             |              |
|-------------------------------------|------------------------|--------------|--------------------------------------|--------------|----------------------------------|--------------|--------------------|--------------|-------------------|--------------|
|                                     |                        |              |                                      |              |                                  |              |                    |              |                   |              |
|                                     | (Dollars in thousands) |              |                                      |              |                                  |              |                    |              |                   |              |
| Certificates of \$100,000 or more   | \$ 62,077              | 3.11%        | \$ 17,767                            | 3.21%        | \$ 70,082                        | 4.06%        | \$ 28,974          | 4.26%        | \$ 178,900        | 3.68%        |
| Certificates of less than \$100,000 | 21,661                 | 3.74%        | 14,778                               | 2.99%        | 55,847                           | 3.89%        | 23,080             | 3.97%        | 115,366           | 3.76%        |
| <b>Total</b>                        | <b>\$ 83,738</b>       | <b>3.27%</b> | <b>\$ 32,545</b>                     | <b>3.11%</b> | <b>\$ 125,929</b>                | <b>3.98%</b> | <b>\$ 52,054</b>   | <b>4.13%</b> | <b>\$ 294,266</b> | <b>3.71%</b> |

**Table of Contents****Borrowings**

Borrowed funds consist of advances from the Federal Home Loan Bank of Atlanta ( FHLB ), securities sold under agreement to repurchase, federal funds purchased, obligations under a capitalized lease for the Bank's main office facility and junior subordinated debentures. The following table summarizes balance and rate information for borrowed funds as of the dates and for the periods indicated.

|   | 2008                   | At or for the Year<br>Ended December 31,<br>2007 | 2006      |
|---|------------------------|--|-----------|
|   | (Dollars in thousands) |  |           |
| <b>AMOUNTS OUTSTANDING AT END OF PERIOD:</b>        |                        |  |           |
| Advances from the FHLB                              |                        |  |           |
| Amount  | \$ 26,000              | \$ 6,000   | \$ 6,000  |
| Weighted average rate                               | 3.14%                  | 3.53%  | 3.53%     |
| Securities sold under agreement to repurchase       |                        |  |           |
| Amount  | \$ 14,623              | \$ 18,193  | \$ 15,473 |
| Weighted average rate                               | 2.07%                  | 2.88%  | 3.69%     |
| Federal funds purchased                             |                        |  |           |
| Amount  | \$ 408                 | \$ 13,316  | \$        |
| Weighted average rate                               | 0.95%                  | 4.60%  |           |
| Capitalized lease obligation                        |                        |  |           |
| Amount  | \$ 1,676               | \$ 1,685   | \$ 1,694  |
| Weighted average rate                               | 8.24%                  | 8.24%  | 8.24%     |
| <b>MAXIMUM AMOUNT OUTSTANDING AT ANY MONTH-END:</b> |                        |  |           |
| Advances from the FHLB                              | \$ 26,000              | \$ 6,000   | \$ 11,056 |
| Securities sold under agreement to repurchase       | 19,931                 | 25,531   | 17,058    |
| Federal funds purchased                             | 18,648                 | 13,316   | 6,337     |
| Capitalized lease obligation                        | 1,685                  | 1,694  | 1,702     |
| <b>AVERAGES DURING THE PERIOD:</b>                  |                        |  |           |
| Advances from the FHLB                              |                        |  |           |
| Average balance                                     | \$ 23,391              | \$ 6,000   | \$ 10,834 |
| Weighted average rate                               | 3.21%                  | 3.53%  | 4.17%     |
| Securities sold under agreement to repurchase       |                        |  |           |
| Average balance                                     | \$ 17,551              | \$ 20,977  | \$ 13,753 |
| Weighted average rate                               | 2.07%                  | 3.70%  | 3.42%     |
| Federal funds purchased                             |                        |  |           |
| Average balance                                     | \$ 4,103               | \$ 340   | \$ 913    |
| Weighted average rate                               | 3.32%                  | 4.41%  | 4.84%     |
| Capitalized lease obligation                        |                        |  |           |
| Average balance                                     | \$ 1,683               | \$ 1,692   | \$ 1,700  |
| Weighted average rate                               | 8.23%                  | 8.24%  | 8.24%     |

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Pursuant to collateral agreements with the FHLB, advances are secured by all of the Company's FHLB stock, investment securities with a carrying value of \$8.4 million at December 31, 2008, and a blanket lien on qualifying first mortgage loans. This agreement with the FHLB provides for a line of credit up to 15% of the Bank's assets. The unused portion of this line of credit is \$54.4 million as of December 31, 2008.

Securities sold under agreement to repurchase are secured by investment securities. The carrying value of the investment securities at December 31, 2008 was \$17.1 million.

Bancshares also has unused lines of credit totaling \$35.1 million from correspondent banks at December 31, 2008.

## **Junior Subordinated Deferrable Interest Debentures**

On December 31, 2001 we privately placed 2,000 shares of American Community Capital Trust I 9% Trust Preferred Securities, having a value of \$2,000,000. On March 1, 2002, we privately placed an additional 1,500 shares of American Community Capital Trust I 9% Trust Preferred Securities, having a liquidation value of \$1,500,000. The trust preferred securities have a dividend yield equal to 9% of their face value each year and distributions are paid on a quarterly basis. Bancshares' source of funds for the required interest payments on the trust preferred securities is interest and dividends payable by the Bank to Bancshares plus proceeds received from additional stock sold by Bancshares. Under the terms of the trust preferred securities, Bancshares is permitted to defer the payment of interest on the trust preferred securities for up to 20 consecutive calendar quarters. The amount of any interest deferred also bears interest and must be paid at such time as funds are available to Bancshares. The Trust Preferred Securities were paid off on March 9, 2007.

During 2003, we formed a special purpose entity organized as a business trust under the laws of the State of Connecticut. This business trust, called American Community Capital Trust II, Ltd was formed in order to allow us to issue trust preferred securities. On December 15, 2003, American Community Capital Trust II, Ltd. issued a floating rate trust preferred security in the amount of \$10,000,000. The Trust used the proceeds from the issuance of the trust preferred security to acquire a \$10,310,000 junior subordinated note of the Company. The trust preferred security essentially mirrors the debt security, carrying a floating interest rate based on 3-month LIBOR plus 280 basis points. The initial interest rate in effect at the time of issuance was 3.97%, which is reset on a quarterly basis. The rate as of December 31, 2008 was 6.56%. The securities have a legal maturity of 30 years, and can be called at the Company's option in whole or part after five years.

## **Banking Technology**

We provide our customers with truncation of their deposit accounts (check imaging), on-line banking and 24 hour telephone banking that permits our depositors to check balances, recently cleared checks and recent deposits. Due to our imaging of all documentation, our customer service representatives can access past statements and paid checks in a matter of seconds, eliminating research fees for our customers and eliminating any waiting time for such research. We implemented Internet banking for our personal customers during the fourth quarter of 2002 and our business Internet banking was implemented in 2003.

The Bank has twelve ATM facilities attached to twelve of its existing banking offices. The Bank's ATM cards are linked to the nationwide Cirrus®, Plus® and Star® systems, allowing the Bank's customers to withdraw funds from any ATM honoring these systems.

## **Competition**

Commercial banking in North Carolina is highly competitive in large part due to early adoption of statewide branching. We compete in our market areas with some of the largest banking organizations in the state and the country and other financial institutions, such as federally and state-chartered savings and loan institutions and credit unions, as well as consumer finance companies, mortgage companies and other lenders engaged in the business of extending credit or taking investment monies such as mutual funds and brokerage firms. Many of our competitors have broader geographic markets and higher lending limits than us and are also able to provide more services and make greater use of media advertising. In Union County, for example, there are currently 37 offices of 10 different commercial banks (including the largest banks in North Carolina). In Mecklenburg County, there are currently 241 offices of 23 different commercial banks (including the largest banks in North Carolina). While we typically do not compete directly for loans with these larger banks, they do influence our deposit products. We do compete more directly with mid-size and small community banks that have offices in our market areas. There are also a number of

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new community banks in Mecklenburg and Union Counties that have a direct competitive effect as borrowers tend to shop the terms of their loans and deposits.

The enactment of legislation authorizing interstate banking has caused great increases in the size and financial resources of some of our competitors. In addition, as a result of interstate banking, out-of-state commercial banks have acquired North Carolina banks and heightened the competition among banks in North Carolina. For example, Atlanta, Georgia based SunTrust, a large multi-state financial institution has branches throughout North Carolina, including Mecklenburg County, Regions Bancshares, from Birmingham, Alabama as well as California Based Wells Fargo and Ohio based Fifth Third, recently expanded their presence in North Carolina.

The banking business is highly competitive in South Carolina as well. American Community competes as a financial intermediary with other commercial banks, savings and loan associations, credit unions, and money market mutual funds operating in the Cherokee County area and elsewhere. In Cherokee County, there are currently 10 offices of 5 different commercial banks. A number of these competitors are well established in the Cherokee County area. Most of them have substantially greater resources and lending limits than the Bank and offer certain services, such as extensive and established branch networks and trust services that we either do not expect to provide or do not currently provide. As a result of these competitive factors, the Bank may have to pay higher rates of interest to attract deposits.

Despite the competition in our market areas, we believe that we have certain competitive advantages that distinguish us from our competition. We believe that our primary competitive advantages are our bankers, each of whom is well known in his or her community with strong personal and business ties to that community with a loyal customer following. We offer customers modern banking services without forsaking community values such as prompt, personal service and friendliness. We also have established local advisory boards in certain of our communities to help us better understand their needs and to be ambassadors of the Bank. We offer many personalized services and attract customers by being responsive and sensitive to their individualized needs. We believe our approach to business builds goodwill among our customers, shareholders, and the communities we serve which results in referrals from shareholders and satisfied customers. We also rely on traditional marketing to attract new customers. To enhance a positive image in the community, we support and participate in local events and our officers and directors serve on boards of local civic and charitable organizations. As an example, American Community was recognized each year from 1999 to 2008 for outstanding contributions to the United Way Campaign for Union County. American Community is very active in the Special Olympics for all markets.

American Community entered into a revenue sharing agreement with Smith Barney in 2000, in which the Bank receives revenue for business generated by a broker located in our main office. As a community service providing a competitive edge, the Bank sponsors small business seminars and features various speakers on topics of interest to growing small businesses. The Bank attempts to bring together in one place a variety of experts to discuss timely issues of importance to business owners regarding such matters as e-commerce, investments, and estate and retirement planning. This social setting also provides small business owners with an opportunity to network with other small business owners in our communities. Further, through its Kidz Club, the Bank offers savings accounts designed for young savers. The Bank has also developed a Senior Citizens account for customers 50 years and older. These products offer free travelers checks, free safe deposit box, interest on daily balances, free wallet-style checks, free breakfasts with guest speakers and periodic day trips. American Community also sponsors the day trips as a way to attract Senior Citizens accounts and to further enhance their loyalty to the Bank.

## **Regulation of the Bank**

The Bank is extensively regulated under both federal and state law. Generally, these laws and regulations are intended to protect depositors and borrowers, not shareholders. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in applicable law or regulation may have a material effect on the business of Bancshares and the Bank.

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*State Law.* The Bank is subject to extensive supervision and regulation by the North Carolina Commissioner of Banks (the Commissioner). The Commissioner oversees state laws that set specific requirements for bank capital and regulate deposits in, and loans and investments by, banks, including the amounts, types, and in some cases, rates. The Commissioner supervises and performs periodic examinations of North Carolina-chartered banks to assure compliance with state banking statutes and regulations, and the Bank is required to make regular reports to the Commissioner describing in detail the resources, assets, liabilities and financial condition. Among other things, the Commissioner regulates mergers and consolidations of state-chartered banks, the payment of dividends, loans to officers and directors, record keeping, types and amounts of loans and investments, and the establishment of branches.

*Deposit Insurance.* The Bank's deposits are insured up to applicable limits through the FDIC's Deposit Insurance Fund (DIF) generally up to a maximum of \$100,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts. In October 2008, the FDIC temporarily increased the maximum to \$250,000 per separately insured depositor until December 2009.

On February 27, 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund. The Board took action by imposing a special assessment on insured institutions of 20 basis points, implementing changes to the risk-based assessment system, and increased regular premium rates for 2009, which banks must pay on top of the special assessment. The 20 basis point special assessment on the industry will be as of June 30, 2009 payable on September 30, 2009. As a result of the special assessment and increased regular assessments, the Company projects it will experience an increase in FDIC assessment expense by approximately \$1.8 million from 2008 to 2009. The 20 basis point special assessment represents \$1.2 million of this increase.

On March 5, 2009, the FDIC Chairman announced that the FDIC intends to lower the special assessment from 20 basis points to 10 basis points. The approval of the cutback is contingent on whether Congress clears legislation that would expand the FDIC's line of credit with the Treasury to \$100 billion. Legislation to increase the FDIC's borrowing authority on a permanent basis is also expected to advance to Congress, which should aid in reducing the burden on the industry. The assessment rates, including the special assessment, are subject to change at the discretion of the Board of Directors of the FDIC.

This increase was part of the Emergency Economic Stabilization Act of 2008. Additionally, The Bank has elected to participate in the FDIC's Temporary Liquidity Guarantee Program. Under this program, all non-interest bearing deposit transaction accounts at the Bank with balances over \$250,000 will also be fully insured through December 31, 2009 at an additional cost to the Bank of 10 basis points per dollar over \$250,000 on a per account basis. The FDIC has set a designated reserve ratio of 1.25% (\$1.25 against \$100 of insured deposits) for the DIF. The FDIC has the authority to set the ratio between 1.15% and 1.50%, and must adopt a restoration plan when the ratio falls below 1.15% and begin paying dividends when the reserve ratio exceeds 1.35%. There is no requirement to achieve a specific ratio within a given time frame. The DIF reserve ratio calculated by the FDIC that was in effect at December 31, 2008 was .76%. In October 2008, the FDIC adopted a restoration plan that would increase the reserve ratio to the 1.15% threshold within five years. As part of that plan, the FDIC increased risk-based assessment rates uniformly by seven cents, on an annual basis, for the first quarter of 2009 due to deteriorating financial conditions in the banking industry.

In addition to risk-based deposit insurance assessments, additional assessments may be imposed by the Financing Corporation, a separate U.S. government agency affiliated with the FDIC, on insured deposits to pay for the interest cost of Financing Corporation bonds. Financing Corporation assessment rates for 2008 ranged from \$.0110 to \$.0114 per \$100 of deposits.

The FDIC can terminate a depository institution's deposit insurance if it finds that the institution is being operated in an unsafe and unsound manner or has violated any rule, regulation, order or condition administered by the institution's regulatory authorities. Any such termination of deposit insurance would likely have a material adverse effect on the Bank, the severity of which would depend on the amount of deposits affected by such a termination. The FDIC evaluates the risk of each financial institution based on its supervisory rating, its financial ratios, and its long-term debt issuer rating. Deposit insurance premium rates in 2008 for nearly all of the financial institution industry varied between five and seven cents every \$100 of domestic deposits. The deposit insurance assessment rates are determined quarterly.

On December 16, 2008, the FDIC adopted a final rule increasing its risk-based deposit insurance assessment scale uniformly by seven (7) basis points for first quarter 2009. The assessment scale for first quarter 2009 will range

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from twelve (12) basis points of assessable deposits for the strongest institutions to fifty (50) basis points for the weakest. The FDIC attributes the assessment increase to recent failures of FDIC-insured institutions. The FDIC's action applies only to the first quarter of 2009. FDIC is considering further changes to the risk-based assessment scale effective April 1, 2009, designed to make the assessment system more risk sensitive and ensure that riskier institutions bear a greater share of the assessments. Proposed adjustments to the scale include: (i) adding a surcharge for certain institutions (institutions in the three riskiest categories for FDIC assessment purposes) that use brokered deposits to fund growth, (ii) providing a possible discount of up to two (2) basis points based on an institution's ratio of long-term unsecured debt, including senior unsecured and subordinated debt, to domestic deposits (for small institutions (generally, those with less than \$10 billion in assets), the ratio could include a certain amount of Tier 1 capital) and (iii) adding a surcharge based upon an institution's ratio of secured liabilities (including Federal Home Loan Bank advances, securities sold under repurchase agreements, secured Federal Funds purchased and certain other secured borrowings) to domestic deposits, if greater than 15%.

*Capital Requirements.* The federal banking regulators have adopted certain risk-based capital guidelines to assist in the assessment of the capital adequacy of a banking organization's operations for both transactions reported on the balance sheet as assets and transactions, such as letters of credit, and recourse arrangements, which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages which range from 0% for assets with low credit risk, such as certain U.S. Treasury securities, to 100% for assets with relatively high credit risk, such as business loans.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk adjusted assets. The regulators measure risk-adjusted assets, which include off balance sheet items, against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1, or core capital, includes common equity, qualifying noncumulative perpetual preferred stock and minority interests in equity accounts of consolidated subsidiaries, less goodwill and other intangibles, subject to certain exceptions.

Tier 2, or supplementary capital, includes among other things, limited-life preferred stock, hybrid capital instruments, mandatory convertible securities, qualifying subordinated debt, and the allowance for loan and lease losses, subject to certain limitations and less required deductions. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Banks and bank holding companies subject to the risk-based capital guidelines are required to maintain a ratio of Tier 1 capital to risk-weighted assets of at least 4% and a ratio of total capital to risk-weighted assets of at least 8%. The appropriate regulatory authority may set higher capital requirements when particular circumstances warrant. As of December 31, 2008, Bancshares was well-capitalized with Tier 1 and Total Risk-Based Capital of 11.38% and 12.64%, respectively.

The federal banking agencies have adopted regulations specifying that they will include, in their evaluations of a bank's capital adequacy, an assessment of the bank's interest rate risk exposure. The standards for measuring the adequacy and effectiveness of a banking organization's interest rate risk management include a measurement of board of director and senior management oversight, and a determination of whether a banking organization's procedures for comprehensive risk management are appropriate for the circumstances of the specific banking organization.

Failure to meet applicable capital guidelines could subject a banking organization to a variety of enforcement actions, including limitations on its ability to pay dividends, the issuance by the applicable regulatory authority of a capital directive to increase capital and, in the case of depository institutions, the termination of deposit insurance by the FDIC, as well as the measures described under the Federal Deposit Insurance Corporation Improvement Act of 1991 below, as applicable to undercapitalized institutions. In addition, future changes in regulations or practices could further reduce the amount of capital recognized for purposes of capital adequacy. Such a change could affect the ability of the Bank to grow and could restrict the amount of profits, if any, available for the payment of dividends to the shareholders.

*Federal Deposit Insurance Corporation Improvement Act of 1991.* In December 1991, Congress enacted the Federal Deposit Insurance Corporation Improvement Act of 1991 (the FDIC Improvement Act), which substantially revised the bank regulatory and funding provisions of the Federal Deposit Insurance Act and made significant revisions to several other federal banking statutes. The FDIC Improvement Act provides for, among other things:

publicly available annual financial condition and management reports for certain financial institutions, including audits by independent accountants,



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the establishment of uniform accounting standards by federal banking agencies,

the establishment of a prompt corrective action system of regulatory supervision and intervention, based on capitalization levels, with greater scrutiny and restrictions placed on depository institutions with lower levels of capital,

additional grounds for the appointment of a conservator or receiver, and

restrictions or prohibitions on accepting brokered deposits, except for institutions which significantly exceed minimum capital requirements.

The FDIC Improvement Act also provides for increased funding of the FDIC insurance funds and the implementation of risk-based premiums.

A central feature of the FDIC Improvement Act is the requirement that the federal banking agencies take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. Pursuant to the FDIC Improvement Act, the federal bank regulatory authorities have adopted regulations setting forth a five-tiered system for measuring the capital adequacy of the depository institutions that they supervise. Under these regulations, a depository institution is classified in one of the following capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution may be deemed by the regulators to be in a capitalization category that is lower than is indicated by its actual capital position if, among other things, it receives an unsatisfactory examination rating with respect to asset quality, management, earnings or liquidity.

The FDIC Improvement Act provides the federal banking agencies with significantly expanded powers to take enforcement action against institutions which fail to comply with capital or other standards. Such action may include the termination of deposit insurance by the FDIC or the appointment of a receiver or conservator for the institution. The FDIC Improvement Act also limits the circumstances under which the FDIC is permitted to provide financial assistance to an insured institution before appointment of a conservator or receiver.

*International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001.* On October 26, 2001, the USA PATRIOT Act of 2001 was enacted. This act contains the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, which sets forth anti-money laundering measures affecting insured depository institutions, broker-dealers and other financial institutions. The Act requires U.S. financial institutions to adopt new policies and procedures to combat money laundering and grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on the operations of financial institutions. The USA PATRIOT Act of 2001 has increased costs of regulatory compliance.

*Miscellaneous.* The dividends that may be paid by the Bank are subject to legal limitations. In accordance with North Carolina banking law, dividends may not be paid by the Bank unless its capital surplus is at least 50% of its paid-in capital.

The earnings of the Bank will be affected significantly by the policies of the Federal Reserve Board, which is responsible for regulating the United States money supply in order to mitigate recessionary and inflationary pressures. Among the techniques used to implement these objectives are open market transactions in United States government securities, changes in the rate paid by banks on bank borrowings, and changes in reserve requirements against bank deposits. These techniques are used in varying combinations to influence overall growth and distribution of bank loans, investments, and deposits, and their use may also affect interest rates charged on loans or paid for deposits.

The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. In view of changing conditions in the national economy and money markets, as well as the effect of actions by monetary and fiscal authorities, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or the business and earnings of the Bank.

We cannot predict what legislation might be enacted or what regulations might be adopted, or if enacted or adopted, the effect thereof on the Bank's operations.

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### **Regulation of Bancshares**

*Federal Regulation.* Bancshares is subject to examination, regulation and periodic reporting under the Bank Holding Company Act of 1956, as administered by the Federal Reserve Board. The Federal Reserve Board has adopted capital adequacy guidelines for bank holding companies on a consolidated basis.

The status of Bancshares as a registered bank holding company under the Bank Holding Company Act does not exempt it from certain federal and state laws and regulations applicable to corporations generally, including, without limitation, the federal securities laws.

Bancshares is required to obtain the prior approval of the Federal Reserve Board to acquire all, or substantially all, of the assets of any bank or bank holding company. Prior Federal Reserve Board approval is required for Bancshares to acquire direct or indirect ownership or control of any voting securities of any bank or bank holding company if, after giving effect to such acquisition, it would, directly or indirectly, own or control more than five percent of any class of voting shares of such bank or bank holding company.

The merger or consolidation of Bancshares with another bank, or the acquisition by Bancshares of assets of another bank, or the assumption of liability by Bancshares to pay any deposits in another bank, will require the prior written approval of the primary federal bank regulatory agency of the acquiring or surviving bank under the federal Bank Merger Act. The decision is based upon a consideration of statutory factors similar to those outlined above with respect to the Bank Holding Company Act. In addition, in certain such cases an application to, and the prior approval of, the Federal Reserve Board under the Bank Holding Company Act and/or the North Carolina Banking Commission may be required.

Bancshares is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of Bancshares' consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, Federal Reserve Board order or directive, or any condition imposed by, or written agreement with, the Federal Reserve Board. Such notice and approval is not required for a bank holding company that would be treated as well capitalized and well managed under applicable regulations of the Federal Reserve Board, that has received a composite 1 or 2 rating at its most recent bank holding company inspection by the Federal Reserve Board, and that is not the subject of any unresolved supervisory issues.

In addition, a bank holding company is prohibited generally from engaging in, or acquiring five percent or more of any class of voting securities of any company engaged in, non-banking activities. One of the principal exceptions to this prohibition is for activities found by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the principal activities that the Federal Reserve Board has determined by regulation to be so closely related to banking as to be a proper incident thereto are:

making or servicing loans;

performing certain data processing services;

providing discount brokerage services;

acting as fiduciary, investment or financial advisor;

leasing personal or real property;

making investments in corporations or projects designed primarily to promote community welfare; and

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acquiring a savings and loan association.

In evaluating a written notice of such an acquisition, the Federal Reserve Board will consider various factors, including among others the financial and managerial resources of the notifying bank holding company and the relative public benefits and adverse effects which may be expected to result from the performance of the activity by an affiliate of such company. The Federal Reserve Board may apply different standards to activities proposed to be commenced de novo and activities commenced by acquisition, in whole or in part, of a going concern. The required notice period may be extended by the Federal Reserve Board under certain circumstances, including a notice for acquisition of a company engaged in activities not previously approved by regulation of the Federal Reserve Board. If such a proposed acquisition is not disapproved or subjected to conditions by the Federal Reserve Board within the applicable notice period, it is deemed approved by the Federal Reserve Board.

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However, with the passage of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999, which became effective on March 11, 2000, the types of activities in which a bank holding company may engage were significantly expanded. Subject to various limitations, the Modernization Act generally permits a bank holding company to elect to become a financial holding company. A financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. Among the activities that are deemed financial in nature are, in addition to traditional lending activities, securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, certain merchant banking activities and activities that the Federal Reserve Board considers to be closely related to banking.

A bank holding company may become a financial holding company under the Modernization Act if each of its subsidiary banks is well capitalized under the Federal Deposit Insurance Corporation Improvement Act prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community Reinvestment Act. In addition, the bank holding company must file a declaration with the Federal Reserve Board that the bank holding company wishes to become a financial holding company. A bank holding company that falls out of compliance with these requirements may be required to cease engaging in some of its activities. Bancshares has not yet elected to become a financial holding company.

Under the Modernization Act, the Federal Reserve Board serves as the primary umbrella regulator of financial holding companies, with supervisory authority over each parent company and limited authority over its subsidiaries. Expanded financial activities of financial holding companies generally will be regulated according to the type of such financial activity: banking activities by banking regulators, securities activities by securities regulators and insurance activities by insurance regulators. The Modernization Act also imposes additional restrictions and heightened disclosure requirements regarding private information collected by financial institutions.

*Capital Requirements.* The Federal Reserve Board uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other things, be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve Board's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies:

a leverage capital requirement expressed as a percentage of adjusted total assets;

a risk-based requirement expressed as a percentage of total risk-weighted assets; and

a Tier 1 leverage requirement expressed as a percentage of adjusted total assets.

The leverage capital requirement consists of a minimum ratio of total capital to total assets of 4%, with an expressed expectation that banking organizations generally should operate above such minimum level. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, of which at least one-half must be Tier 1 capital (which consists principally of shareholders' equity). The Tier 1 leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated companies, with minimum requirements of 4% to 5% for all others.

The risk-based and leverage standards presently used by the Federal Reserve Board are minimum requirements, and higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels.

*U.S. Treasury Capital Purchase Program.* On November 5, 2008, pursuant to the U.S. Department of the Treasury's (the "U.S. Treasury") Capital Purchase Program (the "CPP"), the Company applied for Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value and liquidation preference of \$1,000 per share. The CPP also grants the U. S. Treasury the right to receive warrants to purchase stock of the Company at a price to be determined upon sale of the preferred stock. As of March 24, 2009 the Company has neither been approved nor

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denied participation in the capital program. The securities purchase agreement pursuant to which the securities would be issued to the U.S. Treasury under the CPP would:

Limit the payment of dividends on the Company's common stock without prior approval of the U.S. Treasury

Limit the ability to repurchase shares of its common stock

Grant the holders of the preferred stock, the warrant and the common stock of the Company to be issued under the warrants certain registration rights, and

Subject the Company to certain executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 and the American Relief and Recovery Act of 2009.

*Source of Strength for Subsidiaries.* Bank holding companies are required to serve as a source of financial strength for their depository institution subsidiaries, and, if their depository institution subsidiaries become undercapitalized, bank holding companies may be required to guarantee the subsidiaries' compliance with capital restoration plans filed with their bank regulators, subject to certain limits.

*Dividends.* As a bank holding company that does not, as an entity, currently engage in separate business activities of a material nature, Bancshares' ability to pay cash dividends depends upon the cash dividends it receives from the Bank. At present, Bancshares' only source of income is dividends paid by the Bank and interest earned on any investment securities it holds. Bancshares must pay all of its operating expenses from funds it receives from the Bank. Therefore, shareholders may receive dividends from Bancshares only to the extent that funds are available after payment of our operating expenses and the board decides to declare a dividend. In addition, the Federal Reserve Board generally prohibits bank holding companies from paying dividends except out of operating earnings, and the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality and overall financial condition. We expect that, for the foreseeable future, any dividends paid by the Bank will likely be limited to amounts needed to pay any separate expenses of Bancshares, to pay dividends to shareholders and to make required payments on our debt obligations, including our outstanding debentures underlying trust preferred securities.

The FDIC Improvement Act requires the federal bank regulatory agencies biennially to review risk-based capital standards to ensure that they adequately address interest rate risk, concentration of credit risk and risks from non-traditional activities and, since adoption of the Riegle Community Development and Regulatory Improvement Act of 1994, to do so taking into account the size and activities of depository institutions and the avoidance of undue reporting burdens. In 1995, the agencies adopted regulations requiring as part of the assessment of an institution's capital adequacy the consideration of (a) identified concentrations of credit risks, (b) the exposure of the institution to a decline in the value of its capital due to changes in interest rates and (c) the application of revised conversion factors and netting rules on the institution's potential future exposure from derivative transactions.

In addition, the agencies in September 1996 adopted amendments to their respective risk-based capital standards to require banks and bank holding companies having significant exposure to market risk arising from, among other things, trading of debt instruments, (1) to measure that risk using an internal value-at-risk model conforming to the parameters established in the agencies' standards and (2) to maintain a commensurate amount of additional capital to reflect such risk. The new rules were adopted effective January 1, 1997, with compliance mandatory from and after January 1, 1998.

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ( FIRREA ), depository institutions are liable to the FDIC for losses suffered or anticipated by the FDIC in connection with the default of a commonly controlled depository institution or any assistance provided by the FDIC to such an institution in danger of default. This law would not be applicable to Bancshares because it currently only maintains one subsidiary depository institution.

Subsidiary banks of a bank holding company are subject to certain quantitative and qualitative restrictions imposed by the Federal Reserve Act on any extension of credit to, or purchase of assets from, or letter of credit on behalf of, the bank holding company or its subsidiaries, and on the investment in or acceptance of stocks or securities of such holding company or its subsidiaries as collateral for loans. In addition, provisions of the Federal Reserve Act and Federal Reserve Board regulations limit the amounts of, and establish required procedures and credit standards with respect to, loans and other extensions of credit to officers, directors and principal shareholders of the Bank,



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Bancshares, any subsidiary of Bancshares and related interests of such persons. Moreover, subsidiaries of bank holding companies are prohibited from engaging in certain tying arrangements (with the holding company or any of its subsidiaries) in connection with any extension of credit, lease or sale of property or furnishing of services.

Any loans by a bank holding company to a subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of the subsidiary bank. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank would be assumed by the bankruptcy trustee and entitled to a priority of payment. This priority would also apply to guarantees of capital plans under the FDIC Improvement Act.

## **Interstate Branching**

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Riegle Act), the Federal Reserve Board may approve bank holding company acquisitions of banks in other states, subject to certain aging and deposit concentration limits. As of June 1, 1997, banks in one state may merge with banks in another state, unless the other state has chosen not to implement this section of the Riegle Act. These mergers are also subject to similar aging and deposit concentration limits.

North Carolina opted-in to the provisions of the Riegle Act. Since July 1, 1995, an out-of-state bank that did not already maintain a branch in North Carolina was permitted to establish and maintain a de novo branch in North Carolina, or acquire a branch in North Carolina, if the laws of the home state of the out-of-state bank permit North Carolina banks to engage in the same activities in that state under substantially the same terms as permitted by North Carolina. Also, North Carolina banks may merge with out-of-state banks, and an out-of-state bank resulting from such an interstate merger transaction may maintain and operate the branches in North Carolina of a merged North Carolina bank, if the laws of the home state of the out-of-state bank involved in the interstate merger transaction permit interstate merger.

## **Future Legislation**

We cannot predict what legislation might be enacted in the future or what regulations might be adopted, or if enacted or adopted, the effect thereof on our operations.

## **Employees**

As of December 31, 2008, we had full-time 87 employees and 8 part-time employees. None of these employees are covered by a collective bargaining agreement. We consider relations with our employees to be good.

## **ITEM 1A RISK FACTORS**

Not required for Smaller reporting companies

## **ITEM 1B UNRESOLVED STAFF COMMENTS**

None

**Table of Contents****ITEM 2 PROPERTIES**

The following table sets forth the location of American Community's main office and branch offices, as well as certain information relating to these offices.

| Office Location                | Year Opened | Approximate Square Footage | Owned or Leased |
|--------------------------------|-------------|----------------------------|-----------------|
| <b>Main Office</b>             |             |                            |                 |
| 2593 West Roosevelt Boulevard  |             |                            |                 |
| Monroe NC 28110                | 1999        | 14,774                     | Leased          |
| <b>Indian Trail</b>            |             |                            |                 |
| 13860 East Independence Blvd   |             |                            |                 |
| Indian Trail NC 28079          | 1999        | 3,850                      | Leased          |
| <b>Sunset</b>                  |             |                            |                 |
| 120 East Sunset Drive          |             |                            |                 |
| Monroe, NC 28111               | 1999        | 450                        | Leased          |
| <b>Wal-Mart Superstore</b>     |             |                            |                 |
| 2406 West Roosevelt Blvd       |             |                            |                 |
| Monroe NC 28110                | 2000        | 600                        | Leased          |
| <b>Marshville</b>              |             |                            |                 |
| 7001 East Marshville Blvd      |             |                            |                 |
| Marshville NC 28103            | 2000        | 3,500                      | Leased          |
| <b>Mint Hill</b>               |             |                            |                 |
| 7200 Matthews-Mint Hill Rd     |             |                            |                 |
| Mint Hill NC 28227             | 2000        | 2,500                      | Leased          |
| <b>Mountain Island</b>         |             |                            |                 |
| 3500 Mt. Holly-Huntersville Rd |             |                            |                 |
| Charlotte NC 28216             | 2000        | 4,500                      | Owned           |
| <b>South Park</b>              |             |                            |                 |
| 4500 Cameron Valley Parkway    |             |                            |                 |
| Charlotte NC                   | 2003        | 2,800                      | Leased          |



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|                        |      |        |        |  |
|------------------------|------|--------|--------|--|
| South End              |      |        |        |  |
| 2130 South Boulevard   |      |        |        |  |
| Charlotte NC 28203     | 2005 | 5,405  | Leased |  |
| Gaffney Main           |      |        |        |  |
| 217 N. Granard Street  |      |        |        |  |
| Gaffney S.C. 29341     | 1999 | 11,000 | Owned  |  |
| Blacksburg             |      |        |        |  |
| 207 W. Cherokee Street |      |        |        |  |
| Blacksburg SC 29702    | 2000 | 2,550  | Leased |  |
| Chesnee Highway        |      |        |        |  |
| 626 Chesnee Highway    |      |        |        |  |
| Gaffney S.C 29341      | 2001 | 2,550  | Leased |  |
| Tega Cay               |      |        |        |  |
| 1738 Gold Hill Road    |      |        |        |  |
| Tega Cay SC 29708      | 2005 | 3,082  | Owned  |  |

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In 1999 American Community entered into a Commercial Lease Agreement with TyPar Realty, Inc. for the lease of a portion of a two-story building constructed by L. C. Tyson Construction, Inc. This building serves as the main office of American Community. TyPar Realty, Inc. and L. C. Tyson Construction, Inc. are related interests of Carlton Tyson, a former director of Bancshares. The lease was for thirty years commencing in 1999 with increases every five years plus our share of common area expenses. American Community has a right of first refusal to lease the remainder of the building as it becomes available and to purchase the building should it be offered for sale. This lease was entered into at arms-length and at then current market rates. The lease was reviewed by an independent third party real estate appraiser for assurance that the terms of the lease are not more favorable than would be engaged with any other party. Additionally, after a sealed bid process, L. C. Tyson Construction, Inc. was awarded as low bidder, the construction contract for American Community's permanent buildings in Marshville and Mountain Island. American Community believes the terms of that contract are fair to the bank.

American Community sold and leased back the Marshville branch in 2001 to Carroll Edwards in an arms-length transaction at then current market rates. In 2002 Mr. Edwards was elected to the board of directors of American Community and retired from the board in 2006.

In 2003, American Community entered into a commercial lease agreement with Zebulon Morris, Jr, a former director of American Community, for the lease of a new building constructed by Mr. Morris. The lease is for 10 years commencing in 2003. This lease was entered into at arms-length and at then current market rates. In 1998 Mr. Morris was elected to the board of directors of American Community and retired from the board in 2006.

In 2008, American Community sold the Blacksburg and Highway 11 branches and leased them back for a period of ten years with two renewal options for five years each. The leaseback has been accounted for as an operating lease.

**ITEM 3 LEGAL PROCEEDINGS**

In the normal course of its operations, the Bank from time to time is party to various legal proceedings. Based upon information currently available, there are no legal proceedings to which Bancshares or the Bank is party that would have a material adverse effect on Bancshares business, financial position, or results of operations.

**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

**Table of Contents****PART II****ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

American Community Bancshares' common stock is listed on the Nasdaq Capital Market under the symbol ACBA. It began trading on this market on July 17, 2000. There were 6,643,495 shares of our common stock outstanding at February 27, 2009 owned by approximately 2,500 shareholders. The table below lists the high and low prices at which trades were completed during each quarter indicated for our stock and warrants to buy stock and are adjusted to reflect our three-for-two stock split effective in the form of a 50% stock dividend in February 2006. In 2008 and 2007, the Company paid quarterly dividends in the amount of \$0.05 per share.

|                | Dividends<br>Paid | Sale Price<br>Common Stock |          |
|----------------|-------------------|----------------------------|----------|
|                |                   | High                       | Low      |
| <u>2008</u>    |                   |                            |          |
| First Quarter  | \$ 0.05           | \$ 10.00                   | \$ 7.09  |
| Second Quarter | 0.05              | 9.00                       | 6.15     |
| Third Quarter  | 0.05              | 11.25                      | 5.00     |
| Fourth Quarter | 0.05              | 10.29                      | 7.02     |
| <u>2007</u>    |                   |                            |          |
| First Quarter  | \$ 0.05           | \$ 12.69                   | \$ 10.60 |
| Second Quarter | 0.05              | 12.30                      | 10.87    |
| Third Quarter  | 0.05              | 12.50                      | 10.15    |
| Fourth Quarter | 0.05              | 12.84                      | 9.19     |

See Item 12 of this report for disclosure regarding securities authorized for issuance and equity compensation plans required by Item 201(d) of Regulation S-K.

**Table of Contents****ITEM 6 SELECTED FINANCIAL DATA****AMERICAN COMMUNITY BANCSHARES, INC.****Selected Financial Information and Other Data**

(\$ in thousands, except per share data)

|   | 2008       | At or for the Year Ended December 31, |            |            | 2004       |
|---|------------|---------------------------------------|------------|------------|------------|
|   |            | 2007                                  | 2006       | 2005       |            |
| <b>Operating Data:</b>                              |            |                                       |            |            |            |
| Total interest income                               | \$ 30,411  | \$ 35,426                             | \$ 32,334  | \$ 25,584  | \$ 18,217  |
| Total interest expense                              | 14,699     | 16,193                                | 13,521     | 9,180      | 6,220      |
| Net interest income                                 | 15,712     | 19,233                                | 18,813     | 16,404     | 11,997     |
| Provision for loan losses                           | 4,999      | 1,033                                 | 2,612      | 809        | 574        |
| Net interest income after provision for loan losses | 10,713     | 18,200                                | 16,201     | 15,595     | 11,423     |
| Non-interest income                                 | 2,486      | 3,391                                 | 3,353      | 3,294      | 3,337      |
| Non-interest expenses                               | 17,209     | 13,702                                | 12,838     | 11,742     | 10,400     |
| Income (loss) before income taxes                   | (4,010)    | 7,889                                 | 6,716      | 7,147      | 4,360      |
| Provision for income taxes                          | (1,353)    | 2,869                                 | 2,440      | 2,639      | 1,617      |
| Net income (loss)                                   | \$ (2,657) | \$ 5,020                              | \$ 4,276   | \$ 4,508   | \$ 2,743   |
| <b>Per Share Data: (1)</b>                          |            |                                       |            |            |            |
| Earnings (loss) per share basic                     | \$ (0.41)  | \$ 0.74                               | \$ 0.62    | \$ 0.71    | \$ 0.56    |
| Earnings (loss) per share diluted                   | (0.41)     | 0.72                                  | 0.60       | 0.66       | 0.50       |
| Cash dividends per share                            | 0.20       | 0.20                                  | 0.20       | 0.13       | 0.07       |
| <b>Market Price</b>                                 |            |                                       |            |            |            |
| High  | 11.25      | 12.84                                 | 13.73      | 12.51      | 11.21      |
| Low   | 5.00       | 9.19                                  | 11.00      | 9.46       | 7.58       |
| Close   | 10.25      | 9.59                                  | 11.04      | 12.43      | 10.90      |
| Book value  | 7.76       | 8.31                                  | 7.83       | 7.43       | 7.06       |
| Tangible book value                                 | 6.20       | 6.73                                  | 6.35       | 5.89       | 5.04       |
| <b>Weighted average shares outstanding</b>          |            |                                       |            |            |            |
| Basis   | 6,555,255  | 6,779,635                             | 6,913,534  | 6,364,336  | 4,912,256  |
| Diluted   | 6,555,255  | 6,938,259                             | 7,171,413  | 6,819,523  | 5,513,361  |
| <b>Selected Year-End Balance Sheet Data:</b>        |            |                                       |            |            |            |
| Loans   | \$ 427,492 | \$ 392,959                            | \$ 370,431 | \$ 332,708 | \$ 307,988 |
| Allowance for loan losses                           | 9,124      | 5,740                                 | 5,628      | 4,331      | 3,488      |
| Intangible assets                                   | 10,190     | 10,296                                | 10,403     | 10,510     | 10,617     |
| Total assets  | 535,679    | 505,595                               | 494,658    | 436,671    | 399,458    |
| Deposits  | 429,404    | 399,794                               | 401,137    | 345,401    | 306,665    |
| Borrowings  | 53,017     | 49,504                                | 37,085     | 38,464     | 54,169     |
| Shareholders' equity                                | 51,282     | 54,024                                | 55,068     | 50,886     | 36,972     |
| <b>Selected Average Balances:</b>                   |            |                                       |            |            |            |
| Total assets  | \$ 529,723 | \$ 496,816                            | \$ 468,908 | \$ 420,941 | \$ 366,668 |
| Loans   | 403,626    | 370,832                               | 351,401    | 317,986    | 275,011    |
| Total interest-earning assets                       | 485,203    | 455,076                               | 428,679    | 385,919    | 337,292    |
| Interest-bearing deposits                           | 364,415    | 340,845                               | 314,932    | 278,473    | 239,294    |

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|                                    |         |         |         |         |         |
|------------------------------------|---------|---------|---------|---------|---------|
| Total interest-bearing liabilities | 421,480 | 380,996 | 355,362 | 320,230 | 292,402 |
| Shareholders' equity               | 53,972  | 54,836  | 52,924  | 45,937  | 32,275  |

(1) All share and per share amounts reflect the effects of the 50% stock split paid in 2006

**Table of Contents****Selected Financial Information and Other Data**

(\$ in thousands, except per share data)

|  | At or for the Year Ended December 31, |        |        |         |        |
|--|---------------------------------------|--------|--------|---------|--------|
|  | 2008                                  | 2007   | 2006   | 2005    | 2004   |
| <b>Selected Performance Ratios:</b>                |                                       |        |        |         |        |
| Return on average assets                           | -0.50%                                | 1.01%  | 0.91%  | 1.07%   | 0.74%  |
| Return on average equity                           | -4.92%                                | 9.15%  | 8.08%  | 9.81%   | 8.50%  |
| Net interest margin                                | 3.24%                                 | 4.23%  | 4.39%  | 4.25%   | 3.56%  |
| Net interest margin, fully taxable equivalent      | 3.32% (1)                             | 4.29%  | 4.44%  | 4.28%   | 3.58%  |
| Noninterest expense to average assets              | 3.26%                                 | 2.74%  | 2.74%  | 2.79%   | 2.84%  |
| Efficiency ratio                                   | 93.55%                                | 60.40% | 57.71% | 59.61%  | 67.82% |
| Equity to assets ratio                             | 9.57%                                 | 10.69% | 11.13% | 11.65%  | 9.26%  |
| Dividend payout ratio                              | NM (2)                                | 27.78% | 33.33% | 19.70%  | 14.00% |
| <b>Asset Quality Ratios:</b>                       |                                       |        |        |         |        |
| Nonperforming loans to total loans                 | 1.82%                                 | 0.44%  | 0.49%  | 0.29%   | 0.29%  |
| Allowance for loan losses to period-end loans      | 2.13%                                 | 1.46%  | 1.52%  | 1.30%   | 1.13%  |
| Allowance for loan losses to nonperforming loans   | 118%                                  | 333%   | 311%   | 455%    | 396%   |
| Nonperforming assets to total assets               | 1.45%                                 | 0.34%  | 0.41%  | 0.33%   | 0.30%  |
| Net loan charge-offs (recoveries) to average loans | 0.40%                                 | 0.25%  | 0.37%  | (0.01%) | 0.11%  |

- (1) Yields related to investment securities and loans exempt from Federal income taxes on a fully tax-equivalent basis, assuming a Federal income tax rate of 34%.
- (2) Not meaningful

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**ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

*The following presents management's discussion and analysis of our financial condition and results of operations and should be read in conjunction with the financial statements and related notes combined in Item 8 of this report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ significantly from those anticipated in these forward-looking statements as a result of various factors. The following discussion is intended to assist in understanding the financial condition and results of operations of Bancshares. Because American Community Bancshares, Inc. has no material operations and conducts no business on its own other than owning its subsidiary, American Community Bank (American Community), the discussion contained in this Management's Discussion and Analysis concerns primarily the business of American Community. However, for ease of reading and because the financial statements are presented on a consolidated basis, American Community Bancshares and American Community Bank are collectively referred to herein as American Community Bancshares or Bancshares unless otherwise noted.*

**OVERVIEW**

In April 2000, Bancshares was formed as a holding company for American Community. Upon formation, one share of Bancshares' \$1.00 par value common stock was exchanged for each of the then outstanding 1,492,063 shares of American Community's \$5.00 par value common stock. On April 15, 2004, Bancshares acquired First National Bank of the Carolinas (First National). On April 1, 2005 First National was merged into American Community. Bancshares currently has no operations and conducts no business on its own other than owning American Community.

American Community was opened for business as a North Carolina-chartered commercial bank on November 16, 1998 and completed its first full fiscal year on December 31, 1999. American Community operates out of its main office at 2593 West Roosevelt Boulevard, Monroe, North Carolina. It also operates twelve other full service branches in Union and Mecklenburg Counties of North Carolina and Cherokee and York Counties of South Carolina.

First National commenced operations as a national banking association on October 18, 1996 and was purchased by Bancshares on April 15, 2004. First National was merged into American Community on April 1, 2005.

The Bank's lending activities are oriented to the consumer/retail customer as well as small-to-medium sized businesses located in the Union and Mecklenburg County areas of North Carolina and the Cherokee and York County area of South Carolina. The Bank offers commercial, consumer, and mortgage lending products, as well as the ability to structure credit arrangements to fit specialized needs through accounts receivable financing, leasing arrangements and other products. The deposit services offered by the Bank include small business and personal checking and savings accounts and certificates of deposit. The Bank concentrates on customer relationships in building its customer deposit base and competes aggressively in the area of transaction accounts. Additional funding includes borrowings from the FHLB and various other financial institutions. The Bank also offers investment services through an agreement with Smith Barney.

**Comparison of Financial Condition at December 31, 2008 and 2007**

Total assets at December 31, 2008 increased by \$30.1 million or 6.0% to \$535.7 million compared to \$505.6 million at December 31, 2007. Bancshares had earning assets of \$504.4 million at year-end December 31, 2008 consisting of \$427.5 million in gross loans, \$76.0 million in investment securities and non-marketable equity securities, and \$894,000 in interest-bearing deposits with banks. Total deposits as of December 31, 2008 increased by \$29.6 million or 7.4% to \$429.4 million compared to \$399.8 million at December 31, 2007. Total borrowings as of December 31, 2008 increased by \$3.5 million or 7.1% from \$49.5 million to \$53.0 million. Stockholders' equity was \$51.3 million at December 31, 2008 compared to \$54.0 million at December 31, 2007 for a decrease of \$2.7 million or 5.1%.

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Gross loans grew by \$34.5 million or 8.8% from \$393.0 million as of December 31, 2007 to \$427.5 million at year-end 2008. The composition of the loan portfolio, by category, as of December 31, 2008 is as follows: 10% 1-4 family mortgage loans, 25% commercial mortgage real estate loans, 37% construction/development real estate loans, 10% home equity lines of credit, 14% commercial loans, 4% consumer and other loans to individuals and less than 1% leases. The real estate category grew \$29.7 million from \$276.4 million to \$306.1 million. Within the real estate category, 1-4 family loans increased \$7.7 million from \$35.7 million to \$43.4 million, commercial mortgage real estate loans increased \$1.3 million from \$104.2 million to \$105.5 million and construction/development loans increased \$20.7 million from \$136.5 million to \$157.2 million. These construction/development loans are primarily single family residences and owner occupied commercial properties. Commercial and industrial loans and home equity lines of credit also increased \$2.1 million and \$9.0 million, respectively. Net decreases in other loan categories included \$4.2 million in consumer and other loans and \$2.0 million in leases. The composition of the loan portfolio at December 31, 2007, by category, was 9% 1-4 family mortgage loans, 26% commercial mortgage real estate loans, 35% construction/development real estate loans, 9% home equity lines of credit, 15% commercial loans, 5% consumer and other loans to individuals and 1% leases.

Bancshares recorded a \$5.0 million provision for loan losses for the year ended December 31, 2008, representing an increase of \$4.0 million from the \$1.0 million provision for the year ended December 31, 2007. Bancshares also experienced net charge-offs of \$1.6 million in 2008 compared to net charge-offs of \$921,000 in 2007. The percentage of net loan charge-offs (recoveries) to average loans outstanding was 0.40% for the year ended December 31, 2008 as compared with 0.25% for the year ended December 31, 2007. Non-performing loans and leases, including restructured loans and leases over 90 days past due and still accruing interest, totaled \$7.8 million or 1.82% of total loans at December 31, 2008, up from \$1.7 million or 0.44% of total loans at December 31, 2007. The composition of non-performing loans and leases at December 31, 2008 by category was 84% real estate, 4% commercial loans, 2% home equity lines of credit, 4% consumer and other loans to individuals and 6% leases. This compares to 48% real estate, 20% commercial loans, 6% home equity lines of credit, 6% consumer and other loans to individuals and 20% leases at December 31, 2007. All non-performing loans and leases have been reviewed for collectibility and any specific reserves necessary have been recorded. The allowance for loan losses at December 31, 2008 of \$9.1 million represents 2.13% of total loans and 118% of non-performing loans and lease. The allowance for loan losses at December 31, 2007 of \$5.7 million represented 1.46% of total loans and 333% of non-performing loans. The increase in the provision for loan losses from 2007 is primarily attributable to the increase in non-performing loan and leases and an increase in net charge-offs in 2008. Management believes that the allowance for loan losses as of December 31, 2008 is adequate to absorb known and expected losses inherent in the loan portfolio.

Bancshares had total investment securities of \$76.8 million at December 31, 2008 of which \$71.3 million are accounted for as available for sale under Statement of Financial Accounting Standards (SFAS) No. 115 and are presented at fair value, and \$1.8 million are intended to be held to maturity. The investment securities portfolio decreased by \$3.8 million from the \$75.0 million balance at December 31, 2007. Additions to the investment portfolio included \$10.2 million in new securities purchases, largely funded from \$11.9 million in proceeds from investment maturities, calls, sales and principal re-payments.

Interest-earning deposits with banks decreased by \$36,000. The Company holds funds in interest-earning deposits with banks to provide liquidity for future loan demand and to satisfy fluctuations in deposit levels.

Non interest-earning assets increased by \$1.9 million from \$38.5 million at December 31, 2007 to \$40.4 million at December 31, 2008. The increase is primarily attributable to an increase in the accrued income tax receivable and deferred tax assets of \$4.6 million. This increase was offset by a decrease of \$537,000 in the cash and due from banks category. This includes cash on hand and customer deposits and other cash receipts that are in the process of collection and not available for overnight investment. Accrued interest receivable also decreased \$608,000 to \$2.0 million at December 31, 2008 as a result of the decrease in interest rates during the year. Bank premises and equipment was \$7.1 million at December 31, 2008 a decrease of \$1.6 million from December 31, 2007 primarily due to the sale of two branches in a sale-leaseback transaction and depreciation of assets.



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Total deposits increased \$29.6 million or 7.4% from \$399.8 million on December 31, 2007 to \$429.4 million on December 31, 2008. The composition of the deposit base, by category, at December 31, 2008 is as follows: 11% non-interest bearing demand deposits, 3% savings deposits, 17% money market and interest bearing demand deposits and 69% time deposits. The money market and interest bearing demand deposits and time deposit categories experienced increases over the twelve-month period. Dollar and percentage increases by category were as follows: money market and interest bearing demand deposits, \$4.5 million or 7%, and time deposits, \$41.0 million or 16%. The non-interest bearing demand deposit and savings deposit categories both experienced decreases over the twelve-month period. Dollar and percentage decreases by category were as follows: non-interest bearing demand deposits, \$5.6 million or 10%; and savings deposits, \$10.3 million or 43%. Time deposits of \$100,000 or more totaled \$178.9 million, or 61% of time deposits at December 31, 2008. The composition of deposits at December 31, 2007 was 14% non-interest bearing demand deposits, 6% savings deposits, 17% money market and interest bearing demand deposits and 63% time deposits. Time deposits of \$100,000 or more at December 31, 2007 were \$143.7 million, or 57% of time deposits at December 31, 2007.

At December 31, 2008, \$26.0 million of advances were outstanding with maturity dates ranging from July 2012 through February 2018. The balance of FHLB advances at December 31, 2007 was \$6.0 million. These advances are secured by certain 1-4 family and commercial mortgage loans, Federal Home Loan Bank stock, and \$8.4 million in investment securities. Bancshares also maintained the capital lease for its main office. The recorded obligation under this capital lease at December 31, 2008 was \$1.7 million. In 2003, Bancshares issued junior subordinated debentures in the amount of \$10.3 million all of which was eligible for inclusion as Tier 1 capital for American Community Bancshares, Inc. in 2008. The debentures have a maturity of thirty years with a five-year continuous call provision and are re-priced monthly based on 90 day LIBOR plus 280 basis points. The Bank also offers corporate customers the option to sweep excess checking account balances into one day maturity repurchase agreements which are collateralized by certain of the Bank's investment securities. The balance of these repurchase agreements at December 31, 2008 was \$14.6 million. The Bank also utilizes federal fund lines from correspondent banks. The amount outstanding on these lines as of December 31, 2008 was \$408,000.

Other liabilities decreased by \$297,000 or 13.1% to \$2.0 million at December 31, 2008 from \$2.3 million at December 31, 2007. The decrease was primarily due to the decrease in accrued income taxes for the year as compared to 2007.

Bancshares began 2007 with total stockholders' equity of \$54.0 million. Total equity decreased to \$51.3 million at December 31, 2008. This \$2.7 million decrease was due to a comprehensive loss of \$2.3 million for the year ended December 31, 2008 and the \$1.3 million payment of cash dividends of \$.20 per share in 2008. This was partially offset by net proceeds of \$650,000 from stock options exercised in 2008.

**Net Interest Income**

Like most financial institutions, the primary component of earnings for Bancshares is net interest income. Net interest income is the difference between interest income, principally from loan and investment securities portfolios, and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume, spread and margin. Volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities, as well as levels of non-interest-bearing liabilities. During the fiscal years ended December 31, 2008, 2007 and 2006, average interest-earning assets were \$485.2 million, \$455.1 million, and \$428.7 million, respectively. During these same periods, Bancshares' net yields on average interest-earning assets (net interest margin) were 3.24%, 4.23%, and 4.39%, respectively.

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*Average Balances and Average Rates Earned and Paid.* The following table sets forth, for the periods indicated, information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities, resultant yields or costs, net interest income, net interest spread, net interest margin and ratio of average interest-earning assets to average interest-bearing liabilities. Average loans include non-accruing loans, the effect of which is to lower the average rates shown.

|  | Year Ended December 31, 2008 |           |              | Year Ended December 31, 2007 |           |              | Year Ended December 31, 2006 |           |              |
|--|------------------------------|-----------|--------------|------------------------------|-----------|--------------|------------------------------|-----------|--------------|
|  | Average Balance              | Interest  | Average Rate | Average Balance              | Interest  | Average Rate | Average Balance              | Interest  | Average Rate |
| (Dollars in thousands)   |                              |           |              |                              |           |              |                              |           |              |
| Interest-earning assets:   |                              |           |              |                              |           |              |                              |           |              |
| Loans  | \$ 403,626                   | \$ 26,551 | 6.58%        | \$ 370,832                   | \$ 31,374 | 8.46%        | \$ 351,401                   | \$ 28,800 | 8.20%        |
| Investments  | 78,267                       | 3,805     | 4.86%        | 73,152                       | 3,461     | 4.73%        | 66,446                       | 2,990     | 4.50%        |
| Interest-earning deposits  | 3,310                        | 55        | 1.66%        | 11,092                       | 591       | 5.33%        | 10,832                       | 544       | 5.02%        |
| Total interest-earning assets  | 485,203                      | 30,411    | 6.27%        | 455,076                      | 35,426    | 7.78%        | 428,679                      | 32,334    | 7.54%        |
| Other assets   | 44,520                       |           |              | 41,740                       |           |              | 40,229                       |           |              |
| Total assets   | \$ 529,723                   |           |              | \$ 496,816                   |           |              | \$ 468,908                   |           |              |
| Interest-bearing liabilities:  |                              |           |              |                              |           |              |                              |           |              |
| Deposits:  |                              |           |              |                              |           |              |                              |           |              |
| Savings  | \$ 18,798                    | 182       | 0.97%        | \$ 24,209                    | 606       | 2.50%        | \$ 11,612                    | 40        | 0.34%        |
| Money market and NOW   | 68,987                       | 840       | 1.22%        | 75,839                       | 1,634     | 2.15%        | 80,180                       | 1,597     | 1.99%        |
| Time   | 276,629                      | 11,628    | 4.20%        | 240,797                      | 11,901    | 4.94%        | 223,140                      | 9,620     | 4.31%        |
| Borrowings <sup>(1)</sup>  | 57,066                       | 2,049     | 3.59%        | 40,151                       | 2,052     | 5.11%        | 40,430                       | 2,264     | 5.60%        |
| Total interest-bearing liabilities   | 421,480                      | 14,699    | 3.49%        | 380,996                      | 16,193    | 4.25%        | 355,362                      | 13,521    | 3.80%        |
| Non-interest bearing deposits  | 52,653                       |           |              | 59,376                       |           |              | 58,705                       |           |              |
| Other liabilities  | 1,618                        |           |              | 1,608                        |           |              | 1,917                        |           |              |
| Stockholders' equity   | 53,972                       |           |              | 54,836                       |           |              | 52,924                       |           |              |
| Total liabilities and stockholders' equity                                       | \$ 529,723                   |           |              | \$ 496,816                   |           |              | \$ 468,908                   |           |              |
| Net interest income and interest rate spread                                     |                              | \$ 15,712 | 2.78%        |                              | \$ 19,233 | 3.53%        |                              | \$ 18,813 | 3.74%        |
| Net interest margin  |                              |           | 3.24%        |                              |           | 4.23%        |                              |           | 4.39%        |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 115.12%                      |           |              | 119.44%                      |           |              | 120.63%                      |           |              |

<sup>(1)</sup> Borrowings includes borrowings from the Federal Home Loan Bank, securities sold under agreement to repurchase, federal funds purchased, capital lease obligation and junior subordinated deferrable interest debentures.



**Table of Contents****Rate/Volume Analysis**

The following table analyzes the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. The table distinguishes between (i) changes attributable to volume (changes in volume multiplied by the prior period's rate), (ii) changes attributable to rate (changes in rate multiplied by the prior period's volume), and (iii) net change (the sum of the previous columns). The change attributable to both rate and volume (changes in rate multiplied by changes in volume) has been allocated equally to both the changes attributable to volume and the changes attributable to rate.

|                                      | December 31, 2008 vs. 2007 |                   |                   | December 31, 2007 vs. 2006 |                 |               |
|--------------------------------------|----------------------------|-------------------|-------------------|----------------------------|-----------------|---------------|
|                                      | Increase (Decrease)        |                   |                   | Increase (Decrease)        |                 |               |
|                                      | Due to                     |                   |                   | Due to                     |                 |               |
|                                      | Volume                     | Rate              | Total             | Volume                     | Rate            | Total         |
| <b>Interest income:</b>              |                            |                   |                   |                            |                 |               |
| Loans                                | \$ 2,466                   | \$ (7,289)        | \$ (4,823)        | \$ 1,618                   | \$ 956          | \$ 2,574      |
| Investment securities                | 245                        | 99                | 344               | 310                        | 161             | 471           |
| Interest-earning deposits with banks | (272)                      | (264)             | (536)             | 13                         | 34              | 47            |
| <b>Total interest income</b>         | <b>2,439</b>               | <b>(7,454)</b>    | <b>(5,015)</b>    | <b>1,941</b>               | <b>1,151</b>    | <b>3,092</b>  |
| <b>Interest expense:</b>             |                            |                   |                   |                            |                 |               |
| Deposits                             | 1,429                      | (2,920)           | (1,491)           | 906                        | 1,978           | 2,884         |
| Borrowings                           | 736                        | (739)             | (3)               | (15)                       | (197)           | (212)         |
| <b>Total interest expense</b>        | <b>2,165</b>               | <b>(3,659)</b>    | <b>(1,494)</b>    | <b>891</b>                 | <b>1,781</b>    | <b>2,672</b>  |
| <b>Net interest income</b>           | <b>\$ 274</b>              | <b>\$ (3,795)</b> | <b>\$ (3,521)</b> | <b>\$ 1,050</b>            | <b>\$ (630)</b> | <b>\$ 420</b> |

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**Table of Contents****Comparison of Results of Operations for the Years Ended December 31, 2008 and 2007**

*Net Income.* Bancshares generated a net loss in 2008 of \$2.7 million, or \$(0.41) per diluted share, as compared to net income in 2007 of \$5.0 million, or \$.72 per diluted share for 2007. Return on average assets was -0.50% and 1.01% and return on average equity was -4.92% and 9.15% for the years ended December 31, 2008 and 2007, respectively. Earnings for the year ended December 31, 2008 were negatively impacted by a \$4.0 million increase in the provision for loan losses as well as a decrease of \$3.5 million in net interest income during the year.

*Net Interest Income.* Net interest income decreased \$3.5 million or 18.3% from \$19.2 million in 2007 to \$15.7 million in 2008. Total interest income suffered from a 400 basis point decrease in the target Federal Funds Rate during 2008.

Total average earning assets increased \$30.1 million or 6.6% from an average of \$455.1 million in 2007 to an average of \$485.2 million in 2008. Bancshares experienced solid loan growth during 2008 with average loan balances increasing by \$32.8 million. Average balances for investment securities and interest-earning deposits decreased \$2.7 million. Total interest income decreased \$5.0 million due to the decrease in yield on earning assets from 7.78% in 2007 to 6.27% in 2008. Average total interest-bearing liabilities increased by \$40.5 million during 2008, consisting of a \$23.6 million increase in average interest-bearing deposits and an increase in average borrowings of \$16.9 million.

Net interest margin is interest income earned on loans, securities and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the year ended 2008 was 3.24% compared to 4.23% for 2007. The decrease in net interest margin resulted from the Federal Open Market Committee (FOMC) lowering the target Federal Funds Rate 400 basis points during the year ended December 31, 2008. Interest rates on a significant portion of our earning assets, such as certain loans and short-term investments, are tied to index rates, and conversely rates on a significant portion of interest-bearing liabilities such as certificates of deposits and borrowings remained fixed until maturity. This decrease in rates resulted in immediate decreases in income on loans while the cost of funding sources were slower to react. Deposit rates in particular are significantly affected by competitive pressures in the marketplace and did not decline as quickly as other market rates.

*Provision for Loan Losses.* Bancshares' provision for loan losses for 2008 was \$5.0 million, representing a \$4.0 million or 380% increase from the \$1.0 million recorded for 2007. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management based on factors discussed under *Analysis of Loan Losses*. The allowance for loan losses was \$9.1 million at December 31, 2008, representing 2.13% of total outstanding loans and 118% of non-performing loans. The allowance for loan losses at December 31, 2007 was \$5.7 million, representing 1.46% of total outstanding loans at that date and 333% of non-performing loans. The increase in provision for 2008 was primarily related to an increase in non-accrual loans and leases and an increase in net charge-offs in the loan portfolio during the year. This increase in non-performing loans and net charge-offs is related primarily to our residential construction and land development segments, and businesses that support the housing industry. Declines in these segments were brought on by weaknesses in the economy and the slowdown in new construction and housing starts. Net loan and lease charge-offs totaled \$1.6 million in 2008 as compared to \$921,000 in 2007. In addition, non-performing loans and leases increased \$6.1 million from \$1.7 million at December 31, 2007 to \$7.8 million at December 31, 2008. Management has provided individual reserves related to these non-performing loans and leases in the amount of \$1.6 million at December 31, 2008 and is aggressively pursuing collection and liquidating any underlying collateral as necessary. See the section entitled *Non Performing Assets* for more details on the breakdown of non-performing loans and leases.

*Non-interest Income.* Non-interest income decreased by \$905,000 or 26.7% to \$2.5 million for the year ended December 31, 2008. The largest components of non-interest income were service charges on deposit accounts of \$2.3 million in 2008, a decrease of \$102,000 from 2007, fees from mortgage banking operations of \$259,000 in 2008 as compared to \$326,000 in 2007, a \$67,000 or 20.6% decrease, and a \$593,000 loss on SERP investments which resulted primarily from investments held by the trust in Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) preferred stock. There were no gains or losses on SERP investments in 2007.

*Non-interest Expenses.* Total non-interest expense increased \$3.5 million from \$13.7 million in 2007 to \$17.2 million in 2008. This 25.6% increase was primarily due to an other than temporary impairment recorded on equity investments held by the Bank of \$2.9 million in FNMA and FHLMC preferred stock and \$472,000 in merger expenses related to the proposed merger with Yadkin Valley. Salaries and benefits expense was \$7.1 million for the year ended December

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31, 2008, representing a \$185,000 or 2.7% increase over the \$6.9 million recorded for the prior year. Occupancy and equipment costs were \$2.3 million for the year ended December 31, 2008 representing an \$86,000 or 3.9% increase over the \$2.2 million for the prior year. Other expenses decreased \$41,000 or 0.9% from 2007 the majority of which was due to decreases in advertising expenses and professional fees in 2008. In addition, the Bank recorded an other than temporary loss on non-marketable equity securities of \$59,000 in 2008 related to an investment in a trust company, whose primary shareholders are ten community banks located throughout North Carolina. There was a \$76,000 other than temporary impairment charge taken on this same investment in 2007.

*Provision for Income Taxes.* Bancshares had an income tax benefit of \$1.4 million, or 33.7% of loss before income taxes, for the year ended December 31, 2008 compared to an income tax expense of \$2.9 million in 2007 or 36.4% of income before income taxes.

**Comparison of Results of Operations for the Years Ended December 31, 2007 and 2006**

*Net Income.* Bancshares generated net income in 2007 of \$5.0 million compared to net income in 2006 of \$4.3 million. On a per share basis, fully diluted earnings were \$.72 for 2007 compared to \$.60 for 2006. Return on average assets was 1.01% and 0.91% and return on average equity was 9.15% and 8.08% for the years ended December 31, 2007 and 2006, respectively.

Earnings for the year ended December 31, 2007 were positively impacted by solid growth in average earning assets and by a \$1.6 million decrease in the provision for loan losses. The impact of the growth in average earning assets was further enhanced by the increase in the yield on interest-earning assets, which increased to 7.78% in 2007 from 7.54% in 2006. Earnings were negatively impacted by an increase in the average cost of interest-bearing liabilities from 3.80% in 2006 to 4.25% in 2007, as deposit cost increases outpaced increases in asset yields.

*Net Interest Income.* Net interest income increased \$420,000 from \$18.8 million in 2006 to \$19.2 million in 2007. Total interest income benefited from strong growth in average earning assets.

Total average earning assets increased \$26.4 million or 6.2% from an average of \$428.7 million in 2006 to an average of \$455.1 million in 2007. Bancshares experienced solid loan growth during 2007 with average loan balances increasing by \$19.4 million. The increase in the average balances for investment securities and interest-earning deposits was \$7.0 million. Total interest income increased \$3.1 million due to the increase in average earning assets of \$26.4 million, complemented by an increase in yield on earning assets from 7.54% in 2006 to 7.78% in 2007. Average total interest-bearing liabilities increased by \$25.6 million during 2007, consisting of a \$25.9 million increase in average interest-bearing deposits while average borrowings decreased \$279,000.

Net interest margin is interest income earned on loans, securities and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the year ended 2007 was 4.23% compared to 4.39% for 2006. The decrease in net interest margin resulted from the differences between the terms and conditions of earning assets and interest-bearing liabilities. Interest rates on a significant portion of our earning assets, such as certain loans and short-term investments, are tied to index rates, including the prime lending rate and the Federal Funds rate. The Federal Open Market Committee (FOMC) raised the target Federal Funds Rate to a high in this interest rate cycle of 5.25% on June 6, 2006. The increases through that date resulted in immediate increases in the yield on our loans based on the bank prime rate resulting in an average rate in 2006 of 8.20%. The FOMC left the target Federal Funds Rate unchanged until September 17, 2007 and then reduced it 100 basis points through the end of December 31, 2007 resulting in an average rate on loans in 2007 of 8.46% or a 26 basis point increase. Investments and interest-earning deposits were also similarly affected by the change in rates. The rate on total interest-earning assets increased by 24 basis points from 7.54% in 2006 to 7.78% in 2007. Conversely, rates on a significant portion of interest-bearing liabilities such as certificates of deposits and borrowings remain fixed until maturity. While we benefited from the increase in rates through June of 2006, the stabilization of rates in late 2006 resulted in an increase in our funding costs as fixed rate liabilities matured and were re-priced at current higher rates. Time deposit cost was most affected as the average rate increased 63 basis points from 4.31% in 2006 to 4.94% for 2007. The overall cost of interest-bearing liabilities increased 45 basis points from 3.80% in 2006 to 4.25% in 2007. During the last half of 2007, the FOMC rate decreases resulted in immediate decreases in income on loans while the cost of funding sources remained relatively unchanged. Such interest rates are significantly affected by competitive pressures in the marketplace.

*Provision for Loan Losses.* Bancshares' provision for loan losses for 2007 was \$1.0 million, representing a \$1.6 million or 60.1% decrease from the \$2.6 million recorded for 2006. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management based on factors

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discussed under Analysis of Loan Losses. The allowance for loan losses was \$5.7 million at December 31, 2007, representing 1.46% of total outstanding loans and 333% of non-performing loans. The allowance for loan losses at December 31, 2006 was \$5.6 million, representing 1.52% of total outstanding loans at that date and 311% of non-performing loans. The decrease in provision for 2007 was primarily related to a decrease in net charge-offs in the leasing portfolio during the year. Net lease charge-offs totaled \$637,000 in 2007 as compared to \$1.2 million in 2006. In addition, non-accrual loans and leases decreased \$858,000 from \$1.8 million at December 31, 2006 to \$1.2 million at December 31, 2007. Management has provided individual reserves for these leases and is aggressively pursuing collection and liquidating any underlying collateral as necessary.

*Non-interest Income.* Non-interest income increased by \$38,000 or 1.1% to \$3.4 million for the year ended December 31, 2007. The largest components of non-interest income were service charges on deposit accounts of \$2.4 million in 2007, an increase of \$26,000 from 2006, fees from mortgage banking operations of \$326,000 in 2007 as compared to \$352,000 in 2006, a \$26,000 or 7.4% decrease, and a gain on derivative transactions of \$214,000 as compared to a gain of \$10,000 in 2006. There were no gains on derivative transactions in 2005.

*Non-interest Expenses.* Total non-interest expense increased \$856,000 from \$12.8 million in 2006 to \$13.7 million in 2007. This 6.7% increase was primarily due to increases in compensation and increases in other expenses related to branch growth. Salaries and benefits expense was \$6.9 million for the year ended December 31, 2007, representing a \$419,000 or 6.5% increase over the \$6.5 million recorded for the prior year. Occupancy and equipment costs were \$2.2 million for the year ended December 31, 2007 representing a \$67,000 or 3.0% decrease over the \$2.3 million for the prior year. Other expenses increased \$428,000 or 10.4% from 2006 the majority of which was due to increases in data processing and technology expenses and to professional fees in 2007. In addition, the Bank recorded an other than temporary loss on non-marketable equity securities of \$76,000 in 2007 related to an investment in a trust company. There were no other than temporary impairments in 2006.

*Provision for Income Taxes.* Bancshares had tax expense of \$2.9 million, or 36.4% of income before income taxes, for the year ended December 31, 2007 compared to an income tax expense of \$2.4 million in 2006 or 36.3% of income before income taxes.

**Liquidity and Capital Resources**

Maintaining adequate liquidity while managing interest rate risk is the primary goal of Bancshares' asset and liability management strategy. Liquidity is the ability to fund the needs of Bancshares' borrowers and depositors, pay operating expenses, and meet regulatory liquidity requirements. Maturing investments, loan and mortgage-backed security principal repayments, deposit growth and borrowings from the Federal Home Loan Bank and other lenders are presently the main sources of Bancshares' liquidity. Bancshares' primary uses of liquidity are to fund loans, operating expenses, deposit withdrawals, repay borrowings and to make investments.

As of December 31, 2008, liquid assets (cash and due from banks, interest-earning deposits with banks, and investment securities available for sale) were approximately \$86.0 million, which represents 16% of total assets and 18% of total deposits and borrowings. Supplementing this liquidity, Bancshares has lines of credit from correspondent banks of approximately \$35.1 million and an additional line of credit with the FHLB equal to 15% of assets (subject to available qualified collateral, with borrowings of \$26.0 million outstanding from the FHLB at December 31, 2008). At December 31, 2008, outstanding commitments to extend credit were \$4.5 million and available line of credit balances totaled \$52.5 million. Management believes that the combined aggregate liquidity position of Bancshares is sufficient to meet the funding requirements of loan demand and deposit maturities and withdrawals in the near term.

Certificates of deposit represented 68.5% of Bancshares' total deposits at December 31, 2008 an increase from 63.4% at December 31, 2007. Bancshares' growth strategy will include efforts focused on increasing the relative volume of transaction deposit accounts. Certificates of deposit of \$100,000 or more represented 41.7% of Bancshares' total deposits at December 31, 2008. These deposits are generally considered rate sensitive, but management believes most of them are relationship-oriented. While Bancshares will need to pay competitive rates to retain these deposits at maturity, there are other subjective factors that will determine Bancshares' continued retention of those deposits.

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Banks and bank holding companies, as regulated institutions, must meet required levels of capital. The FDIC and the Federal Reserve, the primary regulators of the Bank and Bancshares, respectively, have adopted minimum capital regulations or guidelines that categorize components and the level of risk associated with various types of assets. Financial institutions are expected to maintain a level of capital commensurate with the risk profile assigned to its assets in accordance with these guidelines. At December 31, 2008, Bancshares maintained capital levels exceeding the minimum levels for adequately capitalized bank holding companies and banks.

**Capital Ratios**

Bancshares and the Bank are subject to minimum capital requirements. As the following table indicates, at December 31, 2008, we exceeded our regulatory capital requirements.

|                                       | At December 31, 2008 |                     |                              |
|---------------------------------------|----------------------|---------------------|------------------------------|
|                                       | Actual Ratio         | Minimum Requirement | Well-Capitalized Requirement |
| <b>American Community Bank:</b>       |                      |                     |                              |
| Total risk-based capital ratio        | 10.95%               | 8.00%               | 10.00%                       |
| Tier 1 risk-based capital ratio       | 9.69%                | 4.00%               | 5.00%                        |
| Leverage ratio                        | 8.03%                | 4.00%               | 5.00%                        |
| <b>American Community Bancshares:</b> |                      |                     |                              |
| Total risk-based capital ratio        | 12.64%               | 8.00%               | NA                           |
| Tier 1 risk-based capital ratio       | 11.38%               | 4.00%               | NA                           |
| Leverage ratio                        | 9.45%                | 4.00%               | NA                           |

The Board of Governors of the Federal Reserve released a final rule confirming that trust preferred securities, such as those issued by American Community Capital Trust II, Ltd., will continue to be included in Tier 1 capital up to applicable quantitative limits until notice is given to the contrary. Accordingly, the ratios contained in the table above reflect the inclusion of our outstanding trust preferred securities. There can be no assurance that the Federal Reserve will continue to allow institutions to include trust preferred securities in Tier 1 capital for regulatory capital purposes. In the event of a disallowance, there would be a reduction in our consolidated capital ratios. However, we believe that the Bank would still exceed the required regulatory minimums for capital adequacy purposes.

**Asset/Liability Management**

Bancshares' asset/liability management, or interest rate risk management, program is focused primarily on evaluating and managing the composition of its assets and liabilities in view of various interest rate scenarios. Factors beyond Bancshares' control, such as market interest rates and competition, may also have an impact on Bancshares' interest income and interest expense.

*Interest Rate Gap Analysis.* As a part of its interest rate risk management policy, Bancshares calculates an interest rate gap. Interest rate gap analysis is a common, though imperfect, measure of interest rate risk, which measures the relative dollar amounts of interest-earning assets and interest-bearing liabilities, which reprice within a specific time period, either through maturity or rate adjustment. The gap is the difference between the amounts of such assets and liabilities that are subject to repricing. A positive gap for a given period means that the amount of interest-earning assets maturing or otherwise repricing within that period exceeds the amount of interest-bearing liabilities maturing or otherwise repricing within the same period. Accordingly, in a declining interest rate environment, an institution with a positive gap would generally be expected, absent the effects of other factors, to experience a decrease in the yield on its assets greater than the decrease in the cost of its liabilities and its income should be negatively affected. Conversely, the cost of funds for an institution with a positive gap would generally be expected to increase more slowly than the yield on its assets in a rising interest rate environment, and such institution's net interest income generally would be expected to be positively affected by rising interest rates. Changes in interest rates generally have the opposite effect on an institution with a negative gap.



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The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2008, which are projected to reprice or mature in each of the future time periods shown. Except as stated below, the amounts of assets and liabilities shown which reprice or mature within a particular period were determined in accordance with the contractual terms of the assets or liabilities. Loans with adjustable rates are shown as being due at the end of the next upcoming adjustment period. Money market deposit accounts and negotiable order of withdrawal or other transaction accounts are assumed to pay out over a decay schedule. In making the gap computations, standard assumptions regarding prepayment rates and deposit decay rates have been used for interest-earning assets and interest-bearing liabilities. In addition, the table reflects scheduled principal payments, which will be received throughout the lives of the loans. The interest rate sensitivity of Bancshares' assets and liabilities illustrated in the following table would vary substantially if different assumptions were used or if actual experience differs from that indicated by such assumptions.

|  | 3 Months<br>or Less | Terms to Repricing at December 31, 2008 |                                       |                   | Total             |
|--|---------------------|---|---------------------------------------|-------------------|-------------------|
|  |                     | More Than<br>3 Months<br>to 6 Months    | More Than<br>6 Months<br>to 12 Months | Over<br>12 Months |                   |
| (Dollars in thousands)   |                     |   |                                       |                   |                   |
| <b>INTEREST EARNING-ASSETS</b>   |                     |   |                                       |                   |                   |
| Loans receivable:  |                     |   |                                       |                   |                   |
| Real estate mortgage loans   | \$ 175,533          | \$ 8,373                                | \$ 18,377                             | \$ 103,842        | \$ 306,125        |
| Home equity lines of credit  | 43,777              |   |                                       |                   | 43,777            |
| Commercial and industrial loans  | 46,346              | 2,939                                   | 2,981                                 | 7,751             | 60,017            |
| Loans to individuals   | 4,793               | 2,497                                   | 2,448                                 | 6,106             | 15,844            |
| Lease financing, net   | 641                 | 293                                     | 424                                   | 543               | 1,901             |
| Interest earning deposits with banks   | 894                 |   |                                       |                   | 894               |
| Investment securities  | 4,192               | 11,053                                  | 7,921                                 | 49,864            | 73,030            |
| Non-marketable equity securities   |                     |   |                                       | 2,980             | 2,980             |
| Derivative financial instruments   | (15,000)            | 15,000                                  |                                       |                   |                   |
| <b>Total interest-earning assets</b>   | <b>\$ 261,176</b>   | <b>\$ 40,155</b>                        | <b>\$ 32,151</b>                      | <b>\$ 171,086</b> | <b>\$ 504,568</b> |
| <b>INTEREST-BEARING LIABILITIES</b>  |                     |   |                                       |                   |                   |
| Deposits:  |                     |   |                                       |                   |                   |
| Interest-bearing demand  | \$ 31,000           | \$ 700                                  | \$ 1,400                              | \$ 53,212         | \$ 86,312         |
| Time   | 83,738              | 32,545                                  | 125,929                               | 52,054            | 294,266           |
| Short-term borrowings  | 15,031              |   |                                       |                   | 15,031            |
| Long-term debt   | 10,310              |   |                                       | 27,676            | 37,986            |
| <b>Total interest-bearing liabilities</b>  | <b>\$ 140,079</b>   | <b>\$ 33,245</b>                        | <b>\$ 127,329</b>                     | <b>\$ 132,942</b> | <b>\$ 433,595</b> |
| <b>INTEREST SENSITIVITY GAP PER PERIOD</b>   | <b>\$ 121,097</b>   | <b>\$ 6,910</b>                         | <b>\$ (95,178)</b>                    | <b>\$ 38,144</b>  | <b>\$ 70,973</b>  |
| <b>CUMULATIVE INTEREST SENSITIVITY GAP</b>   | <b>\$ 121,097</b>   | <b>\$ 128,007</b>                       | <b>\$ 32,829</b>                      | <b>\$ 70,973</b>  | <b>\$ 70,973</b>  |
| <b>CUMULATIVE GAP AS A PERCENTAGE OF TOTAL INTEREST-EARNING ASSETS</b>                               | <b>24.00%</b>       | <b>25.37%</b>                           | <b>6.51%</b>                          | <b>14.07%</b>     | <b>14.07%</b>     |
| <b>CUMULATIVE INTEREST-EARNING ASSETS AS A PERCENTAGE OF CUMULATIVE INTEREST BEARING LIABILITIES</b> | <b>186.45%</b>      | <b>173.85%</b>                          | <b>110.92%</b>                        | <b>116.37%</b>    | <b>116.37%</b>    |

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The Company entered into off-balance sheet contracts that are considered derivative financial instruments in order to assist in achieving a desired level of interest rate sensitivity. As of December 31, 2008, the Company had derivative instruments with a notional amount of \$45.0 million. These derivative instruments consist of two interest rate floor contracts that are used to hedge future cash flows of the first \$45.0 million of certain variable rate loans against the downward effects of their repricing in the event of a decreasing rate environment for a period of three years ending in February 2009 and June 2009. If the prime rate falls below 7.25% during the term of the contract on the first floor, the Company will receive payments based on the \$30.0 million notional amount times the difference between 7.25% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.25% or higher. The Company paid a premium of \$228,000 on this contract. If the prime rate falls below 7.75% during the term of the contract on the second floor, the Company will receive payments based on the \$15.0 million notional amount times the difference between 7.75% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.75% or higher. The Company paid a premium of \$95,250 on this contract. The Company received payments of \$374,167 and \$3,229 in 2008 and 2007, respectively, on the 7.75% contract and received payments of \$482,917 in 2008 on the 7.25% contract. There were no payments received on the 7.25% contract in 2007.

In 2008, the interest rate floors no longer qualified as a cash flow hedge and the hedge designation was removed. As a result, amounts accumulated in other accumulated comprehensive income were reclassified into earnings. Changes in fair value of the interest rate floors are now accounted for in earnings for the period of the change.

## **Critical Accounting Policies and Estimates**

Bancshares' discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Bancshares to make estimates and judgments regarding uncertainties that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, Bancshares evaluates its estimates which are based upon historical experience and on other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Bancshares' significant accounting policies are described in Note 2 to the consolidated financial statements. Bancshares considers the following accounting policies to be most critical in their potential effect on its financial position or results of operations.

### **Allowance for Loan Losses**

The allowance for loan losses is established as probable losses are estimated to have occurred through a provision for loan losses charged to earnings. The provision for loan losses is based upon management's best estimate of the amount needed to maintain the allowance for loan losses at an adequate level. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is evident. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of the current status of the portfolio, historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. Management segments the loan portfolio by loan type in considering each of the aforementioned factors and their impact upon the level of the allowance for loan losses. While management uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, regulatory examiners may require American Community Bank to recognize adjustments to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

Loans are considered impaired when it is probable that all amounts due under the contractual terms of the loan will not be collected. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, or upon the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses.

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### **Other Than Temporary Impairment**

The Company periodically evaluates its investments for any impairment which would be deemed other than temporary. As part of its evaluation, the Company determined that the fair value of its \$2,902,265 investment in Federal National Mortgage Association ( FNMA ) and Federal Home Loan Mortgage Corporation ( FHLMC ) preferred stock and its investment in a trust company were other than temporarily impaired. As a result, the Company wrote down its investment in FNMA and FHLMC stock by \$2,822,756, to an estimated fair value of \$67,100 as of December 31, 2008. In addition, the Company wrote down its investment of \$201,991 in a trust company by an additional \$59,082, to an estimated fair value of \$142,909 as of December 31, 2008. An other than temporary impairment charge of \$75,747 was taken on this same investment in 2007. The write downs were recorded as a charge to earnings in 2008 and 2007.

### **Interest Income Recognition**

Interest on loans is included in income as earned based upon interest rates applied to unpaid principal. Interest is generally not accrued on loans 90 days or more past due unless the loans are adequately secured and in the process of collection. Interest is not accrued on other loans when management believes collection is doubtful. All loans considered impaired are non-accruing. Interest on non-accruing loans is recognized as payments are received when the ultimate collectibility of interest is no longer considered doubtful. When a loan is placed on non-accrual status, all interest previously accrued is reversed against current-period interest income.

### **Goodwill and Other Intangible Assets**

Goodwill arose from the 2004 purchase of First National Bank of the Carolinas. Pursuant to Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets*, goodwill acquired will not be amortized but will be subject to an annual impairment test. The impairment test is a two-step process that begins with a comparison of book value and stock price. If the initial evaluation suggests that an impairment of the asset value exists, the second step would determine the amount of the impairment, if any. If the tests conclude that goodwill is impaired, the carrying value would be adjusted, and an impairment loss would be recorded. The Company also reviews other identified intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment loss is recognized. We performed an interim evaluation of our goodwill balances at December 31, 2008 and an annual goodwill impairment assessment as of April 15, 2008. No impairment has been recorded as a result of goodwill testing performed during 2008 or 2007. Given the substantial decline in our common stock price and the economic outlook for our industry, the excess of the fair value over carrying value has narrowed compared with previous assessments. If our stock price continues to decline, due to the termination of the impending merger with Yadkin Valley, if the Company does not produce anticipated cash flows, or if comparable banks begin selling at significantly lower prices than in the past, our goodwill may be impaired in the future.

**Table of Contents****Contractual Obligations**

The following table reflects the contractual obligations of the Company outstanding as of December 31, 2008.

|  | On Demand<br>or Less<br>than 1<br>Year | Payments Due by Period |                  |                  | Total             |
|--|--|------------------------|------------------|------------------|-------------------|
|  |  | 1-3 Years              | 4-5 Years        | After<br>5 Years |                   |
|  |  |                        |                  |                  |                   |
|  |  | (Dollars in thousands) |                  |                  |                   |
| Advances from FHLB   | \$                                     | \$                     | \$ 16,000        | \$ 10,000        | \$ 26,000         |
| Securities sold under agreement to repurchase and federal funds sold | 15,030                                 |                        |                  |                  | 15,030            |
| Capital lease obligation   | 10                                     | 46                     | 54               | 1,565            | 1,675             |
| Junior subordinated deferrable interest debentures                   |  |                        |                  | 10,310           | 10,310            |
| Operating leases   | 873                                    | 1,057                  | 699              | 2,394            | 5,023             |
| Other contractual obligations  | 597                                    | 635                    |                  |                  | 1,232             |
| <b>Total contractual cash obligations, excluding deposits</b>        | <b>16,510</b>                          | <b>1,738</b>           | <b>16,753</b>    | <b>24,269</b>    | <b>59,270</b>     |
| Deposits   | 377,370                                | 39,703                 | 12,331           |                  | 429,404           |
| <b>Total contractual cash obligations, including deposits</b>        | <b>\$ 393,880</b>                      | <b>\$ 41,441</b>       | <b>\$ 29,084</b> | <b>\$ 24,269</b> | <b>\$ 488,674</b> |

It has been the experience of Bancshares that deposit withdrawals are generally replaced with new deposits, thus not requiring any net cash outflow. Based on that assumption, management believes that it can meet its contractual cash obligations from normal operations.

**Table of Contents****Commitments, Contingencies and Off-Balance Sheet Arrangements**

Bancshares is a party to financial instruments with off-balance sheet risk including commitments to extend credit under existing lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet.

Off-balance sheet financial instruments whose contract amounts represent credit and interest rate risk are summarized as follows:

|   | Amount of Commitment Expiration Per Period<br>(Dollars in thousands) |           |           |                  |           |
|---|--|-----------|-----------|------------------|-----------|
|   | Less<br>than 1 Year  | 1-3 Years | 4-5 Years | After<br>5 Years | Total     |
| Capital South Partnership commitments     | \$ 825   | \$        | \$        | \$               | \$ 825    |
| Standby letters of credit                 | 3,101  |           |           |                  | 3,101     |
| Commitments to extend credit              | 4,526  |           |           |                  | 4,526     |
| Undisbursed lines of credit               | 22,091   | 2,402     | 3,696     | 24,298           | 52,487    |
| Undisbursed portion of construction loans | 16,114   | 5,109     | 1,980     | 759              | 23,962    |
| Total off-balance sheet commitments       | \$ 46,657  | \$ 7,511  | \$ 5,676  | \$ 25,057        | \$ 84,901 |

Bancshares does not have any special purpose entities or other similar forms of off-balance sheet financing arrangements.

Commitments to originate loans or to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Loan commitments generally expire within 30 to 45 days. Most equity line commitments are for a term of 15 years, and commercial lines of credit are generally renewable on an annual basis. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Bancshares evaluates each customer's creditworthiness on a case-by-case basis. The amounts of collateral obtained, if deemed necessary by Bancshares upon extension of credit, is based on management's credit evaluation of the borrower.

**Related Party Transactions**

Bancshares' related party transactions have been limited to 1) loans made to executive officers and directors in the ordinary course of business and 2) the lease of certain buildings at prevailing market rates. At December 31, 2008, Bancshares had loans outstanding to executive officers and directors totaling approximately \$5.2 million. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other non-related borrowers. Management does not believe these loans involve more than the normal risk of collectibility or present other unfavorable features. The \$5.2 million in outstanding related party loans represents 1.2% of Bancshares' total loan portfolio. Bancshares has never charged-off a loan to a related party.

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### **Recent Accounting Pronouncements**

#### FAS 141R

In December 2007, the FASB issued SFAS 141(R), Business Combinations. SFAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this Statement include: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward.

The Company will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. Management is currently evaluating the effects that SFAS 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented in the consolidated financial statements.

#### FAS 157

In September 2006, the Financial Accounting Standards Board issued FASB Statement No. 157, Fair Value Measurements ( FASB No. 157 ), which enhances existing guidance for measuring assets and liabilities using fair value and requires additional disclosure about the use of fair value for measurement. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company adopted the provisions of SFAS 157, Fair Value Measurements effective January 1, 2008. The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

#### FAS 159

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This option is available to all entities. Most of the provisions in SFAS 159 are elective; however, the amendment to SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, applies to all entities with available-for-sale and trading securities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company did not elect the fair value option as of January 1, 2008 for any of its financial assets or financial liabilities and, accordingly, the adoption of the statement did not have a material impact on the Company's consolidated financial statements.

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## SFAS 161

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. This statement applies to all derivatives and hedged items and is effective for periods beginning after November 15, 2008 prospectively, with comparative disclosures encouraged. This statement requires enhanced qualitative disclosures and tabular disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk contingent features in derivative agreements. The Company is currently evaluating the effects that SFAS 161 will have upon adoption as this standard will affect the presentation and disclosure in the consolidated financial statements.

From time to time, the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the consolidated financial statements of the Company and monitors the status of changes to and proposed effective dates of exposure drafts.

**ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk reflects the risk of economic loss resulting from adverse changes in market price and interest rates. This risk of loss can be reflected in diminished current market values and/or reduced potential net interest income in future periods. Our market risk arises primarily from interest rate risk inherent in our lending and deposit-taking activities. The structure of our loan and deposit portfolios is such that a significant decline in interest rates may adversely impact net market values and net interest income. We do not maintain a trading account nor are we subject to currency exchange risk or commodity price risk. Interest rate risk is monitored as part of the Bank's asset/liability management functions. The following table presents information about the contractual maturities, average interest rates and estimated fair values of our financial instruments that are considered market risk sensitive at December 31, 2008.

|                                  | 2008                   | 2009             | 2010             | 2011             | 2012             | Beyond<br>Five<br>Years | Total             | Average<br>Interest Rate | Estimated<br>Fair<br>Value |
|----------------------------------|------------------------|------------------|------------------|------------------|------------------|-------------------------|-------------------|--------------------------|----------------------------|
|                                  | (Dollars in thousands) |                  |                  |                  |                  |                         |                   |                          |                            |
| <b>FINANCIAL ASSETS</b>          |                        |                  |                  |                  |                  |                         |                   |                          |                            |
| Investment securities            |                        |                  |                  |                  |                  |                         |                   |                          |                            |
| Available for sale               | \$                     | \$ 486           | \$ 504           | \$ 1,035         | \$ 5,600         | \$ 62,359               | \$ 69,984         | 5.12%                    | \$ 71,262                  |
| Held to maturity                 |                        |                  |                  |                  |                  | 1,768                   | 1,768             | 5.78%                    | 1,760                      |
| Non-marketable equity            |                        |                  |                  |                  |                  | 2,980                   | 2,980             |                          | 2,980                      |
| Loans                            | 211,359                | 32,655           | 38,288           | 36,186           | 63,101           | 45,903                  | 427,492           | 4.87%                    | 426,123                    |
| <b>Total</b>                     | <b>\$ 211,359</b>      | <b>\$ 33,141</b> | <b>\$ 38,792</b> | <b>\$ 37,221</b> | <b>\$ 68,701</b> | <b>\$ 113,010</b>       | <b>\$ 502,224</b> |                          | <b>\$ 502,125</b>          |
| <b>FINANCIAL LIABILITIES</b>     |                        |                  |                  |                  |                  |                         |                   |                          |                            |
| Interest-bearing demand accounts | \$ 33,100              | \$ 2,801         | \$ 2,801         | \$ 4,201         | \$ 4,201         | \$ 39,208               | \$ 86,312         | 1.24%                    | \$ 73,017                  |
| Time deposits                    | 242,212                | 35,359           | 4,336            | 11,558           | 801              |                         | 294,266           | 3.71%                    | 305,135                    |
| Borrowings                       | 15,041                 | 22               | 24               | 1,026            | 15,028           | 21,876                  | 53,017            | 3.21%                    | 39,554                     |
| <b>Total</b>                     | <b>\$ 290,353</b>      | <b>\$ 38,182</b> | <b>\$ 7,161</b>  | <b>\$ 16,785</b> | <b>\$ 20,030</b> | <b>\$ 61,084</b>        | <b>\$ 433,595</b> |                          | <b>\$ 417,706</b>          |

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**ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

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***Report of Independent Registered Public Accounting Firm***

To the Board of Directors and Stockholders

American Community Bancshares, Inc.

Charlotte, North Carolina

We have audited the accompanying consolidated balance sheets of American Community Bancshares, Inc. and subsidiary (the Company) as of December 31, 2008 and 2007 and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Community Bancshares, Inc. and subsidiary at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

Charlotte, North Carolina

February 19, 2009, except for Note 25, as to which the date is March 26, 2009

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS***December 31, 2008 and 2007*

|   | <b>2008</b>                   | <b>2007</b>       |
|---|-------------------------------|-------------------|
|   | <b>(Amounts in thousands)</b> |                   |
| <b>ASSETS</b>   |                               |                   |
| Cash and due from banks   | \$ 13,809                     | \$ 14,346         |
| Interest-earning deposits with banks  | 894                           | 930               |
| Investment securities available for sale, at fair value (cost of \$69,984 and \$74,420 at December 31, 2008 and 2007, respectively)       | 71,262                        | 75,012            |
| Investment securities held to maturity, at cost (fair value approximates \$1,760 and \$1,804 at December 31, 2008 and 2007, respectively) | 1,768                         | 1,770             |
| Loans   | 427,492                       | 392,959           |
| Allowance for loan losses   | (9,124)                       | (5,740)           |
| <b>NET LOANS</b>  | <b>418,368</b>                | <b>387,219</b>    |
| Accrued interest receivable   | 2,032                         | 2,640             |
| Bank premises and equipment   | 7,125                         | 8,694             |
| Equity securities, at cost  | 2,980                         | 2,119             |
| Goodwill  | 9,838                         | 9,838             |
| Other assets  | 7,603                         | 3,027             |
| <b>TOTAL ASSETS</b>   | <b>\$ 535,679</b>             | <b>\$ 505,595</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                               |                   |
| Deposits  |                               |                   |
| Demand non-interest bearing   | \$ 48,826                     | \$ 54,459         |
| Savings   | 13,903                        | 24,181            |
| Money market and NOW  | 72,409                        | 67,877            |
| Time  | 294,266                       | 253,277           |
| <b>TOTAL DEPOSITS</b>   | <b>429,404</b>                | <b>399,794</b>    |
| Short-term borrowings   | 15,031                        | 31,509            |
| Long-term debt  | 37,986                        | 17,995            |
| Accrued expenses and other liabilities  | 1,976                         | 2,273             |
| <b>TOTAL LIABILITIES</b>  | <b>484,397</b>                | <b>451,571</b>    |
| Stockholders Equity   |                               |                   |
| Preferred stock, no par value, 1,000,000 shares authorized; none issued   | 6,633                         | 6,502             |

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Common stock, \$1 par value, 25,000,000 shares authorized, 6,633,169 and 6,502,288 shares issued and outstanding at December 31, 2008 and 2007, respectively

|   |            |            |
|---|------------|------------|
| Additional paid-in capital                | 33,090     | 32,364     |
| Retained earnings                         | 10,775     | 14,744     |
| Accumulated other comprehensive income    | 784        | 414        |
| <br>                                      |            |            |
| TOTAL STOCKHOLDERS EQUITY                 | 51,282     | 54,024     |
| <br>                                      |            |            |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 535,679 | \$ 505,595 |

*See accompanying notes to these consolidated financial statements.*

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS***Years Ended December 31, 2008, 2007 and 2006*

|   | 2008                          | 2007          | 2006          |
|---|-------------------------------|---------------|---------------|
|   | (Amounts in thousands, except |               |               |
|   | share and per share data)     |               |               |
| <b>INTEREST INCOME</b>  |                               |               |               |
| Loans, including fees   | \$ 25,501                     | \$ 31,366     | \$ 28,800     |
| Investment securities:  |                               |               |               |
| Taxable   | 3,270                         | 3,046         | 2,702         |
| Tax-exempt  | 535                           | 415           | 288           |
| Interest-earning deposits with banks                                      | 55                            | 591           | 544           |
| Other interest income   | 1,050                         | 8             |               |
| <b>TOTAL INTEREST INCOME</b>  | <b>30,411</b>                 | <b>35,426</b> | <b>32,334</b> |
| <b>INTEREST EXPENSE</b>   |                               |               |               |
| Money market, NOW and savings deposits                                    | 1,022                         | 2,240         | 1,637         |
| Time deposits   | 11,628                        | 11,901        | 9,620         |
| Borrowings  | 750                           | 214           | 452           |
| Securities sold under agreement to repurchase and federal funds purchased | 499                           | 793           | 523           |
| Capital lease obligation  | 138                           | 139           | 140           |
| Junior subordinated debentures  | 662                           | 906           | 1,149         |
| <b>TOTAL INTEREST EXPENSE</b>   | <b>14,699</b>                 | <b>16,193</b> | <b>13,521</b> |
| <b>NET INTEREST INCOME</b>  | <b>15,712</b>                 | <b>19,233</b> | <b>18,813</b> |
| <b>PROVISION FOR LOAN LOSSES</b>  | <b>4,999</b>                  | <b>1,033</b>  | <b>2,612</b>  |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>                | <b>10,713</b>                 | <b>18,200</b> | <b>16,201</b> |
| <b>NON-INTEREST INCOME</b>  |                               |               |               |
| Service charges on deposit accounts                                       | 2,317                         | 2,419         | 2,393         |
| Mortgage banking operations   | 259                           | 326           | 352           |
| Gain on sale of investment securities                                     |                               | 20            | 60            |
| Gain on derivative transactions   | 331                           | 214           |               |
| Gain on sale of assets  | 7                             | 53            | 79            |
| Loss on SERP investment   | (593)                         |               |               |
| Other   | 165                           | 359           | 469           |
| <b>TOTAL NON-INTEREST INCOME</b>  | <b>2,486</b>                  | <b>3,391</b>  | <b>3,353</b>  |

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|  |                   |                 |                 |
|--|-------------------|-----------------|-----------------|
| <b>NON-INTEREST EXPENSE</b>                          |                   |                 |                 |
| Salaries and employee benefits                       | 7,078             | 6,893           | 6,474           |
| Occupancy and equipment                              | 2,280             | 2,194           | 2,261           |
| Other than temporary impairment of equity securities | 2,881             | 76              |                 |
| Merger related expenses                              | 472               |                 |                 |
| Other  | 4,498             | 4,539           | 4,103           |
| <b>TOTAL NON-INTEREST EXPENSE</b>                    | <b>17,209</b>     | <b>13,702</b>   | <b>12,838</b>   |
| <b>INCOME (LOSS) BEFORE INCOME TAXES</b>             | <b>(4,010)</b>    | <b>7,889</b>    | <b>6,716</b>    |
| <b>INCOME TAX EXPENSE (BENEFIT)</b>                  | <b>(1,353)</b>    | <b>2,869</b>    | <b>2,440</b>    |
| <b>NET INCOME (LOSS)</b>                             | <b>\$ (2,657)</b> | <b>\$ 5,020</b> | <b>\$ 4,276</b> |
| <b>NET INCOME (LOSS) PER COMMON SHARE</b>            |                   |                 |                 |
| Basic  | \$ (.41)          | \$ .74          | \$ .62          |
| Diluted  | \$ (.41)          | \$ .72          | \$ .60          |
| <b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>    |                   |                 |                 |
| Basic  | 6,555,255         | 6,779,635       | 6,913,534       |
| Diluted  | 6,555,255         | 6,938,259       | 7,171,413       |

*See accompanying notes to these consolidated financial statements.*

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME***Years Ended December 31, 2008, 2007 and 2006*

|  | 2008                   | 2007     | 2006     |
|--|------------------------|----------|----------|
|  | (Amounts in thousands) |          |          |
| NET INCOME (LOSS)  | \$ (2,657)             | \$ 5,020 | \$ 4,276 |
| Other comprehensive income:  |                        |          |          |
| Securities available for sale:                                     |                        |          |          |
| Unrealized holding gains (losses) on available-for-sale securities | (2,125)                | 1,514    | 350      |
| Tax effect   | 819                    | (583)    | (133)    |
| Reclassification adjustment for losses (gains) realized in income  | 2,822                  | (20)     | (60)     |
| Tax effect   | (1,088)                | 8        | 23       |
| Net of tax amount  | 428                    | 919      | 180      |
| Cash flow hedging activities:                                      |                        |          |          |
| Unrealized holding gains (losses) on cash flow hedging activities  | 167                    | 240      | (139)    |
| Tax effect   | (58)                   | (92)     | 53       |
| Reclassification adjustment for gains realized in income           | (271)                  | (6)      |          |
| Tax effect   | 104                    | 2        |          |
| Net of tax amount  | (58)                   | 144      | (86)     |
| Total other comprehensive income                                   | 370                    | 1,063    | 94       |
| Total comprehensive income (loss)                                  | \$ (2,287)             | \$ 6,083 | \$ 4,370 |

*See accompanying notes to these consolidated financial statements.*

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY***Years Ended December 31, 2008, 2007 and 2006*

|   | Common stock<br>Shares | Common stock<br>Amount | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>Comprehensive<br>income (loss) | Total<br>stockholders<br>equity |
|---|------------------------|------------------------|----------------------------------|----------------------|--|---------------------------------|
| (Amounts in thousands, except share data)                     |                        |                        |                                  |                      |  |                                 |
| Balance, January 1, 2006                                      | 4,568,673              | \$ 4,569               | \$ 38,882                        | \$ 8,178             | \$ (743)   | \$ 50,886                       |
| Comprehensive income:   |                        |                        |                                  |                      |  |                                 |
| Net income  |                        |                        |                                  | 4,276                |  | 4,276                           |
| Other comprehensive income, net of tax                        |                        |                        |                                  |                      | 94   | 94                              |
| Total comprehensive income                                    |                        |                        |                                  |                      |  | 4,370                           |
| Stock split effected in the form of a 50% stock dividend      | 2,284,567              | 2,284                  | (2,284)                          |                      |  |                                 |
| Cash dividends of \$.20 per share                             |                        |                        |                                  | (1,382)              |  | (1,382)                         |
| Shares repurchased  | (23,700)               | (24)                   | (239)                            |                      |  | (263)                           |
| Expense recognized in connection with stock options           |                        |                        | 375                              |                      |  | 375                             |
| Common stock issued pursuant to the exercise of stock options | 178,541                | 179                    | 733                              |                      |  | 912                             |
| Tax benefit from the exercise of stock options                |                        |                        | 170                              |                      |  | 170                             |
| Balance, December 31, 2006                                    | 7,008,081              | 7,008                  | 37,637                           | 11,072               | (649)  | 55,068                          |
| Comprehensive income:   |                        |                        |                                  |                      |  |                                 |
| Net income  |                        |                        |                                  | 5,020                |  | 5,020                           |
| Other comprehensive income, net of tax                        |                        |                        |                                  |                      | 1,063  | 1,063                           |
| Total comprehensive income                                    |                        |                        |                                  |                      |  | 6,083                           |
| Cash dividends of \$.20 per share                             |                        |                        |                                  | (1,348)              |  | (1,348)                         |
| Shares repurchased  | (540,791)              | (541)                  | (5,539)                          |                      |  | (6,080)                         |
| Expense recognized in connection with stock options           |                        |                        | 52                               |                      |  | 52                              |
| Common stock issued pursuant to the exercise of stock options | 34,998                 | 35                     | 176                              |                      |  | 211                             |
| Tax benefit from the exercise of stock options                |                        |                        | 38                               |                      |  | 38                              |
| Balance, December 31, 2007                                    | 6,502,288              | 6,502                  | 32,364                           | 14,744               | 414  | 54,024                          |
| Comprehensive loss:   |                        |                        |                                  |                      |  |                                 |
| Net loss  |                        |                        |                                  | (2,657)              |  | (2,657)                         |
| Other comprehensive income, net of tax                        |                        |                        |                                  |                      | 370  | 370                             |
| Total comprehensive loss                                      |                        |                        |                                  |                      |  | (2,287)                         |
| Cash dividends of \$.20 per share                             |                        |                        |                                  | (1,312)              |  | (1,312)                         |
| Expense recognized in connection with stock options           |                        |                        | 50                               |                      |  | 50                              |
| Common stock issued pursuant to the exercise of stock options | 130,881                | 131                    | 519                              |                      |  | 650                             |

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|  |           |          |           |           |    |     |     |    |        |
|--|-----------|----------|-----------|-----------|----|-----|-----|----|--------|
| Excess tax benefits from option exercise |           |          |           |           |    | 157 |     |    | 157    |
| Balance, December 31, 2008               | 6,633,169 | \$ 6,633 | \$ 33,090 | \$ 10,775 | \$ |     | 784 | \$ | 51,282 |

*See accompanying notes to these consolidated financial statements.*



**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS***Years Ended December 31, 2008, 2007 and 2006*

|   | 2008                   | 2007            | 2006            |
|---|------------------------|-----------------|-----------------|
|   | (Amounts in thousands) |                 |                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                        |                 |                 |
| Net income (loss)   | \$ (2,657)             | \$ 5,020        | \$ 4,276        |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:  |                        |                 |                 |
| Depreciation and amortization   | 1,026                  | 937             | 1,072           |
| Provision for loan losses   | 4,999                  | 1,033           | 2,612           |
| Deferred income taxes   | (2,798)                | (342)           | (938)           |
| Gain on sale of investment securities   |                        | (20)            | (60)            |
| Other than temporary impairment of equity securities                                      | 2,881                  | 76              |                 |
| Loss on SERP investment   | 593                    |                 |                 |
| Loss on sale of foreclosed real estate  |                        |                 | 144             |
| (Gain) loss on disposal of fixed assets   |                        | (8)             | 7               |
| Recognition of hedge ineffectiveness  | (331)                  | (214)           | (10)            |
| Decrease in capital lease obligation  | (9)                    | (9)             | (9)             |
| Equity compensation expense   | 50                     | 52              | 375             |
| Change in assets and liabilities:   |                        |                 |                 |
| Decrease (increase) in accrued interest receivable  | 608                    | 298             | (506)           |
| Decrease (increase) in other assets   | (2,552)                | 454             | (97)            |
| Increase (decrease) in accrued expenses and other liabilities                             | (642)                  | 905             | (551)           |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>  | <b>1,168</b>           | <b>8,182</b>    | <b>6,315</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                        |                 |                 |
| Purchases of securities available for sale  | (10,251)               | (29,799)        | (13,299)        |
| Proceeds from sales of securities available for sale                                      |                        | 6,460           | 3,909           |
| Proceeds from maturities, calls and principal repayments of securities available for sale | 11,858                 | 12,823          | 8,763           |
| Proceeds from maturities, calls and principal repayments of securities held to maturity   |                        | 400             |                 |
| Net increase in loans from originations and repayments                                    | (36,460)               | (23,503)        | (39,375)        |
| Purchases of bank premises and equipment  | (184)                  | (379)           | (326)           |
| Proceeds from sale of bank premises and equipment   | 1,277                  | 8               | 6               |
| Proceeds from sale of foreclosed real estate  | 312                    | 249             | 384             |
| Investment in equity securities   | (920)                  | (316)           | (191)           |
| Redemption of non-marketable equity securities  |                        |                 | 308             |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>  | <b>(34,368)</b>        | <b>(34,057)</b> | <b>(39,821)</b> |

*See accompanying notes to these consolidated financial statements.*

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)***Years Ended December 31, 2008, 2007 and 2006*

|   | 2008                   | 2007             | 2006             |
|---|------------------------|------------------|------------------|
|   | (Amounts in thousands) |                  |                  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                        |                  |                  |
| Net increase (decrease) in demand deposits  | (11,379)               | (28,662)         | 31,916           |
| Net increase in time deposits   | 40,989                 | 27,319           | 23,820           |
| Proceeds from issuance of common stock  | 650                    | 211              | 912              |
| Repurchase of common stock  |                        | (6,080)          | (263)            |
| Advances from Federal Home Loan Bank  | 20,000                 |                  |                  |
| Repayment of Federal Home Loan Bank advances  |                        |                  | (5,111)          |
| Redemption of long-term debt  |                        | (3,608)          |                  |
| Excess tax benefits from stock options exercised  | 157                    | 38               | 170              |
| Cash dividends paid on common stock   | (1,312)                | (1,348)          | (1,382)          |
| Net increase (decrease) in securities sold under agreement to repurchase and federal funds purchased    | (16,478)               | 16,036           | 3,740            |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>  | <b>32,627</b>          | <b>3,906</b>     | <b>53,802</b>    |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>   | <b>(573)</b>           | <b>(21,969)</b>  | <b>20,296</b>    |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING</b>   | <b>15,276</b>          | <b>37,245</b>    | <b>16,949</b>    |
| <b>CASH AND CASH EQUIVALENTS, ENDING</b>  | <b>\$ 14,703</b>       | <b>\$ 15,276</b> | <b>\$ 37,245</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>  |                        |                  |                  |
| <b>Cash paid during the year for:</b>   |                        |                  |                  |
| Interest  | \$ 14,694              | \$ 15,957        | \$ 13,725        |
| Income taxes  | 1,573                  | 2,875            | 3,992            |
| <b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:</b>                           |                        |                  |                  |
| Transfer of loans to foreclosed assets  | \$ 312                 | \$ 54            | 337              |
| Change in unrealized gain on available-for-sale securities and cash flow hedging activities, net of tax | 370                    | 1,063            | 94               |
| <i>See accompanying notes to these consolidated financial statements.</i>                               |                        |                  |                  |

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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 1 - ORGANIZATION AND OPERATIONS**

In April 2000, American Community Bancshares, Inc. ( Bancshares ) was formed as a holding company for American Community Bank. Upon formation, one share of Bancshares \$1 par value common stock was exchanged for each of the then outstanding 1,492,063 shares of American Community Bank s \$5 par value common stock. Bancshares currently has no material operations and conducts no business on its own other than owning its wholly owned subsidiary, American Community Bank.

American Community Bank ( American Community ) was incorporated on November 13, 1998 and began banking operations on November 16, 1998. The Bank is engaged in general commercial and retail banking in Union and Mecklenburg Counties of North Carolina and Cherokee and York Counties of South Carolina, operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation and the North Carolina Commissioner of Banks. The Bank undergoes periodic examinations by those regulatory authorities.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The accompanying consolidated financial statements include the accounts of American Community Bancshares, Inc. and American Community Bank, together referred to herein as the Company. All significant inter-company transactions and balances are eliminated in consolidation.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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 relate to the determination of the allowance for loan losses.

*Cash Equivalents*

For the purpose of presentation in the statements of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet captions cash and due from banks and interest-earning deposits with banks.

*Investment Securities*

Investment securities for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Available-for-sale securities are reported at fair value and consist of securities not classified as trading securities or as held-to-maturity securities. Unrealized holding gains and losses on available-for-sale securities, net of deferred income taxes, are reported as a net amount in other comprehensive income. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary would result in write-downs of the individual securities to their fair value. Such write-downs would be included in earnings.

Premiums and discounts are recognized in interest income using the interest method over the period to maturity.



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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Loans*

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Interest on loans is accrued on the unpaid principal balance outstanding. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. When doubt exists as to collectability of a loan (typically 90 days delinquent or impaired), the loan is placed on non-accrual status. When a loan is placed on non-accrual status, interest accrued prior to the judgment of uncollectability is reversed out of income. Loans are returned to an accruing status only as payments are received and when collection of all principal and interest is no longer in doubt. Payments received on such non-accrual loans are applied first to outstanding loan amounts and next as a recovery of lost interest. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

*Allowance for Loan Losses*

The allowance for loan losses is established as probable losses are estimated to have occurred through a provision for loan losses charged to earnings. The provision for loan losses is based upon management's best estimate of the amount needed to maintain the allowance for loan losses at an adequate level. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is evident. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of the current status of the portfolio, historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. Management segments the loan portfolio by loan type in considering each of the aforementioned factors and their impact upon the level of the allowance for loan losses. While management uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, regulatory examiners may require American Community Bank to recognize adjustments to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

Loans are considered impaired when it is probable that all amounts due under the contractual terms of the loan will not be collected. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, or upon the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses.

*Foreclosed Real Estate*

Real estate acquired through, or in lieu of, loan foreclosure is held for sale and is initially recorded at the lower of cost or fair value less estimated cost to sell at the date of foreclosure. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations are included in other expenses.

*Bank Premises and Equipment*

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Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the shorter of the estimated useful lives of the assets or, for those assets leased under capital leases, the lease term. Estimated useful lives are 35-40 years for buildings and 3 to 7 years for furniture and equipment. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Repairs and maintenance costs are charged to operations as incurred, and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in current operations.

### *Non-marketable equity securities*

As a requirement for membership, the Bank invests in stock of the Federal Home Loan Bank of Atlanta ( FHLB ), Bankers Bank, and the Federal Reserve Bank of Richmond. In addition, the Bank also invests in other equity investments for which the stock is not publicly traded. These investments are carried at cost.

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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Intangible Assets*

The Company's acquisition of FNB Bancshares, Inc. generated goodwill of \$9,838,173 and core deposit intangible assets of \$854,329. The Company uses a non-amortization approach to account for purchased goodwill. Intangible assets with finite useful lives are amortized over their useful lives. The carrying value of the core deposit intangible asset totaled \$351,479, net of amortization of \$502,850, as of December 31, 2008. This intangible asset was determined by management to meet the criteria for recognition apart from goodwill and to have a finite life of 8 years. Amortization expense associated with the core deposit intangible asset was \$106,800 for the years ended December 31, 2008, 2007, and 2006. In accordance with the Company's estimate of approximate lives of the acquired deposit relationships, an 8 year straight-line amortization schedule has been established for the core deposit intangible assets. Projected amortization expense for the years ending December 31, 2009, 2010, 2011 is \$106,800 per year. Projected amortization expense for the year ending December 31, 2012 is \$31,079.

Under generally accepted accounting principles, the Company reviews its amortizable intangible assets for impairment when events or changes in circumstances indicated the carrying value may not be recoverable. Goodwill is required to be tested for impairment annually as of April 15<sup>th</sup> and on an interim basis when events or circumstances change. Management completed the annual goodwill impairment tests as of April 15, 2008 and December 31, 2008, which indicated that no impairment had occurred. Management does not believe that events and circumstances subsequent to those dates indicated that goodwill has been impaired.

*Income Taxes*

The Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) on January 1, 2007. FIN 48 applies to all tax positions within the scope of SFAS 109. This statement requires a more-likely-than-not threshold for initial recognition of a tax benefit in the financial statements, and requires measurement of the amount of benefit to be recognized based upon the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement with the taxing authority. The Company has analyzed its tax positions pursuant to the requirements of FIN 48 and determined that no liability for unrecognized tax benefits is needed.

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized. It is the Company's policy to recognize interest and penalties associated with uncertain tax positions as components of income taxes. There were no interest or penalties accrued during the year. The Company's federal and state income tax returns are subject to examination for the years 2005, 2006, 2007 and 2008.

*Stock Compensation Plans*

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, (SFAS No. 123R) which was issued by the FASB in December 2004. SFAS No. 123R revises SFAS No. 123 *Accounting for Stock Based Compensation*, and supersedes APB No. 25, *Accounting for Stock Issued to Employees*, (APB No. 25) and its related interpretations. SFAS No. 123R requires recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). SFAS No. 123R also requires measurement of the cost of employee services received in exchange for an award based on the grant date fair value of the award. SFAS No. 123R also amends SFAS No. 95 *Statement of Cash Flows*, to require that excess tax benefits be reported as financing cash

inflows, rather than as a reduction of taxes paid, which is included within operating cash flows.

The Company adopted SFAS No. 123R using the modified prospective application as permitted under SFAS No. 123R. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. Prior to the adoption of SFAS No. 123R, the Company used the intrinsic value method as prescribed by APB No. 25 and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company's common stock on the date of grant.

*Derivative Financial Instruments and Hedging Activities*

In the normal course of business, the Company enters into derivative contracts to manage interest rate risk by modifying the characteristics of the related balance sheet instruments in order to reduce the adverse effect of changes in interest rates. All derivative financial instruments are recorded at fair value in the financial statements.



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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

On the date a derivative contract is entered into, the Company designates the derivative as a fair value hedge, a cash flow hedge, or a trading instrument. Changes in the fair value of instruments used as fair value hedges are accounted for in the earnings of the period simultaneous with accounting for the fair value change of the item being hedged. Changes in the fair value of the effective portion of cash flow hedges are accounted for in other comprehensive income rather than earnings. Changes in fair value of instruments that are not intended as a hedge are accounted for in the earnings of the period of the change.

If a derivative instrument designated as a fair value hedge is terminated or the hedge designation removed, the difference between a hedged item's then carrying amount and its face amount is recognized into income over the original hedge period. Likewise, if a derivative instrument designated as a cash flow hedge is terminated or the hedge designation removed, related amounts accumulated in other comprehensive income are reclassified into earnings over the original hedge period during which the hedged item affects income.

The Company formally documents all hedging relationships, including an assessment that the derivative instruments are expected to be highly effective in offsetting the changes in fair values or cash flows of the hedged items.

*Comprehensive Income*

Accounting principles require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and hedging activities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The Company's components of accumulated other comprehensive income are unrealized gains (losses) on available-for-sale securities and unrealized gains (losses) on hedging activities.

At December 31, 2008, accumulated other comprehensive income consisted of net unrealized gains on securities available for sale of \$784,000. At December 31, 2007, accumulated other comprehensive income consisted of net unrealized gains on securities available for sale of \$356,000 and net unrealized gains on derivatives of \$58,000.

*Per Share Results*

Basic and diluted net income per common share have been computed by dividing net income (loss) for each period by the weighted average number of shares of common stock outstanding during each period after retroactively adjusting for the stock dividends.

Basic earnings per common share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and warrants and are determined using the treasury stock method.

Basic and diluted net income per share have been computed based upon net income as presented in the accompanying statements of operations divided by the weighted average number of common shares outstanding or assumed to be outstanding as summarized below:

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|  | 2008      | 2007      | 2006      |
|--|-----------|-----------|-----------|
| Weighted average number of common shares used in computing basic net income per share  | 6,555,255 | 6,779,635 | 6,913,534 |
| Effect of dilutive stock options and warrants  |           | 158,624   | 257,879   |
| Weighted average number of common shares and dilutive potential common shares used in computing diluted net income per share | 6,555,255 | 6,938,259 | 7,171,413 |

For the years ended December 31, 2008, 2007, and 2006 there were 132,293, 90,329, and 90,000 options, respectively, that were anti-dilutive since the exercise price exceeded the average market price for the year. Due to the net loss for the year ended

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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

December 31, 2008, anti-dilutive options are not omitted from the calculation of diluted earnings per share. Anti-dilutive options are omitted from the calculation of diluted earnings per share for the years ended December 31, 2007 and 2006.

*Segment Reporting*

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, requires management to report selected financial and descriptive information about reportable operating segments. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. Generally, disclosures are required for segments internally identified to evaluate performance and resource allocation. In all material respects, the Company's operations are entirely within the commercial banking segment, and the consolidated financial statements presented herein reflect the results of that segment. The Company has no foreign operations or customers.

*Recent Accounting Pronouncements*

SFAS 141R

In December 2007, the FASB issued SFAS 141(R), *Business Combinations*. SFAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this Statement include: the acquisition date will be date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward.

The Company will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. Management is currently evaluating the effects that SFAS 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented in the consolidated financial statements and applied in the proposed merger with Yadkin Valley Financial Corporation.

SFAS 157

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, *Fair Value Measurements* (FASB No. 157), which enhances existing guidance for measuring assets and liabilities using fair value and requires additional disclosure about the use of fair value for measurement. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods

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within those fiscal years. The Company adopted the provisions of SFAS 157, Fair Value Measurements effective January 1, 2008. The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**SFAS 159**

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This option is available to all entities. Most of the provisions in SFAS 159 are elective; however, the amendment to SFAS 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company did not elect the fair value option as of January 1, 2008 for any of its financial assets or financial liabilities and, accordingly, the adoption of the statement did not have a material impact on the Company's consolidated financial statements.

**SFAS 161**

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. This statement applies to all derivatives and hedged items and is effective for periods beginning after November 15, 2008 prospectively, with comparative disclosures encouraged. This statement requires enhanced qualitative disclosures and tabular disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk contingent features in derivative agreements. The Company is currently evaluating the effects that SFAS 161 will have upon adoption as this standard will affect the presentation and disclosure in the consolidated financial statements.

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 3 - INVESTMENT SECURITIES**

The following is a summary of the securities portfolio by major classification at December 31, 2008 and 2007:

|                                     | Amortized<br>Cost | 2008   |                               | Fair<br>Value |
|-------------------------------------|-------------------|--|-------------------------------|---------------|
|                                     |                   | Gross<br>Unrealized<br>Gains<br>(Dollars in thousands) | Gross<br>Unrealized<br>Losses |               |
| Securities available for sale:      |                   |  |                               |               |
| U.S. Government agencies            | \$ 9,635          | \$ 211   | \$ 5                          | \$ 9,841      |
| Mortgage-backed securities          | 47,232            | 1,238  | 6                             | 48,464        |
| State and municipal bonds           | 12,143            | 42   | 202                           | 11,983        |
|                                     | 69,010            | 1,491  | 213                           | 70,288        |
| Marketable equity securities        | 974               |  |                               | 974           |
| Total securities available for sale | \$ 69,984         | \$ 1,491   | \$ 213                        | \$ 71,262     |

|                                   | Amortized<br>Cost | 2007   |                               | Fair<br>Value |
|-----------------------------------|-------------------|--|-------------------------------|---------------|
|                                   |                   | Gross<br>Unrealized<br>Gains<br>(Dollars in thousands) | Gross<br>Unrealized<br>Losses |               |
| Securities held to maturity:      |                   |  |                               |               |
| State and municipal bonds         | \$ 1,768          | \$   | \$ 8                          | \$ 1,760      |
| Total securities held to maturity | \$ 1,768          | \$   | \$ 8                          | \$ 1,760      |

|                                     | Amortized<br>Cost | 2007   |                               | Fair<br>Value |
|-------------------------------------|-------------------|--|-------------------------------|---------------|
|                                     |                   | Gross<br>Unrealized<br>Gains<br>(Dollars in thousands) | Gross<br>Unrealized<br>Losses |               |
| Securities available for sale:      |                   |  |                               |               |
| U.S. Government agencies            | \$ 13,635         | \$ 341   | \$ 10                         | \$ 13,966     |
| Mortgage-backed securities          | 49,116            | 385  | 196                           | 49,305        |
| State and municipal bonds           | 10,762            | 109  | 44                            | 10,827        |
|                                     | 73,513            | 835  | 250                           | 74,098        |
| Marketable equity securities        | 907               | 7  |                               | 914           |
| Total securities available for sale | \$ 74,420         | \$ 842   | \$ 250                        | \$ 75,012     |

|                                   | Amortized<br>Cost      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-----------------------------------|------------------------|------------------------------|-------------------------------|---------------|
|                                   | (Dollars in thousands) |                              |                               |               |
| Securities held to maturity:      |                        |                              |                               |               |
| State and municipal bonds         | \$ 1,770               | \$ 34                        | \$                            | \$ 1,804      |
| Total securities held to maturity | \$ 1,770               | \$ 34                        | \$                            | \$ 1,804      |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Years Ended December 31, 2008, 2007 and 2006****NOTE 3 - INVESTMENT SECURITIES (Continued)**

The amortized cost and fair values of securities (excluding marketable equity securities) at December 31, 2008 by contractual maturity are shown below. Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

|  | At December 31, 2008   |                  |
|--|------------------------|------------------|
|  | Amortized Cost         | Fair Value       |
|  | (Dollars in thousands) |                  |
| Due within one year                    | \$                     | \$               |
| Due after one year through five years  | 7,625                  | 7,749            |
| Due after five years through ten years | 17,249                 | 17,540           |
| Due after ten years                    | 45,904                 | 46,759           |
| <b>Total</b>                           | <b>\$ 70,778</b>       | <b>\$ 72,048</b> |

For purposes of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal prepayments.

There were no sales of investment securities for the year ended December 31, 2008. For the years ended December 31, 2007 and 2006, proceeds from sales of investment securities available for sale amounted to \$6,459,570 and \$3,908,955 respectively. Gross realized gains in 2007 and 2006 from these sales amounted to \$19,445 and \$60,072, respectively.

Available for sale securities, consisting of U. S. government agencies, mortgage-backed securities and state and municipal bonds, with carrying values of \$11,651,000 and \$13,173,000 at December 31, 2008 and 2007, respectively, were pledged to secure public monies on deposit as required by law. Available for sale securities, consisting of US government agencies and mortgage-backed securities, with carrying values of \$17,123,000 and \$18,762,000 were pledged to secure securities sold under agreements to repurchase at December 31, 2008 and 2007, respectively. Available for sale securities, consisting of mortgage-backed securities with carrying values of \$8,391,000 and \$997,000 were pledged to secure advances from the Federal Home Loan Bank at December 31, 2008 and 2007, respectively.

The following tables show investment gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2008 and 2007. The unrealized losses relate to debt securities that have incurred fair value reductions due to higher market interest rates since the securities were purchased. The 2008 unrealized losses on investment securities relate to one U.S. Government agency security, four mortgage-backed securities, and twenty-three municipal securities. The 2007 unrealized losses on investment securities relate to two U.S. Government agency securities, twenty-six mortgage-backed securities, and nine municipal securities. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased. Since none of the unrealized losses relate to the marketability of the securities or the issuer's ability to honor redemption obligations, none of the securities are deemed to be other than temporarily impaired. The Company has the positive intent and ability to hold until recovery all investment securities with unrealized losses at December 31, 2008.



|  | Less Than 12 Months |                      | 2008<br>12 Months or More |                      | Total            |                      |
|--|---------------------|----------------------|---------------------------|----------------------|------------------|----------------------|
|  | Fair<br>value       | Unrealized<br>losses | Fair<br>value             | Unrealized<br>losses | Fair<br>value    | Unrealized<br>losses |
| Securities available for sale:               |                     |                      |                           |                      |                  |                      |
| U.S. government agencies                     | \$                  | \$                   | \$ 1,568                  | \$ 5                 | \$ 1,568         | \$ 5                 |
| Mortgage-backed securities                   | 2,213               | 6                    |                           |                      | 2,213            | 6                    |
| State and municipal bonds                    | 8,424               | 202                  |                           |                      | 8,424            | 202                  |
| <b>Total temporarily impaired securities</b> | <b>\$ 10,637</b>    | <b>\$ 208</b>        | <b>\$ 1,568</b>           | <b>\$ 5</b>          | <b>\$ 12,205</b> | <b>\$ 213</b>        |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 3 - INVESTMENT SECURITIES (Continued)**

|                                       | 2007                   |                   |                   |                   |            |                   |
|---------------------------------------|------------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                                       | Less Than 12 Months    |                   | 12 Months or More |                   | Total      |                   |
|                                       | Fair value             | Unrealized losses | Fair value        | Unrealized losses | Fair value | Unrealized losses |
|                                       | (Dollars in thousands) |                   |                   |                   |            |                   |
| Securities available for sale:        |                        |                   |                   |                   |            |                   |
| U.S. government agencies              | \$                     | \$                | \$ 2,731          | \$ 10             | \$ 2,731   | \$ 10             |
| Mortgage-backed securities            | 2,891                  | 12                | 21,674            | 184               | 24,565     | 196               |
| State and municipal bonds             | 1,529                  | 19                | 1,301             | 25                | 2,830      | 44                |
| Total temporarily impaired securities | \$ 4,420               | \$ 31             | \$ 25,706         | \$ 219            | \$ 30,126  | \$ 250            |

The Company periodically evaluates its investments for any impairment which would be deemed other than temporary. As part of its evaluation, the Company determined that the fair value of its investment in Federal National Mortgage Association ( FNMA ) and Federal Home Loan Mortgage Corporation ( FHLMC ) preferred stock of \$2,902,265 was other than temporarily impaired. As a result, the Company wrote down its investment in FNMA and FHLMC stock by \$2,822,756, to an estimated fair value of \$67,100 as of December 31, 2008.

**NOTE 4 - NON-MARKETABLE EQUITY SECURITIES CARRIED AT COST**

The aggregate cost of the Company's cost method investments totaled \$2,979,846 at December 31, 2008. The Company periodically evaluates these investments for any impairment which would be deemed other than temporary. As part of its evaluation, the Company determined that the fair value of an investment in a trust company, whose primary shareholders are ten community banks located throughout North Carolina, was less than the original cost of the investment and that the decline in fair value was not temporary in nature. As a result, in 2007 the Company wrote down its original investment in the trust company of \$277,738 by \$75,747, to an estimated fair value of \$201,991. This write down was recorded as a charge to earnings during the year ended December 31, 2007. The Company wrote down this investment by an additional \$59,082 to \$142,909 by a charge to earnings during the year ended December 31, 2008. This trust company has two common directors with the Company.

Of the remaining \$2,836,937 in equity investments, securities in the Federal Home Loan Bank and Silverton Bank, N.A. amounted to \$2,077,700 and \$84,237, respectively, at December 31, 2008. Because of the redemption provisions of issuers, the Company estimated that the fair value equaled or exceeded the cost of these investments and the investments were not impaired. The Company did not identify any events or changes in circumstances that may have had a significant adverse effect on the fair value of the remaining \$675,000 cost method investments.

**NOTE 5 - LOANS AND THE ALLOWANCE FOR LOAN LOSSES**

Following is a summary of loans at December 31, 2008 and 2007:

2008

2007

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|                                 | Amount                 | Percent        | Amount            | Percent        |
|---------------------------------|------------------------|----------------|-------------------|----------------|
|                                 | (Dollars in thousands) |                |                   |                |
| Real estate mortgage loans:     |                        |                |                   |                |
| 1-4 family                      | \$ 43,431              | 10.16%         | \$ 35,680         | 9.08%          |
| Commercial mortgage             | 105,464                | 24.66%         | 104,209           | 26.51%         |
| Construction/development        | 157,230                | 36.77%         | 136,531           | 34.73%         |
| Home equity lines of credit     | 43,777                 | 10.24%         | 34,784            | 8.85%          |
| Commercial and industrial loans | 60,017                 | 14.03%         | 57,958            | 14.74%         |
| Loans to individuals            | 15,844                 | 3.70%          | 20,010            | 5.09%          |
| Lease financing, net            | 1,901                  | 0.44%          | 3,941             | 1.00%          |
| <b>Subtotal</b>                 | <b>427,664</b>         | <b>100.00%</b> | <b>393,113</b>    | <b>100.00%</b> |
| Allowance for loan losses       | (9,124)                |                | (5,740)           |                |
| Net unamortized deferred fees   | (172)                  |                | (154)             |                |
| <b>Total</b>                    | <b>\$ 418,368</b>      |                | <b>\$ 387,219</b> |                |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Years Ended December 31, 2008, 2007 and 2006****NOTE 5 - LOANS AND THE ALLOWANCE FOR LOAN LOSSES (Continued)**

Loans are primarily made in Union and Mecklenburg Counties, North Carolina and Cherokee and York Counties, South Carolina. Real estate loans can be affected by the condition of the local real estate market. Commercial and installment loans can be affected by the local economic conditions. Significant declines in the housing markets and overall downturn in economic conditions over the past twelve months have resulted in write-downs and could further impact our loan portfolio.

At December 31, 2008 and 2007, respectively, there were \$26,000 and \$-0- of loans past due 90 days or more which were still accruing interest. Impaired loans, which consisted primarily of non-accrual loans and leases, were \$8,062,000 and \$2,477,000 at December 31, 2008 and 2007, respectively. Impaired loans of \$5,508,000 and \$2,477,000 had related allowances for loan losses aggregating \$1,628,000 and \$941,000 at December 31, 2008 and 2007, respectively. There were \$2,554,000 and \$-0- impaired loans without an allowance at December 31, 2008 or 2007, respectively. The average recorded investment in impaired loans during the years ended December 31, 2008 and 2007 was \$2,858,000 and \$1,565,000, respectively. Interest foregone on non-accrual loans was approximately \$272,000 and \$44,000 for the year ended December 31, 2008 and 2007, respectively.

The Company has granted loans to certain directors and executive officers of the Bank and their related interests. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers and, in management's opinion, do not involve more than the normal risk of collectibility. All loans to directors and executive officers or their interests are submitted to the Board of Directors for approval. A summary of loans to directors, executive officers and their related interests follows:

|  | (Dollars in thousands) |         |
|--|------------------------|---------|
| Loans to directors and officers as a group at January 1, 2008          | \$                     | 3,525   |
| New loans or advances on lines during the year ended December 31, 2008 |                        | 4,794   |
| Amounts collected during the year ended December 31, 2008              |                        | (3,169) |
| <br>   |                        |         |
| Loans to directors and officers as a group at December 31, 2008        | \$                     | 5,150   |

At December 31, 2008, the Company had pre-approved but unused lines of credit totaling \$1,987,000 to directors, executive officers and their related interests.

An analysis of the allowance for loan losses follows:

|                              | 2008                   | 2007     | 2006     |
|------------------------------|------------------------|----------|----------|
|                              | (Dollars in thousands) |          |          |
| Balance at beginning of year | \$ 5,740               | \$ 5,628 | \$ 4,331 |

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|                                 |          |          |          |
|---------------------------------|----------|----------|----------|
| Provision charged to operations | 4,999    | 1,033    | 2,612    |
| Charge-offs                     | 1,640    | 1,035    | 1,350    |
| Recoveries                      | (25)     | (114)    | (35)     |
| Net charge-offs                 | 1,615    | 921      | 1,315    |
| Balance at end of year          | \$ 9,124 | \$ 5,740 | \$ 5,628 |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 6 - BANK PREMISES AND EQUIPMENT**

Following is a summary of bank premises and equipment at December 31, 2008 and 2007:

|   | 2008                   | 2007     |
|---|------------------------|----------|
|   | (Dollars in thousands) |          |
| Land                                      | \$ 1,488               | \$ 1,668 |
| Buildings and leasehold improvements      | 6,252                  | 7,192    |
| Furniture and equipment                   | 4,225                  | 4,095    |
|   | 11,965                 | 12,955   |
| Accumulated depreciation and amortization | (4,840)                | (4,261)  |
| Total                                     | \$ 7,125               | \$ 8,694 |

Depreciation and amortization expense amounting to \$741,000, \$791,000 and \$868,000 for the years ended December 31, 2008, 2007 and 2006, respectively, is included in occupancy and equipment expense.

**NOTE 7 - DEPOSITS**

Time deposits in denominations of \$100,000 or more were \$178,900,000 and \$143,732,000 at December 31, 2008 and 2007, respectively. Brokered deposits totaled \$36,116,000 and \$12,001,000 at December 31, 2008 and 2007, respectively.

At December 31, 2008, the scheduled maturities of certificates of deposit were as follows:

|            | Less than<br>\$100,000 | \$100,000<br>or more | Total      |
|------------|------------------------|----------------------|------------|
|            | (Dollars in thousands) |                      |            |
| 2009       | \$ 92,286              | \$ 149,926           | \$ 242,212 |
| 2010       | 17,547                 | 17,812               | 35,359     |
| 2011       | 1,434                  | 2,903                | 4,337      |
| 2012       | 3,857                  | 7,701                | 11,558     |
| 2013       | 242                    | 558                  | 800        |
| Thereafter |                        |                      |            |
| Total      | \$ 115,366             | \$ 178,900           | \$ 294,266 |

**NOTE 8 - BORROWINGS**

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Borrowings consist of advances from the Federal Home Loan Bank of Atlanta, securities sold under agreements to repurchase, federal funds purchased, junior subordinated debt and obligations under a capitalized lease for the Bank's main office facility.

The following table provides a summary of our borrowings:

|                                | 2008                   | 2007      |
|--------------------------------|------------------------|-----------|
|                                | (Dollars in thousands) |           |
| <b>Short-term borrowings</b>   |                        |           |
| Repurchase agreements          | \$ 14,623              | \$ 18,193 |
| Federal funds purchased        | 408                    | 13,316    |
|                                | \$ 15,031              | \$ 31,509 |
| <b>Long-term debt</b>          |                        |           |
| FHLB advances                  | \$ 26,000              | \$ 6,000  |
| Capitalized lease obligation   | 1,676                  | 1,685     |
| Junior subordinated debentures | 10,310                 | 10,310    |
|                                | \$ 37,986              | \$ 17,995 |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Years Ended December 31, 2008, 2007 and 2006****NOTE 8 - BORROWINGS (Continued)**

At December 31, 2008 and 2007, Federal Home Loan Bank advances were as follows:

| Maturity date                               | Call Feature       | 2008      |        | 2007     |        |
|---|--------------------|-----------|--------|----------|--------|
|   |                    | Amount    | Rate   | Amount   | Rate   |
| (Dollars in thousands)                      |                    |           |        |          |        |
| July 16, 2012                               | Callable quarterly | \$ 1,000  | 3.900% | \$ 1,000 | 3.900% |
| February 25, 2013                           | Callable quarterly | 5,000     | 3.450% | 5,000    | 3.450% |
| January 10, 2013                            | Callable quarterly | 10,000    | 3.095% |          |        |
| February 28, 2018                           | Callable quarterly | 5,000     | 2.930% |          |        |
| April 25, 2015                              | Callable quarterly | 5,000     | 2.970% |          |        |
| Total FHLB borrowings/weighted average rate |                    | \$ 26,000 | 3.138% | \$ 6,000 | 3.525% |

Pursuant to a collateral agreement with the FHLB, advances are collateralized by all the Company's FHLB stock of \$2,077,700 and \$1,158,000 at December 31, 2008 and 2007, respectively, qualifying first mortgage loans and qualifying commercial real estate. The balance of qualifying first mortgage loans and qualifying commercial real estate as of December 31, 2008 and 2007 was approximately \$62,495,000 and \$13,459,000, respectively. This agreement with the FHLB provides for a line of credit up to 15% of the Bank's assets.

The Company also had unused lines of credit totaling \$35.1 million and \$16.2 million from correspondent banks at December 31, 2008 and 2007, respectively.

Federal funds purchased and securities sold under agreements to repurchase, which generally mature 1 to 4 days from the transaction date, at December 31, 2008 and 2007 are summarized below:

|  | 2008                   | 2007      |
|--|------------------------|-----------|
|  | (Dollars in thousands) |           |
| Outstanding balance at December 31                   | \$ 15,031              | \$ 31,509 |
| Year-end weighted average rate                       | 1.97%                  | 3.61%     |
| Average outstanding during the year                  | 21,654                 | 21,317    |
| Average rate for the year                            | 2.30%                  | 3.71%     |
| Maximum outstanding at any month-end during the year | 30,194                 | 31,509    |

Available for sale securities, consisting of US government agencies and mortgage-backed securities, with carrying values of \$17,123,000 and \$18,535,000 were pledged to secure securities sold under agreements to repurchase at December 31, 2008 and 2007, respectively and are held at an independent correspondent bank. Available for sale securities, consisting of mortgage-backed securities with carrying values of \$8,391,000 and \$997,000 were pledged to secure advances from the Federal Home Loan Bank at December 31, 2008 and 2007, respectively.





**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 9 - LEASES***Operating Leases*

The Company has entered into non-cancelable operating leases for the land on which its main office is located and for other branch facilities and equipment. These leases have terms from five to thirty years. In 2002, the Company entered into a sale-leaseback arrangement. Under the arrangement, the Company sold its Marshville branch property and leased it back for a period of ten years with two renewal options for five years each. The leaseback has been accounted for as an operating lease. The gain of \$147,156 realized in this transaction has been deferred and is being amortized to income in proportion to rental expense over the term of the lease. In 2008, the Company entered into another sale-leaseback arrangement. The Company sold its Blacksburg and Hwy 11 branch properties and leased them back for a period of ten years with two renewal options for five years each. The leaseback has been accounted for as an operating lease. The gain of \$265,388 realized in this transaction has been deferred and is being amortized to income in proportion to rental expense over the term of the lease. Future rentals under operating leases are as follows:

|                   | <b>(Dollars in thousands)</b> |
|-------------------|-------------------------------|
| 2009              | \$ 873                        |
| 2010              | 600                           |
| 2011              | 457                           |
| 2012              | 384                           |
| 2013              | 315                           |
| 2014 - thereafter | 2,394                         |
| <b>Total</b>      | <b>\$ 5,023</b>               |

Total rent expense under operating leases was approximately \$841,000, \$790,000 and \$783,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

*Capital Lease Obligation*

The Company leases its main office facility under a capital lease. Leases that meet the criteria for capitalization are recorded as assets and the related obligations are reflected as capital lease obligations on the accompanying balance sheets. Amortization of property under capital lease is included in depreciation expense. Included in premises and equipment at December 31, 2008 and 2007 is \$1.7 million as the capitalized cost of the Company's main office and accumulated amortization of \$392,000 and \$349,000 at December 31, 2008 and 2007, respectively.

At December 31, 2008, aggregate future minimum lease payments due under this capital lease obligation are as follows:

|      | <b>(Dollars in thousands)</b> |
|------|-------------------------------|
| 2009 | \$ 148                        |
| 2010 | 158                           |
| 2011 | 158                           |

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|  |                 |
|--|-----------------|
| 2012   | 158             |
| 2013   | 158             |
| 2014 - 2029  | 2,883           |
| <b>Total minimum lease payments</b>                | <b>3,665</b>    |
| Less amount representing interest                  | (1,989)         |
| <b>Present value of net minimum lease payments</b> | <b>\$ 1,676</b> |

Both the land lease and capital leases for the Company's main office discussed above are leased from a former director. Prior to the main facility being completed in November 2000, the Company leased land for its temporary banking facility from that same director. In addition, the Marshville facility is leased from another former director. In January 2003, the Company signed an operating lease for a new branch facility in Mint Hill, North Carolina, with a former director. The lease has an initial term of ten years with two renewal options for five years each. Total lease payments of \$536,000, \$476,000, and \$495,000 were paid to these former directors under these leases during 2008, 2007 and 2006, respectively.

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On December 31, 2001 and March 1, 2002, \$2.0 million and \$1.5 million, respectively, of trust preferred securities were placed through American Community Capital Trust I ( Capital Trust I ). The preferred securities paid cumulative cash distributions quarterly at an annual rate of 9%. The dividends paid to holders of the capital trust preferred securities, which were recorded as interest expense, were deductible for income tax purposes. The quarterly distributions could, at the option of the Company, be deferred up to five years. The preferred securities issued in 2001 and 2002 were redeemable on March 1, 2007 or afterwards at the par of \$1,000 per share. These shares were redeemed on March 9, 2007.

On December 15, 2003, \$10.0 million of trust preferred securities were placed through American Community Capital Trust II, Ltd. ( Capital Trust II ). The preferred securities pay cumulative cash distributions quarterly at a rate priced off 90-day LIBOR plus 280 basis points. The dividends paid to holders of the capital trust preferred securities, which will be recorded as interest expense, are deductible for income tax purposes. The preferred securities issued in 2003 are redeemable on December 15, 2008 or afterwards at par. Redemption is mandatory at December 15, 2033. The proceeds of the preferred securities were invested by Capital Trust II in \$10.0 million principal amount of junior subordinated debentures of the Company due December 15, 2033.

The Company fully and unconditionally guarantees the preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company. A portion of the preferred securities qualify as Tier 1 capital for regulatory capital purposes.

A description of the Junior Subordinated Debentures outstanding is as follows:

| Issuing Entity                            | Date of Issuance | Shares Issued | Interest Rate | Maturity Date | Principal Amount |           |
|---|------------------|---------------|---------------|---------------|------------------|-----------|
|   |                  |               |               |               | 2008             | 2007      |
| American Community Capital Trust II, Ltd. | 12/15/2003       | 10,000        | 6.56%         | 12/15/2033    | \$ 10,310        | \$ 10,310 |

**NOTE 11 - OTHER CONTRACTS**

The Company entered into non-cancelable contracts with third parties for data processing services. The future minimum payments required under these contracts for the years ending December 31, 2010 are as follows:

|              | (Dollars in thousands) |
|--------------|------------------------|
| 2009         | \$ 597                 |
| 2010         | 635                    |
| <b>Total</b> | <b>\$ 1,232</b>        |

The above future payments are based upon the anticipated future growth of the Company and can therefore vary from the above estimates in any year.



**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Years Ended December 31, 2008, 2007 and 2006****NOTE 12 - INCOME TAXES**

The significant components of the provision for income taxes for the periods ended December 31, 2008, 2007 and 2006 are as follows:

|                            | 2008                   | 2007     | 2006     |
|----------------------------|------------------------|----------|----------|
|                            | (Dollars in thousands) |          |          |
| Current tax provision:     |                        |          |          |
| Federal                    | \$ 1,267               | \$ 2,712 | \$ 2,899 |
| State                      | 178                    | 499      | 479      |
|                            | 1,445                  | 3,211    | 3,378    |
| Deferred tax benefit:      |                        |          |          |
| Federal                    | (2,357)                | (314)    | (848)    |
| State                      | (441)                  | (28)     | (90)     |
|                            | (2,798)                | (342)    | (938)    |
| Provision for income taxes | \$ (1,353)             | \$ 2,869 | \$ 2,440 |

The difference between the provision for income taxes and the amounts determined by applying the statutory federal income tax rate of 34% to income before income taxes is summarized below:

|  | 2008                   | 2007     | 2006     |
|--|------------------------|----------|----------|
|  | (Dollars in thousands) |          |          |
| Income tax expense (benefit) computed at statutory rate of 34% | \$ (1,364)             | \$ 2,682 | \$ 2,283 |
| Effect of state income taxes                                   | (173)                  | 311      | 257      |
| Tax exempt interest  | (170)                  | (142)    | (102)    |
| Non-deductible merger expenses                                 | 160                    |          |          |
| Other  | 194                    | 18       | 2        |
| Net provision for income taxes                                 | \$ (1,353)             | \$ 2,869 | \$ 2,440 |

Significant components of deferred taxes at December 31, 2008 and 2007 are as follows:

| 2008 | 2007 |
|------|------|
|------|------|

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|  | (Dollars in thousands) |          |
|--|------------------------|----------|
| <b>Deferred tax assets:</b>                              |                        |          |
| Allowance for loan losses                                | \$ 3,202               | \$ 1,921 |
| Capital lease  | 139                    | 129      |
| Deferred gain on sale-leaseback                          | 113                    | 22       |
| Income from deferred data processing payment             | 28                     | 43       |
| Nondeductible accrued expenses                           | 43                     | 18       |
| Stock compensation expense                               | 121                    | 143      |
| Other than temporary impairment of investment securities | 1,346                  |          |
| Other  | 93                     | 44       |
| <br>   |                        |          |
| Total deferred tax assets                                | 5,085                  | 2,320    |
| <br>   |                        |          |
| <b>Deferred tax liabilities:</b>                         |                        |          |
| Premises and equipment                                   | (131)                  | (144)    |
| Leased property  | (175)                  | (368)    |
| Core deposit intangible                                  | (133)                  | (177)    |
| Prepaid expenses   | (57)                   | (57)     |
| Interest rate hedges                                     | (207)                  | (36)     |
| Net unrealized gains on available-for-sale securities    | (493)                  | (236)    |
| Other  | (12)                   | (2)      |
| <br>   |                        |          |
| Total deferred tax liabilities                           | (1,208)                | (1,020)  |
| <br>   |                        |          |
| Net deferred tax assets                                  | \$ 3,877               | \$ 1,300 |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Years Ended December 31, 2008, 2007 and 2006****NOTE 13 - OTHER NON-INTEREST EXPENSE**

The major components of other non-interest expense for the years ended December 31, 2008, 2007 and 2006 are as follows:

|   | 2008                   | 2007         | 2006         |
|---|------------------------|--------------|--------------|
|   | (Dollars in thousands) |              |              |
| Postage, printing and office supplies     | \$ 260                 | \$ 280       | \$ 340       |
| Advertising and promotion                 | 179                    | 195          | 189          |
| Travel, meals, dues and subscriptions     | 281                    | 265          | 225          |
| Telephone                                 | 216                    | 235          | 150          |
| Data processing and technology            | 1,087                  | 953          | 835          |
| Professional fees and contracted services | 1,242                  | 1,280        | 1,027        |
| Other                                     | 1,233                  | 1,331        | 1,337        |
| <br>Total                                 | <br>\$ 4,498           | <br>\$ 4,539 | <br>\$ 4,103 |

**NOTE 14 - REGULATORY MATTERS**

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The primary sources of funds for the payment of dividends by American Community Bancshares, Inc. are interest and dividends received from its subsidiary, American Community Bank, combined with the proceeds from stock sold by the Company. American Community, as a North Carolina banking corporation, may pay dividends only out of undivided profits as determined pursuant to North Carolina General Statutes Section 53-87. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such limitation is in the public interest and is necessary to ensure a bank's financial soundness.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its bank subsidiary to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2008 and 2007, that the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2008, the most recent notification from the Federal Deposit Insurance Corporation categorized American Community Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. Prompt corrective action provisions are not applicable to bank holding companies.





**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 14 - REGULATORY MATTERS (Continued)**

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2008 and 2007 are presented in the following table.

|   | Actual    |        | Minimum<br>For Capital<br>Requirement |       | Minimum To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Provisions |        |
|---|-----------|--------|---------------------------------------|-------|---|--------|
|   | Amount    | Ratio  | Amount                                | Ratio | Amount  | Ratio  |
| (Dollars in thousands)                  |           |        |                                       |       |   |        |
| December 31, 2008:                      |           |        |                                       |       |   |        |
| Total Capital to Risk Weighted Assets:  |           |        |                                       |       |   |        |
| Consolidated                            | \$ 56,221 | 12.64% | \$ 35,572                             | 8.00% | \$ N/A  | N/A    |
| American Community Bank                 | 48,308    | 10.95% | 35,302                                | 8.00% | 44,128  | 10.00% |
| Tier 1 Capital to Risk Weighted Assets: |           |        |                                       |       |   |        |
| Consolidated                            | 50,618    | 11.38% | 17,786                                | 4.00% | N/A   | N/A    |
| American Community Bank                 | 42,738    | 9.69%  | 17,651                                | 4.00% | 22,064  | 5.00%  |
| Tier 1 Capital to Average Assets:       |           |        |                                       |       |   |        |
| Consolidated                            | 50,618    | 9.45%  | 21,419                                | 4.00% | N/A   | N/A    |
| American Community Bank                 | 42,738    | 8.03%  | 21,277                                | 4.00% | 26,596  | 5.00%  |

|   | Actual    |        | Minimum<br>For Capital<br>Requirement |       | Minimum To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Provisions |        |
|---|-----------|--------|---------------------------------------|-------|---|--------|
|   | Amount    | Ratio  | Amount                                | Ratio | Amount  | Ratio  |
| (Dollars in thousands)                  |           |        |                                       |       |   |        |
| December 31, 2007:                      |           |        |                                       |       |   |        |
| Total Capital to Risk Weighted Assets:  |           |        |                                       |       |   |        |
| Consolidated                            | \$ 58,798 | 14.24% | \$ 33,040                             | 8.00% | \$ N/A  | N/A    |
| American Community Bank                 | 47,012    | 11.42% | 32,940                                | 8.00% | 41,175  | 10.00% |
| Tier 1 Capital to Risk Weighted Assets: |           |        |                                       |       |   |        |
| Consolidated                            | 53,625    | 12.98% | 16,520                                | 4.00% | N/A   | N/A    |
| American Community Bank                 | 41,862    | 10.17% | 16,470                                | 4.00% | 20,587  | 5.00%  |
| Tier 1 Capital to Average Assets:       |           |        |                                       |       |   |        |
| Consolidated                            | 53,625    | 11.02% | 19,461                                | 4.00% | N/A   | N/A    |
| American Community Bank                 | 41,862    | 8.58%  | 19,515                                | 4.00% | 24,394  | 5.00%  |

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The Company is a party to financial instruments with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit is based on management's credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds, and certificates of deposit.

A summary of the contract amounts of the Company's exposure to off-balance sheet credit risk as of December 31, 2008 is as follows:

Financial instruments whose contract amounts represent credit risk:

|   | <b>(Dollars in thousands)</b> |
|---|-------------------------------|
| Capital South II Partnership investment commitment  | \$ 125                        |
| Capital South III Partnership investment commitment | 700                           |
| Standby letters of credit                           | 3,101                         |
| Commitments to extend credit                        | 4,526                         |
| Undisbursed lines of credit                         | 52,487                        |
| Undisbursed portion of construction loans           | 23,962                        |

In the normal course of business, the Company is involved in various legal proceedings. The amount of any liability that may result from those proceedings in which the Company is currently involved is expected to be immaterial to the consolidated financial position.

**NOTE 16 - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS**

Financial instruments for which fair value disclosures are required include cash and due from banks, interest-earning deposits with banks, investment securities, loans, Federal Home Loan Bank and Bankers Bank stock, accrued interest, deposits, borrowings, securities sold under agreements to repurchase, and junior subordinated debentures. Fair value estimates are made at a specific moment in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no active market readily exists for a portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

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### *Cash and Due from Banks and Interest-earning Deposits with Banks*

The carrying amounts for cash and due from banks and interest-earning deposits with banks approximate fair value because of the short maturities of those instruments.

### *Investment Securities*

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 16 - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)**

*Loans*

The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

*Non-marketable Equity Securities*

The carrying value of non-marketable equity securities approximates fair value.

*Accrued Interest Receivable and Payable*

The carrying amount is a reasonable estimate of fair value.

*Assets Held in Rabbi Trust*

The carrying value of assets held in rabbi trust approximates fair value.

*Deposits*

The fair value of demand deposits, savings, money market, and NOW accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting expected cash flows using the rates currently offered for instruments of similar remaining maturities.

*Borrowings, Securities Sold Under Agreements to Repurchase, Federal Funds Purchased and Junior Subordinated Debentures*

The fair values of borrowings and fixed rate junior subordinated debentures are based on discounting expected cash flows at the interest rate for debt with the same or similar remaining maturities and collateral requirements. Short-term borrowings, including securities sold under agreements to repurchase and federal funds purchased, are carried at approximate fair value because of the short maturities of those instruments.

*Financial Instruments with Off-Balance Sheet Risk*

With regard to financial instruments with off-balance sheet risk discussed in Note 15, it is not practicable to estimate the fair value of future financing commitments. The large majority of commitments to extend credit and standby letters of credit are at variable rates and/or have relatively short terms to maturity. Therefore, the fair value for these financial instruments is considered to be immaterial.

The carrying amounts and estimated fair values of the Company's financial instruments, none of which are held for trading purposes, are as follows at December 31, 2008 and 2007:

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|                                      | 2008            |                      | 2007            |                      |
|--------------------------------------|-----------------|----------------------|-----------------|----------------------|
|                                      | Carrying amount | Estimated fair value | Carrying amount | Estimated fair value |
| (Dollars in thousands)               |                 |                      |                 |                      |
| <b>Financial assets:</b>             |                 |                      |                 |                      |
| Cash and due from banks              | \$ 13,809       | \$ 13,809            | \$ 14,346       | \$ 14,346            |
| Interest-earning deposits with banks | 894             | 894                  | 930             | 930                  |
| Securities available for sale        | 71,262          | 71,262               | 75,012          | 75,012               |
| Securities held to maturity          | 1,768           | 1,760                | 1,770           | 1,804                |
| Loans, net                           | 418,368         | 416,999              | 387,219         | 389,718              |
| Accrued interest receivable          | 2,032           | 2,032                | 2,640           | 2,640                |
| Non-marketable equity securities     | 2,980           | 2,980                | 2,119           | 2,119                |
| Assets held in rabbi trust (SERP)    | 997             | 997                  |                 |                      |
| <b>Financial liabilities:</b>        |                 |                      |                 |                      |
| Deposits                             | 429,404         | 412,924              | 399,794         | 377,164              |
| Short-term borrowings                | 15,031          | 15,031               | 31,509          | 31,509               |
| Long-term debt                       | 37,986          | 24,523               | 17,995          | 18,186               |
| Accrued interest payable             | 698             | 698                  | 898             | 898                  |

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***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 16 - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)**

The Company adopted the provisions of SFAS 157, Fair Value Measurements effective January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

*Fair Value Hierarchy*

Under SFAS 157, the Company groups assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

*Investment Securities Available-for-Sale and Assets in Rabbi Trust*

Securities classified as available for sale are reported at fair value utilizing Level 1,2, and 3 inputs. For Level 1 assets, the Company obtains quoted stock prices for identical stocks traded in active markets. For Level 2 assets, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U. S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the bond s terms and conditions, among other things. For Level 3 securities, which include equity securities, the Company measures fair value based on unobservable data that may include net book value of stock and profitability trends, among other things.

*Interest Rate Floors*

Interest rate floors are reported at fair value utilizing Level 3 inputs. For these floors, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider unobservable data that may include discounted cash flow models, among other things.

The following table presents financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2008.

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| Description                              | December 31,<br>2008 | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) |     |    | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |
|--|----------------------|--|-----|----|---|---|
|  |                      | (in thousands)   |     |    |   |   |
| Assets:                                  |                      |  |     |    |   |   |
| Investment securities available for sale | \$ 71,262            | \$   | 3   | \$ | 70,356  | \$ 903  |
| Interest rate floors                     | 590                  |  |     |    |   | 590   |
| Assets in rabbi trust                    | 997                  |  | 985 |    | 12  |   |

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The following table reconciles the changes in Level 3 financial instruments measured at fair value on a recurring basis for the year ended December 31, 2008.

| Description                            | Investment<br>Securities<br>Available for Sale<br>(in thousands) | Interest Rate<br>Floor |
|--|--|------------------------|
| Balance at December 31, 2007           | \$ 903   | \$ 532                 |
| Total gains:                           |  |                        |
| Included in earnings                   |  | 237                    |
| Included in other comprehensive income |  |                        |
| Amortization                           |  | (179)                  |
| Balance at December 31, 2008           | \$ 903   | \$ 590                 |

The following table reflects the changes in fair values of Level 3 financial instruments measured on a recurring basis for the year ended December 31, 2008 and where these changes are included in the financial statements.

| Description           | Net interest<br>income | Non-interest<br>income - Other<br>(in thousands) | Total changes in<br>fair values<br>included in<br>earnings |
|-----------------------|------------------------|--|--|
| Interest rate floors: |                        |  |  |
| Change in fair value  | \$                     | \$ 237   | \$ 237   |
| Amortization          | (179)                  |  | (179)  |
| Total                 | \$ (179)               | \$ 237   | \$ 58  |

*Loans*

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and specific allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, Accounting by Creditors for Impairment of a Loan, (SFAS 114). The fair value of impaired loans is estimated using one of three methods, including collateral value, market value of similar debt, or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded

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investments in such loans. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. As of December 31, 2008, impaired loans of \$5,508,000 had a specific allowance of \$1,628,000, resulting in a fair value of \$3,880,000.

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The following table presents financial assets measured at fair value on a non-recurring basis as of December 31, 2008.

| Description               | December 31,<br>2008 | Quoted Prices in<br>Active<br>Markets<br>for Identical<br>Assets (Level<br>1) |  |    | Significant Other<br>Observable<br>Inputs (Level<br>2) | Significant<br>Unobservable<br>Inputs (Level 3) |
|---------------------------|----------------------|---|--|----|--|---|
|                           |                      | (in thousands)  |  |    |  |   |
| <b>Assets:</b>            |                      |   |  |    |  |   |
| Impaired loans and leases | \$ 3,880             | \$  |  | \$ |  | \$ 3,880  |

**NOTE 17 - EMPLOYEE AND DIRECTOR BENEFIT PLANS***401(k) Retirement Plan*

The Company has adopted a 401(k) retirement plan that covers all eligible employees. The Company matches contributions of up to 3.0% of each employee's salary. Expenses totaled \$114,000, \$105,000 and \$99,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

*Employment Agreement*

The Company has entered into employment agreements with certain officers to ensure a stable and competent management base. These agreements provide for terms ranging from three to five years, with automatic extension for an additional year at the end of the initial term and annually thereafter. The agreements provide for benefits as provided in the contract and cannot be terminated by the Board of Directors, except for cause, without prejudicing the officer's right to receive certain vested rights, including compensation. In the event of a change in control of the Company and in certain other events, as defined in the agreements, the Company or any successor to the Company will be bound to the terms of the contracts and certain change in control compensation payments would result, subject to contractual limitations.

**NOTE 18 - STOCK COMPENSATION PLANS**

The Company has five share-based compensation plans in effect at December 31, 2008. The compensation cost that has been charged against income for those plans was approximately \$50,000, \$52,000 and \$375,000 for the years ended December 31, 2008, 2007 and 2006, respectively. The Company recorded a deferred tax benefit in the amount of \$20,000 and \$123,000 related to share-based compensation during the years ended 2007 and 2006, respectively. There were no deferred tax benefits related to share-based compensation during the year ended December 31, 2008.

In 1999, the Company implemented the 1999 Incentive Stock Option Plan which authorized the Board of Directors to grant up to 246,191 of stock options (as adjusted for stock dividends) to employees and officers of the Company and the 1999 Non-statutory Stock Option Plan which authorized the Board of Directors to grant up to 246,191 of non-qualified stock options to directors. Options granted under the 1999 Stock Option Plans have a term of up to ten years from the date of grant. Vesting of options is determined at the time of grant and ranges from

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immediate to five years. Options under these plans must be granted at a price not less than the fair market value at the date of grant.

In 2001, the Company implemented the 2001 Incentive Stock Option Plan which authorized the Board of Directors to grant up to 210,300 of stock options (as adjusted for stock dividends) to employees and officers of the company. Options granted under the 2001 Stock Option Plan have a term of up to ten years from the date of grant. These options have a five year vesting period. Options under this plan must be granted at a price not less than the fair market value at the date of grant.

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In 2002, the Company implemented the 2002 Non-statutory Stock Option Plan which authorized the Board of Directors to grant up to 37,500 stock options (as adjusted for stock dividends) to directors of the Company. Options granted under the 2002 Non-Statutory

Stock Option Plans have a term of up to ten years from the date of grant. Vesting of options is three years. Options under this plan must be granted at a price not less than the fair market value at the date of grant.

In 2004, the Company acquired FNB Bancshares, Inc. ( First National ). First National had two stock option plans, the 1997 Incentive Stock Option Plan and the 1997 Non-statutory Stock Option Plan. At the acquisition date the plans had 133,162 and 160,577 options outstanding, respectively, which vested immediately.

*Stock Options*

The fair market value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. The Company granted 21,000, 15,000, and 98,000 stock options for the years ended December 31, 2008, 2007 and 2006, respectively, with a weighted average fair value of \$1.93, \$3.98, and \$4.52 per option, respectively.

Assumptions in estimating option values:

|                         | 2008    | 2007    | 2006    |
|-------------------------|---------|---------|---------|
| Risk-free interest rate | 3.08%   | 4.08%   | 4.83%   |
| Dividend yield          | 2.35%   | 1.77%   | 1.54%   |
| Volatility              | 23.13%  | 21.04%  | 30.24%  |
| Expected life           | 7 years | 7 years | 7 years |

The risk-free interest rate is based upon a U.S. Treasury instrument with a life that is similar to the expected life of the option grant. Expected volatility is based upon the historical volatility of the Company based upon the previous seven years trading history. The expected term of the options is based upon the average life of previously issued stock options. The expected dividend yield is based upon current yield on date of grant. No post-vesting restrictions exist for these options.

At December 31, 2008, there were 350,895 exercisable options with a weighted average exercise price of \$7.31. At December 31, 2007, there were 471,466 exercisable options with a weighted average exercise price of \$6.62. Of the total options outstanding at December 31, 2008 and 2007, the remaining average contractual lives were 2.42 and 3.44 years, respectively.

A summary of option activity under the stock option plans as of December 31, 2008 and 2007, and changes during the year ended December 31, 2008 and 2007 is presented below:

Shares

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|                                  |           | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual Term | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|-----------|--|--|---------------------------------|
| Outstanding at December 31, 2006 | 561,084   | \$ 7.00                                  | 4.28 years   | \$ 2,268,658                    |
| Exercised                        | (34,998)  | 6.03                                     |  |                                 |
| Authorized                       |           |  |  |                                 |
| Forfeited                        | (11,000)  | 10.77                                    |  |                                 |
| Granted                          | 15,000    | 11.73                                    |  |                                 |
| Outstanding at December 31, 2007 | 530,086   | \$ 7.12                                  | 3.44 years   | \$ 1,636,043                    |
| Exercised                        | (130,881) | 4.97                                     |  |                                 |
| Authorized                       |           |  |  |                                 |
| Forfeited                        | (25,500)  | 12.13                                    |  |                                 |
| Granted                          | 21,000    | 8.47                                     |  |                                 |
| Outstanding at December 31, 2008 | 394,705   | \$ 7.58                                  | 3.05 years   | \$ 1,257,694                    |
| Exercisable at December 31, 2008 | 350,895   | \$ 7.31                                  | 2.42 years   | \$ 1,207,934                    |

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For the years ended December 31, 2008, 2007 and 2006 the intrinsic value of options exercised was approximately \$430,000, \$191,000, and \$1,163,000, respectively.

The fair value of stock options vested over the years ended December 31, 2008, 2007 and 2006 was \$50,000, \$52,000, and \$375,000, respectively.

As of December 31, 2008, there was \$86,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all of the Company's stock benefit plans. That cost is expected to be recognized over a weighted-average period of 1.70 years.

The Company funds the option shares from authorized but unissued shares. Company policy does allow option holders to exercise options with seasoned shares.

The actual tax benefit in stockholders equity realized for the tax deductions from option exercise of the share-based payment arrangements totaled \$157,000, \$38,000 and \$170,000 for the years ended 2008, 2007 and 2006, respectively.

The adoption of SFAS 123R and its fair value compensation cost recognition provisions are different from the non-recognition provisions under SFAS 123 and the intrinsic value method for compensation cost allowed by APB 25. The effect (increase/(decrease)) of the adoption of SFAS 123R on cash flow activities for the years ended December 31, 2008, 2007 and 2006 is as follows:

|  | 2008           | 2007    | 2006     |
|--|----------------|---------|----------|
|  | (In thousands) |         |          |
| Cash flow from operating activities        | \$             | \$ (38) | \$ (170) |
| Cash flow provided by financing activities |                | 38      | 170      |

**NOTE 19 - DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES**

In the normal course of business, the Company enters into derivative contracts to manage interest rate risk by modifying the characteristics of the related balance sheet instruments in order to reduce the adverse effect of changes in interest rates. All derivative financial instruments are recorded at fair value in the consolidated financial statements.

On the date a derivative contract is entered into, the Company designates the derivative as a fair value hedge, a cash flow hedge, or a trading instrument. Changes in the fair value of instruments used as fair value hedges are accounted for in the earnings of the period simultaneous with accounting for the fair value change of the item being hedged. Changes in the fair value of the effective portion of cash flow hedges are accounted for in other comprehensive income rather than earnings. Changes in fair value of instruments that are not intended as a hedge are accounted for in the earnings of the period of the change.

If a derivative instrument designated as a fair value hedge is terminated or the hedge designation removed, the difference between a hedged item's then carrying amount and its face amount is recognized into income over the original hedge period. Likewise, if a derivative instrument designated as a cash flow hedge is terminated or the hedge designation removed, related amounts accumulated in other accumulated

comprehensive income are reclassified into earnings over the original hedge period during which the hedged item affects income.



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***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 19 - DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES (Continued)**

As of December 31, 2008, the Company had two derivative instruments with notional amounts of \$30.0 million and \$15.0 million, respectively. Both derivative instruments consist of an interest rate floor contract that is used to protect certain designated variable rate loans from the downward effects of their repricing in the event of a decreasing rate environment for a period of three years ending in February 2009 and June 2009, respectively. If the prime rate falls below 7.25% during the term of the first contract, the Company will receive payments based on the \$30.0 million notional amount times the difference between 7.25% and the daily weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.25% or higher. The Company paid a premium of \$228,000 on this contract, which is being amortized over the three-year term of the contract. Total payments received on the 7.25% floor were \$482,917 and \$-0- during 2008 and 2007, respectively and were recorded in other interest income. On the second floor, if the prime rate falls below 7.75% during the term of this contract, the Company will receive payments based on the \$15.0 million notional amount times the difference between 7.75% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.75% or higher. The Company paid a premium of \$95,250 on this contract. Total payments received on the 7.75% floor were \$374,167 and \$3,229 during 2008 and 2007, respectively and were recorded in other interest income. The interest rate floors are carried at a fair market value of \$589,566 and \$532,319 and are included in other assets as of December 31, 2008 and 2007, respectively.

As of March 31, 2007 the \$15.0 million, 7.75% interest rate floor contract no longer qualified as a cash flow hedge and the hedge designation was removed. As a result, amounts accumulated in the other accumulated comprehensive income of approximately \$6,000 at the beginning of the year were reclassified into earnings during the first quarter of 2007. Changes in fair value of the 7.75% interest rate floor are now accounted for in earnings for the period of the change. As of December 31, 2008, the \$30.0 million, 7.25% interest rate floor contract no longer qualified as a cash flow hedge and the hedge designation was removed. Approximately \$167,000 of other accumulated comprehensive income was reclassified into earnings at that time. Changes in fair value of the remaining hedged instrument on the 7.25% floor are now recorded to other income. For the year ended December 31, 2008, the Company recorded a \$224,000 gain in other income for the change in fair value of the 7.25% floor and a \$107,000 gain in other income for the change in fair value of the 7.75% interest rate floor. For the year ended December 31, 2007, the Company recorded a \$144,000 gain, net of tax in other comprehensive income for the effective portion of the 7.25% floor. The Company recorded a \$205,000 gain in other income during the year ended December 31, 2007 for the change in fair value of the 7.75% interest rate floor, and a \$9,250 gain in other income for the ineffective portion of the 7.25% hedged instrument. For the year ended December 31, 2006 the Company recorded a \$10,000 gain in other income for the ineffective portions of the 7.25% and 7.75% hedged instruments and an \$86,000 loss, net of tax in other comprehensive income for the effective portion of the floors.

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 20 - PARENT COMPANY FINANCIAL DATA**

Following are condensed financial statements of American Community Bancshares, Inc. as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007 and 2006.

**Condensed Statements of Financial Condition****December 31, 2008 and 2007**

|   | <b>2008</b>                   | <b>2007</b>      |
|---|-------------------------------|------------------|
|   | <b>(Dollars in thousands)</b> |                  |
| <b>Assets:</b>  |                               |                  |
| Cash and due from banks                                 | \$ 77                         | \$ 16            |
| Interest earning deposits with banks                    | 4,219                         | 8,757            |
| Investment in securities available for sale             | 904                           | 904              |
| Investment in American Community Bank                   | 53,711                        | 52,571           |
| Investment in American Community Capital Trust II, Ltd. | 310                           | 310              |
| Other assets  | 3,648                         | 1,981            |
| <b>Total Assets</b>                                     | <b>\$ 62,869</b>              | <b>\$ 64,539</b> |
| <b>Liabilities and Stockholders Equity:</b>             |                               |                  |
| <b>Liabilities:</b>                                     |                               |                  |
| Due to American Community Capital Trust II, Ltd.        | \$ 10,310                     | \$ 10,310        |
| Due to American Community Bank                          | 1,277                         |                  |
| Other liabilities                                       |                               | 205              |
| <b>Total Liabilities</b>                                | <b>11,587</b>                 | <b>10,515</b>    |
| <b>Stockholders Equity:</b>                             |                               |                  |
| Common stock  | 6,633                         | 6,502            |
| Additional paid-in capital                              | 33,090                        | 32,364           |
| Retained earnings                                       | 10,775                        | 14,744           |
| Accumulated other comprehensive income                  | 784                           | 414              |
| <b>Total stockholders equity</b>                        | <b>51,282</b>                 | <b>54,024</b>    |
| <b>Total Liabilities and Stockholders Equity</b>        | <b>\$ 62,869</b>              | <b>\$ 64,539</b> |

**Condensed Statements of Operations****Years Ended December 31, 2008, 2007 and 2006**

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|  | 2008                   | 2007     | 2006     |
|--|------------------------|----------|----------|
|  | (Dollars in thousands) |          |          |
| <b>Interest income:</b>  |                        |          |          |
| Dividends from subsidiary  | \$                     | \$ 4,999 | \$       |
| Interest-earning deposits with banks   | 416                    | 571      | 944      |
| Total interest income  | 416                    | 5,570    | 944      |
| <b>Interest expense:</b>   |                        |          |          |
| Junior subordinated debentures issued to American Community Capital Trust I and II | 663                    | 906      | 1,149    |
| <b>Non-interest income:</b>  |                        |          |          |
| Equity in undistributed earnings (loss) of American Community Bank                 | (2,437)                | 317      | 4,424    |
| <b>Non-interest expense:</b>   |                        |          |          |
| Professional fees  | 3                      | 34       | 14       |
| Other  | 84                     | 80       | 22       |
| Total non-interest expense   | 87                     | 114      | 36       |
| Income (loss) before taxes   | (2,771)                | 4,867    | 4,183    |
| Income tax benefit   | (114)                  | (153)    | (93)     |
| Net income (loss)  | \$ (2,657)             | \$ 5,020 | \$ 4,276 |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Years Ended December 31, 2008, 2007 and 2006****NOTE 20 - PARENT COMPANY FINANCIAL DATA (Continued)****Condensed Statements of Cash Flows****Years Ended December 31, 2008, 2007 and 2006**

|  | 2008                   | 2007     | 2006      |
|--|------------------------|----------|-----------|
|  | (Dollars in thousands) |          |           |
| Cash flows from operating activities:                            |                        |          |           |
| Net income (loss)  | \$ (2,657)             | \$ 5,020 | \$ 4,276  |
| Equity in undistributed (earnings) loss of subsidiary            | 2,437                  | (317)    | (4,424)   |
| Decrease (increase) in other assets                              | (1,667)                | 884      | (1,321)   |
| Increase (decrease) in other liabilities                         | (205)                  | 205      |           |
| Net cash provided (used) by operating activities                 | (2,092)                | 5,792    | (1,469)   |
| Cash flows from investing activities:                            |                        |          |           |
| Redemption of Capital Trust I stock                              |                        | 108      |           |
| Investment in securities available for sale                      |                        | (501)    |           |
| Investment in American Community Bank                            | (3,000)                |          |           |
| Net cash used by investing activities                            | (3,000)                | (393)    |           |
| Cash flows from financing activities:                            |                        |          |           |
| Advances from subsidiary   | 1,277                  |          |           |
| Redemption of junior subordinated deferrable interest debentures |                        | (3,608)  |           |
| Repurchase of common stock                                       |                        | (6,080)  | (263)     |
| Proceeds from issuance of common stock                           | 650                    | 211      | 912       |
| Cash dividends paid on common stock                              | (1,312)                | (1,348)  | (1,382)   |
| Net cash provided (used) by financing activities                 | 615                    | (10,825) | (733)     |
| Increase (decrease) in cash and cash equivalents                 | (4,477)                | (5,426)  | (2,202)   |
| Cash and cash equivalents, beginning                             | 8,773                  | 14,199   | 16,401    |
| Cash and cash equivalents, ending                                | \$ 4,296               | \$ 8,773 | \$ 14,199 |

**NOTE 21 - STOCK SPLIT**

On January 25, 2006, the Company declared a three-for-two stock split effected in the form of a 50% stock dividend to shareholders of record on February 7, 2006 and payable on February 21, 2006. All references to net income per share and weighted average shares outstanding have been adjusted for the effect of this stock split.

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 22 - QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

The following table sets forth, for the periods indicated selected information from our consolidated quarterly financial information. This information is derived from our unaudited financial statements, which include, in the opinion of management, all normal recurring adjustments which management considers necessary for a fair presentation of the results for such periods.

|  | Year ended December 31, 2008         |                  |                   |                  |
|--|--------------------------------------|------------------|-------------------|------------------|
|  | Fourth<br>Quarter                    | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
|  | (In thousands except per share data) |                  |                   |                  |
| Total interest income                                    | \$ 7,082                             | \$ 7,572         | \$ 7,569          | \$ 8,188         |
| Total interest expense                                   | 3,629                                | 3,568            | 3,629             | 3,873            |
| Net interest income                                      | 3,453                                | 4,004            | 3,940             | 4,315            |
| Provision for loan losses                                | 2,837                                | 1,441            | 296               | 425              |
| Net interest income after provision for loan losses      | 616                                  | 2,563            | 3,644             | 3,890            |
| Non-interest income                                      |                                      |                  |                   |                  |
| Service charges on deposit accounts                      | 525                                  | 593              | 597               | 602              |
| Mortgage banking operations                              | 35                                   | 43               | 95                | 86               |
| Gain (loss) on derivatives                               | 211                                  | (4)              | (148)             | 272              |
| Loss on SERP investment                                  | (105)                                | (397)            | (72)              | (19)             |
| Other  | (25)                                 | 51               | 68                | 78               |
| Total non-interest income                                | 641                                  | 286              | 540               | 1,019            |
| Non-interest expense                                     |                                      |                  |                   |                  |
| Salaries and employee benefits                           | 1,823                                | 1,873            | 1,639             | 1,743            |
| Occupancy and equipment                                  | 516                                  | 566              | 614               | 584              |
| Other than temporary impairment of investment securities | 128                                  | 2,753            |                   |                  |
| Merger related expenses                                  | 73                                   | 399              |                   |                  |
| Other  | 1,155                                | 1,109            | 1,190             | 1,044            |
| Total non-interest expense                               | 3,695                                | 6,700            | 3,443             | 3,371            |
| Income (loss) before income taxes                        | (2,438)                              | (3,851)          | 741               | 1,538            |
| Provision (benefit) for income taxes                     | (1,504)                              | (653)            | 257               | 547              |
| Net income (loss)  | \$ (934)                             | \$ (3,198)       | \$ 484            | \$ 991           |

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|                             |           |           |         |          |
|-----------------------------|-----------|-----------|---------|----------|
| Net income (loss) per share |           |           |         |          |
| Basic                       | \$ (0.14) | \$ (0.49) | \$ 0.07 | \$ 0.15  |
| Diluted                     | (0.14)    | (0.49)    | 0.07    | 0.15     |
| Common stock price          |           |           |         |          |
| High                        | \$ 10.29  | \$ 11.25  | \$ 9.00 | \$ 10.00 |
| Low                         | 7.02      | 5.00      | 6.15    | 7.09     |

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***Years Ended December 31, 2008, 2007 and 2006***NOTE 22 - QUARTERLY FINANCIAL INFORMATION (UNAUDITED) (Continued)**

|   | Year Ended December 31, 2007             |                  |                   |                  |
|---|--|------------------|-------------------|------------------|
|   | Fourth<br>Quarter                        | Third<br>Quarter | Second<br>Quarter | First<br>Quarter |
|   | (In thousands except for per share data) |                  |                   |                  |
| Total interest income                             | \$ 8,737                                 | \$ 9,070         | \$ 8,921          | \$ 8,698         |
| Total interest expense                            | 4,068                                    | 4,225            | 4,001             | 3,899            |
| Net interest income                               | 4,669                                    | 4,845            | 4,920             | 4,799            |
| Provision for loan losses                         | 471                                      | 156              | 231               | 183              |
| Net interest income after provision for loan loss | 4,198                                    | 4,689            | 4,689             | 4,616            |
| Non-interest income                               |  |                  |                   |                  |
| Service charges on deposit accounts               | 613                                      | 617              | 608               | 581              |
| Mortgage banking operations                       | 83                                       | 70               | 93                | 80               |
| Realized gains on sale of securities              |  | 3                |                   | 17               |
| Gain (loss) on economic hedge                     | 132                                      | 138              | (67)              | 11               |
| Other   | 73                                       | 133              | 88                | 118              |
| Total non-interest income                         | 901                                      | 961              | 722               | 807              |
| Non-interest expense                              |  |                  |                   |                  |
| Salaries and employee benefits                    | 1,724                                    | 1,768            | 1,743             | 1,658            |
| Occupancy and equipment                           | 505                                      | 560              | 564               | 565              |
| Other than temporary impairment                   |  |                  |                   | 76               |
| Other   | 1,132                                    | 1,121            | 1,175             | 1,103            |
| Total non-interest expense                        | 3,361                                    | 3,449            | 3,482             | 3,402            |
| Income before income taxes                        | 1,738                                    | 2,201            | 1,929             | 2,021            |
| Provision for income taxes                        | 626                                      | 801              | 707               | 735              |
| Net income  | \$ 1,112                                 | \$ 1,400         | \$ 1,222          | \$ 1,286         |
| Net income per share                              |  |                  |                   |                  |
| Basic   | \$ 0.17                                  | \$ 0.21          | \$ 0.18           | \$ 0.18          |
| Diluted   | 0.17                                     | 0.20             | 0.17              | 0.18             |



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|                    |          |          |          |          |
|--------------------|----------|----------|----------|----------|
| Common stock price |          |          |          |          |
| High               | \$ 12.84 | \$ 12.50 | \$ 12.30 | \$ 12.69 |
| Low                | 9.19     | 10.15    | 10.87    | 10.60    |

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***AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY***

***NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***

***Years Ended December 31, 2008, 2007 and 2006***

**NOTE 23 - SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN**

In July 2007, the Bank established a Supplemental Executive Retirement Plan ( SERP ), which is a nonqualified plan that provides additional retirement benefits to the Bank s chief executive officer. Under the terms of the SERP, upon retirement or the occurrence of certain other events, the Company will pay benefits to the Bank s chief executive officer in the form of a single cash lump sum payment. Benefits under the SERP vest at a rate of 10% per year beginning at age 53 and are fully vested at age 62. Compensation expense related to the plan was \$159,000 and \$53,000 for the years ended December 31, 2008 and 2007, respectively. The plan was funded in February, 2008 in the amount of \$1,590,000. The assets related to this plan are maintained in a rabbi trust and are included in other assets. The assets are accounted for at market value in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities , with the resulting gains or losses in value recorded in income. During the year ended December 31, 2008, the impact on net income as a result of the decline in fair value of the assets held in the rabbi trust was a charge of \$593,472. The assets had a market value of \$996,528 at December 31, 2008. The accrued liability related to this plan was \$132,870 at December 31, 2008.

**NOTE 24 - MERGER AGREEMENT**

On September 9, 2008, the Company entered into a definitive agreement to be acquired by Yadkin Valley Financial Corporation ( Yadkin Valley ). The Bank will become a wholly-owned division of Yadkin Valley operating under its current name. Pursuant to the agreement, the Company will merge with and into Yadkin Valley and each of the Company s shareholders will be entitled to receive in exchange for each share of the Company s common stock one of the following: (i) .8517 shares of Yadkin Valley common stock, (ii) \$12.35 in cash, or (iii) a combination of both stock and cash. In total, the merger consideration will be allocated as follows: 80.5% of the Company s outstanding shares of common stock will be exchanged for shares of Yadkin Valley common stock and 19.5% of the Company s outstanding shares of common stock will be exchanged for cash. The parties have received all regulatory approvals required for consummation of the merger, including approval of the Board of Governors of the Federal Reserve System, the North Carolina Commission of Banks and the Federal Deposit Insurance Corporation. The parties anticipate closing of the transaction during the second quarter of 2009.

**NOTE 25 - SUBSEQUENT EVENT**

On February 27, 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund. The Board took action by imposing a special assessment on insured institutions of 20 basis points, implementing changes to the risk-based assessment system, and increased regular premium rates for 2009, which banks must pay on top of the special assessment. The 20 basis point special assessment on the industry will be as of June 30, 2009 payable on September 30, 2009. As a result of the special assessment and increased regular assessments, the Company projects it will experience an increase in FDIC assessment expense by approximately \$1.8 million from 2008 to 2009. The 20 basis point special assessment represents \$1.2 million of this increase.

On March 5, 2009, the FDIC Chairman announced that the FDIC intends to lower the special assessment from 20 basis points to 10 basis points. The approval of the cutback is contingent on whether Congress clears legislation that would expand the FDIC s line of credit with the Treasury to \$100 billion. Legislation to increase the FDIC s borrowing authority on a permanent basis is also expected to advance to Congress, which should aid in reducing the burden on the industry. The assessment rates, including the special assessment, are subject to change at the discretion of the Board of Directors of the FDIC.

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### **ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

### **ITEM 9A CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

At the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-14.

Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective (1) to provide reasonable assurance that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities Exchange Act was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) to provide reasonable assurance that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

#### **Management's Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. Management has made a comprehensive review, evaluation and assessment of the Company's internal control over financial reporting as of December 31, 2008. In making its assessment of internal control over financial reporting, management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in Internal Control - Integrated Framework. In accordance with Section 404 of the Sarbanes - Oxley Act of 2002, management makes the following assertions:

Management has implemented a process to monitor and assess both the design and operating effectiveness of internal control over financial reporting.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Based on that assessment, we believe that, as of December 31, 2008, the company's internal control over financial reporting is effective based on those criteria.

Due to the Company's status as a Smaller reporting company there is no auditor attestation as to the effectiveness of the Company's internal controls over financial reporting as of December 31, 2008.

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**Changes in Internal Control over Financial Reporting**

Management of the Company has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, changes in the Company's internal controls over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act) during the fourth quarter of 2008. In connection with such evaluation, the Company has determined that there have been no changes in internal control over financial reporting during the fourth quarter that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Randy P Helton  
*President & Chief Executive Officer*

Dan R. Ellis, Jr.  
*Chief Financial Officer*

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**Table of Contents****ITEM 9B OTHER INFORMATION**

On March 24, 2009 the Company's Board of Directors voted to suspend payment of the Company's quarterly cash dividend. The Board concluded that it was more important to preserve capital than to pay a quarterly dividend. Suspending the dividend will save approximately \$325,000 per quarter or \$1.3 million annually in capital.

**PART III****ITEM 10 DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE****Board of Directors**

The Company's Bylaws provide that its board shall consist of between seven and twenty members. If there are more than nine members, the board shall be divided into three classes in as equal a number as possible. Such classes shall be elected to staggered three-year terms. The Board of Directors has set the number of directors of the Company at thirteen. The members of the Company's board of directors are set forth in the following table.

| Name and Age                    | Position(s) Held  | Director Term        |         | Principal Occupation and Business   |
|---------------------------------|---|----------------------|---------|---|
|                                 |   | Since <sup>(1)</sup> | Expires | Experience During Past Five Years   |
| Robert G. Dinsmore, Jr.<br>(64) | Lead Independent Director   | 2001                 | 2009    | Consultant, International Tax, Mergers and Acquisitions; Retired partner KPMG, LLP  |
| Frank L. Gentry<br>(66)         | Director  | 2002                 | 2010    | Independent Consultant; former Executive Vice President of Corporate Strategy and Development, Bank of America, Charlotte, NC, 1973-2000      |
| Philip R. Gilboy<br>(54)        | Director  | 2003                 | 2009    | President, PR Gilboy & Associates, Inc., Weddington, NC (NASD registered broker dealer)   |
| David J. Guilford<br>(60)       | Director  | 2003                 | 2009    | President, DLG Associates, Inc., Charlotte, NC (executive search firm)  |
| Thomas J. Hall<br>(61)          | Director  | 1998                 | 2011    | President, Hall Group, Inc., Charlotte, NC (real estate holding company)  |
| Larry S. Helms<br>(63)          | Director  | 1998                 | 2011    | Owner, Larry S. Helms and Associates, Monroe, NC (insurance)  |
| Randy P. Helton<br>(53)         | President, Chief Executive Officer (CEO), Director and Chairperson of the Company | 1998                 | 2011    | Chairman of the Board, President and Chief Executive Officer of the Company; President and Chief Executive Officer of American Community Bank |

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| Name and Age               | Position(s) Held  | Director             | Term    | Principal Occupation and Business   |
|----------------------------|---|----------------------|---------|---|
|                            |   | Since <sup>(1)</sup> | Expires | Experience During Past Five Years   |
| V. Stephen Moss<br>(59)    | Senior Vice President and South Carolina Regional Executive of the Bank, Director | 1995                 | 2011    | Senior Vice President and South Carolina Regional Executive of American Community Bank  |
| Peter A. Pappas<br>(47)    | Director  | 2003                 | 2009    | President and Managing Partner, Pappas Properties, LLC, Charlotte, NC (real estate development)   |
| L. Steven Phillips<br>(58) | Director  | 1998                 | 2011    | President Old South Landscape Services, LLC, Mt. Pleasant, SC (landscape contractor)  |
| Alison J. Smith<br>(54)    | Director  | 2000                 | 2010    | President, Smith Capital, Inc., Charlotte, NC (financial advisory, investment banking)  |
| David D. Whitley<br>(62)   | Director  | 1998                 | 2010    | President, Whitley Mortgage Associates, Inc., (mortgage broker) and Whitley Real Estate, Inc. (realty firm), Monroe, NC; Chairperson of the Board of Directors of American Community Bank |
| Gregory N. Wylie<br>(54)   | Director  | 1998                 | 2010    | Retired; former Chief Executive Officer, Metro Marketing, Inc., Charlotte, NC (specialty food brokerage)  |

<sup>(1)</sup> If applicable, includes prior service as director of American Community Bank or First National Bank of the Carolinas, which was acquired by the Company in 2004.

**Table of Contents****Executive Officers**

Set forth below is certain information regarding the executive officers of the Company.

| <b>Name</b>         | <b>Age</b> | <b>Employed Since</b>   | <b>Position With Company</b>   | <b>Business Experience</b>   |
|---------------------|------------|-------------------------|--|--|
| Randy P. Helton     | 53         | 04/15/98                | Chairman, President and CEO  | Chairman of the Board, President and CEO of the Company; President and CEO of American Community Bank. |
| V. Stephen Moss     | 59         | 10/01/95 <sup>(1)</sup> | Senior Vice President and South Carolina Regional Executive of American Community Bank | Former President and CEO of First National Bank of the Carolinas, Gaffney, South Carolina              |
| Dan R. Ellis, Jr.   | 53         | 08/31/98                | Senior Vice President, Chief Financial Officer and Corporate Secretary                 | Certified Public Accountant; Senior Vice President, Chief Financial Officer and Corporate Secretary    |
| William M. DeMarcus | 44         | 03/04/08                | Senior Vice President and Chief Banking Officer of American Community Bank             | Former Senior Vice President, Wachovia, Charlotte, NC  |
| Stephanie D. Helms  | 39         | 11/12/99                | Senior Vice President and Chief Administrative Officer                                 | Lifelong resident of Monroe, NC with 15 years of banking experience in Monroe and Charlotte markets    |

<sup>(1)</sup> Includes prior service as an officer of First National Bank of the Carolinas

Set forth below is certain information regarding American Community Bank's market area and other executive officers.

| <b>Name</b>         | <b>Age</b> | <b>Employed Since</b> | <b>Position With American Community Bank</b>                | <b>Business Experience</b>  |
|---------------------|------------|-----------------------|---|---|
| W. R. Randy Adcock  | 52         | 06/02/98              | Senior Vice President and Monroe City Executive             | Mr. Adcock, a lifelong resident of Monroe, NC, has 29 years of banking experience in the Bank's market.       |
| Steven L. Barnes    | 53         | 11/4/99               | Senior Vice President and Indian Trail City Executive       | Mr. Barnes, a lifelong resident of Indian Trail, NC, has 24 years of banking experience in the Bank's market. |
| Richard M. Cochrane | 56         | 02/19/99              | Senior Vice President and Matthews/Mint Hill City Executive | Mr. Cochrane, a lifelong resident of Mint Hill, NC, has 27 years of banking experience in the Bank's market.  |
| Jeff N. Coley       | 49         | 09/13/99              | Senior Vice President and Marshville City Executive         | Mr. Coley, a lifelong resident of Marshville, NC, has 26 years of banking experience in the Bank's market.    |

**Section 16(a) Beneficial Ownership Reporting Compliance**

Directors and executive officers of the Company are required by federal law to file reports with the Securities and Exchange Commission (SEC) regarding the amount of and changes in their beneficial ownership of the Company's common stock. To the best knowledge of the Company, all such ownership reports have been timely filed and the ownership status of the Company's common stock by such individuals is current.





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### **Meetings and Committees of the Board of Directors**

The Company's Board of Directors held eleven meetings in 2008. Each director attended 75% or more of the aggregate board and committee meetings of which he or she was a member.

It is the policy of the Company that directors attend each annual meeting and any special meetings of the Company's shareholders. All of the Company's directors attended the 2008 annual meeting of shareholders except for Gregory N. Wylie who was out of town on business.

The Company's Board of Directors has several standing committees including an Audit Committee, Nominating Committee and Compensation Committee.

*Audit Committee.* The members of the Audit Committee are Chairperson Robert G. Dinsmore, Jr., Frank L. Gentry, Philip R. Gilboy, Alison J. Smith and Gregory N. Wylie. The members of the Audit Committee are independent as defined by NASDAQ listing standards and the regulations promulgated under the Securities Exchange Act of 1934. The Audit Committee met five times during 2008. The Board of Directors has adopted a written Audit Committee Charter which is available at [www.americancommunitybank.com](http://www.americancommunitybank.com). The report of the Audit Committee is included in Item 14 of this annual report on Form 10-K and incorporated by reference herein.

*Nominating Committee.* The members of the Nominating Committee are Chairperson Alison J. Smith, Robert G. Dinsmore, Jr., Larry S. Helms, L. Steven Phillips, David D. Whitley, and Gregory N. Wylie. The Committee met once in 2008. The duties of the Nominating Committee include: (i) assisting the Board, on an annual basis, by identifying individuals qualified to become Board members, and recommending to the Board the director nominees for the next annual meeting of shareholders; (ii) assisting the Board in the event of any vacancy on the Board by identifying individuals qualified to become Board members, and recommending to the Board qualified individuals to fill any such vacancy; and (iii) recommending to the Board, on an annual basis, director nominees for each committee of the Board.

The Company's common stock is listed on the NASDAQ Capital Market and the members of the Nominating Committee are independent as defined by NASDAQ listing standards. The bylaws of the Company state that candidates may be nominated for election to the Board of Directors by the Nominating Committee or by any shareholder of the Company's common stock. It is the policy of the Nominating Committee to consider all shareholder nominations. Shareholder nominations must be submitted to the Nominating Committee in writing on or before September 30<sup>th</sup> of the year preceding the Annual Meeting at which the nominee would stand for election to the Board of Directors and must be accompanied by each nominee's written consent to serve as a director of the Company if elected. No shareholder nominations were received during the year. The bylaws of the Company require that all nominees for director, including shareholder nominees, have business, economic or residential ties to the Company's market area and have owned at least 1,000 shares of the Company's common stock for a period of twelve (12) months preceding the date of the nomination. In evaluating nominees for director, the Nominating Committee values community involvement and experience in finance or banking including prior service as an officer or director of an entity engaged in the financial services business, although such experience is not a prerequisite for nomination. The Board of Directors has adopted a written Nominating Committee Charter, which is available at [www.americancommunitybank.com](http://www.americancommunitybank.com).

*Compensation Committee.* The members of the Compensation Committee are Chairperson Gregory N. Wylie, Robert G. Dinsmore, Jr., Thomas J. Hall, Alison Smith and David D. Whitley. The Compensation Committee meets on an as needed basis to review the salaries and compensation programs required to attract and retain the Company's executive officers. The Compensation Committee met two times in 2008. The committee approves the compensation of the President and Chief Executive Officer and reporting officers to the President including the Chief Financial Officer, Chief Banking Officer, and Chief Administrative Officer. The salary of each of such reporting officers is determined based upon the recommendation by the President and Chief Executive Officer and such officer's experience, managerial effectiveness, contribution to the Company's overall profitability, maintenance of regulatory compliance standards and professional leadership. The Committee also compares the compensation of the Company's executive officers with compensation paid to executives of similarly situated bank holding companies,

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other businesses in the Company's market area and appropriate state and national salary data. The Committee is not bound by recommendations made by the President and Chief Executive Officer. Furthermore, the President and Chief Executive Officer does not have any input into his own compensation. The compensation committee engages third party compensation consultants on occasion to assist in determining executive pay or additional benefits, but does not delegate its duties. The Board of Directors has adopted a written Compensation Committee Charter which is available at [www.americancommunitybank.com](http://www.americancommunitybank.com).

The Company has adopted a code of ethics that applies, among others, to its principal executive officer and principal financial officer. The Company's code of ethics is available at [www.americancommunitybank.com](http://www.americancommunitybank.com).

## **ITEM 11 EXECUTIVE COMPENSATION**

### **Director Compensation**

*Board Fees.* During 2008, all non-employee directors received an annual retainer of \$10,000. In addition, all non-employee directors received \$500 for each board meeting attended and \$500 for each Committee meeting attended, with the exception of the Chairman of the Board of the Bank who received \$600 for each meeting chaired and Committee Chairpersons, who received \$600 for each committee meeting chaired.

*1999 Nonstatutory Stock Option Plan for Directors.* At the 1999 Annual Meeting the shareholders of the Bank approved the 1999 Nonstatutory Stock Option Plan for Directors (the "1999 Nonstatutory Option Plan") pursuant to which options covering 246,191 shares of the Bank's common stock were available for issuance to members of the Board of Directors and the board of any subsidiary. In connection with the reorganization of the Bank into the holding company form which resulted in the creation of the Company, the Nonstatutory Option Plan was adopted by the Company and options under such plan are now options of the Company. On April 14, 1999, all options were granted under the 1999 Nonstatutory Option Plan at the exercise price of \$11.00 per share which was the fair market value on the date of grant. The original exercise price is currently \$5.55 per share as a result of a 20% stock dividend in 1999, 10% stock dividend in 2002 and a 50% stock dividend in 2006. Another 69,000 of the original options issued were forfeited and reissued on April 26, 2006 at the exercise price of \$12.98 per share which was the fair market value on the date of grant. All but 5,080 of these options have been granted and there are currently 127,706 options outstanding with a weighted average exercise price of \$8.98 per share which was the fair market value on the date of grant adjusted for stock dividends.

*2002 Nonstatutory Stock Option Plan.* At the 2002 Annual Meeting, the shareholders of the Company approved the 2002 Nonstatutory Stock Option Plan (the "2002 Nonstatutory Option Plan") pursuant to which options covering 37,500 shares of the Company's common stock were available for issuance to members of the Board of Directors and the board of any subsidiary. All but 1,500 of these options have been granted and there are currently 19,500 options outstanding with a weighted average exercise price of \$6.64 per share which was the fair market value on the date of grant adjusted for stock dividends.

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The following table presents a summary of all compensation paid by the Company to its directors for their service as such during the year ended December 31, 2008.

**DIRECTOR COMPENSATION TABLE**

|                                | Fees Earned<br>or Paid in<br>Cash | Stock Awards | Option<br>Awards <sup>(1)</sup> | All Other<br>Compensation | Total      |
|--------------------------------|-----------------------------------|--------------|---------------------------------|---------------------------|------------|
| Robert G. Dinsmore, Jr.        | \$ 30,700                         | \$           | \$                              | \$                        | \$ 30,700  |
| Frank L. Gentry                | 23,300                            |              |                                 |                           | 23,300     |
| Philip Gilboy                  | 22,900                            |              |                                 |                           | 22,900     |
| David J. Guilford              | 27,300                            |              |                                 |                           | 27,300     |
| Thomas J. Hall                 | 23,500                            |              |                                 |                           | 23,500     |
| Larry S. Helms                 | 22,800                            |              |                                 |                           | 22,800     |
| Randy P. Helton <sup>(2)</sup> |                                   |              |                                 |                           |            |
| V. Stephen Moss <sup>(2)</sup> |                                   |              |                                 |                           |            |
| Peter A. Pappas                | 20,200                            |              |                                 |                           | 20,200     |
| L. Steven Phillips             | 15,800                            |              |                                 |                           | 15,800     |
| Alison J. Smith                | 24,600                            |              |                                 |                           | 24,600     |
| David D. Whitley               | 28,600                            |              |                                 |                           | 28,600     |
| Gregory N. Wylie               | 25,000                            |              |                                 |                           | 25,000     |
| Total                          | \$ 264,700                        | \$           | \$                              | \$                        | \$ 264,700 |

(1) Expense calculated in accordance with FAS 123R. The assumptions used in estimating the fair value of options are set forth in note 18 to the Company's audited consolidated financial statements at December 31, 2008.

(2) Compensation paid to Mr. Helton in connection with his service as President and Chief Executive Officer of the Company and Mr. Moss as Senior Vice President of the Company is presented in the Summary Compensation Table below.

**EXECUTIVE COMPENSATION**

*Employment Agreements.* American Community Bank has entered into an employment agreement with Randy P. Helton, President and Chief Executive Officer (dated April 15, 1998), to establish his duties and compensation and to provide for his continued employment with the Bank. The employment agreement provided for an initial term of employment of five years. The term automatically renews for an additional year at the end of each year unless notice of termination is received prior to renewal. The employment agreement provides for an annual base salary to be reviewed by the Board of Directors not less often than annually. In addition, the employment agreement provides for discretionary bonuses, participation in other pension and profit-sharing retirement plans maintained by the Bank on behalf of its employees, as well as fringe benefits normally associated with the officer's office or made available to all other employees. The employment agreement provides that the officer may be terminated for cause, as defined in the employment agreement, by the Bank, and otherwise be terminated by the Bank (subject to vested rights) or by the officer. The employment agreement provides that in the event of a termination event following a change in control of the Bank (i) the employee shall be able to terminate the agreement and receive 299% of his base amount of compensation and (ii) the term of the agreement shall be not less than 36 months from the employee's notice of termination of the agreement. A termination event will occur if (i) the employee is assigned any duties or responsibilities that are inconsistent with his position, duties, responsibilities or status at the time of the change in control or with his reporting responsibilities or title with the Bank in effect at the time of the change in control; (ii) the employee's annual base salary rate is reduced below the annual amount in effect as of the change in control; (iii) the employee's life insurance, medical or hospitalization insurance, disability insurance, stock option plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the employee as of the date of the change in control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the

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Bank who participated in such benefits prior to the change in control; or (iv) the employee is transferred to a location outside of Charlotte, North Carolina without the employee's express written consent. A change in control of the Bank will occur if (i) any individual or entity, directly or indirectly, acquires beneficial ownership of voting securities or acquires irrevocable proxies or any combination of voting securities and irrevocable proxies, representing 25% or more of any class of voting securities of the Bank, or acquires control in any manner of the election of a majority of the directors of the Bank; (ii) the Bank is consolidated or merged with or into another corporation, association or entity where the Bank is not the surviving corporation; or (iii) all or substantially all of the assets of the Bank are sold or otherwise transferred to or are acquired by any other corporation, association or other person, entity or group.

American Community Bank has also entered into an employment agreement with V. Stephen Moss, Senior Vice President and South Carolina Regional Executive of the Bank (dated April 15, 2004), to establish his duties and compensation and to provide for his continued employment with the Bank. The employment agreement provided for an initial term of employment of three years. The term automatically renews for an additional year at the end of each year of the term unless notice of termination is received prior to such renewal. The employment agreement provides for an annual base salary to be reviewed by the Board of Directors not less often than annually. In addition, the employment agreement provides for discretionary bonuses, participation in other pension and profit sharing retirement plans maintained by the Bank on behalf of its employees, as well as fringe benefits normally associated with Mr. Moss's office or made available to all other employees. The employment agreement provides that Mr. Moss may be terminated, by the Bank, for cause as defined in the employment agreement and further provides that the employment agreement may otherwise be voluntarily terminated by Mr. Moss or by the Bank (subject to vested rights). The employment agreement also provides that in the event of a termination event following a change of control of the Bank (i) Mr. Moss shall be able to terminate his employment agreement and receive 200% of his base amount of compensation. The definitions of the terms change of control and termination event under Mr. Moss' employment agreement are substantially identical to the definitions of those terms in Mr. Helton's employment agreement, which is summarized above.

American Community Bank has also entered into a change of control agreement with Stephanie D. Helms, Senior Vice President and Chief Administrative Officer of the Company and Dan R. Ellis, Jr, Senior Vice President and Chief Financial Officer. The change of control agreements provide that in the event of a termination event following a change of control of the Bank Ms. Helms and Mr. Ellis shall be able to receive 200% of their base amount of compensation. The definitions of the terms change of control and termination event under Ms. Helms' and Mr. Ellis' change of control agreements are substantially identical to the definitions of those terms in Mr. Helton's employment agreement, which is summarized above.

American Community Bank has also entered into a change of control agreement with William M. DeMarcus, Senior Vice President and Chief Banking Officer of the Company. The change of control agreement provides that in the event of a termination event following a change of control of the Bank Mr. DeMarcus shall be able to receive 100% of his base amount of compensation. The definitions of the terms change of control and termination event under Mr. DeMarcus' change of control agreement are substantially identical to the definitions of those terms in Mr. Helton's employment agreement, which is summarized above.

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The following table shows all compensation paid to or received by Randy P. Helton, Dan R. Ellis, Jr., V. Stephen Moss, William M. DeMarcus, and Stephanie D. Helms (the Named Executive Officers ) for services rendered in all capacities during the fiscal year ended December 31, 2008.

**SUMMARY COMPENSATION TABLE**

| Name and<br>Principal Position   | Year | Salary     | Option<br>Awards <sup>(1)</sup> | Non-Equity<br>Incentive<br>Plan<br>Compensation | Change in<br>Pension<br>Value<br>and<br>Nonqualified<br>Deferred<br>Compensation<br>Earnings | All Other<br>Compensation <sup>(2)</sup> | Total      |
|--|------|------------|---------------------------------|---|--|--|------------|
| Randy P. Helton,<br>Chairman of the Board, President and CEO of the<br>Company and President and CEO of the Bank | 2008 | \$ 325,000 | \$                              | \$  | \$   | \$ 9,965                                 | \$ 334,965 |
|  | 2007 | 280,000    |                                 | 80,000  |  | 8,807                                    | 368,807    |
|  | 2006 | 265,200    | 3,419                           | 67,000  |  | 8,025                                    | 343,644    |
| Dan R. Ellis, Jr.<br>Senior Vice President, Chief Financial Officer and<br>Corporate Secretary of the Company    | 2008 | 160,000    |                                 |   |  | 5,945                                    | 165,945    |
|  | 2007 | 140,000    |                                 | 32,000  |  | 5,202                                    | 177,202    |
|  | 2006 | 115,500    |                                 | 23,000  |  | 4,529                                    | 143,029    |
| V. Stephen Moss,<br>Senior Vice President and South Carolina Regional<br>Executive of the Bank                   | 2008 | 149,000    |                                 |   |  | 4,513                                    | 153,513    |
|  | 2007 | 142,000    |                                 |   |  | 5,198                                    | 147,198    |
|  | 2006 | 135,200    |                                 | 10,000  |  | 4,530                                    | 149,730    |
| William M. DeMarcus,<br>Senior Vice President and Chief Banking Officer<br>of the Bank                           | 2008 | 175,000    | 3,095                           | 47,062  |  | 270                                      | 225,427    |
|  | 2007 |            |                                 |   |  |  |            |
|  | 2006 |            |                                 |   |  |  |            |
| Stephanie D. Helms,<br>Senior Vice President and Chief Administrative<br>Officer of the Bank                     | 2008 | 115,000    |                                 |   |  | 2,042                                    | 117,042    |
|  | 2007 | 98,050     |                                 | 19,000  |  | 2,243                                    | 119,293    |
|  | 2006 | 92,500     |                                 | 19,000  |  | 2,148                                    | 113,648    |

(1) Expense calculated in accordance with FAS 123R. The assumptions used in estimating the fair value of options are set forth in note 18 to Company's audited consolidated financial statements at December 31, 2008.

(2) Includes life insurance premiums and contributions to 401(k) Plan.

**Table of Contents****Stock Options**

*1999 Incentive Stock Option Plan.* The shareholders previously approved the 1999 Incentive Stock Option Plan (the 1999 Incentive Option Plan ) pursuant to which options are available for issuance to officers and key employees of the Company and any of its subsidiaries. In connection with the reorganization of the Bank into the holding company form of organization, which resulted in the organization of the Company, the 1999 Incentive Option Plan was adopted by the Company and options under such plan are now options of the Company.

*2001 Incentive Stock Option Plan.* The shareholders approved the 2001 Incentive Stock Option Plan (the 2001 Incentive Option Plan ) at the 2001 annual meeting. The 2001 Incentive Option Plan also provides for the issuance of incentive stock options to officers and key employees of the Company and any of its subsidiaries. The plan originally provided for the grant of stock options covering up to 135,300 shares of the Company's common stock. At the 2005 Annual Meeting of Shareholders, the shareholders approved an amendment to the 2001 Incentive Stock Option Plan authorizing stock options covering an additional 75,000 shares of the Company's stock.

All stock options under the Company's incentive option plans are granted with a per share exercise price equal to 100% of the fair market value of the Company's common stock. The per share exercise price may then be adjusted in response to certain corporate actions, such as stock dividends and stock splits. For example, the option exercise prices in the table below have been adjusted for the effect of the 1999 20% stock dividend, the 2002 10% stock dividend, and the 2006 50% stock split where applicable.

Stock options were granted to William M. DeMarcus during the fiscal year ended December 31, 2008. Disclosed in the following table are the threshold, target and maximum incentive payments which each of the Named Executive Officers could realize under the Company's non-equity incentive plan upon attainment of stated corporate and individual goals under the plan.

**GRANTS OF PLAN BASED AWARDS****Estimated Future Payouts Under Non-Equity****Incentive Plan Awards**

| <b>Name</b>         | <b>Grant Date</b> | <b>Threshold</b> | <b>Target</b> | <b>Maximum</b> | <b>All other Stock Awards; Number of Shares of Stock or Units</b> | <b>All other Option Awards; Number of Securities Underlying Options</b> | <b>Exercise or Base Price of Option Awards</b> |
|---------------------|-------------------|------------------|---------------|----------------|---|---|--|
| Randy P. Helton     |                   | \$ 20,000        | \$ 130,000    | \$ 168,000     |   |   |  |
| Dan R. Ellis, Jr.   |                   | 10,000           | 40,000        | 56,000         |   |   |  |
| V. Stephen Moss     |                   | 10,000           | 37,250        | 52,150         |   |   |  |
| William M. DeMarcus |                   | 10,000           | 43,750        | 61,250         |   | 10,000  | \$ 8.70  |
| Stephanie D. Helms  |                   | 10,000           | 28,750        | 40,250         |   |   |  |

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The following table sets forth information regarding vested and unvested incentive stock options as of December 31, 2008. With the exception of Mr. Ellis and Mr. Helton, each of the Named Executive Officers had unexercisable stock options as of December 31, 2008. Incentive stock options granted by the Company are subject to a five-year vesting schedule, with 20% vesting on each anniversary of the option grant date. Option exercise prices reported below have been adjusted for the effect of all stock dividends occurring subsequent to the option grant date. The Company has not adopted any plan providing for the grant of restricted stock or long-term compensation units to employees and, accordingly, there is no information reported in the four columns on the right hand side of the table below.

**OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END**

| Name                | No. of Securities Underlying Unexercised Options Exercisable | No. of Securities Underlying Unexercised Options Unexercisable | Equity Incentive Plan Awards; No. of Securities Underlying Unexercised Options | Option Exercise Price <sup>(1)</sup> | Option Expiration Date | No. of Shares or Units of Stock That Have Not Vested | Market Value of Shares or Units of Stock That Have Not Vested | Equity Incentive Plan Awards; No. of Unearned Shares, Units or Other Rights That Have Not Vested | Equity Incentive Plan Awards; Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested |
|---------------------|--|--|--|--------------------------------------|------------------------|--|---|--|---|
| Randy P. Helton     | 89,178   | -0-  |  | \$ 5.55                              | 04/14/09               |  |   |  |   |
|                     | 12,041   | 3,010  |  | 8.92                                 | 04/24/14               |  |   |  |   |
|                     | 2,000  | 3,000  |  | 12.98                                | 04/25/16               |  |   |  |   |
| Dan R. Ellis, Jr.   | 12,824   | -0-  |  | 5.55                                 | 04/14/09               |  |   |  |   |
| V. Stephen Moss     | 12,000   | 3,000  |  | 8.83                                 | 04/16/14               |  |   |  |   |
| William M. DeMarcus | -0-  | 10,000   |  | 8.70                                 | 03/18/18               |  |   |  |   |
| Stephanie D. Helms  | 825  | -0-  |  | 6.33                                 | 02/20/11               |  |   |  |   |
|                     | 2,475  | -0-  |  | 4.70                                 | 07/18/11               |  |   |  |   |
|                     | 6,000  | 1,500  |  | 8.92                                 | 04/24/14               |  |   |  |   |

<sup>(1)</sup> As adjusted for stock dividends and stock split.

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The following table sets forth information regarding stock options exercised by the Named Executive Officers during the fiscal year ended December 31, 2008. Mr. Helton and Mr. Ellis exercised stock options covering 9,201 and 4,500 shares, respectively, of the Company's common stock during the year at a per share exercise price of \$5.55 per share.

**OPTION EXERCISES AND STOCK VESTED**

| Name                | Option Awards                               |                               | Stock Awards                               |                              |
|---------------------|---|-------------------------------|--|------------------------------|
|                     | Number of Shares<br>Acquired<br>on Exercise | Value Realized on<br>Exercise | Number of Shares<br>Acquired<br>on Vesting | Value Realized<br>on Vesting |
| Randy P. Helton     | 9,201                                       | \$ 28,328                     |  |                              |
| Dan R. Ellis, Jr.   | 4,500                                       | 10,506                        |  |                              |
| V. Stephen Moss     |   |                               |  |                              |
| William M. DeMarcus |   |                               |  |                              |
| Stephanie D. Helms  |   |                               |  |                              |

**Supplemental Retirement Plan**

In October 2007, the Company implemented a non-qualified supplemental retirement benefit plan (SERP) for selected executive officers. At December 31, 2008 the only executive officer designated to receive benefits under the SERP was Randy P. Helton. The Company may, however, designate other executive officers to receive benefits under the SERP in the future. The SERP is designed to provide a retirement benefit to plan participants at their normal retirement dates and upon the occurrence of certain other events. The plan was implemented because limits on qualified plan contributions and distributions, as well as Social Security, often limit bank executives' retirement benefits to 30% to 50% of final pay. In contrast, other bank staff are unaffected, or less severely affected, by such limits. An arrangement such as the SERP can remedy the shortfall in executive retirement compensation and deliver retirement benefits commensurate with bank executives' final pay.

Under the terms of the SERP, upon retirement or the occurrence of certain other events, the Company will pay benefits to plan participants in the form of a single cash lump sum payment. Benefits under the SERP vest at a rate of 10% per year beginning at age 53 and are fully vested at age 62. At retirement on or after age 53, the Company will pay the vested benefits to the participating officer. In the case of disability or death prior to retirement which results in termination of the officer's employment, the full benefit is payable within 90 days. The full benefit is also payable upon termination of employment for good reason following a change of control of the Company. As of December 31, 2008, Mr. Helton's participation in the SERP would have entitled him to a lump sum payment of \$996,528, had he terminated his employment for good reason following a change in control of the Company or had his employment terminated due to death or disability. No benefits are payable at any time to a participant that has been terminated for cause.



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Participants' benefits under the SERP are unfunded and are not intended to constitute a tax-qualified retirement plan under Section 401(a) of the Internal Revenue Code of 1986, as amended. As of December 31, 2008, Randy P Helton had \$99,652 vested benefits under the plan.

| Name                | Plan Name | Number of Years Credited Service | Present Value of Accumulated Benefit | Payments During Last Fiscal Year |
|---------------------|-----------|----------------------------------|--------------------------------------|----------------------------------|
| Randy P. Helton     | SERP      | 1                                | \$ 99,652                            | \$ -0-                           |
| Dan R. Ellis, Jr.   |           |                                  |                                      |                                  |
| V. Stephen Moss     |           |                                  |                                      |                                  |
| William M. DeMarcus |           |                                  |                                      |                                  |
| Stephanie D. Helms  |           |                                  |                                      |                                  |

**Stock Splits**

The Company has had three stock splits since opening as follows:

1999 five-for-four stock split in the form of a 20% stock dividend paid in December 1999

2002 eleven-for-ten stock split in the form of a 10% stock dividend paid in January 2002

2006 two-for-one stock split in the form of a 50% stock dividend paid in February 2006

**401(k) Savings Plan**

In 1999, the Bank adopted a tax-qualified plan (the Savings Plan) which covers all current, full-time employees and any new full-time employees who have been employed for twelve months and who have attained the age of twenty-one. Under the Savings Plan, a participating employee may contribute up to 20% of his or her base salary (up to the maximum allowed by law) on a tax-deferred basis through salary reduction as permitted under Section 401(k) of the Internal Revenue Code of 1986, as amended (the Code). The Bank is permitted to make contributions equal to 50% of the employees' contributions up to a maximum equal to 3% of the employee's aggregate compensation. The employer contributions vest completely after six years of service. The Bank may make additional discretionary contributions that also vest completely after six years of service with the Bank. The value of a participant's accounts under the Savings Plan becomes payable to him or her according to the vesting schedule upon retirement, total or permanent disability or termination of employment for any other reason, or becomes payable to a designated beneficiary upon a participant's death. The Savings Plan also contains provisions for withdrawals in the event of certain hardships. A participant's contributions, matching contributions and discretionary contributions of the Bank, and any income accrued on such contributions, are not subject to federal or state taxes until such time as the participant withdraws them.

**ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS****Voting Securities**

The voting securities of the Company are the shares of its common stock, par value \$1.00 per share, of which 25,000,000 shares are authorized and preferred stock, no par value, of which 1,000,000 shares are authorized. At March 24, 2009, there were 6,651,295 shares of common stock and no shares of preferred stock outstanding. There are approximately 2,500 holders of record of the Company's common stock.

**Table of Contents****Ownership of Voting Securities**

As of March 24, 2009, there were no shareholders known to management to own more than 5% of the Company's common stock, except those listed below.

| NAME AND ADDRESS<br>OF BENEFICIAL OWNER | AMOUNT AND NATURE OF<br>BENEFICIAL OWNERSHIP | PERCENTAGE<br>OF CLASS |
|---|--|------------------------|
| Marla Braun<br>Coral Gables, FL         | 474,807                                      | 7.14                   |

As of March 24, 2009 the beneficial ownership of the Company's common stock, by directors and executive officers individually, and by directors and executive officers as a group, was as follows:

| NAME AND ADDRESS<br>OF BENEFICIAL OWNER                            | AMOUNT AND NATURE OF<br>BENEFICIAL OWNERSHIP <sup>(1)(2)</sup> | PERCENT OF<br>CLASS <sup>(3)</sup> |
|--|--|------------------------------------|
| William M. DeMarcus<br>Cornelius, NC                               | 2,202  | *                                  |
| Robert G. Dinsmore, Jr.<br>Charlotte, NC                           | 19,430   | *                                  |
| Dan R. Ellis, Jr.<br>Monroe, NC                                    | 32,017 <sup>(4)</sup>  | *                                  |
| Frank L. Gentry<br>Charlotte, NC                                   | 15,500   | *                                  |
| Philip R. Gilboy<br>Waxhaw, NC                                     | 19,366   | *                                  |
| David J. Guilford<br>Charlotte, NC                                 | 16,250   | *                                  |
| Thomas J. Hall<br>Charlotte, NC                                    | 51,403   | *                                  |
| Larry S. Helms<br>Monroe, NC                                       | 25,140   | *                                  |
| Stephanie D. Helms<br>Monroe, NC                                   | 12,669   | *                                  |
| Randy P. Helton<br>Charlotte, NC                                   | 150,457 <sup>(5)</sup>   | 2.23                               |
| V. Stephen Moss<br>Blacksburg, SC                                  | 39,242   | *                                  |
| Peter A. Pappas<br>Charlotte, NC                                   | 13,250   | *                                  |
| L. Steven Phillips<br>Isle of Palms, SC                            | 75,030   | 1.13                               |
| Alison J. Smith<br>Charlotte, NC                                   | 63,521   | *                                  |
| David D. Whitley<br>Monroe, NC                                     | 30,281 <sup>(6)</sup>  | *                                  |
| Gregory N. Wylie<br>Waxhaw, NC                                     | 78,041   | 1.17                               |
| All Directors and Executive<br>Officers as a Group<br>(16 persons) | 644,949  | 9.37                               |

- (1) Except as otherwise noted, to the best knowledge of the Company's management, the above individuals and group exercise sole voting and investment power with respect to all shares shown as beneficially owned other than the following shares as to which such powers are shared: Mr. Dinsmore 8,100 shares, Mr. Ellis 13,599, Mr. Guilford 330 shares, Mr. Moss 20,000, and Mr. Whitley 3,460 shares.
- (2) Included in the beneficial ownership tabulations are the following options to purchase shares of common stock of the Company: Mr. DeMarcus 2,000, Mr. Dinsmore 5,000, Mr. Ellis 12,824, Mr. Gentry 5,000, Mr. Gilboy 5,000, Mr. Guilford 9,500, Mr. Hall 5,000, Mr. Helms 5,000, Ms. Helms 9,300, Mr. Helton 101,419, Mr. Moss 12,000, Mr. Pappas 9,500, Mr. Phillips 10,694, Ms. Smith 5,000, Mr. Whitley 5,000, and Mr. Wylie 30,327, and an aggregate of 232,564 options for the group.
- (3) The calculation of the percentage of class beneficially owned by each individual and the group is based on the sum of (i) 6,651,295 shares of common stock outstanding as of March 24, 2009, and (ii) options exercisable within 60 days of March 24, 2009 for the individual and the group.
- (4) Includes 1,974 shares owned by Mr. Ellis's spouse

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- (5) Includes 1,565 shares owned by Mr. Helton's spouse.
- (6) Includes 7,263 shares owned by Mr. Whitley's spouse.

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Set forth below is certain information regarding the Registrant's various stock option plans.

| <b>Plan Category</b>                                       | <b>Number of securities to be issued upon exercise of outstanding options, warrants, and rights<br/>(a)</b> | <b>Weighted-average exercise price of outstanding options, warrants, and rights<br/>(b)</b> | <b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br/>(c)</b> |
|--|---|---|--|
| Equity compensation plans approved by security holders     | 1999 Incentive:   |   |  |
|  | 169,600   | \$6.02  | 862  |
|  | 1999 Non-statutory:   |   |  |
|  | 127,704   | \$8.98  | 5,080  |
|  | 2001 Incentive:   |   |  |
|  | 77,901  | \$8.91  | 67,685   |
|  | 2002 Non-statutory:   |   |  |
|  | 19,500  | \$6.64  | 1,500  |
| Equity compensation plans not approved by security holders | None  | None  | None   |
| <b>Total</b>   | <b>394,705</b>  | <b>\$7.58</b>   | <b>75,127</b>  |

**ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE****Director Independence**

With the exception of Mr. Helton and Mr. Moss, each member of the Company's Board of Directors is independent as defined by NASDAQ listing standards and the regulations promulgated under the Securities Exchange Act of 1934 (the Exchange Act). In making this determination, the Board considered all insider transactions with directors for the provision of goods or services to the Company or the Bank. All such transactions were conducted at arm's length upon terms no less favorable than those that would be available from an independent third party.

**Director Relationships**

No director is a director of any company with a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 or subject to the requirements of Section 15(d) thereof, or any company registered as an investment company under the Investment Company Act of 1940.

**Lead Independent Director**

The board has long recognized the importance of independent leadership on the board, as evidenced by its designation of a lead independent director in 2004. The independent directors elect the lead independent director, and in January 2008, the independent directors elected Mr. Dinsmore to continue in his role as the board's lead independent director. The duties and responsibilities of the lead independent director include the following:

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assisting the Chairman of the Board with board-related matters, including approving board meeting agendas, board meeting schedules and various information sent to the board;

serving as the principal liaison between the independent directors and the Chairman of the Board;

presiding at any meetings of the non-employee directors or independent directors or at any meetings of the board at which the Chairman of the Board is not present, and

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any other duties or responsibilities that may be requested by the independent directors or the Chairman of the Board, including, as the lead independent director deems appropriate, calling any meetings of the non-employee directors or independent directors or meeting with any of the Company’s executive officers, stockholders or other constituents.

**Indebtedness of and Transactions with Management**

The Company has had, and expects to have in the future, banking transactions in the ordinary course of business with certain of its current directors, nominees for director, executive officers and their associates. All loans included in such transactions were made on substantially the same terms, including interest rates, repayment terms and collateral, as those prevailing at the time such loans were made for comparable transactions with other persons, and do not involve more than the normal risk of collectibility or present other unfavorable features.

Loans made by either American Community Bank to directors and executive officers are subject to the requirements of Regulation O of the Board of Governors of the Federal Reserve System. Regulation O requires, among other things, prior approval of the Board of Directors with any interested director not participating, dollar limitations on amounts of certain loans and prohibits any favorable treatment being extended to any director or executive officer in any of the bank’s lending matters. To the best knowledge of the management of the Company and the bank, Regulation O has been complied with in its entirety.

**ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The Audit Committee of the Board of Directors has appointed the firm of Dixon Hughes PLLC, Certified Public Accountants, as the Company’s independent registered public accounting firm for 2009. A representative of Dixon Hughes PLLC is expected to be present at the Annual Meeting and available to respond to appropriate questions, and will have the opportunity to make a statement if he desires to do so.

The Company has paid Dixon Hughes PLLC fees in connection with its assistance in the Company’s annual audit and review of the Company’s financial statements. From time to time, the Company engages Dixon Hughes PLLC to assist in other areas.

The following table sets forth the fees paid to Dixon Hughes PLLC in various categories during 2008 and 2007.

| Category           | Actual<br>2008         | Actual<br>2007            |
|--------------------|------------------------|---------------------------|
| Audit Fees         | 183,800 <sup>(1)</sup> | \$ 200,750 <sup>(1)</sup> |
| Audit-Related Fees | 25,233 <sup>(2)</sup>  | 22,250 <sup>(2)</sup>     |
| Tax Fees           | 22,725 <sup>(3)</sup>  | 11,250 <sup>(3)</sup>     |
| Total Fees Paid    | \$ 231,758             | \$ 234,250                |

<sup>(1)</sup> Audit fees include fees billed and expected to be billed to the Company by Dixon Hughes in connection with the annual audit of the Company’s financial statements, reviews of the Company’s interim financial statements, and review of registration statements filed with the SEC incurred in 2008 and attest services provided pursuant to Section 404 of the Sarbanes-Oxley Act incurred in 2007.

<sup>(2)</sup> Audit related services include routine accounting consultations and employee benefit plan audit.

<sup>(3)</sup> Tax fees include corporate tax compliance, as well as counsel and advisory services.

All services rendered by Dixon Hughes PLLC during 2008 and 2007 were subject to pre-approval by the Audit Committee.

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**Report of the Audit Committee**

In the performance of its oversight functions, the Audit Committee is responsible for receiving and reviewing the annual audit report of the Company's independent auditors and reports of examinations by bank regulatory agencies, and helps formulate, implement, and review the Company's and its subsidiaries' internal audit programs. The Audit Committee assesses the performance and independence of the Company's independent accountants and recommends their appointment. The Audit Committee has in place pre-approval policies and procedures that involve an assessment of the performance and independence of the Company's independent auditors, an evaluation of any conflicts of interest that may impair the independence of the independent auditors and pre-approval of an engagement letter that outlines all services to be rendered by the independent auditors.

Management is responsible for the preparation and presentation of the Company's financial statements and its overall financial reporting process and, with the assistance of the Company's outsourced internal auditors, for maintaining appropriate internal controls and procedures that provide for compliance with accounting standards and applicable laws. The independent auditors are responsible for planning and carrying out a proper audit of the Company's financial statements, expressing an opinion as to their conformity with generally accepted accounting principles and annually auditing management's assessment of the effectiveness of internal control over financial reporting. Members of the Audit Committee are not professionally engaged in the practice of auditing or accounting and are not full-time employees of the Company.

During the course of its examination of the Company's audit process in 2008, the Audit Committee reviewed and discussed the audited financial statements with management. The Audit Committee also discussed with the independent auditors, Dixon Hughes PLLC, all matters required to be discussed by the Statement of Auditing Standards No. 61, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T. Furthermore, the Audit Committee received from Dixon Hughes disclosures regarding their independence required by the PCAOB Rule 3526 "Communication with Audit Committees Concerning Independence". Based on the review and discussions above, the Audit Committee (i) recommended to the board that the audited financial statements be included in the Company's annual report on Form 10-K for the year ended December 31, 2008 for filing with the SEC and (ii) recommended that shareholders ratify the appointment of Dixon Hughes PLLC as auditors for 2009.

The Audit Committee has a written charter which is reviewed by the Committee for adequacy on an annual basis. The members of the Audit Committee are independent and financially literate as defined by the NASDAQ listing standards. The Board of Directors has determined that Robert G. Dinsmore, Jr., a member of the Audit Committee, meets the requirements adopted by the SEC for qualification as an audit committee financial expert. An audit committee financial expert is defined as a person who has the following attributes: (i) an understanding of generally accepted accounting principles and financial statements; (ii) the ability to assess the general application of GAAP in connection with the accounting for estimates, accruals and reserves; (iii) experience preparing, auditing, analyzing or evaluating financial statements that are of the same level of complexity that can be expected in the registrant's financial statements, or experience supervising people engaged in such activities; (iv) an understanding of internal controls and procedures for financial reporting; and (v) an understanding of audit committee functions.

This report is submitted by the Audit Committee,

Robert G. Dinsmore, Jr. Chairman

Frank L. Gentry

Philip R. Gilboy

Alison J. Smith

Gregory N. Wylie

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**PART IV**

**ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

The following documents are filed as part of this report:

1. Financial statements required to be filed by Item 8 of this Form:
  - a) Report of independent registered public accounting firm
  - b) Consolidated Balance Sheets as of December 31, 2008 and 2007
  - c) Consolidated Statements of Operations for the years ended December 31, 2008, 2007 and 2006
  - d) Consolidated Statements of Comprehensive Income for the years ended December 31, 2008, 2007 and 2006
  - e) Consolidated Statements of Stockholders' Equity for the years ended December 31, 2008, 2007 and 2006
  - f) Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006
  - g) Notes to Consolidated Financial Statements
  
2. Financial statement schedules required to be filed by Item 8 of this Form:  
None
  
3. Exhibits

**(a) Index to Exhibits**

| <b>EXHIBIT<br/>NUMBER</b> | <b>DESCRIPTION OF EXHIBIT</b>  |
|---------------------------|--|
| 3.1                       | Registrant's Articles of Incorporation <sup>(4)</sup>                          |
| 3.2                       | Registrant's Bylaw <sup>(4)</sup>  |
| 4.1                       | Specimen Stock Certificate <sup>(1)</sup>                                      |
| 10.1                      | Employment Agreement of Randy P. Helton <sup>(1)</sup> , a management contract |
| 10.2                      | 1999 Incentive Stock Option Plan, a compensatory plan <sup>(1)</sup>           |



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- 10.3 1999 Nonstatutory Stock Option Plan, a compensatory plan<sup>(1)</sup>
- 10.4 401(k) Plan, a compensatory plan<sup>(1)</sup>
- 10.5(i) Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Amended and Restated Declaration of Trust, dated December 15, 2003<sup>(2)</sup>
- 10.5(ii) Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Indenture, dated December 15, 2003<sup>(2)</sup>
- 10.5(iii) Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Guarantee Agreement, dated December 31, 2003<sup>(2)</sup>
- 10.5(iv) Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Form of Floating Rate

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|        |  |
|--------|--|
|        | Junior Subordinated Debenture of American Community Bancshares, Inc. (incorporated by reference to Exhibit A of Exhibit 10.5(ix)) <sup>(2)</sup> |
| 10.6   | 2001 Incentive Stock Option Plan, a compensatory plan <sup>(3)</sup>   |
| 10.7   | 2002 Nonstatutory Stock Option Plan, a compensatory plan <sup>(4)</sup>  |
| 10.8   | Dividend Reinvestment and Common Stock Purchase Plan <sup>(6)</sup>  |
| 10.9   | Agreement and Plan of Merger by and between Yadkin Valley Financial Corporation and American Community Bancshares, Inc. <sup>(7)</sup>           |
| 21     | Subsidiaries of Registrant (Filed herewith)  |
| 23     | Consent of Dixon Hughes, PLLC  |
| 31(i)  | Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act (Filed herewith)                                  |
| 31(ii) | Certification of Principal Accounting Officer Pursuant to Section 302 of the Sarbanes Oxley Act (Filed herewith)                                 |
| 32(i)  | Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes Oxley Act (Filed herewith)                                  |
| 32(ii) | Certification of Principal Accounting Officer Pursuant to Section 906 of the Sarbanes Oxley Act (Filed herewith)                                 |
| 99     | Registrant's Definitive Proxy Statement <sup>(5)</sup>   |

- (1) Incorporated by reference from exhibits to Registrant's Registration Statement on Form S-4 (File No. 333-31148)
- (2) Incorporated by reference from Registrant's Current Report on Form 8-K dated December 18, 2003 (File No. 000-30517)
- (3) Incorporated by reference from Exhibit 10.5 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.
- (4) Incorporated by reference from Registrant's Registration Statement on Form S-8 (File No. 333-101208)
- (5) Filed with the Commission pursuant to Rule 14a-6.
- (6) Incorporated by reference from Exhibit 99.1 to Registrant's Statement on Form S-3D (File No. 333-129991)
- (7) Incorporated by reference from Registrant's current report on Form 8-K dated September 10, 2008 (File No. 000-30517)

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Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 30, 2009

/s/ Randy P. Helton  
Randy P. Helton  
President and Chief Executive Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

|  |                |
|--|----------------|
| /s/ Randy P. Helton<br>Randy P. Helton, President,<br>Chief Executive Officer and Director | March 30, 2009 |
| /s/ Dan R. Ellis, Jr.<br>Dan R. Ellis, Jr., Chief Financial Officer                        | March 30, 2009 |
| /s/ Robert D. Dinsmore<br>Robert D. Dinsmore, Director                                     | March 30, 2009 |
| /s/ Frank L. Gentry<br>Frank L. Gentry, Director   | March 30, 2009 |
| /s/ Thomas J. Hall<br>Thomas J. Hall, Director   | March 30, 2009 |
| /s/ Larry S. Helms<br>Larry S. Helms, Director   | March 30, 2009 |
| /s/ V. Stephen Moss<br>V. Stephen Moss, Director   | March 30, 2009 |
| /s/ Peter A. Pappas<br>Peter A. Pappas, Director   | March 30, 2009 |
| /s/ L. Steven Phillips<br>L. Steven Phillips, Director                                     | March 30, 2009 |
| /s/ Alison J. Smith<br>Alison J. Smith, Director   | March 30, 2009 |
| /s/ David D. Whitley<br>David D. Whitley, Director   | March 30, 2009 |
| /s/ Gregory N. Wylie<br>Gregory N. Wylie, Director   | March 30, 2009 |
| /s/ Philip R. Gilboy<br>Philip R. Gilboy, Director   | March 30, 2009 |

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