AMERICAN NATIONAL BANKSHARES INC
Form 10-Q
May 10, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2012.

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

Commission file number: 0-12820

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

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

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

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

Yes x No ¨

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

Yes x No ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
Yes ¨ No x

At May 7, 2012, the Company had 7,830,247 shares of Common Stock outstanding, $1 par value.

AMERICAN NATIONAL BANKSHARES INC.

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Part I. Financial Information
Item 1. Financial Statements

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

ASSETS	(Unaudited) March 31, 2012	(Audited) December 31, 2011
Cash and due from banks	$ 28,197	$ 22,561
Interest-bearing deposits in other banks	26,649	6,332
Securities available for sale, at fair value	337,376	333,366
Restricted stock, at cost	6,019	6,019
Loans held for sale	3,774	6,330
Loans, net of unearned income	816,471	824,758
Less allowance for loan losses	(11,691)	(10,529)
Net loans	804,780	814,229
Premises and equipment, net	25,833	25,674
Other real estate owned, net	6,369	5,353
Goodwill	39,352	38,899
Core deposit intangibles, net	6,048	6,595
Bank owned life insurance	13,165	13,058
Accrued interest receivable and other assets	25,698	26,290
Total assets	$ 1,323,260	$ 1,304,706
LIABILITIES and SHAREHOLDERS' EQUITY		
Liabilities:		
Demand deposits -- noninterest bearing	$ 199,066	$ 179,148
Demand deposits -- interest bearing	168,757	189,212
Money market deposits	174,110	182,347
Savings deposits	78,650	74,193
Time deposits	454,147	433,854
Total deposits	1,074,730	1,058,754
Short-term borrowings:		
Customer repurchase agreements	48,651	45,575
Other short-term borrowings	-	3,000
Long-term borrowings	10,175	10,206

Trust preferred capital notes		27,237		27,212
Accrued interest payable and other liabilities		7,443		7,130
Total liabilities		1,168,236		1,151,877
Shareholders' equity:				
Preferred stock, $5 par, 2,000,000 shares authorized,				
none outstanding		-		-
Common stock, $1 par, 20,000,000 shares authorized,				
7,830,247 shares outstanding at March 31, 2012 and				
7,806,869 shares outstanding at December 31, 2011		7,830		7,807
Capital in excess of par value		56,633		56,395
Retained earnings		84,171		81,797
Accumulated other comprehensive income, net		6,390		6,830
Total shareholders' equity		155,024		152,829
Total liabilities and shareholders' equity	$	1,323,260	$	1,304,706

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

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

	Three Months Ended March 31	
	2012	2011
Interest and Dividend Income:		
Interest and fees on loans	$ 13,120	$ 6,679
Interest and dividends on securities:		
Taxable	1,079	1,169
Tax-exempt	1,082	716
Dividends	51	27
Other interest income	10	70
Total interest and dividend income	15,342	8,661
Interest Expense:		
Interest on deposits	1,837	1,580
Interest on short-term borrowings	43	80
Interest on long-term borrowings	84	53
Interest on trust preferred capital notes	206	343
Total interest expense	2,170	2,056
Net Interest Income	13,172	6,605
Provision for Loan Losses	733	337
Net Interest Income After Provision for Loan Losses	12,439	6,268
Noninterest Income:		
Trust fees	882	928
Service charges on deposit accounts	488	421
Other fees and commissions	457	316
Mortgage banking income	531	147
Securities gains, net	-	1
Other	876	158
Total noninterest income	3,234	1,971
Noninterest Expense:		
Salaries	4,111	2,485
Employee benefits	1,078	541
Occupancy and equipment	965	699
FDIC assessment	233	205
Bank franchise tax	183	175
Core deposit intangible amortization	547	94
Foreclosed real estate, net	(243)	22
Merger related expenses	251	309
Other	2,802	1,249
Total noninterest expense	9,927	5,779

Income Before Income Taxes		5,746		2,460
Income Taxes		1,571		682
Net Income	$	4,175	$	1,778
Net Income Per Common Share:				
Basic	$	0.53	$	0.29
Diluted	$	0.53	$	0.29
Average Common Shares Outstanding:				
Basic		7,822,228		6,143,602
Diluted		7,833,061		6,152,738

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

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

	Three Months Ended March 31 2012	Three Months Ended March 31 2011
Net income	$ 4,175	$ 1,778
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	(677)	960
Income tax benefit (expense)	237	(336)
Reclassification adjustment for gains (losses) on securities available for sale, net of tax	-	(1)
Other comprehensive income (loss)	(440)	623
Comprehensive income	$ 3,735	$ 2,401

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

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American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Three Months Ended March 31, 2012 and 2011
(Dollars in thousands) (Unaudited)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2010	$ 6,128	$ 27,268	$ 74,850	$ (159)	$ 108,087
Net income	-	-	1,778	-	1,778
Other comprehensive income				623	623
Total comprehensive income					2,401
Stock options exercised	10	162	-	-	172
Stock option expense	-	16	-	-	16
Equity based compensation	15	95	-	-	110
Cash dividends declared, $0.23 per share	-		(1,414)	-	(1,414)
Balance, March 31, 2011	$ 6,153	$ 27,541	$ 75,214	$ 464	$ 109,372
Balance, December 31, 2011	$ 7,807	$ 56,395	$ 81,797	$ 6,830	$ 152,829
Net income	-	-	4,175	-	4,175
Other comprehensive loss				(440)	(440)
Total comprehensive income					3,735

Stock options exercised	3	42	-	-	45
Stock option expense	-	16	-	-	16
Equity based compensation	20	180	-	-	200
Cash dividends declared, $0.23 per share	-		(1,801)	-	(1,801)
Balance, March 31, 2012	$ 7,830	$ 56,633	$ 84,171	$ 6,390	$ 155,024

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

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American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Three Months Ended March 31, 2012 and 2011
(Dollars in thousands) (Unaudited)

	2012	2011
Cash Flows from Operating Activities:		
Net income	$ 4,175	$ 1,778
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	733	337
Depreciation	422	304
Core deposit intangible amortization	547	94
Net accretion of fair value adjustments	(2,754)	-
Net amortization (accretion) of securities	792	267
Net gain on sale or call of securities	-	(1)
Gain on sale of loans held for sale	(473)	(123)
Proceeds from sales of loans held for sale	22,532	8,678
Originations of loans held for sale	(19,503)	(6,729)
Net (gain) loss on foreclosed real estate	(248)	12
Valuation allowance on foreclosed real estate	5	10
Net gain on sale of premises and equipment	(495)	-
Stock-based compensation expense	16	16
Equity based compensation expense	200	110
Deferred income tax expense (benefit)	(237)	41
Net change in interest receivable	209	348
Net change in other assets	296	226
Net change in interest payable	(38)	(77)
Net change in other liabilities	351	342
Net cash provided by operating activities	6,530	5,633
Cash Flows from Investing Activities:		
Proceeds from maturities and calls of securities available for sale	16,475	29,423
Proceeds from maturities and calls of securities held to maturity	-	190

Purchases of securities available for sale		(21,953)		(26,608)
Net decrease in loans		9,485		3,474
Proceeds from sale of premises and equipment		563		-
Purchases of premises and equipment		(649)		(103)
Proceeds from sales of foreclosed real estate		1,106		340
Net cash provided by investing activities		5,027		6,716
Cash Flows from Financing Activities:				
Net change in demand, money market, and savings deposits		(4,317)		17,047
Net change in time deposits		20,430		6,338
Net change in customer repurchase agreements		3,076		(3,213)
Net change in other short-term borrowings		(3,000)		(6,110)
Net change in long-term borrowings		(37)		(4,038)
Common stock dividends paid		(1,801)		(1,414)
Proceeds from exercise of stock options		45		172
Net cash provided by financing activities		14,396		8,782
Net Increase in Cash and Cash Equivalents		25,953		21,131
Cash and Cash Equivalents at Beginning of Period		28,893		18,514
Cash and Cash Equivalents at End of Period	$	54,846	$	39,645

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

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

Note 1 – Basis of Presentation

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

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, goodwill and intangible assets, pension obligations, other than temporary impairment, the fair value of financial instruments, and the valuation of foreclosed real estate.

In April 2006, AMNB Statutory Trust I, a Delaware statutory trust (the "AMNB Trust") and a wholly owned subsidiary of the Company, was formed for the purpose of issuing preferred securities (the "Trust Preferred Securities") in a private placement pursuant to an applicable exemption from registration. Proceeds from the securities were used to fund the acquisition of Community First Financial Corporation ("Community First") which occurred in April 2006.

On July 1, 2011, the Company completed its merger with MidCarolina Financial Corporation ("MidCarolina"). MidCarolina was headquartered in Burlington, North Carolina, and engaged in banking operations through its subsidiary bank, MidCarolina Bank.

In July 2011, and in connection with its acquisition of MidCarolina, the Company assumed the liabilities of the MidCarolina I and MidCarolina Trust II, two separate Delaware statutory trusts (the "MidCarolina Trusts"), which were also formed for the purpose of issuing preferred securities. Refer to Note 9 for further details concerning these entities

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

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position as of March 31, 2012; the consolidated statements of income for the three months ended March 31, 2012 and 2011; the consolidated statements of comprehensive income for the three months ended March 31, 2012 and 2011; the consolidated statements of changes in shareholders' equity for the three months ended March 31, 2012 and 2011; and the consolidated statements of cash flows for the three months ended March 31, 2012 and 2011. Operating results for the three month period ended March 31, 2012 are not necessarily indicative of the results that may occur for the year ending December 31, 2012. Certain reclassifications have been made to prior period balances to conform to the current period presentation. These statements should be read in conjunction with the Notes to Consolidated Financial

Statements included in the Company’s Form 10-K for the year ended December 31, 2011.

Note 2 –Merger with MidCarolina

On July 1, 2011, the Company completed its merger with MidCarolina pursuant to the Agreement and Plan of Reorganization, dated December 15, 2010, between the Company and MidCarolina (the “merger agreement”). MidCarolina was headquartered in Burlington, North Carolina, and engaged in banking operations through its subsidiary bank, MidCarolina Bank. The transaction has significantly expanded the Company’s footprint in North Carolina, adding eight branches in Alamance and Guilford Counties.

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Pursuant to the terms of the merger agreement, as a result of the merger, the holders of shares of MidCarolina common stock received 0.33 shares of the Company's common stock for each share of MidCarolina common stock held immediately prior to the effective date of the merger. Each option to purchase a share of MidCarolina common stock outstanding immediately prior to the effective date of the merger was converted into an option to purchase shares of Company common stock, adjusted for the 0.33 exchange ratio. Additionally, the holders of shares of noncumulative perpetual Series A preferred stock of MidCarolina received one share of a newly authorized noncumulative perpetual Series A preferred stock of the Company for each MidCarolina preferred share held immediately before the merger. The Company's Series A preferred stock was issued with terms, preferences, rights and limitations that are identical in all material respects to the MidCarolina Series A preferred stock.

The Company issued 1,626,157 shares of additional common stock in connection with the MidCarolina merger. This represents 20.9% of the outstanding shares of the Company as of March 31, 2012.

In connection with the transaction, MidCarolina Bank was merged with and into the Bank.

On November 15, 2011, the Company repurchased all 5,000 shares of the Series A preferred stock issued in the merger. The shares had a $1,000 liquidation preference per share. While the Series A preferred stock was subject to redemption at 104.5% of par during the twelve month period beginning August 15, 2011, the Company paid 62% of par, or an aggregate purchase price of $3.1 million, to repurchase all 5,000 outstanding shares from the sole holder of the securities.

The merger with MidCarolina was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration paid were recorded at their estimated fair values as of the merger date. The excess of consideration paid over the fair value of net assets acquired was originally recorded as goodwill in the amount of approximately $16.4 million, which will not be amortizable and is not deductible for tax purposes, the Company allocated the total balance of goodwill to its community banking segment. The Company also recorded $6.6 million in core deposit intangibles which will be amortized over nine years using a declining balance method.

In connection with the merger, the consideration paid, and the fair value of identifiable assets acquired and liabilities assumed as of the merger date are summarized in the following table.

(dollars in thousands)		
Consideration Paid:		
Common shares issued (1,626,157)	$	29,905
Cash paid to Shareholders		12
Fair Value of Options		132
Preferred shares issued (5,000)		5,000
Value of consideration		35,049
Assets acquired:		
Cash and cash equivalents		34,783
Investment securities		51,442
Loans held for sale		113
Loans, net of unearned income		328,123
Premises and equipment, net		5,708
Deferred income taxes		15,310
Core deposit intangible		6,556
Other real estate owned		3,538
Other assets		13,535

Total assets		459,108
Liabilities assumed:		
Deposits		420,248
FHLB advances		9,858
Other borrowings		6,546
Other liabilities		4,291
Total Liabilities		440,943
Net assets acquired		18,165
Goodwill resulting from merger with MidCarolina	$	16,884

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The following table details the changes in the fair value of net assets acquired and liabilities assumed from the amounts originally reported in the Form 10-K for the period ending December 31, 2011 (in thousands).

Goodwill at December 31, 2011	$16,431
Effect of adjustments to:	
Other liabilities	453
Goodwill at March 31, 2012	$16,884

The increase in goodwill during the first quarter of 2012 was due to a change in estimated tax refunds due to MidCarolina.

In many cases, the fair values of assets acquired and liabilities assumed were determined by estimating the cash flows expected to result from those assets and liabilities and discounting them at appropriate market rates. The most significant category of assets for which this procedure was used was that of acquired loans. The Company acquired the $367.4 million loan portfolio at a fair value discount of $39.9 million. The performing portion of the portfolio estimated fair value was $286.5 million. The excess of expected cash flows above the fair value of the performing portion of loans will be accreted to interest income over the remaining lives of the loans in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 310-20 (formerly SFAS 91).

Certain loans, those for which specific credit-related deterioration since origination was identified, are recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition on these loans is based on reasonable expectation about the timing and amount of cash flows to be collected. Acquired loans deemed impaired and considered collateral dependent, with the timing of the sale of loan collateral indeterminate, remain on non-accrual status and have no accretable yield.

The following table details the acquired loans that are accounted for in accordance with FASB ASC 310-30 (formerly Statement of Position (“SOP”) 03-3) as of July 1, 2011 (in thousands).

Contractually required principal and interest at acquisition	$56,681
Contractual cash flows not expected to be collected (nonaccretable difference)	17,472
Expected cash flows at acquisition	39,209
Interest component of expected cash flows (accretable discount)	1,663
Fair value of acquired loans accounted for under FASB ASC 310-30	$37,546

In accordance with U.S. GAAP, there was no carryover of the allowance for loan losses that had been previously recorded by MidCarolina.

In connection with the merger with MidCarolina, the Company acquired an investment portfolio with a fair value of $51.4 million. The fair value of the investment portfolio was determined by taking into account market prices obtained from independent valuation sources.

In connection with the merger with MidCarolina, the Company recorded a deferred income tax asset of $15.3 million related to MidCarolina’s valuation allowance on foreclosed real estate and bad debt expenses, as well as other tax attributes of the acquired company, along with the effects of fair value adjustments resulting from applying the acquisition method of accounting.

In connection with the merger with MidCarolina, the Company acquired other real estate owned with a fair value of $3.5 million. Other real estate owned was measured at fair value less estimated cost to sell.

In connection with the merger with MidCarolina, the Company acquired premises and equipment with a fair value of $5.7 million. Property appraisals for all owned locations were obtained. The fair value adjustment will be amortized as expense over the remaining lives of the properties. The Company also acquired several lease obligations in connection with the merger. The unfavorable lease position will be amortized over the remaining lives of the leases.

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The fair value of savings and transaction deposit accounts acquired from MidCarolina was assumed to approximate their carrying value as these accounts have no stated maturity and are payable on demand. Certificates of deposit accounts were valued by comparing the contractual cost of the portfolio to an identical portfolio bearing current market rates. The portfolio was segregated into pools based on segments: retail, individual retirement accounts brokered, and Certificate of Deposit Account Registry Service (often referred to as "CDARs"). For each segment, the projected cash flows from maturing certificates were then calculated based on contractual rates and prevailing market rates. The valuation adjustment for each segment is equal to the present value of the difference of these two cash flows, discounted at the assumed market rate for a certificate with a corresponding maturity. This valuation adjustment will be accreted to reduce interest expense over the remaining maturities of the respective pools.

The fair value of the Federal Home Loan Bank of Atlanta (“FHLB”) advances was determined based on the discounted cash flows of future payments. This adjustment to the face value of the borrowings will be amortized to increase interest expense over the remaining lives of the respective borrowings.

The fair value of junior subordinated debentures (Other Borrowings) was determined based on the fair value of similar debt or equity instruments with reasonably comparable terms. This adjustment to the face value of the borrowings will be amortized to increase interest expense over the remaining lives of the respective borrowings.

Direct costs related to the acquisition were expensed as incurred. During the entire year of 2011, the Company incurred $1,600,000 in merger and acquisition expenses. During 2012, the Company incurred $251,000 in merger related expense, mostly related to the deconversion of MidCarolina to the Company’s operating system.

The following table presents unaudited pro forma information as if the merger with MidCarolina had occurred on January 1, 2011. This pro forma information gives effect to certain adjustments, including purchase accounting fair value adjustments, amortization of core deposit and other intangibles and related income tax effects. The pro forma information does not necessarily reflect the results of operations that would have occurred had the merger with MidCarolina occurred in 2011. In particular, expected operational cost savings are not reflected in the pro forma amounts.

(dollars in thousands)		Three Months Ended Pro Forma March 31, 2011	
Net interest income	$	13,385	
Provision for loan loss		(1,537	)
Non-interest income		2,511	
Non-interest expense and income taxes		(9,345	)
Income taxes		(1,500	)
Net income	$	3,514	

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Note 3 – Securities

The amortized cost and estimated fair value of investments in debt and equity securities at March 31, 2012 and December 31, 2011 were as follows:

	March 31, 2012			
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Federal agencies and GSEs	$ 40,338	$ 489	$ 60	$ 40,767
Mortgage-backed and CMOs	101,399	1,921	267	103,053
State and municipal	180,405	10,806	28	191,183
Corporate	2,323	50	-	2,373
Total securities available for sale	$ 324,465	$ 13,266	$ 355	$ 337,376

	December 31, 2011			
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Federal agencies and GSEs	$ 32,071	$ 608	$ -	$ 32,679
Mortgage-backed and CMOs	102,444	1,874	414	103,904
State and municipal	182,952	11,454	1	194,405
Corporate	2,312	66	-	2,378
Total securities available for sale	$ 319,779	$ 14,002	$ 415	$ 333,366

Temporarily Impaired Securities

The following table shows estimated fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2012. The reference point for determining when securities are in an unrealized loss position is month-end. Therefore, it is possible that a security's market value exceeded its amortized cost on other days during the past twelve-month period.

Available for sale securities that have been in a continuous unrealized loss position are as follows:

	Total		Less than 12 Months		12 Months or More	
(in thousands)	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Federal agencies and GSEs	$ 17,869	$ 60	$ 17,869	$ 60	$ -	$ -
Mortgage-backed	25,444	163	25,444	163	-	-
CMOs	2,618	80	2,618	80	-	-
Private label CMOs	71	24	-	-	71	24
State and municipal	4,581	28	4,180	27	401	1
Total	$ 50,583	$ 355	$ 50,111	$ 330	$ 472	$ 25

GSE debt securities: The unrealized losses on investments in six GSEs ("government sponsored entities") were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2012.

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GSEs residential mortgage-backed securities: The unrealized losses on the Company's investment in 14 GSE mortgage-backed securities were caused by interest rate increases. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2012.

Collateralized Mortgage Obligations ("CMOs"): The unrealized loss associated with one CMO was caused by interest rate increases. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2012.

Private-Label Collateralized Mortgage Obligations: The unrealized loss associated with one private residential CMO is primarily driven by higher projected collateral losses, wider credit spreads, and changes in interest rates. We assess for credit impairment using a cash flow model. Based upon management's assessment of the expected credit losses of the securities given the performance of the underlying collateral compared to the credit enhancement, the Company expects to recover the remaining amortized cost basis of these securities.

State and municipal securities: The unrealized losses on five investments in state and municipal securities were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2012.

The Company's investment in FHLB stock totaled $3,160,000 at March 31, 2012. FHLB stock is generally viewed as a long-term investment and as a restricted investment security, which is carried at cost, because there is no market for the stock, other than the FHLB or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Company does not consider this investment to be other-than-temporarily impaired at March 31, 2012 and no impairment has been recognized. FHLB stock is shown in restricted stock on the balance sheet and is not a part of the available for sale securities portfolio.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities had been in a continuous unrealized loss position, at December 31, 2011.

	Total		Less than 12 Months		12 Months or More	
(in thousands)	Estimated Fair	Unrealized Loss	Estimated Fair	Unrealized Loss	Estimated Fair	Unrealized Loss

	Value				Value				Value			
Mortgage-backed	$	28,431	$	266	$	28,431	$	266	$	-	$	-
Private label CMOs		3,375		148		3,306		115		69		33
State and municipal		401		1		401		1		-		-
Total	$	32,207	$	415	$	32,138	$	382	$	69	$	33

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Other-Than-Temporary-Impaired Securities

As of March 31, 2012 and December 31, 2011, there were no securities classified as other-than-temporary impaired.

Note 4 - Loans

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

(in thousands)	March 31, 2012	December 31, 2011
Commercial	$ 130,112	$ 134,166
Commercial real estate:		
Construction and land development	41,512	54,433
Commercial real estate	354,279	351,961
Residential real estate:		
Residential	188,416	179,812
Home equity	94,734	96,195
Consumer	7,418	8,191
Total loans	$ 816,471	$ 824,758

Interest income, including accretion, on loans acquired from MidCarolina for the three months ended March 31, 2012 was approximately $5.2 million. The outstanding principal balance and the carrying amount of these loans included in the consolidated balance sheet at March 31, 2012 and December 31, 2012 are as follows:

(in thousands)	March 31, 2012	December 31, 2011
Oustanding principal balance	$ 291,827	$ 321,002
Carrying amount	268,047	293,569

The outstanding principal balance and related carrying amount of acquired loans, for which the Company applies ASC 310-30 (formerly SOP 03-3), to account for interest earned, as of the indicated dates is as follows:

(in thousands)	March 31, 2012	December 31, 2011
Oustanding principal balance	$ 37,973	$ 45,760
Carrying amount	28,115	34,027

The following table presents changes in the accretable discount on acquired loans, for which the Company applies ASC 310-30 (formerly SOP 03-3), for the quarter ended March 31, 2012. The accretion reflected below include $881,000 related to loan payoffs.

Accretable

(in thousands)	Discount
Balance at December 31, 2011	$ 1,056
Accretion	(933)
Reclassification from nonaccretable difference	1,112
Balance at March 31, 2012	$ 1,235

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The following table shows an analysis by portfolio segment of the Company's past due loans at March 31, 2012.

(in thousands)	30- 59 Days Past Due	60-89 Days Past Due	90 Days + Past Due and Still Accruing	Non-Accrual Loans	Total Past Due	Current	Total Loans
Commercial	$ 104	$ -	$ -	$ 1,624	$ 1,728	$ 128,384	$ 130,112
Commercial real estate:							
Construction and land development	2	603	-	4,499	5,104	36,408	41,512
Commercial real estate	1,835	258	-	2,685	4,778	349,501	354,279
Residential:							
Residential	1,114	-	183	3,966	5,263	183,153	188,416
Home equity	184	99	-	558	841	93,893	94,734
Consumer	14	7	-	5	26	7,392	7,418
Total	$ 3,253	$ 1,150	$ -	$ 13,337	$ 17,740	$ 798,731	$ 816,471

The following table shows an analysis by portfolio segment of the Company's past due loans at December 31, 2011.

30- 59 Days	60-89 Days	90 Days + Past Due and Still	Non-Accrual	Total Past