

AMERICAN COMMUNITY BANCSHARES INC

Form 10-Q

May 10, 2007

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# U. S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

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## FORM 10-Q

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☒ **Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended March 31, 2007

☐ **Transition Report Under Section 13 or 15(d) of the Exchange Act**  
For the transition period ended \_\_\_\_\_

Commission File Number 000-30517

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# AMERICAN COMMUNITY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

**NORTH CAROLINA**  
(State or other jurisdiction of

**56-2179531**  
(IRS Employer

incorporation or organization)

Identification Number)

**4500 Cameron Valley Parkway, Suite 150, Charlotte, NC 28211**

(Address of principal office)

**(704) 225-8444**

(Registrant's Telephone Number, Including Area Code)

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Indicate whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the past 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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer    in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer    ☐    Accelerated filer    ☒    Non-accelerated filer    ☐

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

As of May 1, 2007, 7,020,343 shares of the issuer's common stock, \$1.00 par value, were outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1 - Financial Statements*****AMERICAN COMMUNITY BANCSHARES, INC.******CONSOLIDATED BALANCE SHEETS***

|   | March 31,<br>2007<br>(Unaudited) | December 31,<br>2006* |
|---|----------------------------------|-----------------------|
|   | (In Thousands)                   |                       |
| ASSETS  |                                  |                       |
| Cash and due from banks   | \$ 17,977                        | \$ 19,950             |
| Interest-earning deposits with banks  | 14,381                           | 17,295                |
| Investment securities available for sale at fair value  | 57,773                           | 63,018                |
| Investment securities held to maturity at cost  | 2,173                            | 2,174                 |
| Loans   | 375,395                          | 370,431               |
| Allowance for loan losses   | (5,472)                          | (5,628)               |
|   |                                  |                       |
|   | NET LOANS                        | 369,923               |
|   |                                  | 364,803               |
| Accrued interest receivable   | 2,751                            | 2,938                 |
| Bank premises and equipment   | 9,046                            | 9,105                 |
| Foreclosed real estate  | 25                               | 195                   |
| Non-marketable equity securities  | 1,819                            | 1,879                 |
| Goodwill  | 9,838                            | 9,838                 |
| Other assets  | 3,302                            | 3,463                 |
|   |                                  |                       |
|   | TOTAL ASSETS                     | \$ 489,008            |
|   |                                  | \$ 494,658            |
| LIABILITIES AND STOCKHOLDERS' EQUITY  |                                  |                       |
| Deposits  |                                  |                       |
| Demand non-interest bearing   | \$ 62,414                        | \$ 61,735             |
| Savings   | 20,450                           | 15,111                |
| Money market and NOW  | 74,594                           | 98,333                |
| Time  | 238,532                          | 225,958               |
|   |                                  |                       |
|   | TOTAL DEPOSITS                   | 395,990               |
|   |                                  | 401,137               |
| Short-term borrowings   | 16,932                           | 15,473                |
| Long-term debt  | 18,002                           | 21,612                |
| Accrued expenses and other liabilities  | 1,797                            | 1,368                 |
|   |                                  |                       |
|   | TOTAL LIABILITIES                | 432,721               |
|   |                                  | 439,590               |
| Stockholders' Equity  |                                  |                       |
| Preferred stock, no par value, 1,000,000 shares authorized; none issued   |                                  |                       |
| Common stock, \$1 par value, 25,000,000 shares authorized; 7,020,343 and 7,008,081 issued and outstanding, respectively |                                  |                       |
|   | 7,020                            | 7,008                 |
| Additional paid-in capital  | 37,706                           | 37,637                |
| Retained earnings   | 12,007                           | 11,072                |
| Accumulated other comprehensive loss  | (446)                            | (649)                 |

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|  |                           |        |        |
|--|---------------------------|--------|--------|
|  | TOTAL STOCKHOLDERS EQUITY | 56,287 | 55,068 |
|--|---------------------------|--------|--------|

Commitments (Note B)

|  |   |            |            |
|--|---|------------|------------|
|  | TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 489,008 | \$ 494,658 |
|--|---|------------|------------|

*\*Derived from audited consolidated financial statements.*

See accompanying notes.

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**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF INCOME (Unaudited)****Three Months Ended March 31, 2007 and 2006**

|   | Three months<br>ended<br>March 31, 2007<br>(Amounts in thousands, except<br>share and per share data) | Three months<br>ended<br>March 31, 2006 |
|---|---|---|
| <b>INTEREST INCOME</b>  |   |   |
| Loans   | \$ 7,828  | \$ 6,574                                |
| Investments   | 737   | 672                                     |
| Interest-earning deposits with banks                                | 133   | 82                                      |
| <b>TOTAL INTEREST INCOME</b>  | <b>8,698</b>  | <b>7,328</b>                            |
| <b>INTEREST EXPENSE</b>   |   |   |
| Money market, NOW and savings deposits                              | 632   | 333                                     |
| Time deposits   | 2,747   | 1,944                                   |
| Short-term borrowings   | 161   | 101                                     |
| Long-term debt  | 359   | 419                                     |
| <b>TOTAL INTEREST EXPENSE</b>                                       | <b>3,899</b>  | <b>2,797</b>                            |
| <b>NET INTEREST INCOME</b>  | <b>4,799</b>  | <b>4,531</b>                            |
| <b>PROVISION FOR LOAN LOSSES</b>                                    | <b>183</b>  | <b>272</b>                              |
| <b>NET INTEREST INCOME AFTER</b>                                    |   |   |
| <b>PROVISION FOR LOAN LOSSES</b>                                    | <b>4,616</b>  | <b>4,259</b>                            |
| <b>NON-INTEREST INCOME</b>  |   |   |
| Service charges on deposit accounts                                 | 581   | 562                                     |
| Mortgage operations   | 80  | 81                                      |
| Gain on sale of investment securities                               | 17  | 25                                      |
| Other   | 129   | 159                                     |
| <b>TOTAL NON-INTEREST INCOME</b>                                    | <b>807</b>  | <b>827</b>                              |
| <b>NON-INTEREST EXPENSE</b>   |   |   |
| Salaries and employee benefits                                      | 1,658   | 1,529                                   |
| Occupancy and equipment   | 565   | 571                                     |
| Other than temporary impairment of non-marketable equity securities | 76  |   |
| Other   | 1,102   | 923                                     |
| <b>TOTAL NON-INTEREST EXPENSE</b>                                   | <b>3,401</b>  | <b>3,023</b>                            |
| <b>INCOME BEFORE INCOME TAXES</b>                                   | <b>2,022</b>  | <b>2,063</b>                            |
| <b>INCOME TAXES</b>   | <b>735</b>  | <b>756</b>                              |

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|  |            |           |           |
|--|------------|-----------|-----------|
|  | NET INCOME | \$ 1,287  | \$ 1,307  |
| NET INCOME PER COMMON SHARE                |            |           |           |
| BASIC                                      |            | \$ .18    | \$ .19    |
| DILUTED                                    |            | \$ .18    | \$ .18    |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING |            |           |           |
| BASIC                                      |            | 7,008,971 | 6,853,240 |
| DILUTED                                    |            | 7,176,577 | 7,156,948 |
| DIVIDEND DECLARED PER COMMON SHARE         |            | \$ 0.05   | \$ 0.05   |

See accompanying notes.



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## AMERICAN COMMUNITY BANCSHARES, INC.

### CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

Three Months Ended March 31, 2007 and 2006

|  | Three months<br>ended<br>March 31, 2007 | Three months<br>ended<br>March 31, 2006 |
|--|---|---|
|  | (In Thousands)                          |   |
| NET INCOME   | \$ 1,287                                | \$ 1,307                                |
| Other comprehensive income (loss):                                 |   |   |
| Securities available for sale:                                     |   |   |
| Unrealized holding gains/(losses) on securities available for sale | 335                                     | (260)                                   |
| Tax effect   | (129)                                   | 100                                     |
| Reclassification adjustment for gains realized in income           | (17)                                    | (25)                                    |
| Tax effect   | 6                                       | 9                                       |
| Net of tax amount  | 195                                     | (176)                                   |
| Cash flow hedging activities:                                      |   |   |
| Unrealized holding gains/(losses) on cash flow hedging activities  | 17                                      | (115)                                   |
| Tax effect   | (6)                                     | 44                                      |
| Reclassification adjustment for gains realized in income           | (6)                                     |   |
| Tax effect   | 2                                       |   |
| Net of tax amount  | 7                                       | (71)                                    |
| Total other comprehensive income (loss)                            | 202                                     | (247)                                   |
| TOTAL COMPREHENSIVE INCOME   | \$ 1,489                                | \$ 1,060                                |

See accompanying notes.

**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)****Three Months Ended March 31, 2007 and 2006**

|  | Three Months Ended<br>March 31,<br>2007      2006<br>(In thousands) |          |
|--|---|----------|
| CASH FLOWS FROM OPERATING ACTIVITIES   |   |          |
| Net income   | \$ 1,287  | \$ 1,307 |
| Adjustments to reconcile net income to net cash provided by operating activities:                    |   |          |
| Depreciation and amortization  | 250   | 293      |
| Provision for loan losses  | 183   | 272      |
| Loss (gain) on sale of foreclosed real estate  | (28)  | 7        |
| Loss on sale and disposal of fixed assets  |   | 3        |
| Gain on sale of securities available for sale  | (17)  | (25)     |
| Other than temporary impairment of investment securities   | 76  |          |
| Recognition of hedge ineffectiveness   | (11)  |          |
| Decrease in capital lease obligation   | (2)   |          |
| Equity compensation expense  | 13  | 14       |
| Change in assets and liabilities   |   |          |
| Decrease (increase) in accrued interest receivable   | 187   | (95)     |
| Decrease (increase) in other assets  | 29  | (557)    |
| Increase (decrease) in accrued expenses and other liabilities  | 429   | (159)    |
| NET CASH PROVIDED BY OPERATING ACTIVITIES  | 2,396   | 1,060    |
| CASH FLOWS FROM INVESTING ACTIVITIES   |   |          |
| Purchases of investment securities available for sale  | (925)   | (2,891)  |
| Proceeds from sale of securities available for sale  | 4,457   | 1,926    |
| Proceeds from maturities, calls and principal repayments of investment securities available for sale | 2,033   | 2,133    |
| Net increase in loans from originations and repayments   | (5,303)   | (17,883) |
| Purchases of bank premises and equipment   | (148)   | (44)     |
| Proceeds from the sale of bank premises and equipment  |   | 5        |
| Proceeds from sale of foreclosed real estate   | 198   | 288      |
| Purchase of non-marketable equity securities   | (16)  | (66)     |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES  | 296   | (16,532) |
| CASH FLOWS FROM FINANCING ACTIVITIES   |   |          |
| Net increase (decrease) in demand deposits   | (17,721)  | 3,767    |
| Net increase in time deposits  | 12,574  | 17,410   |
| Net decrease in advances from Federal Home Loan Bank   |   | (111)    |
| Net increase in federal funds purchased and securities sold under agreements to repurchase           | 1,459   | 1,532    |
| Redemption of junior subordinated deferrable interest debentures                                     | (3,608)   |          |
| Excess tax benefits from stock options exercised   | 38  |          |
| Cash paid for dividends  | (352)   | (342)    |
| Repurchase of common stock   | (89)  |          |
| Proceeds from issuance of common stock   | 120   |          |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES  | (7,579)   | 22,256   |

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|  |           |           |
|--|-----------|-----------|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (4,887)   | 6,784     |
| CASH AND CASH EQUIVALENTS, BEGINNING                 | 37,245    | 16,949    |
| CASH AND CASH EQUIVALENTS, ENDING                    | \$ 32,358 | \$ 23,733 |

See accompanying notes.

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**Table of Contents****AMERICAN COMMUNITY BANCSHARES, INC.****Notes to Consolidated Financial Statements****NOTE A BASIS OF PRESENTATION**

In management's opinion, the financial information, which is unaudited, reflects all adjustments (consisting solely of normal recurring adjustments) necessary for a fair presentation of the financial information as of and for the three months ended March 31, 2007 and 2006, in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of American Community Bancshares, Inc. (the Company) and its wholly owned subsidiary, American Community Bank (ACB). All significant inter-company transactions and balances are eliminated in consolidation. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2007.

The organization and business of the Company, accounting policies followed by the Company and other information are contained in the notes to the consolidated financial statements filed as part of the Company's 2006 annual report on Form 10-K. This quarterly report should be read in conjunction with such annual report.

**NOTE B COMMITMENTS**

At March 31, 2007, loan commitments are as follows:

|                             |               |
|-----------------------------|---------------|
| Undisbursed lines of credit | \$ 95,409,546 |
| Stand-by letters of credit  | 2,134,019     |
| Loan commitments            | 7,077,250     |

**NOTE C PER SHARE RESULTS**

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per 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 are determined using the treasury stock method.

|  | <b>Three months ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <b>2007</b>                             | <b>2006</b> |
| Weighted average number of common shares used in computing basic net income per share  | 7,008,971                               | 6,853,240   |
| Effective of dilutive stock options  | 167,606                                 | 303,708     |
| Weighted average number of common shares and dilutive potential common shares used in computing diluted net income per share | 7,176,577                               | 7,156,948   |

For the three months ended March 31, 2007, there were 93,000 options that were antidilutive. For the three months ended March 31, 2006 there were no options that were antidilutive.

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***AMERICAN COMMUNITY BANCSHARES, INC.***

***Notes to Consolidated Financial Statements***

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**NOTE D 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.

In 2006, the Company entered into two interest rate floor contracts with a notional amount of \$30.0 million and \$15.0 million, respectively. At inception, both derivative instruments were designated as cash flow hedges and consisted of interest rate floor contracts that are 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. 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.

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 quarter were reclassified into earnings during the current quarter. Changes in fair value of the 7.75% interest rate floor are now accounted for in earnings for the period of the change. Changes in fair value of the remaining hedged instrument on the 7.25% floor that are deemed effective are still offset in other comprehensive income net of tax while the ineffective portion of the hedge is recorded to other income. The interest rate floors are carried at a fair market value of \$188,000 and are included in other assets as of March 31, 2007. The company recorded \$5,000 of other income during the quarter ended March 31, 2007 for the change in fair value of the 7.75% interest rate floor. There was no ineffective portion of the 7.25% hedged instrument as of March 31, 2007.

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***AMERICAN COMMUNITY BANCSHARES, INC.***

***Notes to Consolidated Financial Statements***

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**NOTE E STOCK DIVIDEND**

On January 25, 2006, the Company declared a three-for-two stock split in the form of a 50% stock dividend to shareholders of record on February 7, 2006 and payable on February 21, 2006. As a result of the stock dividend, 2,284,567 additional shares of common stock were issued and additional paid in capital was reduced by \$2,284,567. All references to net income per share, weighted average shares outstanding, and options available through stock compensation plans have been adjusted for the effect of this stock split.

**NOTE F SHARE REPURCHASE AND DIVIDEND REINVESTMENT PROGRAMS**

On February 1, 2006, the Company's Board of Directors authorized a share repurchase program for up to 225,000 shares of the Company's outstanding common stock. The Board's authorization permits the Company to repurchase shares in the open market or through privately negotiated transactions during the next twelve months when, in the opinion of management, market conditions warrant such action. On March 27, 2007, the Company's Board of Directors extended the 225,000 share repurchase program for another twelve months. When shares are repurchased, the shares are cancelled. Since February 1, 2006, the Company has repurchased 31,713 shares, of which 8,013 shares were repurchased in the first quarter of 2007. The Board of Directors also voted to establish a dividend reinvestment and stock purchase plan under which shares of the Company's common stock are available for sale to the registered shareholders of the Company. The Plan provides shareholders with an alternative way to increase their holdings of our common stock by reinvesting dividends or making optional cash payments to purchase additional shares.

**NOTE G OTHER THAN TEMPORARY IMPAIRMENT OF NON-MARKETABLE EQUITY SECURITIES**

The Company periodically evaluates its investments for any impairment which would be deemed other than temporary. As part of its quarterly evaluation, the Company determined that the fair value of an investment in a trust company, was less than the original cost of the investment and that the decline in fair value was not temporary in nature. As a result, the Company wrote down its original investment in the trust company of \$277,738, to an estimated fair value of \$201,991 as of March 31, 2007. This write down was recorded directly to earnings in the current quarter. This trust company has two common directors with the Company.

**NOTE H RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENT**

The Company adopted the Financial Accounting Standards Board's Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48), effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements and requires the impact of a tax position to be recognized in the financial statements if that position is more likely than not of being sustained by the taxing authority. The adoption of FIN 48 did not have a material effect on our consolidated financial position or results of operations.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Quarterly Report on Form 10-Q may contain certain forward-looking statements consisting of estimates with respect to the financial condition, results of operations and business of the Company that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to, general economic conditions, changes in interest rates, deposit flows, loan demand, real estate values, and competition; changes in accounting principles, policies, or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory, and technological factors affecting the Company's operations, pricing, products, and services. There are no pending legal proceedings other than those incurred in the normal course of business to which the Company or subsidiaries are a party, or of which any of their property is the subject.

#### ***COMPARISON OF FINANCIAL CONDITION AT MARCH 31, 2007 AND DECEMBER 31, 2006***

Total assets at March 31, 2007 decreased by \$5.7 million or 1.1% to \$489.0 million compared to \$494.7 million at December 31, 2006. The Company had earning assets of \$451.5 million at March 31, 2007. Gross loans increased by \$5.0 million or 1.3% to \$375.4 million from \$370.4 million at December 31, 2006. Investment securities and other non-marketable equity securities decreased by \$5.3 million or 7.9% to \$61.8 million from \$67.1 million at December 31, 2006. Overnight investments decreased by \$2.9 million or 16.8% from \$17.3 million at December 31, 2006 to \$14.4 million. Total deposits as of March 31, 2007 decreased by \$5.1 million or 1.3% to \$396.0 million compared to \$401.1 million at December 31, 2006. Total borrowed money as of March 31, 2007 decreased \$2.2 million or 5.9% to \$34.9 million compared to \$37.1 million at December 31, 2006. Stockholders' equity was \$56.3 million at March 31, 2007 compared to \$55.1 million at December 31, 2006 for an increase of \$1.2 million or 2.2%.

The Company recorded a \$183,000 provision for loan losses for the quarter ended March 31, 2007, representing a decrease of \$89,000 or 32.7% from the \$272,000 provision for the quarter ended March 31, 2006. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management. The Company has continued to provide provisions for loan losses principally as a result of the continued growth in the loan portfolio. The allowance for loan losses decreased by \$156,000 or 2.8% to \$5.5 million at March 31, 2007 as compared to \$5.6 million at December 31, 2006, primarily due to a decrease in non-performing loans during the first quarter of 2007. The allowance for loan losses equaled 1.46% of total loans outstanding at March 31, 2007 as compared to 1.52% at December 31, 2006. In addition the allowance for loan losses equaled 358% of non-performing loans and leases, which totaled \$1.5 million at March 31, 2007 and 268% of non-performing loans and leases at December 31, 2006 which totaled \$1.8 million.

The Company had investment securities available for sale of \$57.8 million at March 31, 2007. The portfolio decreased by \$5.2 million or 8.3% from the \$63.0 million balance at December 31, 2006 due principally to the sale of \$4.5 million in securities. In addition the Company had investment securities held to maturity of \$2.2 million at March 31, 2007 and December 31, 2006.

Interest-earning deposits with banks at March 31, 2007 decreased by \$2.9 million or 16.8% to \$14.4 million compared to \$17.3 million at December 31, 2006. 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 at March 31, 2007 decreased by \$2.6 million or 5.7% to \$42.9 million compared to \$45.5 million at December 31, 2006. The decrease is primarily attributable to a decrease of \$2.0 million to \$18.0 million in the cash and due from banks category. Cash and due from banks primarily represents customer deposits that are in the process of collection and not available for overnight investment combined with cash on hand in the branches. In addition, bank premises and equipment was \$9.0 million at March 31, 2007, a decrease of \$59,000. Accrued interest receivable

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decreased \$187,000 to \$2.8 million at March 31, 2007 as a result of the timing in the collection of interest income. Foreclosed real estate decreased by \$170,000, from \$195,000 at December 31, 2006 to \$25,000 at March 31, 2007, as a result of the sale of six 1-4 family properties at a gain of \$28,000. Other assets decreased by \$161,000 at March 31, 2007 to \$3.3 million.

Total deposits decreased \$5.1 million or 1.3% from \$401.1 million at December 31, 2006 to \$396.0 million at March 31, 2007. The composition of the deposit base, by category, at March 31, 2007 is as follows: 16% non-interest bearing demand deposits, 5% savings deposits, 19% money market and NOW accounts and 60% time deposits. The non-interest bearing demand deposits, savings deposits, and time deposit categories all experienced increases over the three-month period. Dollar and percentage increases were as follows: non-interest bearing demand deposits, \$679,000 or 1.1%; savings deposits, \$5.3 million or 35.3%; and time deposits, \$12.6 million or 5.6%. The money market and NOW accounts category experienced a decrease of, \$23.7 million or 24.1%. The decrease was primarily attributable to the fact that the Company was the escrow agent for a community bank start-up. The bank broke escrow in March and withdrew escrow funds in the amount of \$19.2 million. Time deposits of \$100,000 or more totaled \$131.6 million, or 33% of total deposits at March 31, 2007. The composition of deposits at December 31, 2006 was 15% non-interest bearing demand deposits, 4% savings deposits, 25% money market and NOW accounts and 56% time deposits.

Short-term borrowings consist of securities sold under agreement to repurchase and federal funds purchased. Total securities sold under agreement to repurchase and federal funds purchased, secured by certain of the Company's investment securities, increased \$1.4 million or 9.4% from \$15.5 million at December 31, 2006 to \$16.9 million at March 31, 2007. Long-term borrowings consist of advances from the Federal Home Loan Bank of Atlanta, subordinated debentures, and capital lease obligations. The Company had advances from the Federal Home Loan Bank of Atlanta at March 31, 2007 and December 31, 2006 of \$6.0 million with maturity dates ranging from July 2012 through February 2013. These advances are secured by a blanket lien on 1-4 family real estate loans, certain commercial real estate loans and certain securities available for sale. The Company also maintained the capital lease for its main office. The recorded obligation under this capital lease at March 31, 2007 and December 31, 2006 was \$1.7 million. In addition, the Company carried subordinated debentures in the amount of \$10.3 million at March 31, 2007, a decrease of \$3.6 million or 25.9% from December 31, 2006. On March 9, 2007, the Company redeemed \$3,500,000 of its 9.00% Trust Preferred Securities. The redemption included interest from January 1, 2007 through the redemption date and was paid with the proceeds from the sale of investment securities available for sale. The maturity date of the remaining subordinated debentures is December 2033 and they are redeemable on or after December 2008.

Other liabilities increased \$429,000 or 31.4% to \$1.8 million at March 31, 2007 from \$1.4 million at December 31, 2006. The increase is primarily attributable to an increase in accrued income taxes.

### ***Comparison of Results of Operations for the Three Months Ended March 31, 2007 and 2006***

**Net Income.** The Company generated net income for the three months ended March 31, 2007 of \$1,287,000 compared to net income for the three months ended March 31, 2006 of \$1,307,000. On a fully diluted per share basis earnings were \$.18 for the quarter ended March 31, 2007 compared to \$.18 for the quarter ended March 31, 2006. For the three months ended March 31, 2007 and 2006, respectively annualized return on average assets was 1.05% and 1.19% and annualized return on average equity was 9.36% and 10.32%.

**Net Interest Income.** Net interest income increased \$268,000 from \$4.5 million for the three months ended March 31, 2006 to \$4.8 million for the three months ended March 31, 2007. Total interest income benefited from growth in average earning assets offset by a decrease in net interest margin.

Total average earning assets increased \$29.7 million or 7.7% from an average of \$414.3 million during the first quarter of 2006 to an average of \$444.0 million during the first quarter of 2007. The Company experienced strong loan growth with average loan balances increasing by \$30.7 million, while average



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balances for investment securities and interest-earning deposits decreased \$937,000. Average interest-bearing liabilities increased by \$34.7 million of which \$35.1 million was attributable to deposits while borrowings decreased \$390,000.

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 quarter ended March 31, 2007 was 4.38% compared to 4.44% for the same quarter in 2006. The decrease in net interest margin is primarily a result of deposit and borrowings costs increasing faster than the yield on earning assets. The Federal Open Market Committee (FOMC) increased short-term rates twelve times beginning February 2, 2005 and ending June 29, 2006. Since the majority of our loans (approximately 60%) float with the prime lending rate, the yield on our loans increased immediately as the FOMC increased rates. Due to the longer term maturity structure of our deposits and borrowings, the costs of those liabilities were slower to increase. Once the FOMC stopped raising rates, our interest bearing liability rates increased faster than the rates on our earning assets. The yield on our interest earning assets increased 76 basis points from 7.08% for the three months ended March 31, 2006 to 7.84% for the three months ended March 31, 2007. During the same time period, the cost of our interest bearing liabilities increased from 3.34% to 4.22% or 88 basis points. The interest rate spread, which is the difference between the average yield on earning assets and the cost of interest-bearing funds, decreased 12 basis points from 3.73% in the quarter ended March 31, 2006 to 3.61% for the same quarter in 2007.

**Provision for Loan Losses.** Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management. The Company's provision for loan losses for the quarter ended March 31, 2007 was \$183,000, representing an \$89,000 or 32.7% decrease from the \$272,000 recorded for the quarter ended March 31, 2006. The decrease primarily resulted from slower loan growth in the 2007 period compared to the same period in 2006.

**Non-interest Income.** Non-interest income decreased by \$20,000 or 2.4% to \$807,000 for the three months ended March 31, 2007 compared with \$827,000 for the same period in the prior year. Non-interest income as a percentage of total revenue (defined as net interest income plus non-interest income) decreased to 14.4% for the three months ended March 31, 2007 from 15.4% for the same period in the prior year primarily as a result of the increase in the Company's net interest income. The largest components of non-interest income were service charges on deposit accounts of \$581,000 for the quarter ended March 31, 2007, compared to \$562,000 in 2006 and fees from mortgage banking operations of \$80,000 in 2007 as compared to \$81,000 in 2006.

**Non-interest Expense.** Total non-interest expense increased from \$3.0 million for the three months ended March 31, 2006 to \$3.4 million for the same period in 2007. The increase is primarily related to increased compensation expenses of \$129,000 related to additional lending personnel and an increase in professional fees of \$108,000. In addition, Federal Deposit Insurance Corporation (FDIC) expense increased \$60,000 due to the implementation of a new risk-based assessment system by the FDIC. The other than temporary impairment adjustment of \$76,000 is the result of the write-down of the carrying value of a non-marketable equity investment in a trust company owned primarily by community banks. The original investment of \$278,000 has been written down to a carrying value of \$202,000. At the current time, no additional impairment is anticipated.

**Provision for Income Taxes.** The Company's provision for income taxes, as a percentage of income before income taxes, was 36.4% and 36.6% for the three months ended March 31, 2007 and 2006, respectively.

## ***Liquidity and Capital Resources***

The primary goal of the Company's asset and liability management strategy is to maintain adequate liquidity while managing interest rate risk. Liquidity is the ability to fund the needs of the Company's borrowers and depositors, pay operating expenses, and meet regulatory liquidity requirements.

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Maturing investments, loan and mortgage-backed security principal repayments, deposit growth, borrowings from the Federal Home Loan Bank, and federal funds lines from correspondent banks are presently the main sources of the Company's liquidity. The Company's primary uses of liquidity are to fund loans, operating expenses, deposit withdrawals, repay borrowings and to make investments.

As of March 31, 2007, liquid assets (cash and due from banks, interest-earning deposits with banks, and investment securities available for sale) were approximately \$90.1 million, which represents 18.4% of total assets and 20.9% of total deposits and borrowings. Supplementing this liquidity, the Company has available lines of credit from correspondent banks of approximately \$29.5 million and an additional line of credit with the FHLB equal to 15% of bank assets (subject to available qualified collateral, with borrowings of \$6.0 million outstanding from the FHLB at March 31, 2007). At March 31, 2007, outstanding commitments to extend credit were \$7.1 million and available line of credit balances totaled \$95.4 million. Management believes that the combined aggregate liquidity position of the Company is sufficient to meet the funding requirements of loan demand and deposit maturities and withdrawals in the near term.

Certificates of deposit represented 60.2% of the Company's total deposits at March 31, 2007, and 60.0% at December 31, 2006. The Company's branch and growth strategy will include efforts focused on increasing the relative percentage of non-interest bearing transaction deposit accounts. Certificates of deposit of \$100,000 or more were \$131.6 million, and represented 33.2% of the Company's total deposits at March 31, 2007, of which \$15.0 million were brokered deposits. These deposits are generally considered rate sensitive and with the exception of the brokered deposits are relationship-oriented and a product of the markets we serve.

Banks and bank holding companies, as regulated institutions, must meet required levels of capital. The FDIC and the Federal Reserve, the primary federal 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 March 31, 2007, the Company maintained capital levels exceeding the minimum levels for well capitalized bank holding companies and banks.

### **Item 3. 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.

The Company's market risk arises primarily from interest rate risk inherent in its lending and deposit-taking activities. The structure of the Company's loan and deposit portfolios is such that a significant decline in interest rates may adversely impact net market values and net interest income. The Company does not maintain a trading account nor is the Company subject to currency exchange risk or commodity price risk. Interest rate risk is monitored as part of the Company's asset/liability management function, which is discussed above in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading Liquidity and Capital Resources.

Management does not believe there has been any significant change in the overall analysis of financial instruments considered market risk sensitive since December 31, 2006.

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**Item 4. 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 are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC Filings.

There were no material changes in the Company's internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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There has been no change in the risk factors included in the Company's most recent form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table sets forth information with respect to shares of common stock repurchased by the Company during the three months ended March 31, 2007.

|  | (a) Total<br>Number of<br>Shares<br>Purchased | (b) Average<br>Price Paid per<br>Share | (c) Total Number<br>of Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or Program | (d) Maximum<br>Dollar Value of<br>Shares that May<br>Yet Be<br>Purchased Under<br>the Plans |
|--|---|--|--|---|
| January 1, 2007 Through January 31, 2007   |   | \$                                     |  | \$  |
| February 1, 2007 Through February 28, 2007 |   | \$                                     |  | \$  |
| March 1, 2007 Through March 31, 2007       | 8,013   | \$ 11.08                               | 31,713   | \$ 2,174,479  |
| Total                                      | 8,013   | \$ 11.08                               | 31,713   | \$ 2,174,479  |

On February 1, 2006, the Company's Board of Directors authorized a share repurchase program for up to 225,000 shares of the Company's outstanding common stock. The Board's authorization permitted the Company to repurchase shares in the open market or through privately negotiated transactions during the next twelve months when, in the opinion of management, market conditions warrant such action. On March 27, 2007, the Company's Board of Directors extended the 225,000 share repurchase program for another twelve months.

**Item 6. Exhibits**

(a) Exhibits:

**EXHIBIT**

| NUMBER | DESCRIPTION OF EXHIBIT                   |
|--------|--|
| 3.1    | Registrant's Articles of Incorporation*  |
| 3.2    | Registrant's Bylaws*                     |
| 4.1    | Specimen Stock Certificate*              |
| 10.1   | Employment Agreement of Randy P. Helton* |
| 10.2   | 1999 Incentive Stock Option Plan*        |
| 10.3   | 1999 Nonstatutory Stock Option Plan*     |
| 10.4   | 401(k) Plan*                             |

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|           |   |
|-----------|---|
| 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**   |
| 10.5(ii)  | Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Indenture, dated December 15, 2003**   |
| 10.5(iii) | Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Guarantee Agreement, dated December 31, 2003**   |
| 10.5(iv)  | Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Form of Floating Rate Junior Subordinated Debenture of American Community Bancshares, Inc. (incorporated by reference to Exhibit A of Exhibit 10.5(ix)) ** |
| 10.6      | 2001 Incentive Stock Option Plan***   |
| 10.7      | 2002 Nonstatutory Stock Option Plan****   |
| 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 Executive Officer Pursuant to Section 906 of the Sarbanes Oxley Act (Filed herewith)   |

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\* Incorporated by reference from exhibits to Registrant's Registration Statement on Form S-4 (File No. 333-31148)

\*\* Incorporated by reference from Registrant's Current Report on Form 8-K dated December 18, 2003 (File No. 000-30517)

\*\*\* Incorporated by reference from Exhibit 10.5 to Registrant's Annual Report on Form 10-KSB for the year ended December 31, 2000.

\*\*\*\* Incorporated by reference from Registrant's Registration Statement on Form S-8 (File No. 333-101208)

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**SIGNATURES**

Under the requirements 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.

**AMERICAN COMMUNITY BANCSHARES, INC.**

Date: May 2, 2007

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

Date: May 2, 2007

By: /s/ Dan R. Ellis, Jr.  
Dan R. Ellis, Jr.  
Senior Vice President and Chief Financial Officer

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