AMERICAN NATIONAL BANKSHARES INC
Form 10-Q
August 05, 2010

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 June 30, 2010.

¨ 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 ¨ 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 August 4, 2010, the Company had 6,124,892 shares of Common Stock outstanding, $1 par value.

AMERICAN NATIONAL BANKSHARES INC.

Part I. Financial Information
Item 1. Financial Statements

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

	(Unaudited) June 30, 2010	(Audited) December 31, 2009
ASSETS		
Cash and due from banks	$ 11,398	$ 13,250
Interest-bearing deposits in other banks	22,705	10,693
Securities available for sale, at fair value	211,574	188,795
Securities held to maturity (fair value of $5,028 at June 30, 2010 and $6,763 at December 31, 2009)	4,823	6,529
Total securities	216,397	195,324
Restricted stock, at cost	4,362	4,362
Loans held for sale	2,879	2,490
Loans, net of unearned income	519,416	527,991
Less allowance for loan losses	(8,135)	(8,166)
Net loans	511,281	519,825
Premises and equipment, net	19,658	19,195
Other real estate owned, net	3,730	3,414
Goodwill	22,468	22,468
Core deposit intangibles, net	1,509	1,698
Accrued interest receivable and other assets	16,257	16,254
Total assets	$ 832,644	$ 808,973
LIABILITIES and SHAREHOLDERS' EQUITY		
Liabilities:		
Demand deposits -- noninterest bearing	$ 100,099	$ 101,735
Demand deposits -- interest bearing	92,771	97,025
Money market deposits	81,247	75,554
Savings deposits	64,425	61,873
Time deposits	291,609	268,086
Total deposits	630,151	604,273

Customer repurchase agreements		61,665		65,929
Long-term borrowings		8,563		8,638
Trust preferred capital notes		20,619		20,619
Accrued interest payable and other liabilities		2,886		3,125
Total liabilities		723,884		702,584
Shareholders' equity:				
Preferred stock, $5 par, 2,000,000 shares authorized,				
none outstanding		-		-
Common stock, $1 par, 20,000,000 shares authorized,				
6,124,892 shares outstanding at June 30, 2010 and				
6,110,335 shares outstanding at December 31, 2009		6,125		6,110
Capital in excess of par value		27,131		26,962
Retained earnings		73,590		72,208
Accumulated other comprehensive income, net		1,914		1,109
Total shareholders' equity		108,760		106,389
Total liabilities and shareholders' equity	$	832,644	$	808,973

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

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

	Three Months Ended June 30	
	2010	2009
Interest and Dividend Income:		
Interest and fees on loans	$ 7,071	$ 7,917
Interest and dividends on securities:		
Taxable	1,275	1,233
Tax-exempt	554	416
Dividends	24	21
Other interest income	87	103
Total interest and dividend income	9,011	9,690
Interest Expense:		
Interest on deposits	1,647	2,180
Interest on short-term borrowings	99	177
Interest on long-term borrowings	63	80
Interest on trust preferred capital notes	344	344
Total interest expense	2,153	2,781
Net Interest Income	6,858	6,909
Provision for Loan Losses	285	492
Net Interest Income After Provision for Loan Losses	6,573	6,417
Noninterest Income:		
Trust fees	801	767
Service charges on deposit accounts	483	511
Other fees and commissions	288	251
Mortgage banking income	343	568
Brokerage fees	22	73
Securities gains (losses), net	4	1
Foreclosed real estate gains (losses), net	(281)	(43)
Other	102	125
Total noninterest income	1,762	2,253
Noninterest Expense:		
Salaries	2,596	2,732
Employee benefits	633	832
Occupancy and equipment	698	724
FDIC assessment	199	564
Bank franchise tax	168	160
Core deposit intangible amortization	95	95
Other	1,204	1,214

Total noninterest expense		5,593		6,321
Income Before Income Taxes		2,742		2,349
Income Taxes		728		643
Net Income	$	2,014	$	1,706
Net Income Per Common Share:				
Basic	$	0.33	$	0.28
Diluted	$	0.33	$	0.28
Average Common Shares Outstanding:				
Basic		6,123,790		6,096,034
Diluted		6,129,943		6,097,047

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

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

	Six Months Ended June 30	
	2010	2009
Interest and Dividend Income:		
Interest and fees on loans	$ 14,226	$ 15,951
Interest and dividends on securities:		
Taxable	2,591	2,353
Tax-exempt	1,020	802
Dividends	47	43
Other interest income	178	191
Total interest and dividend income	18,062	19,340
Interest Expense:		
Interest on deposits	3,282	4,707
Interest on short-term borrowings	204	413
Interest on long-term borrowings	127	211
Interest on trust preferred capital notes	687	687
Total interest expense	4,300	6,018
Net Interest Income	13,762	13,322
Provision for Loan Losses	570	842
Net Interest Income After Provision for Loan Losses	13,192	12,480
Noninterest Income:		
Trust fees	1,613	1,525
Service charges on deposit accounts	962	1,013
Other fees and commissions	566	493
Mortgage banking income	589	854
Brokerage fees	43	130
Securities gains (losses), net	(25)	1
Foreclosed real estate gains (losses), net	(284)	(1,222)
Other	219	193
Total noninterest income	3,683	2,987
Noninterest Expense:		
Salaries	4,994	5,263
Employee benefits	1,273	1,645
Occupancy and equipment	1,477	1,464
FDIC assessment	394	781
Bank franchise tax	335	323
Core deposit intangible amortization	189	189
Other	2,428	2,531
Total noninterest expense	11,090	12,196

Income Before Income Taxes		5,785		3,271
Income Taxes		1,586		797
Net Income	$	4,199	$	2,474
Net Income Per Common Share:				
Basic	$	0.69	$	0.41
Diluted	$	0.69	$	0.41
Average Common Shares Outstanding:				
Basic		6,121,615		6,089,055
Diluted		6,127,137		6,091,291

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

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Six Months Ended June 30, 2010 and 2009
(Dollars in thousands) (Unaudited)

	Common Stock		Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
Balance, December 31, 2008	6,085,628	$ 6,086	$ 26,491	$ 71,090	$ (1,367)	$ 102,300
Net income	-	-	-	2,474	-	2,474
Change in unrealized gains on securities available for sale, net of tax, $232	-	-	-	-	432	
Less: Reclassification adjustment for gains on securities available for sale, net of tax, $0	-	-	-	-	(1)	
Other comprehensive income					431	431
Total comprehensive income						2,905
Stock repurchased and retired	(7,600)	(8)	(33)	(80)	-	(121)
Stock options exercised	22,302	22	283	-	-	305

Stock option expense	-	-	31	-	-	31
Cash dividends declared, $0.46 per share	-	-	-	(2,802)	-	(2,802)
Balance, June 30, 2009	6,100,330	$ 6,100	$ 26,772	$ 70,682	$ (936)	$ 102,618
Balance, December 31, 2009	6,110,335	$ 6,110	$ 26,962	$ 72,208	$ 1,109	$ 106,389
Net income	-	-	-	4,199	-	4,199
Change in unrealized gains on securities available for sale, net of tax, $424	-	-	-	-	789	
Add: Reclassification adjustment for losses on impairment of securites, net of tax, $11	-	-	-	-	20	
Less: Reclassification adjustment for gains on securities available for sale, net of tax of $(2)	-	-	-	-	(4)	
Other comprehensive gain					805	805
Total comprehensive income						5,004
Stock options exercised	2,813	3	43	-	-	46
Stock option expense	-	-	32	-	-	32
	11,744	12	94	-	-	106

Equity based compensation						
Cash dividends declared, $0.46 per share	-	-		(2,817)	-	(2,817)
Balance, June 30, 2010	6,124,892	$ 6,125	$ 27,131	$ 73,590	$ 1,914	$ 108,760

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

American National Bankshares Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Six Months Ended June 30, 2010 and 2009
(Dollars in thousands) (Unaudited)

	2010	2009
Cash Flows from Operating Activities:		
Net income	$ 4,199	$ 2,474
Adjustments to reconcile net income to net		
cash provided by (used in) operating activities:		
Provision for loan losses	570	842
Depreciation	636	566
Core deposit intangible amortization	189	189
Net amortization (accretion) of bond premiums and discounts	126	(144)
Net gain on sale or call of securities	(6)	(1)
Impairment of securities	31	-
Gain on loans held for sale	(523)	(752)
Proceeds from sales of loans held for sale	20,911	30,756
Originations of loans held for sale	(20,777)	(38,648)
Net loss (gain) on foreclosed real estate	3	(17)
Net change in valuation allowance on foreclosed real estate	281	1,239
Stock-based compensation expense	32	31
Equity based compensation	106	-
Deferred income tax benefit	(110)	(510)
Net change in interest receivable	(313)	(149)
Net change in other assets	310	1,199
Net change in interest payable	(36)	(211)
Net change in other liabilities	(526)	1,327
Net cash provided by (used in) operating activities	5,103	(1,809)
Cash Flows from Investing Activities:		
Proceeds from maturities and calls of securities available for sale	54,604	48,188
Proceeds from maturities and calls of securities held to maturity	1,145	411
Purchases of securities available for sale	(75,735)	(58,393)
Net decrease in loans	7,252	12,202
	(1,099)	(2,349)

Purchases of bank property and equipment				
Proceeds from sales of foreclosed real estate		122		190
Net cash provided by (used in) investing activities		(13,711)		249
Cash Flows from Financing Activities:				
Net change in demand, money market, and savings deposits		2,355		8,873
Net change in time deposits		23,523		17,220
Net change in repurchase agreements		(4,264)		7,696
Net change in short-term borrowings		-		(7,850)
Net change in long-term borrowings		(75)		(5,075)
Cash dividends paid		(2,817)		(2,802)
Repurchase of stock		-		(121)
Proceeds from exercise of stock options		46		305
Net cash provided by financing activities		18,768		18,246
Net Increase in Cash and Cash Equivalents		10,160		16,686
Cash and Cash Equivalents at Beginning of Period		23,943		24,098
Cash and Cash Equivalents at End of Period	$	34,103	$	40,784

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

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. and its wholly owned subsidiary, American National Bank and Trust Company (collectively referred to as the "Company"). American National 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 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 and the valuation of foreclosed real estate.

In April 2006, AMNB Statutory Trust I, a Delaware statutory trust (the "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. Refer to Note 9 for further details concerning this variable interest entity.

All significant inter-company transactions and accounts are eliminated in consolidation, with the exception of the Trust, 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 June 30, 2010; the consolidated statements of income for the three and six months ended June 30, 2010 and 2009; the consolidated statements of changes in shareholders' equity for the six months ended June 30, 2010 and 2009; and the consolidated statements of cash flows for the six months ended June 30, 2010 and 2009. Operating results for the three and six month periods ended June 30, 2010 are not necessarily indicative of the results that may occur for the year ending December 31, 2010. 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, 2009.

Note 2 – Recent Accounting Pronouncements

In June 2009, the FASB issued new guidance relating to the accounting for transfers of financial assets. The new guidance, which was issued as SFAS No. 166, "Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140", was adopted into Codification in December 2009 through the issuance of Accounting Standards Updated ("ASU") 2009-16. The new standard provides guidance to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued new guidance relating to the variable interest entities. The new guidance, which was issued as SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)," was adopted into Codification in December 2009. The objective of the guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS No. 167 is effective as of January 1, 2010. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update No. 2009-15 (ASU 2009-15), "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing." ASU 2009-15 amends Subtopic 470-20 to expand accounting and reporting guidance for own-share lending arrangements issued in contemplation of convertible debt issuance. ASU 2009-15 is effective for fiscal years beginning on or after December 15, 2009 and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued ASU 2010-04, Accounting for Various Topics – Technical Corrections to SEC Paragraphs. ASU 2010-04 makes technical corrections to existing SEC guidance including the following topics: accounting for subsequent investments, termination of an interest rate swap, issuance of financial statements - subsequent events, use of residual method to value acquired assets other than goodwill, adjustments in assets and liabilities for holding gains and losses, and selections of discount rate used for measuring defined benefit obligation. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued Accounting Standards Update No. 2010-08, "Technical Corrections to Various Topics." ASU 2010-08 clarifies guidance on embedded derivatives and hedging. ASU 2010-08 is effective for interim and annual periods beginning after December 15, 2009. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued Accounting Standards Update No. 2010-09, "Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements." ASU 2010-09 addresses both the interaction of the requirements of Topic 855 with the SEC's reporting requirements and the intended breadth of the reissuance disclosures provisions related to subsequent events. An entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. ASU 2010-09 is effective immediately. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The new disclosure guidance will significantly expand the existing requirements and will lead to greater transparency into a company's exposure to credit losses from lending arrangements. The extensive new disclosures of information as of the end of a reporting period will become effective for both interim and annual reporting periods ending after December 15, 2010. Specific items regarding activity that occurred before the issuance of the ASU, such as the allowance rollforward and modification disclosures, will be required for periods beginning after December 15, 2010. The Company is currently assessing the impact that ASU 2010-20 will have on its consolidated financial statements.

Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2009 for previously announced accounting pronouncements.

Note 3 – Securities

The amortized cost and estimated fair value of investments in debt and equity securities at June 30, 2010 and December 31, 2009 were as follows:

	June 30, 2010			
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Federal agencies & GSE	$ 75,460	$ 1,207	$ -	$ 76,667
Mortgage-backed & CMO’s	49,499	1,853	271	51,081
State and municipal	79,256	2,556	109	81,703
Corporate	1,967	156	-	2,123
Total securities available for sale	206,182	5,772	380	211,574
Securities held to maturity:				
Mortgage-backed & CMO’s	172	17	-	189
State and municipal	4,651	188	-	4,839
Total securities held to maturity	4,823	205	-	5,028
Total securities	$ 211,005	$ 5,977	$ 380	$ 216,602

	December 31, 2009			
(in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities available for sale:				
Federal agencies & GSE	$ 81,279	$ 1,474	$ 7	$ 82,746
Mortgage-backed & CMO’s	41,365	1,535	310	42,590
State and municipal	58,035	1,442	181	59,296
Corporate	3,962	201	-	4,163
Total securities available for sale	184,641	4,652	498	188,795
Securities held to maturity:				
Mortgage-backed & CMO’s	199	14	-	213
State and municipal	6,330	220	-	6,550
Total securities held to maturity	6,529	234	-	6,763
Total securities	$ 191,170	$ 4,886	$ 498	$ 195,558

Temporarily Impaired Securities

The following table shows estimated fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2010. 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 and held to maturity 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	Unrealized	Estimated	Unrealized	Estimated	Unrealized

	Fair Value	Loss	Fair Value	Loss	Fair Value	Loss
GSE debt securities	$ 13,002	$ -	$ 13,002	$ -	$ -	$ -
Mortgage-backed	5,173	13	5,173	13	-	-
CMO's	2,615	258	846	13	1,769	245
State and municipal	12,286	109	11,859	96	427	13
Total	$ 33,076	$ 380	$ 30,880	$ 122	$ 2,196	$ 258

GSE debt securities. The unrealized losses on the three investments in GSEs (“government sponsored entities”) were caused by interest rate increases and aggregate less than $1,000. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases 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 bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2010.

GSE residential mortgage-backed securities. The unrealized losses on the Company's investment in three GSE mortgage-backed securities and one collateralized mortgage obligation (“CMO”) were caused by interest rate increases. The contractual cash flows of those investments are guaranteed by an agency or GSE 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 bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2010.

Private-Label Residential Mortgage-Backed Securities: The unrealized losses associated with four private residential collateralized mortgage obligations are 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 our assessment of the expected credit losses of the security given the performance of the underlying collateral compared to our credit enhancement, we expect to recover the remaining amortized cost basis of three of these four securities. See Other than Temporarily Impaired Securities below regarding one of these issues.

State and municipal securities: The unrealized losses on the 15 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 bases 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 bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2010.

The Company’s investment in restricted stock of $4,362,000 at June 30, 2010, shown as a separate line item on the consolidated balance sheets, includes $2,812,000 in stock of the Federal Home Loan Bank of Atlanta (“FHLB”). FHLB stock is generally viewed as a long-term and restricted investment security, 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 FHLB did temporarily suspend dividends and repurchases of excess capital stock in 2009. However, they have recently resumed both activities on a limited basis. The Company does not consider this investment to be other-than-temporarily impaired at June 30, 2010 and no impairment has been recognized.

Other than Temporarily Impaired Securities

One variable rate CMO was downgraded below investment grade to CCC status by Standard and Poor’s during the first quarter 2010. Based upon a review of the security by an independent advisory firm, the Company elected to recognize an impairment charge to earnings of $31,000 in the first quarter. The impairment charge was based on a review of recent actual historical performance and an estimate of expected annual ongoing losses of 0.91% and loss on loans sixty days or greater of 6.41%. The Other Comprehensive Income (“OCI”) adjustment was based on an estimated 15% fair value return based on current market conditions. The investment was reviewed again for other than temporarily impairment ("OTTI") in the second quarter. No additional impairment was deemed necessary at this time.

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, 2009.

	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
GSE debt securities	$ 28,918	$ 7	$ 28,918	$ 7	$ -	$ -
Mortgage-backed	7,294	95	7,294	95	-	-
CMO's	2,151	215	-	-	2,151	215
State and municipal	7,420	181	6,991	145	429	36
Total	$ 45,783	$ 498	$ 43,203	$ 247	$ 2,580	$ 251

Note 4 - Loans

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

(in thousands)	June 30, 2010	December 31, 2009
Construction and land development	$ 40,039	$ 40,371
Commercial real estate	202,602	208,066
Residential real estate	119,410	121,639
Home equity	63,992	64,678
Total real estate	426,043	434,754
Commercial and industrial	86,924	86,312
Consumer	6,449	6,925
Total loans	$ 519,416	$ 527,991

The following is a summary of information pertaining to impaired and nonaccrual loans:

(in thousands)	June 30, 2010	December 31, 2009
Impaired loans with a valuation allowance	$ -	$ 1,284
Impaired loans without a valuation allowance	1,995	2,540
Total impaired loans	$ 1,995	$ 3,824
Allowance provided for impaired loans, included in the allowance for loan losses	$ -	$ 796
Nonaccrual loans excluded from the impaired loan disclosure	$ 2,083	$ 1,885

(in thousands)	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009

Average balance in impaired loans	$	3,452	$	3,348
Interest income recognized on impaired loans		-		83
Interest income recognized on nonaccrual loans		-		-
Interest on nonaccrual loans had they been accruing		134		202
Loans past due 90 days and still accruing interest		8		-

No additional funds are committed to be advanced in connection with impaired loans.

Foreclosed real estate was $3,730,000 at June 30, 2010 and $3,414,000 December 31, 2009.

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

Changes in the allowance for loan losses and the reserve for unfunded lending commitments for the six months ended June 30, 2010 and 2009, and for the year ended December 31, 2009, are presented below:

(in thousands)	Six Months Ended June 30, 2010	Year Ended December 31, 2009	Six Months Ended June 30, 2009
Allowance for Loan Losses			
Balance, beginning of period	$ 8,166	$ 7,824	$ 7,824
Provision for loan losses	570	1,662	842
Charge-offs	(732)	(1,601)	(798)
Recoveries	131	281	66
Balance, end of period	$ 8,135	$ 8,166	$ 7,934
Reserve for unfunded lending commitments			
Balance, beginning of period	$ 260	475	$ 475
Provision for unfunded commitments	(29)	-	(12)
Charge-offs	-	(215)	(215)
Balance, end of period	$ 231	$ 260	$ 248

The reserve for unfunded loan commitments is included on the consolidated balance sheet in other liabilities.

Note 6 – Goodwill and Other Intangible Assets

In January 2002, the Company adopted SFAS No. 142 (ASC 805), "Goodwill and Other Intangible Assets". Accordingly, goodwill is no longer subject to amortization, but is subject to at least an annual assessment for impairment by applying a fair value test. A fair value-based test was performed during the third quarter as of June 30, 2010 that determined there has been no impairment in the value of goodwill.

The changes in the carrying amount of goodwill for the quarter ended June 30, 2010, are as follows (in thousands):

Balance as of December 31, 2009	$22,468
Goodwill recorded during the period	-
Impairment losses	-
Balance as of June 30, 2010	$22,468

Core deposit intangible assets resulting from an acquisition were originally recorded at $3,112,000 in April 2006, and are being amortized over 99 months. The net core deposit intangible at June 30, 2010 was $1,509,000.

13

Note 7 – Short-term Borrowings

Short-term borrowings consist of customer repurchase agreements, overnight borrowings from the FHLB, and Federal Funds purchased. Customer repurchase agreements are collateralized by securities of the U.S. Government or its agencies and they mature daily. The interest rates are generally fixed but may be changed at the discretion of the Company. The securities underlying these agreements remain under the Company's control. FHLB overnight borrowings have floating interest rates that may change daily at the discretion of the FHLB. Federal Funds purchased are unsecured overnight borrowings from other financial institutions. Customer repurchase agreements were $61,665,000 at June 30, 2010 and $65,929,000 at December 31, 2009.

Note 8 – Long-term Borrowings

Under the terms of its collateral agreement with the FHLB, the Company provides a blanket lien covering all of its residential first mortgage loans, second mortgage loans and home equity lines of credit. In addition, the Company pledges as collateral its capital stock in the FHLB and deposits with the FHLB. The Company has a line of credit with the FHLB equal to 30% of the Company's assets, subject to the amount of collateral pledged. As of June 30, 2010, $91,588,000 in 1-4 family residential mortgage loans and $58,167,000 in home equity lines of credit were pledged under the blanket floating lien agreement which covers both short-term and long-term borrowings. Long-term borrowings consisted of the following fixed rate, long term advances as of June 30, 2010 and December 31, 2009 (in thousands):

June 30, 2010				December 31, 2009			
Due by	Advance Amount	Weighted Average Rate		Due by	Advance Amount	Weighted Average Rate	
March 2011	$ 8,000	2.93		March 2011	$ 8,000	2.93	
April 2014	563	3.78		April 2014	638	3.78	
	$ 8,563	2.99	%		$ 8,638	2.99	%

In the regular course of conducting its business, the Company takes deposits from political subdivisions of Virginia and North Carolina. At June 30, 2010, the Bank's public deposits totaled $87,634,000. The Company is required to provide collateral to secure the deposits that exceed the insurance coverage provided by the Federal Deposit Insurance Corporation. This collateral can be provided in the form of certain types of government, agency, or GSE bonds or letters of credit from the FHLB. At June 30, 2010, the Company had $40 million in letters of credit with the FHLB outstanding to provide collateral for such deposits. The Company had also pledged $31,009,000 of its investment portfolio for the same purpose.

Note 9 – Trust Preferred Capital Notes

On April 7, 2006, AMNB Statutory Trust I, a Delaware statutory trust and a newly formed, wholly owned subsidiary of the Company, issued $20,000,000 of preferred securities in a private placement pursuant to an applicable exemption from registration. The Trust Preferred Securities mature on June 30, 2036, but may be redeemed at the Company's option beginning on June 30, 2011. The securities require quarterly distributions by the Trust to the holder of the Trust Preferred Securities at a fixed rate of 6.66%. Effective June 30, 2011, the rate will reset quarterly at the three-month LIBOR plus 1.35%. Distributions are cumulative and will accrue from the date of original issuance, but may be deferred by the Company from time to time for up to twenty consecutive quarterly periods. The Company has guaranteed the payment of all required distributions on the Trust Preferred Securities.

The proceeds of the Trust Preferred Securities received by the Trust, along with proceeds of $619,000 received by the Trust from the issuance of common securities by the Trust to the Company, were used to purchase $20,619,000 of the Company's junior subordinated debt securities (the "Trust Preferred Capital Notes"), issued pursuant to a Junior Subordinated Indenture entered into between the Company and Wilmington Trust Company, as trustee. The proceeds of the Trust Preferred Capital Notes were used to fund the cash portion of the merger consideration to the former shareholders of Community First in connection with the Company's acquisition of that company and for general corporate purposes. In accordance with FASB ASC 810-10-15-14, the Corporation did not eliminate through consolidation the Corporation's $619,000 equity investment in AMNB Statutory Trust I. Instead, the Corporation reflected this equity investment in the "Accrued interest receivable and other assets" line item in the consolidated balance sheets.

Note 10 – Share Based Compensation

Stock Options

A summary of stock option transactions for the six months ended June 30, 2010, is as follows:

	Option Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Average Intrinsic Value ($000)
Outstanding at December 31, 2009	162,603	$ 21.39		
Granted	-	-		
Exercised	(2,813)	16.31		
Forfeited	(200)	24.50		
Outstanding at June 30, 2010	159,590	$ 21.48	5.1	$ 306
Exercisable at June 30, 2010	129,090	$ 22.56	4.3	$ 168

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and expensed over the options' vesting period. As of June 30, 2010, there was $95,000 in total unrecognized compensation expense related to nonvested stock option grants. .

Restricted Stock

The Company from time-to-time grants shares of restricted stock to key employees and non-employee directors. These awards help align the interests of these employees and directors with the interests of the shareholders of the Company by providing economic value directly related to increases in the value of the Company's stock. The value of the stock awarded is established as the fair market value of the stock at the time of the grant. The Company recognizes expense, equal to the total value of such awards, ratably over the vesting period of the stock grants.

The Company made its first restricted grant to executive officers in the first quarter 2010. These grants cliff vest over a 24 month period. On January 19, 2010, the Company issued 8,712 shares of restricted stock to its six executive officers and three regional executives.

Nonvested restricted stock for the six months ended June 30, 2010 is summarized in the following table.

Restricted Stock	Shares	Grant date fair value
Nonvested at January 1, 2010	-	-
Granted	8,712	$ 21.36
Vested	-	-
Forfeited	-	-
Nonvested at June 30, 2010	8,712	$ 21.36

As of June 30, 2010, there was $140,000 of total unrecognized compensation cost related to nonvested restricted stock granted under the plan. This cost is expected to be recognized over the next 21 months.

Starting in 2010, the Company has begun offering its directors an option on director compensation. Their regular monthly retainer could be received as $1,000 per month in cash or $1,250 in immediately vested, but restricted stock. Eight of twelve directors elected to receive stock in lieu of cash for their retainer fees. Only outside directors receive board fees. The Company issued 3,032 shares and recognized share based compensation expense of $60,000 during the six-month period.

Note 11 – Earnings Per Share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of potentially dilutive common stock. Potentially dilutive common stock had no effect on income available to common shareholders.

	Three Months Ended June 30,			
	2010		2009	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic	6,123,790	$ .33	6,096,034	$ .28
Effect of dilutive securities - stock options	6,153	-	1,013	-
Diluted	6,129,943	$ .33	6,097,047	$ .28

	Six Months Ended June 30,			
	2010		2009	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic	6,121,615	$ .69	6,089,055	$ .41

Effect of dilutive securities -				
stock options	5,522	-	2,236	-
Diluted	6,127,137	$ .69	6,091,291	$ .41

Stock options on common stock which were not included in computing diluted earnings per share for the six month periods ended June 30, 2010 and 2009, because their effects were antidilutive, averaged 82,627 and 106,511, respectively.

Note 12 – Employee Benefit Plans

Following is information pertaining to the Company's non-contributory defined benefit pension plan.

Components of Net Periodic Benefit Cost (in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Service cost	$ 23	$ 184	$ 46	$ 368
Interest cost	117	146	234	292
Expected return on plan assets	(135)	(203)	(270)	(406)
Recognized net actuarial loss	57	111	114	222
Net periodic benefit cost	$ 62	$ 238	$ 124	$ 476

The Company's does not anticipate contributing to the plan for 2010.

Note 13 – Segment and Related Information

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

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

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

Amounts shown in the "Other" column includes activities of American National Bankshares Inc. which are primarily debt service on trust preferred securities and corporate items. Intersegment eliminations primarily consist of American National Bankshares Inc.'s interest income on deposits held by its banking subsidiary.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

Segment information as of and for the six month periods ended June 30, 2010 and 2009, is shown in the following table.

Six Months Ended June 30, 2010

(in thousands)	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$ 18,062	$ -	$ 74	$ (74)	$ 18,062
Interest expense	3,687	-	687	(74)	4,300
Noninterest income	2,006	1,656	21	-	3,683
Operating income before income taxes	5,447	1,080	(742)	-	5,785
Depreciation and amortization	817	8	0	-	825
Total assets	831,971	-	673	-	832,644
Capital expenditures	1,098	1	-	-	1,099

Six Months Ended June 30, 2009

(in thousands)	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$ 19,340	$ -	$ 159	$ (159)	$ 19,340
Interest expense	5,490	-	687	(159)	6,018
Noninterest income	1,305	1,654	28	-	2,987
Operating income before income taxes	2,878	1,063	(670)	-	3,271
Depreciation and amortization	746	8	1	-	755
Total assets	810,728	-	755	-	811,483
Capital expenditures	2,341	8	-	-	2,349

Three Months Ended June 30, 2010

(in thousands)	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$ 9,011	$ -	$ 37	$ (37)	$ 9,011
Interest expense	1,846	-	344	(37)	2,153
Noninterest income	927	824	11	-	1,762
Operating income before income taxes	2,563	532	(353)	-	2,742
Depreciation and amortization	403	4	-	-	407
Total assets	831,971	-	673	-	832,644
Capital expenditures	826	-	-	-	826

Three Months Ended June 30, 2009

(in thousands)	Community Banking	Trust and Investment Services	Other	Intersegment Eliminations	Total
Interest income	$ 9,690	$ -	$ 79	$ (79)	$ 9,690

Interest expense	2,516	-	344	(79)	2,781
Noninterest income	1,398	839	16	-	2,253
Operating income before income taxes	2,135	557	(343)	-	2,349
Depreciation and amortization	379	4	-	-	383
Total assets	810,728	-	755	-	811,483
Capital expenditures	1,160	-	-	-	1,160

Note 14 – Fair Value of Financial Instruments

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic of FASB ASC, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

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

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2010 (in thousands):

		Fair Value Measurements at June 30, 2010 Using		
Description	Balance as of June 30, 2010	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Securities available for sale	$ 211,574	$ -	$ 211,146	$ 428

		Fair Value Measurements at December 31, 2009 Using		
Description	Balance as of December 31, 2009	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Securities available for sale	$ 188,795	$ -	$ 188,795	$ -

Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans held for sale: Loans held for sale are carried at estimated fair value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during the year ended June 30, 2010. Gains and losses on the sale of loans are recorded within income from mortgage banking on the Consolidated Statements of Income.

Impaired loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Other real estate owned: Certain assets such as other real estate owned ("OREO") are measured at fair value less cost to sell. We believe that the fair value component in our valuation of OREO follows the provisions of accounting standards.

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

		Fair Value Measurements at June 30, 2010 Using		
Description	Balance as of June 30, 2010	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets				
Impaired loans, net of valuation allowance	-	-	-	-
Other real estate owned	3,730	-	3,730	-

		Fair Value Measurements at December 31, 2009 Using		
Description	Balance as of December 31, 2009	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets				
Impaired loans, net of valuation allowance	488	-	488	-
Other real estate owned	3,414	-	3,414	-

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
	Total Realized / Unrealized Gains (Losses) Included in				
Balances as of January 1, 2010	Net Income	Other Comprehensive Income	Purchases, Sales, Issuances and Settlements,	Transfer In (Out) of Level 3	Balances as of June 30, 2010

				Net		
Securities available for sale						
Private label Collateralized Mortgage Obligation (ARM)	$-	$(31)	$ (201)	$(9)	$684	$443
Total assets	$-	$(31)	$ (201)	$(9)	$684	$443

21

The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments are as follows:

	June 30, 2010		December 31, 2009	
(in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	$ 34,103	$ 34,103	$ 23,943	$ 23,943
Securities available for sale	211,574	211,574	188,795	188,795
Securities held to maturity	4,823	5,028	6,529	6,673
Loans held for sale	2,879	2,879	2,490	2,490
Loans, net of allowance	511,281	513,160	519,825	528,631
Accrued interest receivable	3,584	3,584	3,268	3,268
Financial liabilities:				
Deposits	$ 630,151	$ 632,450	$ 604,273	$ 607,015
Repurchase agreements	61,665	61,665	65,929	65,929
Other borrowings	8,563	8,554	8,638	8,620
Trust preferred capital notes	20,619	20,532	20,619	20,640
Accrued interest payable	841	841	899	899

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and cash equivalents. The carrying amount is a reasonable estimate of fair value.

Securities. Fair values are based on quoted market prices or dealer quotes.

Loans held for sale. The carrying amount is a reasonable estimate of fair value.

Loans. For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate loans are estimated based upon discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

Deposits. The fair value of demand deposits, savings deposits, and money market deposits equals the carrying value. The fair value of fixed-rate certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposit instruments would be offered to depositors for the same remaining maturities.

Repurchase agreements. The carrying amount is a reasonable estimate of fair value.

Other borrowings. The fair values of long-term borrowings are estimated using discounted cash flow analyses based on the interest rates for similar types of borrowing arrangements.

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

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

Off-balance sheet instruments. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At June 30, 2010 and December 31, 2009, the fair value of off balance sheet instruments was deemed immaterial, and therefore was not included in the previous table.

The Company assumes interest rate risk in its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rates change and that change may be either favorable or unfavorable to the Company.

Note 15 – Supplemental Cash Flow Information

	Six Months Ended June 30, 2010	2009
Supplemental Schedule of Cash and Cash Equivalents:		
Cash and due from banks	$ 11,398	$ 13,905
Interest-bearing deposits in other banks	22,705	26,879
	$ 34,103	$ 40,784
Supplemental Disclosure of Cash Flow Information:		
Cash paid for:		
Interest on deposits and borrowed funds	$ 4,358	$ 6,296
Income taxes	2,285	505
Noncash investing and financing activities:		
Transfer of loans to other real estate owned	722	1,134
Unrealized gain on securities available for sale	1,238	663

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

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

Forward-Looking Statements

This report contains forward-looking statements with respect to the financial condition, results of operations and business of American National Bankshares Inc. and its wholly owned subsidiary, American National Bank and Trust Company (the “Bank”) (collectively referred to as the “Company”). These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Company and on information available to management at the time these statements and disclosures were prepared. Forward-looking statements are subject to numerous assumptions, estimates, risks, and uncertainties that could cause actual conditions, events, or results to differ materially from those stated or implied by such forward-looking statements.

A variety of factors may affect the operations, performance, business strategy, and results of the Company. Those factors include but are not limited to the following:

- Financial market volatility including the level of interest rates could affect the values of financial instruments and the amount of net interest income earned;
- General economic or business conditions, either nationally or in the market areas in which the Company does business, may be less favorable than expected, resulting in deteriorating credit quality, reduced demand for credit, or a weakened ability to generate deposits;
- Competition among financial institutions may increase and competitors may have greater financial resources and develop products and technology that enable those competitors to compete more successfully than the Company;
- Businesses that the Company is engaged in may be adversely affected by legislative or regulatory changes, including changes in accounting standards;
- The ability to retain key personnel; and
- The failure of assumptions underlying the allowance for loan losses.

Reclassification

In certain circumstances, reclassifications have been made to prior period information to conform to the 2009 presentation.

Critical Accounting Policies

The accounting and reporting policies followed by the Company conform with U.S. generally accepted accounting principles (“GAAP”) and they conform to general practices within the banking industry. The Company’s critical accounting policies, which are summarized below, relate to (1) the allowance for loan losses and (2) goodwill impairment. A summary of the Company’s significant accounting policies is set forth in Note 1 to the Consolidated Financial Statements in the Company’s 2009 Annual Report on Form 10-K.

The financial information contained within the Company’s financial statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset, or relieving a liability. In addition, GAAP itself may change from one previously acceptable method to another method.

Allowance for Loan Losses and Reserve for Unfunded Loan Commitments

The allowance for loan losses is an estimate of the losses inherent in the loan portfolio at the balance sheet date. The allowance is based on two basic principles of accounting: FASB Topic 450-25 Contingencies - Recognition which requires that losses be accrued when they are probable of occurring and estimable and FASB Topic 310-10 Receivables – Overall – Subsequent Measurement which requires that losses on impaired loans be accrued based on the differences between the value of collateral, present value of future cash flows, or values observable in the secondary market, and the loan balance.

The Company's allowance for loan losses has three basic components: the formula allowance, the specific allowance and the unallocated allowance. Each of these components is determined based upon estimates that can and do change. The formula allowance uses a historical loss view as an indicator of future losses along with various qualitative factors, including levels and trends in delinquencies, nonaccrual loans, charge-offs and recoveries; trends in volume and terms of loans; effects of changes in underwriting standards; experience of lending staff and economic conditions; and portfolio concentrations. In the formula allowance, the historical loss rate is combined with the qualitative factors, resulting in an adjusted loss factor for each risk-grade category of loans. The adjusted loss factor is multiplied by the period-end balances for each risk-grade category. The formula allowance is calculated for a range of outcomes. The specific allowance uses various techniques to arrive at an estimate of loss for specifically identified impaired loans. The unallocated allowance includes estimated losses whose impact on the portfolio has yet to be recognized in either the formula or specific allowance. The use of these values is inherently subjective and actual losses could be greater or less than the estimates.

The reserve for unfunded loan commitments is an estimate of the losses inherent in off-balance-sheet loan commitments at the balance sheet date. It is calculated by multiplying an estimated loss factor by an estimated probability of funding, and then by the period-end amounts for unfunded commitments. The reserve for unfunded loan commitments is included in other liabilities.

Goodwill Impairment

The Company tests goodwill on an annual basis or more frequently if events or circumstances indicate that there may have been impairment. If the carrying amount of goodwill exceeds its implied fair value, the Company would recognize an impairment loss in an amount equal to that excess. The goodwill impairment test requires management to make judgments in determining the assumptions used in the calculations. The goodwill impairment testing conducted by the Company in 2010 indicated that goodwill is not impaired and is properly recorded in the financial statements. No events or circumstances since December 31, 2009 have occurred that would question the impairment of goodwill.

Non-GAAP Presentations

The analysis of net interest income in this document is performed on a taxable equivalent basis to facilitate performance comparisons among various taxable and tax-exempt assets.

Internet Access to Corporate Documents

The Company provides access to its Securities and Exchange Commission ("SEC") filings through a link on the Investors Relations page of the Company's web site at www.amnb.com. Reports available include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after the reports are filed electronically with the SEC. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

RESULTS OF OPERATIONS

Earnings Performance

Three months ended June 30, 2010 and 2009

For the quarter ended June 30, 2010, the Company reported net income of $2,014,000 compared to $1,706,000 for the comparable quarter in 2009. The $308,000 or 18.1% increase in earnings was primarily due to:

- a $207,000 decrease in provision for loan losses, primarily related to the decline in overall loan volume,
- a $491,000 decrease in noninterest income, primarily related to reduction in income from sale of secondary market mortgages and write downs of foreclosed assets, and
- a $728,000 decrease in expenses, related to reductions in personnel and benefits costs and to the FDIC special assessment levied in the 2009 quarter.

SUMMARY INCOME STATEMENT
(dollars in thousands)

For the three months ended June 30,	2010	2009	$ change	% change
Interest income	$ 9,011	$ 9,690	$ (679)	-7.0 %
Interest expense	(2,153)	(2,781)	628	-22.6 %
Net interest income	6,858	6,909	(51)	-0.7 %
Provision for loan losses	(285)	(492)	207	-42.1 %
Noninterest income	1,762	2,253	(491)	-21.8 %
Noninterest expense	(5,593)	(6,321)	728	-11.5 %
Income tax expense	(728)	(643)	(85)	13.2 %
Net income	$ 2,014	$ 1,706	$ 308	18.1 %

Six months ended June 30, 2010 and 2009

For the six month period ended June 30, 2010, the Company reported net income of $4,199,000 compared to $2,474,000 for the comparable quarter in 2009. The $1,725,000 or 69.7% increase in earnings was primarily due to:

- a $440,000 increase in net interest income, primarily related to declining deposit rates,

- a $272,000 decrease in provision for loan losses, primarily related to the decline in loan volume,

- a $696,000 increase in noninterest income, related to various factors, the largest of which was a $1.2 million other real estate write down in the 2009 period, and

- a $1,106,000 decrease in expenses, related to reductions in personnel and benefits costs and to the FDIC special assessment levied in the 2009 quarter.

SUMMARY INCOME STATEMENT
(dollars in thousands)

For the six months ended June 30,	2010	2009	$ change	% change
Interest income	$ 18,062	$ 19,340	$ (1,278)	-6.6 %
Interest expense	(4,300)	(6,018)	1,718	-28.5 %
Net interest income	13,762	13,322	440	3.3 %
Provision for loan losses	(570)	(842)	272	-32.3 %
Noninterest income	3,683	2,987	696	23.3 %
Noninterest expense	(11,090)	(12,196)	1,106	-9.1 %
Income tax expense	(1,586)	(797)	(789)	99.0 %
Net income	$ 4,199	$ 2,474	$ 1,725	69.7 %

Net Interest Income

Net interest income is the difference between interest income on earning assets, primarily loans and securities, and interest expense on interest bearing liabilities, primarily deposits and other funding sources. Fluctuations in interest rates as well as volume and mix changes in earning assets and interest bearing liabilities can materially impact net interest income. The following discussion of net interest income is presented on a taxable equivalent basis to facilitate performance comparisons among various taxable and tax-exempt assets, such as certain state and municipal securities. A tax rate of 35% was used in adjusting interest on tax-exempt assets to a fully taxable equivalent basis. Net interest income divided by average earning assets is referred to as the net interest margin. The net interest spread represents the difference between the average rate earned on earning assets and the average rate paid on interest bearing liabilities.

Three months ended June 30, 2010 and 2009

Net interest income on a taxable equivalent basis increased slightly to $43,000 or 0.6%, for the second quarter of 2010 compared to the same quarter of 2009. Changes in the rate paid and volume of time deposits were the primary drivers of this change in net interest income, as indicated by the Rate/Volume Analysis shown later in this section.

For the second quarter of 2010 and 2009, the Company’s yield on earnings assets was 5.00% compared to 5.33%. The cost of interest bearing liabilities was 1.42% compared to 1.83%. The interest rate spread was 3.58% compared to 3.50%. The net interest margin, on a fully taxable equivalent basis, was 3.85% compared to 3.84%. Yields and rates generally fell between periods, but most of the improvement in spread and margin was related to reductions in liability pricing, notably time deposits.

The following presentation is an analysis of net interest income and related yields and rates, on a taxable equivalent basis, for the three months ended June 30, 2010 and 2009. Nonaccrual loans are included in average balances. Interest income on nonaccrual loans, if recognized, is recorded on a cash basis or when the loan returns to accrual status.

Net Interest Income Analysis
For the Three Months Ended June 30, 2010 and 2009
(in thousands, except rates)

	Average Balance		Interest Income/Expense		Yield/Rate	
	2010	2009	2010	2009	2010	2009
Loans:						
Commercial	$ 78,673	$ 91,701	$ 939	$ 1,100	4.77 %	4.80 %
Real estate	437,856	470,859	6,033	6,669	5.51	5.67
Consumer	6,485	7,881	137	175	8.45	8.88
Total loans	523,014	570,441	7,109	7,944	5.44	5.57
Securities:						
Federal agencies	66,019	46,225	525	525	3.18	4.54
Mortgage-backed & CMO's	45,651	41,382	479	550	4.20	5.32
State and municipal	79,622	51,718	1,079	731	5.42	5.65
Other	6,997	8,251	61	72	3.49	3.49
Total securities	198,289	147,576	2,144	1,878	4.33	5.09
Deposits in other banks	25,576	26,882	87	103	1.36	1.53
Total interest-earning assets	746,879	744,899	9,340	9,925	5.00	5.33
Non-earning assets	71,861	67,505				
Total assets	$ 818,740	$ 812,404				
Deposits:						
Demand	$ 96,098	$ 92,447	21	42	0.09	0.18
Money market	82,372	78,143	101	148	0.49	0.76
Savings	64,561	62,557	22	37	0.14	0.24
Time	271,932	280,729	1,503	1,953	2.21	2.78
Total deposits	514,963	513,876	1,647	2,180	1.28	1.70
Customer repurchase agreements	62,072	60,876	99	176	0.64	1.16
Other short-term borrowings	-	1,553	-	1	-	0.26
Long-term borrowings	29,212	30,460	407	424	5.57	5.57

Total interest-bearing liabilities	606,247	606,765	2,153	2,781	1.42	1.83
Noninterest bearing demand deposits	100,493	98,258				
Other liabilities	3,873	4,519				
Shareholders' equity	108,127	102,862				
Total liabilities and shareholders' equity	$ 818,740	$ 812,404				
Interest rate spread					3.58 %	3.50 %
Net interest margin					3.85 %	3.84 %
Net interest income (taxable equivalent basis)			7,187	7,144		
Less: Taxable equivalent adjustment			329	235		
Net interest income			$ 6,858	$ 6,909		

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

	Three months ended June 30 2010 vs. 2009		
	Interest Increase (Decrease)	Change Attributable to	
Interest income		Rate	Volume
Loans:			
Commercial	$ (161)	$ (5)	$ (156)
Real Estate	(636)	(178)	(458)
Consumer	(38)	(8)	(30)
Total loans	(835)	(191)	(644)
Securities:			
Federal agencies	-	(185)	185
Mortgage-backed	(71)	(124)	53
State and municipal	348	(31)	379
Other securities	(11)	-	(11)
Total securities	266	(340)	606
Deposits in other banks	(16)	(11)	(5)
Total interest income	(585)	(542)	(43)
Interest expense			
Deposits:			
Demand	(21)	(23)	2
Money market	(47)	(55)	8
Savings	(15)	(16)	1
Time	(450)	(390)	(60)
Total deposits	(533)	(484)	(49)
Customer repurchase agreements	(77)	(80)	3
Other borrowings	(18)	20	(38)
Total interest expense	(628)	(544)	(84)
Net interest income	$ 43	$ 2	$ 41

Six months ended June 30, 2010 and 2009

Net interest income on a taxable equivalent basis increased $589,000 or 4.28%, for the six months ended June 30, 2010 compared to the comparable period in 2009. This increase was due primarily to changes in rates and volumes of liabilities, especially time deposits.

For the first six months of 2010 and 2009, the Company’s yield on earnings assets was 5.03% compared to 5.35%. The cost of interest bearing liabilities was 1.43% compared to 1.99%. The interest rate spread was 3.60% compared to 3.36%. The net interest margin, on a fully taxable equivalent basis, was 3.86% compared to 3.72%. Yields and rates generally fell between periods, but most of the improvement in spread and margin was related to reductions in liability pricing, notably time deposits.

The following presentation is an analysis of net interest income and related yields and rates, on a taxable equivalent basis, for the six months ended June 30, 2010 and 2009. Nonaccrual loans are included in average balances. Interest income on nonaccrual loans, if recognized, is recorded on a cash basis or when the loan returns to accrual status.

Net Interest Income Analysis
For the Six Months Ended June 30, 2010 and 2009
(in thousands, except rates)

	Average Balance		Interest Income/Expense		Yield/Rate	
	2010	2009	2010	2009	2010	2009
Loans:						
Commercial	$ 78,974	$ 93,887	$ 1,892	$ 2,200	4.79 %	4.69 %
Real estate	437,550	470,106	12,128	13,448	5.54	5.72
Consumer	6,628	7,888	271	353	8.18	8.95
Total loans	523,152	571,881	14,291	16,001	5.46	5.60
Securities:						
Federal agencies	65,886	45,997	1,076	1,046	3.27	4.55
Mortgage-backed & CMO's	44,722	42,962	980	1,112	4.38	5.18
State and municipal	73,614	47,247	2,006	1,335	5.45	5.65
Other	7,308	6,641	130	105	3.56	3.16
Total securities	191,530	142,847	4,192	3,598	4.38	5.04
Deposits in other banks	28,094	25,237	178	191	1.27	1.51
Total interest-earning assets	742,776	739,965	18,661	19,790	5.02	5.35
Non-earning assets	72,882	68,106				
Total assets	$ 815,658	$ 808,071				
Deposits:						
Demand	$ 96,578	$ 102,397	42	232	0.09	0.45
Money market	81,595	71,433	191	346	0.47	0.97
Savings	63,686	61,927	44	77	0.14	0.25
Time	269,256	276,600	3,005	4,052	2.23	2.93
Total deposits	511,115	512,357	3,282	4,707	1.28	1.84
Customer repurchase agreements	63,005	58,477	204	409	0.65	1.40
Other short-term borrowings	-	1,811	-	4	-	0.44
Long-term borrowings	29,230	32,418	814	898	6	5.54
Total interest-bearing						

liabilities	603,350	605,063	4,300	6,018	1.43	1.99
Noninterest bearing demand deposits	99,676	95,748				
Other liabilities	3,818	4,406				
Shareholders' equity	107,814	102,854				
Total liabilities and shareholders' equity	$ 814,658	$ 808,071				
Interest rate spread					3.59 %	3.36 %
Net interest margin					3.87 %	3.72 %
Net interest income (taxable equivalent basis)			14,361	13,772		
Less: Taxable equivalent adjustment			599	450		
Net interest income			$ 13,762	$ 13,322		

30

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

	Six months ended June 30 2010 vs. 2009		
	Interest Increase	Change Attributable to	
Interest income	(Decrease)	Rate	Volume
Loans:			
Commercial	$ (308)	$ 48	$ (356)
Real Estate	(1,320)	(409)	(911)
Consumer	(82)	(29)	(53)
Total loans	(1,710)	(390)	(1,320)
Securities:			
Federal agencies	30	(345)	375
Mortgage-backed	(132)	(176)	44
State and municipal	671	(49)	720
Other securities	25	14	11
Total securities	594	(556)	1,150
Deposits in other banks	(13)	(33)	20
Total interest income	(1,129)	(979)	(150)
Interest expense			
Deposits:			
Demand	(190)	(178)	(12)
Money market	(155)	(199)	44
Savings	(33)	(35)	2
Time	(1,047)	(942)	(105)
Total deposits	(1,425)	(1,354)	(71)
Repurchase agreements	(205)	(235)	30
Other borrowings	(88)	49	(137)
Total interest expense	(1,718)	(1,540)	(178)
Net interest income	$ 589	$ 561	$ 28

Noninterest Income

All comparisons discussed below are between the second quarter 2010 and the second quarter of 2009, unless otherwise noted.

Noninterest income decreased to $1,762,000 in 2010 from $2,253,000 in 2009, a $491,000 or 21.8% reduction. The major factors impacting that change are discussed below.

Fees from the management of trusts, estates, and asset management accounts increased to $801,000 in 2010 from $767,000 in 2009, a $34,000 or 4.4% increase. A substantial portion of Trust fees are earned based on account market values, so changes in the equity markets may have a large and potentially volatile impact on revenue.

Service charges on deposit accounts decreased to $483,000 in 2010 from $511,000 in 2009, a $28,000 or 5.5% decline. This reduction was primarily the result of lower deposit account fee volume.

Other fees and commissions increased to $288,000 in 2010 from $251,000 in 2009, an increase of $37,000 or 14.7% due primarily to increases in VISA check card and insurance income. Management expects this income category will decline after implementation of recent banking reform legislation, which is expected to have a negative impact on electronic banking fee income.

Mortgage banking income decreased to $343,000 in 2010 from $568,000 in 2009, a decline of $225,000 or 39.6%. This business area boomed in 2009, but volume has decreased in 2010 with the expiration of the home buyer tax credit and the overall slowdown in the real estate market.

Brokerage fees decreased to $22,000 in 2010 from $73,000 in 2009, a $51,000 or 69.9% decline. The reduction was due to a decline in retail investment activity and personnel turnover.

Securities gains increased to $4,000 for 2010 from $1,000 in 2009. This change was related to gains on early calls of selected government securities.

Foreclosed real estate losses were $281,000 for 2010 compared to $43,000 in 2009. The major driver in this increased loss in the second quarter of 2010 was a $253,000 charge adjusting the appraised value of certain foreclosed real estate. That same property was written down $1.2 million in the first quarter of 2009.

Noninterest income for the six month period ended June 30, 2010 increased to $3,683,000 compared to $2,987,000 for the 2009 period, $696,000 or 23.3% increase. The biggest driver in this improvement was the other real estate write down, mentioned in the preceding paragraph.

Noninterest Expense

All comparisons discussed below are between the second quarter 2010 and the second quarter of 2009, unless otherwise noted.

Noninterest expense was $5,593,000 for 2010 compared to $6,321,000 for 2009, a $728,000 or 11.5% decrease. The major factors impacting that change are discussed below.

Salaries were $2,596,000 for 2010 compared to $2,732,000 for 2009, a $136,000 or 5% decrease. This is primarily the result of a mid-2009 management decision to reduce the number of full time equivalent employees in the Bank by approximately 5% of the workforce. This was accomplished through a combination of retirements, unfilled vacancies, and a small number of layoffs.

Employee benefits were $633,000 for 2010 compared to $832,000 for 2009, a $199,000 or 23.9% decrease. This was due primarily to the change in the Company’s defined benefit plan to a cash balance plan, which was effective December 31, 2009.

FDIC insurance assessment was $199,000 for 2010 compared to $564,000 for 2009, a $365,000 or 64.7% decrease. The decrease was driven by the second quarter 2009 special FDIC insurance assessment, which cost the Company approximately $360,000.

Noninterest expense in the six months ended June 30, 2010 was $11,090,000 compared to $12,196,000 for the same period in 2009, for a decrease of $1,106,000 or 9.1%. This decrease was the result of the same factors discussed above for the quarter.

Income Taxes

The effective tax rate for the second quarter of 2010 was 26.5% compared to 27.4% for the second quarter of 2009.

The effective tax rate for the six months ended June 30, 2010 was 27.4% compared to 24.4% for the same period of 2009.

The effective tax rate is lower than the statutory rate primarily due to income that is not taxable for Federal income tax purposes. The primary non-taxable income is that of state and municipal securities and industrial revenue bonds or loans. However, in the first quarter of 2009, the effective tax rate was also impacted by the $1.2 million valuation adjustment on certain foreclosed real estate.

Impact of Inflation and Changing Prices

The majority of assets and liabilities of a financial institution are monetary in nature and therefore differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. The most significant effect of inflation is on noninterest expense, which tends to rise during periods of inflation. Changes in interest rates have a greater impact on a financial institution's profitability than do the effects of higher costs for goods and services. Through its balance sheet management practices, the Company has the ability to react to those changes and measure and monitor its interest rate and liquidity risk. During the reported periods, inflation and interest rates have been very low.

CHANGES IN FINANCIAL POSITION

BALANCE SHEET ANALYSIS

Securities

The securities portfolio generates income, plays a major role in the management of interest rate sensitivity, provides a source of liquidity, is used to meet collateral requirements for public deposits, and facilitates commercial customers' repurchase agreements. The portfolio consists primarily of high quality, investment-grade securities. Federal agency and U. S. government sponsored enterprises, mortgage-backed securities, and state and municipal securities comprise the majority of the portfolio.

The available for sale securities portfolio was $211,574,000 at June 30, 2010 compared to $188,795,000 at December 31, 2009, a $22,779,000 or 12.1% increase.

The held to maturity securities portfolio decreased to $4,823,000 at June 31, 2010 from $6,529,000 at December 31, 2009, a $1,706,000 or 26.1% decline. As a practical matter, virtually any new security purchase is classified as available for sale.

At June 30, 2010, the available for sale portfolio had an estimated fair value of $211,574,000 and an amortized cost of $206,182,000, resulting in a net unrealized gain of $5,392,000.

At the same dates, the held to maturity portfolio had an estimated fair value of $5,028,000 and an amortized cost of $4,823,000, resulting in a net unrealized gain of $205,000.

At June 30, 2010, mortgage-backed securities consist principally of obligations of U.S. Government sponsored enterprises. CMOs (collateralized mortgage obligations) issued by non-U.S. Government sponsored enterprises, as of June 30, 2010, had an amortized cost of $2,014,000 and an estimated fair value of $1,769,000; resulting in an estimated net unrealized loss of $245,000. One of these bonds, with a $629,000 book value was downgraded in the first quarter by Standard and Poor's to CCC status. After reviewing the security, management elected to take an OTTI charge of $31,000 against the bond. The current estimated market value of the security is $428,000, resulting in an estimated unrealized loss of $201,000.

The current economic challenges on a local, regional and national level have resulted in a significant slowdown in business activity throughout 2009 and continuing into 2010. This slowdown has manifested itself on the Company's balance sheet with a moderate reduction in the size of our loan portfolio, a slight increase in deposits and a substantial increase in our investment portfolio. The Company is cognizant of the historically low interest rate environment and has elected to maintain an investment strategy of purchasing high quality taxable securities of relatively short duration and longer term tax exempt securities, whose market values are not as volatile in rising rate environments as similar termed taxable investments.

Loans

The loan portfolio consists primarily of commercial and residential real estate loans, commercial loans, construction and land development loans, and home equity loans. Loans were $519,416,000 at June 30, 2010 compared to $527,991,000 at December 31, 2009, an $8,575,000 or 1.6% decrease. Management considers the decline in the loan portfolio primarily the result of the current economic climate and the overall slowdown in business activity and, secondarily, the Company's deliberate decision to maintain a conservative risk profile in consideration of long term asset quality.

Allowance for Loan Losses, Asset Quality, and Credit Risk Management

The allowance for loan losses was $8,135,000 at June 30, 2010 compared to $8,166,000 at December 31, 2009. At the same dates, the allowance was 1.57% of loans compared to 1.55%. The dollar amount of the reserve is slightly decreased during the period and is directionally consistent with the decrease in total loans, although not consistent in percentage magnitude. Management considers the size of the allowance appropriate because of continuing deterioration and negative trends in the local and regional economy, including unemployment, delinquency and foreclosure rates in Virginia and North Carolina. Bank management is aware of the possible financial impact of extended economic stress in our marketplace and has incorporated that into its qualitative assessment of the allowance for loan loss.

Annualized net charge-offs represented 0.20% of total loans during the second quarter of 2010 compared to 0.26% in the first quarter of 2010 and 0.28% in the second quarter of 2009.

Nonperforming loans include loans on which interest is no longer accrued, accruing loans that are contractually past due 90 days or more as to principal and interest payments, and any loans classified as troubled debt restructurings. Nonperforming assets include nonperforming loans and foreclosed real estate. Nonperforming assets represented 0.93% and 0.87% of total assets, respectively, at June 30, 2010 and December 31, 2009. There were no troubled debt restructurings at June 30, 2010 and December 31, 2009.

The following table summarizes nonperforming assets (in thousands):

	June 30, 2010	December 31, 2009
Loans 90 days or more past due	$ 8	$ -
Nonaccrual loans	4,005	3,642
Nonperforming loans	4,013	3,642
Foreclosed real estate	3,730	3,414
Nonperforming assets	$ 7,743	$ 7,056

Premises and equipment

Premises and equipment were $19,658,000 at June 30, 2010 compared to $19,195,000, at December 31, 2009, a $463,000 or 2.4% increase. Most of this increase was related to the construction of a new branch in South Boston, Virginia, whose completion is expected by September 2010.

Deposits

The Company's deposits consist primarily of checking, money market, savings, and consumer time deposits. Total deposits were $630,151,000 at June 30, 2010 compared to $604,273,000 at December 31, 2009, a $25,878,000 or 4.3% increase. Core deposit growth continues to be an ongoing strategic goal and challenge for the Company and the community banking industry in general.

Shareholders' Equity

The Company's capital management strategy is to be classified as "well capitalized" under regulatory capital ratios and provide as high as possible total return to our shareholders.

Shareholders' equity was $108,760,000 at June 30, 2010 compared to $106,389,000 at December 31, 2009, an increase of $2,371,000 or 2.2%.

The Company paid cash dividends of $0.23 per share during the second quarter of 2010 while the basic and diluted earnings per share for the same period were $0.33 per share. The Company paid cash dividends of $0.46 per share for the first half of 2010 while the basic and diluted earnings per share were $0.69 per share. The Company's current capital position provided the Board of Directors with the strategic flexibility to temporarily pay a cash dividend relatively high relative to current earnings.

Banking regulators have defined minimum regulatory capital ratios that the Company and its banking subsidiary are required to maintain. These ratios take into account risk factors identified by those regulatory authorities associated with the assets and off-balance sheet activities of financial institutions. The guidelines require percentages, or "risk weights," be applied to those assets and off-balance sheet assets in relation to their perceived risk. Under the guidelines, capital strength is measured in two tiers. Tier I capital consists primarily of shareholders' equity and trust preferred capital notes, while Tier II capital consists of qualifying allowance for loan losses. "Total" capital is the combination of Tier I and Tier II capital. Another regulatory indicator of capital adequacy is the leverage ratio, which is computed by dividing Tier I capital by average quarterly assets less intangible assets.

The regulatory guidelines require that minimum total capital (Tier I plus Tier II) of 8% be held against total risk-adjusted assets, at least half of which (4%) must be Tier I capital. At June 30, 2010, the Company's Tier I and total capital ratios were 18.18% and 19.43%, respectively. At December 31, 2009, these ratios were 17.56% and 18.82%, respectively. The ratios for both periods were in excess of the regulatory requirements. The Company's leverage ratio was 12.95% and 12.81% at June 30, 2010 and December 31, 2009, respectively. The leverage ratio has a regulatory minimum of 4%, with most institutions required to maintain a ratio of 4-5%, depending upon risk profiles and other factors.

As mandated by bank regulations, the following five capital categories are identified for insured depository institutions: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." These regulations require the federal banking regulators to take prompt corrective action with respect to insured depository institutions that do not meet minimum capital requirements. Under the regulations, well capitalized institutions must have Tier I risk-based capital ratios of at least 6%, total risk-based capital ratios of at least 10%, and leverage ratios of at least 5%, and not be subject to capital directive orders. Management believes, as of June 30, 2010, that the Company met the requirements to be considered “well capitalized."

Off-Balance-Sheet Activities

The Company enters into certain financial transactions in the ordinary course of performing traditional banking services that result in off-balance sheet transactions. Other than AMNB Statutory Trust I, formed in 2006 to issue Trust Preferred Securities, the Company does not have any off-balance sheet subsidiaries. Off-balance sheet transactions were as follows (in thousands):

	June 30, 2010	December 31, 2009
Commitments to extend credit	$ 133,353	$ 133,692
Standby letters of credit	1,986	2,624
Mortgage loan rate-lock commitments	3,980	2,054

Commitments to extend credit to customers represent legally binding agreements with fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future funding requirements. Standby letters of credit are conditional commitments issued by the Company guaranteeing the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk Management

Effectively managing market risk is essential to achieving the Company's financial objectives. Market risk reflects the risk of economic loss resulting from changes in interest rates and market prices. The Company is not subject to currency exchange risk or commodity price risk. The Company's primary market risk exposure is interest rate risk; however, market risk also includes liquidity risk. Both are discussed below.

Interest Rate Risk Management

Interest rate risk and its impact on net interest income is a primary market risk exposure. The Company manages its exposure to fluctuations in interest rates through policies approved by its Asset/Liability Investment Committee ("ALCO") and Board of Directors, both of which receive and review periodic reports of the Company's interest rate risk position.

The Company uses simulation analysis to measure the sensitivity of projected earnings to changes in interest rates. Simulation takes into account current balance sheet volumes and the scheduled repricing dates and maturities of assets and liabilities. It incorporates numerous assumptions including growth, changes in the mix of assets and liabilities, prepayments, and average rates earned and paid. Based on this information, management uses the model to project net interest income under multiple interest rate scenarios.

A balance sheet is considered asset sensitive when its earning assets (loans and securities) reprice faster than its liabilities (deposits and borrowings). An asset sensitive balance sheet will produce more net interest income when interest rates rise and less net interest income when they decline. Based on the Company's simulation analysis, management believes the Company's interest sensitivity position is asset sensitive. The simulation projects that if rates increase over a 12 month period by one percent, net interest income is expected to increase by 4.3%. Management has no expectation that market rates will decline in the near term, given the prevailing economy.

Liquidity Risk Management

Liquidity is the ability of the Company to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining the Company's ability to meet the daily cash flow requirements of its customers, whether they are borrowers requiring funds to meet their credit needs or depositors desiring to withdraw funds. Additionally, the parent company requires cash for various operating needs including dividends to shareholders, stock repurchases, the servicing of debt, and the payment of general corporate expenses. The Company manages its exposure to fluctuations in interest rates through policies approved by the ALCO and Board of Directors, both of which receive periodic reports of the Company's interest rate risk position. The Company uses a simulation and budget model to manage the future liquidity needs of the Company.

Liquidity sources include cash and amounts due from banks, deposits in other banks, loan repayments, increases in deposits, lines of credit from the Federal Home Loan Bank of Atlanta ("FHLB") and the Federal Reserve Bank's discount window, federal funds lines of credit from two correspondent banks, and maturities and sales of securities. Management believes that these sources provide sufficient and timely liquidity.

The Company has a line of credit with the FHLB, equal to 30% of the Company's assets, subject to the amount of collateral pledged. Under the terms of its collateral agreement with the FHLB, the Company provides a blanket lien covering all of its residential first mortgage loans and home equity lines of credit. In addition, the Company pledges as collateral its capital stock in and deposits with the FHLB. At June 30, 2010, principal obligations to the FHLB consisted of $8,563,000 in fixed-rate, long-term advances compared to $8,638,000 at December 31, 2009. In addition, for the same periods, the Company had outstanding $40 million in letters of credit. The letters of credit provide the Bank with alternate collateral for securing public entity deposits above FDIC insurance levels, thereby providing less need for pledging from the bond portfolio.

The Company had fixed-rate term borrowing contracts with the FHLB as of June 30, 2010, with the following final maturities (in thousands):

Amount	Maturity Date
$ 4,000,000	March 2011
4,000,000	April 2011
563,000	March 2014
$ 8,563,000	

The Company has federal funds lines of credit established with two other banks in the amounts of $15,000,000 and $10,000,000, and has access to the Federal Reserve Bank's discount window. There were no amounts outstanding under these facilities at June 30, 2010.

There have been no material changes to market risk as disclosed in the Company's 2009 Annual Report on Form 10-K. Refer to those disclosures for further information.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company's management, including the Chief Executive Officer and Chief Financial Officer, evaluated the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934), as amended (the "Exchange Act") as of June 30 , 2010. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms. There were no significant changes in the Company's internal controls over financial reporting that occurred during the quarter ended June 30, 2010 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART II

OTHER INFORMATION

Item:

1. Legal Proceedings

The nature of the business of the Company ordinarily results in a certain amount of litigation. The Company is involved in various legal proceedings, all of which are considered incidental to the normal conduct of business. Management believes that these proceedings will not have a material adverse effect on the consolidated financial position or consolidated results of operations of the Company.

1A. Risk Factors

There have been no material changes to the risk factors disclosed in the Company’s 2010 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 12, 2010.

2. Unregistered Sales of Equity Securities and Use of Proceeds

None

3. Defaults Upon Senior Securities

None

4. (Removed and Reserved)

5. Other Information

(a) Required 8-K disclosures

None

(b) Changes in Nominating Process

None

6. Exhibits

3.1 Articles of Incorporation (as amended June 1, 2010)
3.2 Bylaws (as amended May 18, 2010)
11. Refer to EPS calculation in the Notes to Financial Statements
31.1 Section 302 Certification of Charles H. Majors, President and Chief Executive Officer
31.2 Section 302 Certification of William W. Traynham, Senior Vice President and Chief Financial Officer
32.1 Section 906 Certification of Charles H. Majors, President and Chief Executive Officer
32.2 Section 906 Certification of William W. Traynham, Senior Vice President and Chief Financial Officer

SIGNATURES

Pursuant to 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 NATIONAL BANKSHARES INC.

	/s/ Charles H. Majors
	Charles H. Majors
Date – August 5, 2010	President and Chief Executive Officer
	/s/ William W. Traynham
	William W. Traynham
	Senior Vice President and
Date – August 5, 2010	Chief Financial Officer