

AMERICAN COMMUNITY BANCSHARES INC
Form 10QSB
April 28, 2004
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U. S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-QSB

Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2004

Transition Report Under Section 13 or 15(d) of the Exchange Act

For the transition period ended _____

Commission File Number 000-30517

AMERICAN COMMUNITY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

NORTH CAROLINA
(State or other jurisdiction of

incorporation or organization)

56-2179531
(IRS Employer

Identification Number)

2593 WEST ROOSEVELT BOULEVARD, MONROE, NORTH CAROLINA 28111

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(Address of principal office)

(704) 225-8444

(Registrant's Telephone Number, Including Area Code)

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

As of March 31, 2004, 2,827,709 shares of the issuer's common stock, no par value, were outstanding.

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	March 31, 2004	December 31,
	(Unaudited)	2003*
	_____	_____
	(In Thousands)	
ASSETS		
Cash and due from banks	\$ 9,351	\$ 7,330
Interest-earning deposits with banks	7,520	11,012
Investment securities available for sale at fair value	47,018	50,178
Investment securities held to maturity at cost	1,890	1,891
Loans	212,066	204,533
Allowance for loan losses	(2,645)	(2,529)
	_____	_____
NET LOANS	209,421	202,004
Accrued interest receivable	1,184	1,131
Bank premises and equipment	5,267	5,339
Foreclosed real estate	21	117
Federal Home Loan Bank stock at cost	672	792
Other assets	1,774	1,459
	_____	_____
TOTAL ASSETS	\$ 284,118	\$ 281,253
	_____	_____
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits		
Demand	\$ 35,638	\$ 29,782
Savings	6,959	6,197
Money market and NOW	38,267	40,865
Time	129,969	131,319
	_____	_____
TOTAL DEPOSITS	210,833	208,163
Borrowings	13,278	13,444
Securities sold under agreement to repurchase	19,443	19,667
Capital lease obligation	1,707	1,708
Accrued expenses and other liabilities	851	582
Trust preferred securities	13,500	13,500
	_____	_____
TOTAL LIABILITIES	259,612	257,064
	_____	_____
Stockholders Equity		
Preferred stock, no par value, 1,000,000 shares authorized; none issued		
Common stock, \$1 par value, 9,000,000 shares authorized; 2,827,709 and 2,825,709 issued and outstanding, respectively	2,828	2,826

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Additional paid-in capital	19,216	19,201
Retained earnings	2,263	2,071
Accumulated other comprehensive income	199	91
	<u> </u>	<u> </u>
TOTAL STOCKHOLDERS EQUITY	24,506	24,189
	<u> </u>	<u> </u>
Commitments (Note B)		
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 284,118	\$ 281,253
	<u> </u>	<u> </u>

* Derived from audited financial statements.

See accompanying notes.

Table of Contents**AMERICAN COMMUNITY BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)****Three Months Ended March 31, 2004 and 2003**

	Three months ended March 31, 2004	Three months ended March 31, 2003
	(In Thousands, except share and per share data)	
INTEREST INCOME		
Loans	\$ 3,127	\$ 2,751
Investments	401	260
Interest-earning deposits with banks	6	19
TOTAL INTEREST INCOME	3,534	3,030
INTEREST EXPENSE		
Money market, NOW and savings deposits	49	52
Time deposits	889	957
Borrowings	408	257
TOTAL INTEREST EXPENSE	1,346	1,266
NET INTEREST INCOME	2,188	1,764
PROVISION FOR LOAN LOSSES	118	365
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	2,070	1,399
NON-INTEREST INCOME		
Service charges on deposit accounts	465	467
Mortgage operations	66	140
Gain on sale of investment securities	58	
Other	113	73
TOTAL NON-INTEREST INCOME	702	680
NON-INTEREST EXPENSE		
Salaries and employee benefits	1,011	854
Occupancy and equipment	369	297
Other	634	514
TOTAL NON-INTEREST EXPENSE	2,014	1,665
INCOME BEFORE INCOME TAXES	758	414
INCOME TAXES	283	151

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NET INCOME	\$ 475	\$ 263
NET INCOME PER COMMON SHARE		
BASIC	\$.17	\$.09
DILUTED	\$.15	\$.09
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING		
BASIC	2,826,039	2,824,376
DILUTED	3,145,162	2,829,897
DIVIDEND DECLARED PER COMMON SHARE	\$ 0.10	\$ 0.08

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Table of Contents**AMERICAN COMMUNITY BANCSHARES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)****Three Months Ended March 31, 2004 and 2003**

	Three months ended March 31, 2004	Three months ended March 31, 2003
(In Thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 475	\$ 263
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	268	185
Provision for loan losses	118	365
Loss on sale of foreclosed real estate	7	28
Gain on sale of securities available for sale	(58)	
Change in assets and liabilities		
Increase in accrued interest receivable	(53)	(25)
Increase in other assets	(381)	(446)
Increase (decrease) in accrued expenses and other liabilities	268	(358)
NET CASH PROVIDED BY OPERATING ACTIVITIES	644	12
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investment securities available for sale	(7,067)	(12,614)
Purchases of investment securities held to maturity		(1,482)
Proceeds from sale of securities available for sale	4,048	
Proceeds from maturities, calls and principal repayments of investment securities	6,288	8,031
Net increase in loans from originations and repayments	(7,536)	(9,219)
Purchases of bank premises and equipment	(69)	(329)
Proceeds from sale of foreclosed real estate	89	324
(Purchase) redemption of Federal Home Loan Bank stock	119	(350)
NET CASH USED BY INVESTING ACTIVITIES	(4,128)	(15,639)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	4,020	5,234
Net increase (decrease) in time deposits	(1,350)	2,809
Net increase (decrease) in advances from Federal Home Loan Bank	(167)	6,945
Net increase (decrease) in securities sold under agreement to repurchase	(224)	1,293
Cash paid for dividends	(283)	(226)
Proceeds from common stock sold, net	17	
NET CASH PROVIDED BY FINANCING ACTIVITIES	2,013	16,055
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,471)	428
CASH AND CASH EQUIVALENTS, BEGINNING	18,342	16,838

CASH AND CASH EQUIVALENTS, ENDING	\$ 16,871	\$ 17,266
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Table of Contents***AMERICAN COMMUNITY BANCSHARES, INC.******Notes to Consolidated Financial Statements*****NOTE A - BASIS OF PRESENTATION**

In management's opinion, the financial information, which is unaudited, reflects all adjustments (consisting solely of normal recurring adjustments) necessary for a fair presentation of the financial information as of and for the three month periods ended March 31, 2004 and 2003, in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of American Community Bancshares, Inc. (the Company) and its wholly owned subsidiaries, American Community Bank (the Bank), American Community Capital Trust I (Capital Trust I), and American Community Capital Trust II, Ltd. (Capital Trust II). All significant inter-company transactions and balances are eliminated in consolidation. Operating results for the three-month period ended March 31, 2004 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2004.

The organization and business of the Company, accounting policies followed by the Company and other information are contained in the notes to the consolidated financial statements filed as part of the Company's 2003 annual report on Form 10-KSB. This quarterly report should be read in conjunction with such annual report.

NOTE B - COMMITMENTS

At March 31, 2004, loan commitments are as follows:

Undisbursed lines of credit	\$ 37,259,979
Stand-by letters of credit	2,908,101

NOTE C - PER SHARE RESULTS

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

Three months ended	
March 31,	
2004	2003

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Weighted average number of common shares used in computing basic net income per share	2,826,039	2,824,376
Effective of dilutive stock options	319,123	5,521
	<hr/>	<hr/>
Weighted average number of common shares and dilutive potential common shares used in computing diluted net income per share	3,145,162	2,829,897
	<hr/>	<hr/>

For the quarter ended March 31, 2004, there were no options or warrants that were antidilutive.

Table of Contents**AMERICAN COMMUNITY BANCSHARES, INC.****Notes to Consolidated Financial Statements****NOTE D COMPREHENSIVE INCOME**

Total comprehensive income, consisting of net income and unrealized gains and losses on available for sale securities, net of taxes, was \$583,000 and \$178,000 for the three months ended March 31, 2004 and 2003.

NOTE E STOCK COMPENSATION PLAN

Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, encourages all entities to adopt a fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, whereby compensation cost is the excess, if any, of the quoted market price of the stock at the grant date (or other measurement date) over the amount an employee must pay to acquire the stock. Stock options issued under the company's stock option plans have no intrinsic value at the grant date and, under Opinion No. 25, no compensation cost is recognized for them. The company has elected to continue with the accounting methodology in Opinion No. 25. Presented below are the pro forma disclosures of net income and earnings per share and other disclosures as if the fair value based method of accounting had been applied.

	Three months ended	
	March 31,	
	2004	2003
	<u> </u>	<u> </u>
Net income:		
As reported	\$ 475,000	\$ 263,000
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(17,300)	(23,800)
	<u> </u>	<u> </u>
Pro forma	\$ 457,700	\$ 239,200
	<u> </u>	<u> </u>
Basic net income per share		
As reported	\$ 0.17	\$ 0.09
Proforma	0.16	0.08
Diluted net income per share		
As reported	0.15	0.09
Proforma	0.15	0.08

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AMERICAN COMMUNITY BANCSHARES, INC.

Notes to Consolidated Financial Statements

NOTE F SUBSEQUENT EVENT

On November 5, 2003, the Bank entered into an agreement and Plan of Reorganization and Merger with First National Bancshares, Inc. (First National), a bank holding company headquartered in Gaffney, SC, which is the parent company of First National Bank of the Carolinas. Shareholders of First National as of the close of the merger will be entitled to receive a combination of cash and American Community common stock which, at the time the merger was announced, had a value of \$20.50 per share. The merger was consummated effective April 15, 2004.

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

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

COMPARISON OF FINANCIAL CONDITION AT MARCH 31, 2004 AND DECEMBER 31, 2003

Total assets at March 31, 2004 increased by \$2.8 million or 1.0% to \$284.1 million compared to \$281.3 million at December 31, 2003. The Company had earning assets of \$269.2 million at month-end March 31, 2004 consisting of \$212.1 million in gross loans, \$49.6 million in investment securities and Federal Home Loan Bank (FHLB) stock and \$7.5 million in overnight investments. Total deposits as of March 31, 2004 increased by \$2.6 million or 1.2% to \$210.8 million compared to \$208.2 million at December 31, 2003. Total borrowed money as of March 31, 2004 decreased \$391,000 or .89% to \$47.9 million compared to \$48.3 million at December 31, 2003. Stockholders' equity was \$24.5 million at March 31, 2004 compared to \$24.2 million at December 31, 2003 for an increase of \$317,000 or 1.2%. The increase resulted from net income of \$475,000, the exercise of stock options which provided net proceeds of \$17,000, other comprehensive income of \$108,000 offset by the payment of a cash dividend in the amount of \$283,000.

The Company recorded a \$118,000 provision for loan losses for the quarter ended March 31, 2004, representing a decrease of \$247,000 or 68% from the \$365,000 provision for the quarter ended March 31, 2003. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management. The Company has continued to provide provisions for loan losses principally as a result of the continued growth in the loan portfolio. Total loans receivable increased by \$7.5 million during the quarter ended March 31, 2004. The allowance for loan losses at March 31, 2004 of \$2.65 million equaled 1.25% of total loans outstanding and 945% of non-performing loans, which totaled \$280,000. The allowance for loan losses at December 31, 2003 of \$2.53 million equaled 1.24% of total loans outstanding and 766% of non-performing loans which totaled \$330,000.

The Company had investment securities available for sale of \$47.0 million at March 31, 2004. The portfolio decreased by \$3.2 million or 6.4% from the \$50.2 million balance at December 31, 2003 as the Company sold two available for sale securities for a gain of \$58,000. In addition the Company had investment securities held to maturity of \$1.9 million at March 31, 2004 and December 31, 2003.

Interest-earning deposits with banks at March 31, 2004 decreased by \$3.5 million or 31.8% to \$7.5 million compared to \$11.0 million at December 31, 2003. This decrease was primarily a result of the increase in cash and due from banks. The Company holds funds in interest-earning deposits with banks to provide liquidity for future loan demand and to satisfy fluctuations in deposit levels.

Non interest-earning assets at March 31, 2004 increased by \$2.2 million or 14.3% to \$17.6 million compared to \$15.4 million at December 31, 2003. The increase is primarily attributable to an increase of \$2.0 million to \$9.3 million in the cash and due from banks category. This primarily represents customer deposits that are in the process of collection and not available for overnight investment combined with cash on hand in the branches. Accrued interest receivable increased \$53,000 to \$1.2 million at March 31, 2004 as a result of the timing in the collection of interest income. Bank premises

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and equipment was \$5.3 million at March 31, 2004, a decrease of \$72,000 from December 31, 2003. The net decrease resulted from depreciation of \$142,000 offset by purchases of \$70,000. Other real estate owned decreased by \$96,000 as a result of the sale of a 1-4 family property obtained through foreclosure. Other assets increased by \$315,000 at March 31, 2004 to \$1.8 million primarily as a result of the increase in other receivables and capitalized merger expenses.

Total deposits increased \$2.6 million or 1.3% from \$208.2 million at December 31, 2003 to \$210.8 million at March 31, 2004. The composition of the deposit base, by category, at March 31, 2004 is as follows: 17% non-interest bearing demand deposits, 3% savings deposits, 18% money market and interest bearing demand deposits and 62% time deposits. The non-interest bearing deposits and savings categories both experienced increases over the three-month period. Dollar and percentage increases were as follows: non-interest bearing demand deposits, \$5.9 million or 20%; and savings deposits, \$762,000 or 12%. The money market and time deposits both experienced decreases over the three-month period. Dollar and percentage decreases were as follows: money market, \$2.6 million or 6%, and time deposits, \$1.4 million or 1%. Time deposits of \$100,000 or more totaled \$62.9 million, or 30% of total deposits at March 31, 2004. The composition of deposits at December 31, 2003 was 14% non-interest bearing demand deposits, 3% savings deposits, 20% money market and interest bearing demand deposits and 63% time deposits.

The Company had advances from the Federal Home Loan Bank of Atlanta at March 31, 2004 of \$13.3 million with maturity dates ranging from June 2004 through February 2013. The balance of Federal Home Loan Bank advances at December 31, 2003 was \$13.4 million with maturity dates ranging from June 2004 through February 2013. These advances are secured by a blanket lien on 1-4 family real estate loans, certain commercial real property and certain securities available for sale. Total securities sold under agreement to repurchase decreased \$224,000 or 1.1% from \$19.7 million at December 31, 2003 to \$19.4 million at March 31, 2004. These borrowings are secured by certain of the Company's investment securities. The Company also maintained the capital lease for its main office. The recorded obligation under this capital lease at March 31, 2004 was \$1.7 million. In addition, Capital Trust I maintained Trust Preferred Securities in the amount of \$3.5 million at a fixed rate of 9%. The Trust Preferred securities have a maturity date of March 1, 2032, are redeemable on or after March 1, 2007 at par value and are eligible for inclusion as Tier I capital. Capital Trust II maintained Trust Preferred Securities in the amount of \$10.0 million at a rate based off 90 day LIBOR.

Other liabilities increased by \$269,000 to \$851,000 or 46.2% at March 31, 2004 from \$582,000 at December 31, 2003. The increase was primarily due to the increase in accrued expenses.

Comparison of Results of Operations for the Three Months Ended March 31, 2004 and 2003

Net Income The Company generated net income for the three months ended March 31, 2004 of \$475,000 compared to a profit for the three months ended March 31, 2003 of \$263,000. On a fully diluted per share basis earnings were \$.15 for 2004 compared to \$.09 for 2003. Return on average assets was 0.69% and 0.48% and return on average equity was 7.84% and 4.61% for the three months ended March 31, 2004 and 2003, respectively. Earnings for the three months ended March 31, 2004 were positively impacted by strong growth in average earning assets and by increases in net interest income and non-interest income.

Net Interest Income. Net interest income increased \$424,000 from \$1.8 million for the three months ended March 31, 2003 to \$2.2 million for the three months ended March 31, 2004. Total interest income benefited from growth in average earning assets.

Total average earning assets increased \$56.5 million or 27.4% from an average of \$206.5 million during the first quarter of 2003 to an average of \$263.0 during the first quarter of 2004. The Company experienced strong loan growth with average loan balances increasing by \$41.8 million.

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The increase in average balances for investment securities and interest-earning deposits was \$20.3 million. Average interest-bearing liabilities increased by \$47.6 million during the first quarter of 2004 of which \$20.2 million was attributable to deposits while borrowings increased \$27.4 million.

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Net interest margin is interest income earned on loans, securities and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the quarter ended March 31, 2004 was 3.38% compared to 3.47% for the same quarter in 2003. The decrease in net interest margin resulted primarily from the decrease in yields on the Bank's loan portfolio. The interest rate spread, which is the difference between the average yield on earning assets and the cost of interest-bearing funds, decreased 13 basis points from 2.97% in the quarter ended March 31, 2003 to 2.84% for the same quarter in 2004.

Provision for Loan Losses. The Company's provision for loan losses for the quarter ended March 31, 2004 was \$118,000, representing a \$247,000 or 68% decrease from the \$365,000 recorded for the quarter ended March 31, 2003. While the Company has continued to provide provisions for loan losses as a result of the continued growth in the loan portfolio, the provision in the 2003 quarter was greater due to the charge-off of a loan in the amount of \$138,000 for which no previous loan allowance had been recorded. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management.

Non-interest Income. Non-interest income increased by \$22,000 or 3.2% to \$702,000 for the three months ended March 31, 2004 compared with \$680,000 for the same period in the prior year. Non-interest income as a percentage of total revenue (defined as net interest income plus non-interest income) decreased to 24% for the three months ended March 31, 2004 from 28% for the same period in the prior year. The largest components of non-interest income were service charges on deposit accounts of \$465,000 for the quarter ended March 31, 2004 as compared to \$467,000 for the same period in 2003 or a 0.4% decrease and fees from mortgage banking operations of \$66,000 in 2004 as compared to \$140,000 in 2003 or a 52.9% decrease. Fees from mortgage banking operations decreased due to a slowdown in the refinancing market in the first quarter of 2004. These decreases were offset by a gain on the sale of investment securities in the amount of \$58,000 and rental income received in the amount of \$20,000 from the lease of excess space in one of our branch locations which began April 2003.

Non-interest Expense. Total non-interest expense increased from \$1.7 million for the three months ended March 31, 2003 to \$2.0 million for the same period in 2004. This 21% increase was primarily due to increased expenses resulting from the full operation of all eight branches in 2004. In the first quarter of 2003, only six of our eight branches had been fully operational for the entire quarter.

Provision for Income Taxes. The Company's provision for income taxes, as a percentage of income before income taxes, was 37.3% and 36.5% for the three months ended March 31, 2004 and 2003, respectively.

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Asset Quality

No material changes have occurred in the Company's asset quality since December 31, 2003.

Item 3. Controls and Procedures

The company maintains a system of internal controls and procedures designed to provide reasonable assurance as to the reliability of our published financial statements and other disclosures included in this report. The Company's Board of Directors, operating through its audit committee which is composed entirely of independent outside directors, provides oversight to the Company's financial reporting process.

The Company's management, under the supervision and with the participation of the Chief Executive Officer and the Chief Financial Officer of the Company (its principal executive officer and principal financial officer, respectively), have concluded based on their evaluation as of the end of the period covered by this quarterly report that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the Chief Executive Officer and the Chief Financial Officer of the Company, as appropriate to allow timely decisions regarding required disclosure.

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

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Part II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

<u>Exhibit #</u>	<u>Description</u>
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K.

On February 2, 2004, the Registrant issued a press release dated January 27, 2004 with respect to the Registrant's financial results for the year ended December 31, 2003.

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SIGNATURES

Under the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AMERICAN COMMUNITY BANCSHARES, INC.

Date: 4/27/04

By: /s/ Randy P. Helton

Randy P. Helton
President and Chief Executive Officer

Date: 4/27/04

By: /s/ Dan R. Ellis, Jr.

Dan R. Ellis, Jr.
Senior Vice President and Chief Financial Officer

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