AMERICAN COMMUNITY BANCSHARES INC
Form 10-K
March 29, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

OR

¨ **TRANSITIONAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______.

COMMISSION FILE NUMBER 000-30517

AMERICAN COMMUNITY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

NORTH CAROLINA	**56-2179531**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
4500 Cameron Valley Parkway, Suite 150	**28211**

Charlotte, North Carolina
(Address of Principal Executive Offices) **(Zip Code)**
Registrant s Telephone number, including area code: (704) 225-8444

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

NONE

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

COMMON STOCK, PAR VALUE $1.00 PER SHARE

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

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

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act from their obligations under those Sections.

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. x Yes ¨ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. $81,460,000

Indicate the number of shares outstanding of each of the registrant s classes of Common Stock as of the latest practicable date. 7,003,068 shares of Common Stock outstanding as of March 22, 2007:

Documents Incorporated by Reference.

2007 Annual Meeting Proxy Statement

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PART 1

ITEM 1 BUSINESS

Who We Are

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

Since opening in November of 1998, we have accomplished the following:

- Grown the bank to almost $500 Million in assets with a compound annualized growth rate of 31.3% since 1999;
- Assembled a management team consisting of resident bankers from local markets who each have over 25 years of banking experience;
- Assembled an experienced and diverse board of directors that provides strategic expertise unique to a community bank of our size;
- Completed the acquisition in 2004 of FNB Bancshares, Inc. and its subsidiary, First National Bank of the Carolinas, Gaffney, SC, thus giving us branch expansion opportunities into South Carolina;
- Currently operating thirteen (13) full service banking offices throughout North and South Carolina;
- Stock listed on the Nasdaq Global Market under the symbol ACBA;
- Developed a local identity in the communities we serve by sponsoring a wide variety of civic and charitable events;
- Implemented a shareholder dividend reinvestment program and stock purchase plan;
- Implemented a stock repurchase plan;
- Annualized return to initial shareholders of approximately 13% over the last eight years;
- Currently paying a cash dividend yield of 1.80%.

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

Our Market Area

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

Union County had an estimated 2006 population of 175,000 and Mecklenburg County an estimated population of 850,000. Both counties have a balanced and diversified economy. Monroe, with a population of approximately 30,000, is the largest city in Union County. Union County is currently the fastest growing county in North Carolina and 15th fastest growing county in the country. The population of Union County grew 42% from 2000 to 2005. Charlotte, which is ranked 26th in US population, is Mecklenburg County s and North Carolina s largest city and has consistently been one of the fastest growing areas of the Southeast. The population of Charlotte and Mecklenburg County had a growth rate of 19% between 2000 and 2005. The most recent unemployment rate was 4.3% for Union County and 4.3% for Mecklenburg County; both lower than the North Carolina state rate of 4.5%. Cherokee County, previous headquarters for the First National Bank of the Carolinas, has an estimated population of 54,000 and an estimated growth rate of 4%. York County, South Carolina is the region s second fastest growing county and has an estimated population of 200,000. York County also averaged a 21% growth rate between 2000 and 2005, ranking 4th in per capita income in South Carolina. It is also the second fastest growing county in the region behind Union County.

Strategy

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

Lending Activities

General. The Bank provides to its customers a full range of short- to medium-term commercial, agricultural, Small Business Administration guaranteed, mortgage, construction and personal loans, both secured and unsecured. The Bank also makes real estate mortgage and construction loans. The Bank has maintained a good balance between variable and fixed rate loans within its portfolio. Variable rate loans accounted for 59% of the loan balances outstanding at December 31, 2006 while fixed rate loans accounted for 41% of the balances.

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

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

	2006		2005		2004		2003		2002	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Real estate mortgage loans:										
1-4 family	$ 26,897	7.26%	$ 28,933	8.70%	$ 27,161	8.81%	$ 15,894	7.77%	$ 12,426	7.52%
Commercial mortgage	70,585	19.05%	84,694	25.45%	84,621	27.47%	80,395	39.32%	58,237	35.24%
Construction/development	77,005	20.78%	44,037	13.24%	39,844	12.93%	28,469	13.92%	25,079	15.18%
Home equity lines of credit	24,388	6.58%	27,732	8.33%	24,575	7.98%	16,526	8.08%	14,643	8.86%
Commercial and industrial loans	126,602	34.16%	97,197	29.21%	85,911	27.88%	41,121	20.11%	33,313	20.16%
Loans to individuals	36,782	9.93%	35,941	10.80%	30,813	10.00%	8,672	4.25%	9,990	6.05%
Lease financing, net	8,316	2.24%	14,193	4.27%	15,177	4.93%	13,397	6.55%	11,548	6.99%
Subtotal	370,575	100.00%	332,727	100.00%	308,102	100.00%	204,474	100.00%	165,236	100.00%
Less: allowance for loan losses	(5,628)		(4,331)		(3,488)		(2,529)		(2,375)	
Plus: net unamortized deferred fees and costs	(144)		(19)		(114)		59		130	
Total	$ 364,803		$ 328,377		$ 304,500		$ 202,004		$ 162,991	

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The following table sets forth the contractual maturity of loans at December 31, 2006:

	One Year Or Less	Greater than One Year Through 5 Years	More Than 5 Years	Total
		(Dollars in thousands)		
Real estate mortgage loans:				
1-4 family	$ 7,878	$ 17,450	$ 1,568	$ 26,896
Commercial mortgage	14,618	47,734	8,233	70,585
Construction/development	49,322	26,620	1,063	77,005
Home equity lines of credit	82	3,005	21,301	24,388
Commercial and industrial loans	57,048	65,999	3,556	126,603
Loans to individuals	14,874	19,864	2,044	36,782
Lease financing, net	1,186	7,130		8,316
Total	$ 145,008	$ 187,802	$ 37,765	$ 370,575

The following table sets forth loans with fixed and variable rates having contractual maturities greater than one year at December 31, 2006:

	Fixed Rate	Variable Rate	Total
	(Dollars in thousands)		
Real estate mortgage loans	$ 59,832	$ 42,836	$ 102,668
Home equity lines of credit		24,306	24,306
Commercial and industrial loans	38,352	31,203	69,555
Loans to individuals	16,058	5,850	21,908
Lease financing, net	7,130		7,130
	$ 121,372	$ 104,195	$ 225,567

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

Residential one-to-four family loans amounted to $26.9 million at December 31, 2006. The Bank s residential mortgage loans are typically construction loans that convert into permanent financing and are secured by properties located within the Bank s market areas. Most of the permanent one-to-four family residential mortgage loans that the Bank originates are for the account of third parties. Such loans are closed by the third party and therefore are not shown in the Bank s financial statements. The Bank receives a fee for each such loan originated, with such fees aggregating $351,481 for the year ended December 31, 2006. The Bank anticipates that it will continue to be an active originator of residential loans for the account of third parties.

The Bank has made, and anticipates continuing to make, commercial real estate loans. Commercial real estate loans equaled $70.6 million at December 31, 2006. This lending has involved loans secured principally by owner occupied commercial buildings for office, storage and warehouse space. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

Another of the Bank s primary lending focus is construction/development lending with balances outstanding as of December 31, 2006 of $77.0 million. The Bank originates one to four family residential construction loans for the

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

Commercial Loans. Commercial business lending is also a focus of the Bank s lending activities. At December 31, 2006, the Bank s commercial loan portfolio equaled $126.6 million. Commercial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans generally are secured by accounts receivable, inventory and/or equipment. The Bank also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment. Commercial loans generally provide greater yields and reprice more frequently than other types of loans, such as real estate loans. More frequent repricing means that yields on our commercial loans adjust with changes in interest rates.

Loans to Individuals and Home Equity Lines of Credit. Loans to individuals (consumer loans) include automobile loans, boat and recreational vehicle financing, home equity and home improvement loans and miscellaneous secured and unsecured personal loans and totaled $36.8 million at December 31, 2006. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. Consumer loan collections are sensitive to job loss, illness and other personal factors. The Bank attempts to manage the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

Leasing. The Bank offered lease financing primarily to small businesses in our local market. At December 31, 2006 the Bank s lease portfolio equaled $8.3 million. This type of lease financing is generally limited to heavy machinery, manufacturing equipment, and specific vehicles. The leasing division also requires personal guarantees on the majority of our leases. In 2006, the Bank determined that the leasing business has become extremely competitive and is dominated by a few large players. The Bank felt that leasing is not the best use of its capital and has contracted with a third party leasing company to liquidate the remaining leases in our portfolio. The bank no longer originates leases and is allowing the portfolio to pay down. During the year, the bank experienced some credit quality problems with a portion of the lease portfolio. Those credit problems are discussed in more detail in the Management Discussion and Analysis section of this report.

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

Loan Approvals. The Bank s loan policies and procedures establish the basic guidelines governing its lending operations. Generally, the guidelines address the type of loans that the Bank seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower s total outstanding indebtedness to the Bank, including any indebtedness as a guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Bank. The Bank supplements its own supervision of the loan underwriting and approval process with periodic loan audits by independent, outside professionals experienced in loan review.

Responsibility for loan review and loan underwriting resides with the Chief Credit Officer. He is responsible for

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loan processing, loan underwriting and approval. On an annual basis, the Board of Directors of the Bank determines the President s lending authority, who then delegates lending authorities to the Chief Credit Officer and other lending officers of the Bank. Delegated authorities may include loans, letters of credit, overdrafts, uncollected funds and such other authorities as determined by the Board of Directors or the President within his delegated authority.

The President of American Community, and the Chief Credit Officer each have the authority to approve loans up to the lending limit set by the Board of Directors, which was $2,000,000 and $1,500,000, respectively, at December 31, 2006. All loans above the lending limit of the President are reviewed and approved by the Loan Committee, which consists of the President and eight outside directors. In addition, the Chief Credit Officer serves as a non-voting member of this committee. At December 31, 2006, the Loan Committee had the authority to approve loans up to the Bank s legal lending limit. The Bank s legal lending limit was $7.0 million at December 31, 2006. The Bank seldom makes loans approaching its legal lending limit. All loans made to executive officers and directors must be approved by the full Board of Directors.

Non-performing Assets

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

	At December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Non-accrual loans	$ 563	$ 469	$ 881	$ 330	$ 580
Non-accrual leases	1,246	482			
Restructured loans					
Total non-performing loans	1,809	951	881	330	580
Foreclosed real estate and other repossessed assets	201	479	311	157	463
Total non-performing assets	$ 2,010	$ 1,430	$ 1,192	$ 487	$ 1,043
Accruing loans past due 90 days or more	$ 291	$ 1,402	$ 1,117	$ 597	$ 684
Allowance for loan losses	5,628	4,331	3,488	2,529	2,375
Non-performing loans to period end loans	0.49%	0.29%	0.29%	0.16%	0.35%
Allowance for loan losses to period end loans	1.52%	1.30%	1.13%	1.24%	1.44%
Allowance for loan losses to non-performing loans	311%	455%	396%	766%	409%
Non-performing assets to total assets	0.41%	0.33%	0.30%	0.17%	0.48%

The financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on loans, unless a loan is placed on non-accrual basis. Loans are accounted for on a non-accrual basis when there are serious doubts about the collectibility of principal or interest. Loans are placed on non-accrual status in cases where there is uncertainty as to whether the borrower can satisfy the contractual terms of the loan agreement. Amounts received on non-accrual loans generally are applied first to principal and then to interest only after all principal has been collected. Restructured loans are those for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal, have been granted due to the borrower s weakened financial condition. Interest on restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur. Potential problem loans are loans which are currently performing and are not included in non-accrual or restructured loans above, but about which we have

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serious doubts as to the borrower s ability to comply with present repayment terms. These loans are likely to be included later in non-accrual, past due or restructured loans, so they are considered by management in assessing the adequacy of the allowance for loan losses. At December 31, 2006, no major loans had been identified as potential problem loans.

At December 31, 2006, the Bank had $1,809,000 in non-accrual loans. Interest foregone on non-accrual loans was approximately $42,000 for the year ended December 31, 2006 and $26,000 for the year ended December 31, 2005.

Other real estate owned consists of foreclosed properties. At December 31, 2006, foreclosed real estate and other repossessed assets totaled $201,000 or .04% of total assets, and consisted of seven residences and two vehicles. At December 31, 2005, foreclosed real estate and other repossessed assets totaled $478,758 or .11% of total assets, and consisted of four residences and eight vehicles.

Analysis of Allowance for Loan Losses

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

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

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

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

Growth in loans outstanding has been the primary reason for increases in the allowance for loan losses and the resultant provisions for loan losses necessary to provide for those increases. This growth has been spread among the major loan categories, with the concentrations of major loan categories being relatively consistent in recent years. Between December 31, 2002 and December 31, 2006, the range of each major category of loans as a percentage of total loans outstanding is as follows: 1-4 family mortgage loans 7% to 9%, commercial mortgage loans 19% to 39%, construction/development real estate loans 10% to 21%; home equity loans 7% to 9%; commercial and industrial loans 20% to 34%; loans to individuals 4% to 10%; and lease financing 2% to 7%. For all full fiscal

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years through 2006, loan loss experience was similar to that of other banks our age, with net loan charge-offs in each year no greater than 0.37% of average loans outstanding. The allowance for loan losses at December 31, 2006 of $5.6 million represents 1.5% of total loans and 311% of non-performing loans. The increase in both the provision for loan losses and the increase in the allowance for loan losses in 2006 is primarily attributable to the increase in non-performing leases.

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

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

	At December 31,									
	2006		2005		2004		2003		2002	
	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)
	(Dollars in thousands)									
Real estate loans	$ 1,829	32.50%	$ 2,155	47.39%	$ 2,149	49.21%	$ 1,283	61.01%	$ 994	57.94%
Home equity lines of credit	122	2.17%	137	8.33%	72	7.98%	50	8.08%	42	8.86%
Commercial and industrial loans	1,637	29.09%	929	29.21%	731	27.88%	676	20.11%	970	20.16%
Loans to individuals	419	7.44%	215	10.80%	232	10.00%	162	4.25%	219	6.05%
Lease financing, net	1,621	28.80%	895	4.27%	304	4.93%	358	6.55%	150	6.99%
Total	$ 5,628	100.00%	$ 4,331	100.00%	$ 3,488	100.00%	$ 2,529	100.00%	$ 2,375	100.00%

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

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

	At or for the Years Ended December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Balance at beginning of period	$ 4,331	$ 3,488	$ 2,529	$ 2,375	$ 1,736
Charge-offs:					
Real estate loans	10		51		
Home equity lines of credit	43				
Commercial and industrial loans	64	8	211	598	298
Lease financing, net	1,182	28	24		
Loans to individuals	50	45	54	67	16
Total charge-offs	1,349	81	340	665	314
Recoveries:					
Real estate loans			1		
Home equity lines of credit					
Commercial and industrial loans	1	100	12	35	34
Lease financing, net	25	4			
Loans to individuals	8	11	27		4
Total recoveries	34	115	40	35	38
Net charge-offs (recoveries)	1,315	(34)	300	630	276
Allowance acquired from First National merger			685		
Provision for loan losses	2,612	809	574	784	915
Balance at end of period	$ 5,628	$ 4,331	$ 3,488	$ 2,529	$ 2,375
Total loans outstanding	$ 370,431	$ 332,708	$ 307,988	$ 204,533	$ 165,366
Average loans outstanding	$ 351,401	$ 317,986	$ 275,011	$ 182,108	$ 146,530
Allowance for loan losses to total loans outstanding	1.52%	1.30%	1.13%	1.24%	1.44%
Ratio of net loan charge-offs (recoveries) to average loans outstanding	0.37%	-0.01%	0.11%	0.35%	0.19%

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Investment Activities

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

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

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

	2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
U. S. Government agencies	$ 20,202	$ 44	$ 117	$ 20,129
Mortgage-backed securities	37,047	10	835	36,222
State and municipal bonds	6,265	32	42	6,255
	63,514	86	994	62,606
Marketable equity securities	407	5		412
Total securities available for sale	$ 63,920	$ 91	$ 994	$ 63,018

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
State and municipal bonds	$ 2,174	$ 18	$	$ 2,192
Total securities held to maturity	$ 2,174	$ 18	$	$ 2,192

	2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
U. S. Government agencies	$ 15,770	$ 21	$ 129	$ 15,662
Mortgage-backed securities	42,791	16	1,082	41,725
State and municipal bonds	4,357	17	44	4,330
	62,918	54	1,255	61,717
Marketable equity securities	407	3		410
Total securities available for sale	$ 63,325	$ 57	$ 1,255	$ 62,127

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
State and municipal bonds	$ 2,180	$ 8	$ 15	$ 2,173
Total securities held to maturity	$ 2,180	$ 8	$ 15	$ 2,173

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The following table summarizes the amortized cost and recorded market values of investment securities (excluding marketable equity securities) at December 31, 2006, by contractual maturity groups:

	Amortized Cost	Fair Value	Book Yield (1)
	(Dollars in thousands)		
Securities available for sale and held to maturity			
U S Government agencies			
Due within one year	$ 500	$ 493	3.15%
Due after one but within five years	13,436	13,364	4.78%
Due after five but within ten years	4,317	4,334	5.45%
Due after ten years	1,948	1,938	5.67%
	20,201	20,129	4.97%
Mortgage-backed securities			
Due within one year	159	158	4.05%
Due after one but within five years	881	862	4.12%
Due after five but within ten years	8,162	7,948	4.21%
Due after ten years	27,845	27,254	5.65%
	37,047	36,222	4.54%
Municipal bonds			
Due after one but within five years	507	493	4.54%
Due after five but within ten years	2,556	2,563	5.55%
Due after ten years	5,376	5,391	5.87%
	8,439	8,447	5.70%
Total investment securities			
Due within one year	$ 659	$ 651	3.37%
Due after one but within five years	14,824	14,719	4.73%
Due after five but within ten years	15,035	14,845	4.80%
Due after ten years	35,169	34,583	5.69%
	$ 65,687	$ 64,798	4.82%

(1) Yields on tax-exempt investments have been adjusted to tax equivalent basis using 34% for 2006.

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Deposit Activities

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

The Bank periodically uses brokered deposits consistent with asset and liability management policies. At December 31, 2006 the Bank had $8,628,000 in brokered deposits. We rarely bid on political funds for municipalities as such deposits are extremely rate sensitive and due to fiduciary pressures on government officials, not as stable as regular corporate and individual customers.

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

	Year Ended December 31,					
	2006		2005		2004	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Interest bearing NOW, savings, and money market accounts	$ 91,792	1.78%	$ 82,270	1.28%	$ 77,548	0.74%
Other time deposits	102,697	3.76%	87,656	3.05%	69,551	2.87%
Time deposits greater than $100,000	120,443	4.78%	108,547	3.28%	92,195	3.75%
Total interest bearing deposits	314,932	3.57%	278,473	2.62%	239,294	2.52%
Demand and other non-interest bearing deposits	58,705		53,753		39,861	
Total average deposits	$ 373,637	3.01%	$ 332,226	2.19%	$ 279,155	2.16%

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The following table indicates the amount of the Bank s certificates of deposit by interest rate and by time remaining until maturity as of December 31, 2006.

	Three months or less		More than three months to six months		More than six months to one year		More than one year		Total	
					(Dollars in thousands)					
Certificates of $100,000 or more	$ 29,230	4.51%	$ 35,288	5.07%	$ 39,178	5.06%	$ 18,205	4.56%	$ 121,901	4.86%
Certificates of less than $100,000	21,819	4.25%	34,976	4.86%	33,889	4.82%	13,373	4.25%	104,057	4.64%
Total	$ 51,049	4.40%	$ 70,264	4.97%	$ 73,067	4.95%	$ 31,578	4.43%	$ 225,958	4.76%

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Borrowings

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

	At or for the Year Ended December 31,		
	2006	**2005**	**2004**
	(Dollars in thousands)		
AMOUNTS OUTSTANDING AT END OF PERIOD:			
Advances from the FHLB			
Amount	$ 6,000	$ 11,111	$ 12,778
Weighted average rate	3.53%	4.11%	3.84%
Securities sold under agreement to repurchase			
Amount	$ 15,473	$ 8,615	$ 25,763
Weighted average rate	3.69%	2.62%	1.96%
Federal funds purchased			
Amount	$	$ 3,118	$
Weighted average rate		4.60%	
Capitalized lease obligation			
Amount	$ 1,694	$ 1,702	$ 1,710
Weighted average rate	8.24%	8.24%	8.24%
MAXIMUM AMOUNT OUTSTANDING AT ANY MONTH-END:			
Advances from the FHLB	$ 11,056	$ 12,722	$ 15,388
Securities sold under agreement to repurchase	17,058	25,882	27,497
Federal funds purchased	6,337	7,000	3,000
Capitalized lease obligation	1,702	1,710	1,710
AVERAGES DURING THE PERIOD:			
Advances from the FHLB			
Average balance	$ 10,834	$ 12,215	$ 14,101
Weighted average rate	4.17%	3.85%	3.84%
Securities sold under agreement to repurchase			
Average balance	$ 13,753	$ 13,138	$ 23,406
Weighted average rate	3.42%	2.18%	1.25%
Federal funds purchased			
Average balance	$ 913	$ 778	$ 342
Weighted average rate	4.84%	1.80%	1.62%
Capitalized lease obligation			
Average balance	$ 1,700	$ 1,708	$ 1,709
Weighted average rate	8.24%	8.24%	8.24%

Pursuant to collateral agreements with the FHLB, advances are secured by all of the Company s FHLB stock, investment securities with a carrying value of $1.0 million at December 31, 2006, and a blanket lien on qualifying first mortgage loans.

Securities sold under agreement to repurchase are secured by investment securities. The carrying value of the investment securities at December 31, 2006 was $17.4 million.

Bancshares also has lines of credit totaling $29.5 million from correspondent banks at December 31, 2006.

Junior Subordinated Deferrable Interest Debentures

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

During 2003, we formed a special purpose entity organized as a business trust under the laws of the State of Connecticut. This business trust, called American Community Capital Trust II, Ltd was formed in order to allow us to issue trust preferred securities. On December 15, 2003, American Community Capital Trust II, Ltd. issued a floating rate trust preferred security in the amount of $10,000,000. The Trust used the proceeds from the issuance of the trust preferred security to acquire a junior subordinated note of the Company. The trust preferred security essentially mirrors the debt security, carrying a floating interest rate based on 3-month LIBOR plus 280 basis points. The initial interest rate in effect at the time of issuance was 3.97%, which is reset on a quarterly basis. The rate as of December 31, 2006 was 8.17%. The securities have a legal maturity of 30 years, and can be called at the Company s option in whole or part after five years.

Banking Technology

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

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

Competition

Commercial banking in North Carolina is highly competitive in large part due to early adoption of statewide branching. We compete in our market areas with some of the largest banking organizations in the state and the country and other financial institutions, such as federally and state-chartered savings and loan institutions and credit unions, as well as consumer finance companies, mortgage companies and other lenders engaged in the business of extending credit or taking investment monies such as mutual funds and brokerage firms. Many of our competitors have broader geographic markets and higher lending limits than us and are also able to provide more services and make greater use of media advertising. In Union County, for example, there are currently 37 offices of 11 different commercial banks (including the largest banks in North Carolina). In Mecklenburg County, there are currently 226 offices of 22 different commercial banks (including the largest banks in North Carolina). While we typically do not compete directly for loans with these larger banks, they do influence our deposit products. We do compete more directly with mid-size and small community banks that have offices in our market areas. There are also a number of new community banks in Mecklenburg and Union Counties that have a direct competitive effect as borrowers tend to shop the terms of their loans and deposits.

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

The banking business is highly competitive in South Carolina as well. American Community competes as a financial intermediary with other commercial banks, savings and loan associations, credit unions, and money market mutual funds operating in the Cherokee County area and elsewhere. In Cherokee County, there are currently 13 offices of 6 different commercial banks. A number of these competitors are well established in the Cherokee County area. Most of them have substantially greater resources and lending limits than the Bank and offer certain services, such as extensive and established branch networks and trust services that we either do not expect to provide or do not currently provide. As a result of these competitive factors, the Bank may have to pay higher rates of interest to attract deposits.

Despite the competition in our market areas, we believe that we have certain competitive advantages that distinguish us from our competition. We believe that our primary competitive advantages are our bankers, each of whom is well known in his or her community with strong personal and business ties to that community with a loyal customer following. We offer customers modern banking services without forsaking community values such as prompt, personal service and friendliness. We also have established local advisory boards in certain of our communities to help us better understand their needs and to be ambassadors of the Bank. We offer many personalized services and attract customers by being responsive and sensitive to their individualized needs. We believe our approach to business builds goodwill among our customers, shareholders, and the communities we serve which results in referrals from shareholders and satisfied customers. We also rely on traditional marketing to attract new customers. To enhance a positive image in the community, we support and participate in local events and our officers and directors serve on boards of local civic and charitable organizations. As an example, American Community was recognized each year from 1999 to 2006 for outstanding contributions to the United Way Campaign for Union County. American Community is very active in the Special Olympics for Union County and has been honored by Special Olympics as Business of the Year for our sponsorship and volunteer efforts.

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

Regulation of the Bank

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

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

Deposit Insurance. As a member institution of the FDIC, the Bank s deposits are insured up to a per depositor maximum of $250,000 for retirement accounts and $100,000 for all other accounts through the Deposit Insurance Fund, administered by the FDIC, and each member institution is required to pay semi-annual deposit insurance premium assessments to the FDIC. The Deposit Insurance Fund assessment rates have a range of 0 cents to 27 cents for every $100 in assessable deposits. Banks with no premium are subject to an annual statutory minimum assessment.

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

A banking organization s risk-based capital ratios are obtained by dividing its qualifying capital by its total risk adjusted assets. The regulators measure risk-adjusted assets, which include off balance sheet items, against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1, or core capital, includes common equity, qualifying noncumulative perpetual preferred stock and minority interests in equity accounts of consolidated subsidiaries, less goodwill and other intangibles, subject to certain exceptions. Tier 2, or supplementary capital, includes among other things, limited-life preferred stock, hybrid capital instruments, mandatory convertible securities, qualifying subordinated debt, and the allowance for loan and lease losses, subject to certain limitations and less required deductions. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Banks and bank holding companies subject to the risk-based capital guidelines are required to maintain a ratio of Tier 1 capital to risk-weighted assets of at least 4% and a ratio of total capital to risk-weighted assets of at least 8%. The appropriate regulatory authority may set higher capital requirements when particular circumstances warrant. As of December 31, 2006, Bancshares was classified as well-capitalized with Tier 1 and Total Risk-Based Capital of 14.93% and 16.18%, respectively.

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

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

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

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

- the establishment of uniform accounting standards by federal banking agencies,

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

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

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

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

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

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

International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. On October 26, 2001, the USA Patriot Act of 2001 was enacted. This act contains the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001, which sets forth anti-money laundering measures affecting insured depository institutions, broker-dealers and other financial institutions. The Act requires U.S. financial institutions to adopt new policies and procedures to combat money laundering and grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on the operations of financial institutions. The USA Patriot Act of 2001 has not had a material impact on our operations.

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

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

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

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

Regulation of Bancshares

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

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

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

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

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

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

- making or servicing loans;
- performing certain data processing services;
- providing discount brokerage services;
- acting as fiduciary, investment or financial advisor;
- leasing personal or real property;

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

- acquiring a savings and loan association.

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

If such a proposed acquisition is not disapproved or subjected to conditions by the Federal Reserve Board within the applicable notice period, it is deemed approved by the Federal Reserve Board.

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

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

Under the Modernization Act, the Federal Reserve Board serves as the primary umbrella regulator of financial holding companies, with supervisory authority over each parent company and limited authority over its subsidiaries. Expanded financial activities of financial holding companies generally will be regulated according to the type of such financial activity: banking activities by banking regulators, securities activities by securities regulators and insurance activities by insurance regulators. The Modernization Act also imposes additional restrictions and heightened disclosure requirements regarding private information collected by financial institutions. We cannot predict the full sweep of the new legislation.

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

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

- a leverage capital requirement expressed as a percentage of adjusted total assets;
- a risk-based requirement expressed as a percentage of total risk-weighted assets; and
- a Tier 1 leverage requirement expressed as a percentage of adjusted total assets.

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

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

Source of Strength for Subsidiaries. Bank holding companies are required to serve as a source of financial strength for their depository institution subsidiaries, and, if their depository institution subsidiaries become undercapitalized,

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bank holding companies may be required to guarantee the subsidiaries compliance with capital restoration plans filed with their bank regulators, subject to certain limits.

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

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

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

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

Subsidiary banks of a bank holding company are subject to certain quantitative and qualitative restrictions imposed by the Federal Reserve Act on any extension of credit to, or purchase of assets from, or letter of credit on behalf of, the bank holding company or its subsidiaries, and on the investment in or acceptance of stocks or securities of such holding company or its subsidiaries as collateral for loans. In addition, provisions of the Federal Reserve Act and Federal Reserve Board regulations limit the amounts of, and establish required procedures and credit standards with respect to, loans and other extensions of credit to officers, directors and principal shareholders of the Bank, Bancshares, any subsidiary of Bancshares and related interests of such persons. Moreover, subsidiaries of bank holding companies are prohibited from engaging in certain tie-in arrangements (with the holding company or any of its subsidiaries) in connection with any extension of credit, lease or sale of property or furnishing of services.

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

Interstate Branching

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Riegle Act), the Federal Reserve Board may approve bank holding company acquisitions of banks in other states, subject to certain aging and deposit concentration limits. As of June 1, 1997, banks in one state may merge with banks in another state, unless

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the other state has chosen not to implement this section of the Riegle Act. These mergers are also subject to similar aging and deposit concentration limits.

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

Future Legislation

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

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ITEM 1A RISK FACTORS

An investment in our common stock involves a number of risks. We urge you to read all of the information contained in this annual report on Form 10-K. In addition, we urge you to consider carefully the following factors before you invest in shares of the registrant s common stock.

We may not be able to maintain and manage our growth, which may adversely affect our results of operations and financial condition and the value of our common stock.

Our strategy has been to increase the size of our company by opening new offices, acquiring other banks and by pursuing business development opportunities. We have grown rapidly since we commenced operations. We can provide no assurance that we will continue to be successful in increasing the volume of loans and deposits at acceptable risk levels and upon acceptable terms while managing the costs and implementation risks associated with our growth strategy. There can be no assurance that our further expansion will be profitable or that we will continue to be able to sustain our historical rate of growth, either through internal growth or through successful expansion of our markets, or that we will be able to maintain capital sufficient to support our continued growth. If we grow too quickly, however, and are not able to control costs and maintain asset quality, rapid growth also could adversely affect our financial performance.

Changes in interest rates affect our interest margins, which can adversely affect our profitability.

We may not be able to effectively manage changes in interest rates that affect what we charge as interest on our earning assets and the expense we must pay on interest-bearing liabilities, which may significantly reduce our earnings. Since rates charged on our loans often tend to react to market conditions faster than do rates paid on our deposit accounts, these rate cuts may have a negative impact on our earnings until we could make appropriate adjustments in our deposit rates. Fluctuations in interest rates are not predictable or controllable and, therefore, there can be no assurances of our ability to continue to maintain a consistent positive spread between the interest earned on our earning assets and the interest paid on our interest-bearing liabilities.

Our profitability depends significantly on economic conditions in our market area.

Our success depends to a large degree on the general economic conditions in our market areas. The local economic conditions in these areas have a significant impact on the amount of loans that we make to our borrowers, the ability of our borrowers to repay these loans and the value of the collateral securing these loans. A significant decline in general economic conditions caused by inflation, recession, unemployment or other factors beyond our control would impact these local economic conditions and could negatively affect our financial condition and performance.

If we lose key employees with significant business contacts in our market area, our business may suffer.

Our success is largely dependent on the personal contacts of our officers and employees in our market area. If we lose key employees temporarily or permanently, our business could be hurt. We could be particularly hurt if our key employees went to work for our competitors. Our future success depends on the continued contributions of our existing senior management personnel.

If we experience greater loan losses than anticipated, it will have an adverse effect on our net income.

While the risk of nonpayment of loans is inherent in banking, if we experience greater nonpayment levels than we anticipate, our earnings and overall financial condition, as well as the value of our common stock, could be adversely affected.

We cannot assure you that our monitoring procedures and policies will reduce certain lending risks or that our allowance for loan losses will be adequate to cover actual losses. In addition, as a result of the rapid growth in our loan portfolio, loan losses may be greater than management s estimates. Loan losses can cause insolvency and failure of a financial institution and, in such an event, our shareholders could lose their entire investment. In addition, future provisions for loan losses could materially and adversely affect our profitability. Any loan losses will reduce the loan loss allowance. A reduction in the loan loss allowance will be restored by an increase in our provision for loan losses. This would reduce our earnings which could have an adverse effect on our stock price.

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In order to be profitable, we must compete successfully with other financial institutions which have greater resources and capabilities than we do.

The banking business in North Carolina in general is extremely competitive. Most of our competitors are larger and have greater resources than we do and have been in existence a longer period of time. We must overcome historical bank-customer relationships to attract customers away from our competition. We compete with the following types of institutions:

other commercial banks	securities brokerage firms
savings banks	mortgage brokers
thrifts	insurance companies
credit unions	mutual funds
consumer finance companies	trust companies

Some of our competitors are not regulated as extensively as we are and, therefore, may have greater flexibility in competing for business. Some of these competitors are subject to similar regulation but have the advantages of larger established customer bases, higher lending limits, extensive branch networks, numerous automated teller machines, greater advertising-marketing budgets or other factors.

Our legal lending limit is determined by law. The size of the loans which we offer to our customers may be less than the size of the loans that larger competitors are able to offer. This limit may affect to some degree our success in establishing relationships with the larger businesses in our market.

New or acquired branch facilities and other facilities may not be profitable.

We may not be able to correctly identify profitable locations for new branches and the costs to start up new branch facilities or to acquire existing branches, and the additional costs to operate these facilities, may increase our noninterest expense and decrease earnings in the short term. If other banks or branches of other banks become available for sale, we may acquire them. It may be difficult to adequately and profitably manage our growth through the establishment of these branches. In addition, we can provide no assurance that these branch sites will successfully attract enough deposits to offset the expenses of operating these branch sites. Any new or acquired branches will be subject to regulatory approval, and there can be no assurance that we will succeed in securing such approvals.

Government regulations may prevent or impair our ability to pay dividends, engage in additional acquisitions, or operate in other ways.

Current and future legislation and the policies established by federal and state regulatory authorities will affect our operations. We are subject to supervision and periodic examination by the Federal Reserve Board and the North Carolina Commissioner of Banks. Our principal subsidiary, American Community Bank, as a state chartered commercial bank, also receives regulatory scrutiny from the North Carolina Commissioner of Banks and the FDIC. Banking regulations are designed primarily for the protection of depositors rather than shareholders, and they may limit our growth and the return to you as an investor by restricting its activities, such as:

- the payment of dividends to shareholders;
- possible transactions with or acquisitions by other institutions;
- desired investments;
- loans and interest rates;

- interest rates paid on deposits;

- the possible expansion of branch offices; and

- the ability to provide securities or trust services.

We are registered with the Federal Reserve Board as a bank holding company. We cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our business. The cost of compliance with regulatory requirements may adversely affect our ability to operate profitably.

Our stock trading volume has been low compared with larger bank holding companies.

The trading volume in our common stock on the Nasdaq Global Market has been comparable to other similarly sized bank holding companies since trading on the Global Market began in July 2001. Nevertheless, this trading volume does not compare with more seasoned companies listed on other stock exchanges. Thus, the market in our common stock is somewhat limited in scope relative to some other companies. In addition, we can provide no assurance that a more active and liquid trading market for our stock will develop in the future.

Our articles of incorporation include anti-takeover provisions that may prevent shareholders from receiving a premium for their shares or effecting a transaction favored by a majority of shareholders.

Our articles of incorporation include anti-takeover provisions, including a supermajority vote requirement for a merger under certain circumstances as well as a provision allowing our Board of Directors to consider the social and economic effects of a proposed merger. Such provisions may have the effect of preventing shareholders from receiving a premium for their shares of common stock and discouraging a change of control by allowing management to prevent a transaction favored by a majority of the shareholders.

Our securities are not FDIC insured.

Our common stock is not a savings or deposit account or other obligation of the Bank, and is not insured by the Federal Deposit Insurance Corporation or any other governmental agency and is subject to investment risk, including the possible loss of principal.

Our recent operating results may not be indicative of our future operating results.

We may not be able to sustain our historical rate of growth. Because of our relatively small size and short operating history, it will be difficult for us to replicate our historical earnings growth as we continue to expand. Consequently, our historical results of operations will not necessarily be indicative of our future operations. Various factors, such as economic conditions, regulatory and legislative considerations, and competition, may also impede our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected because a high percentage of our operating costs are fixed expenses.

We are subject to extensive regulation that could limit or restrict our activities.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by the North Carolina Office of the Commissioner of Banks, the FDIC, and the Federal Reserve Board. Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits, and locations of offices. We must also meet regulatory capital requirements. If we fail to meet these capital and other regulatory requirements, our financial condition, liquidity, and results of operations would be materially and adversely affected. Our failure to remain well capitalized and well managed for regulatory purposes could affect customer confidence, our ability to grow, our cost of funds and FDIC insurance, our ability to pay dividends on common stock, and our ability to make acquisitions.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability. For example, new legislation or regulation could limit the manner in which we may conduct our business, including our ability to obtain financing, attract deposits, and make loans. Many of these regulations are intended to protect depositors, the public, and the FDIC, not shareholders. In addition, the burden imposed by these regulations may place us at a competitive disadvantage compared to competitors who are less regulated. The laws, regulations, interpretations, and enforcement policies that apply to us have been subject to significant change in recent years, sometimes retroactively applied, and may change significantly in the future. Our cost of compliance could adversely affect our ability to operate profitably.

Our growth may require us to raise additional capital that may not be available when it is needed, or at all.

We are required by regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our capital resources will satisfy our capital requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth. Our ability to raise additional capital, if needed, will depend in part on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we may be unable to raise additional capital, if and when needed, on terms acceptable to us, or at all. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired. In addition, if we issue additional equity capital, the interests of existing shareholders would be diluted.

Efforts to comply with the Sarbanes-Oxley Act will involve significant expenditures, and non-compliance with the Sarbanes-Oxley Act may adversely affect us.

The Sarbanes-Oxley Act of 2002, and the related rules and regulations promulgated by the Securities and Exchange Commission that are now applicable to us, have increased the scope, complexity, and cost of corporate governance, reporting, and disclosure practices. We have experienced, and we expect to continue to experience, greater compliance costs, including costs related to internal controls, as a result of the Sarbanes-Oxley Act. We expect these new rules and regulations to continue to increase our accounting, legal, and other costs, and to make some activities more difficult, time consuming, and costly. In the event that we are unable to achieve or maintain compliance with the Sarbanes-Oxley Act and related rules, we may be adversely affected.

We are evaluating our internal control systems in order to allow management to report on, and our independent registered public accounting firm to attest to, our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. If we identify significant deficiencies or material weaknesses in our internal control over financial reporting that we cannot remediate in a timely manner, or if we are unable to receive a positive attestation from our independent registered public accounting firm with respect to our internal control over financial reporting, the trading price of our common stock could decline, our ability to obtain any necessary equity or debt financing could suffer, and, if accepted for listing, our common stock could ultimately be delisted from the NASDAQ Global Market. In this event, the liquidity of our common stock would be severely limited and the market price of our common stock would likely decline significantly.

In addition, the new rules adopted as a result of the Sarbanes-Oxley Act could make it more difficult or more costly for us to obtain certain types of insurance, including directors and officers liability insurance, which could make it more difficult for us to attract and retain qualified persons to serve on our board of directors or as executive officers.

The holder of our junior subordinated debenture has rights that are senior to those of our common shareholders.

We have supported our continued growth through the issuance of trust preferred securities from special purpose trusts and the accompanying sale of a $13.5 million junior subordinated debenture to such trusts. Payments of the principal and interest on the trust preferred securities of these trusts are conditionally guaranteed by us. Further, the accompanying junior subordinated debentures that we issued to the trusts are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holder of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We have the right to defer distributions on the junior subordinated debentures (and the related trust preferred securities) for up to five years, however, in the event of such a deferral, no dividends may be paid on our common stock.

ITEM 1B UNRESOLVED STAFF COMMENTS

Not applicable

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ITEM 2 PROPERTIES

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

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

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

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

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

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

Employees

As of December 31, 2006, we had full-time 105 employees and 10 part-time employees. None of these employees are covered by a collective bargaining agreement. We consider relations with our employees to be good.

ITEM 3 LEGAL PROCEEDINGS

Not Applicable

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable

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PART II

ITEM 5 MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

American Community Bancshares common stock is listed on the Nasdaq Global Market under the symbol ACBA . It began trading on this market on July 17, 2000. In addition, warrants to buy shares of American Community Bancshares included as a part of the units sold in April 2002 were also traded on the Nasdaq Global Market under the symbol ACBAW . The warrants entitled the holder to purchase one share of common stock at $10.50 per share and expired on April 30, 2005. At expiration of the warrants, 999,012 common shares were issued and total capital received was $10,489,626. There were 7,003,068 shares of our common stock outstanding at March 22, 2007 owned by approximately 2,500 shareholders. The table below lists the high and low prices at which trades were completed during each quarter indicated for our stock and warrants to buy stock and are adjusted to reflect our three-for-two stock split effective in the form of a 50% stock dividend in February 2006. In 2005 and 2006, the Company paid quarterly dividends in the amount of $0.05 per share.

	Dividends	Sale Price Common Stock		Sale Price Warrants	
	Paid	High	Low	High	Low
2006					
First Quarter	$ 0.05	$ 13.73	$ 12.14	$	$
Second Quarter	0.05	13.49	12.04		
Third Quarter	0.05	12.23	11.18		
Fourth Quarter	0.05	11.71	11.00		
2005					
First Quarter	$ 0.05	$ 9.53	$ 9.46	$ 4.50	$ 2.33
Second Quarter	0.05	11.53	11.33	2.67	2.33
Third Quarter	0.05	11.47	11.44		
Fourth Quarter	0.05	12.51	12.07		

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

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Performance Graph

The following graph compares (i) the yearly change in the cumulative total stockholder return on the Company s common stock with (ii) the cumulative return of the Nasdaq Composite, and (iii) the Nasdaq Bank Stock Index. The graph assumes that the value of an investment in the Company s common stock and in each index was $100 on December 31, 2000, and that all dividends were reinvested. The performance shown in the graph represents past performance and should not be considered an indication of future performance.

American Community Bancshares, Inc.

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ITEM 6 SELECTED FINANCIAL DATA

AMERICAN COMMUNITY BANCSHARES, INC.

Selected Financial Information and Other Data

($ in thousands, except per share data)

	At or for the Year Ended December 31,				
	2006	2005	2004	2003	2002
Operating Data:					
Total interest income	$ 32,334	$ 25,584	$ 18,217	$ 13,055	$ 11,463
Total interest expense	13,521	9,180	6,220	5,169	5,294
Net interest income	18,813	16,404	11,997	7,886	6,169
Provision for loan losses	2,612	809	574	784	915
Net interest income after provision for loan losses	16,201	15,595	11,423	7,102	5,254
Non-interest income	3,353	3,294	3,337	2,645	2,030
Non-interest expenses	12,838	11,742	10,400	7,552	6,067
Income before income taxes (benefit)	6,716	7,147	4,360	2,195	1,217
Provision for income taxes (benefit)	2,440	2,639	1,617	807	(83)
Net income	$ 4,276	$ 4,508	$ 2,743	$ 1,388	$ 1,300
Per Share Data: (1)					
Earnings per share basic	$ 0.62	$ 0.71	$ 0.56	$ 0.33	$ 0.34
Earnings per share diluted	0.60	0.66	0.50	0.32	0.34
Cash dividends per share	0.20	0.13	0.07	0.05	
Market Price					
High	13.73	12.51	11.21	8.73	6.00
Low	11.00	9.46	7.58	5.42	5.10
Close	11.04	12.43	10.90	8.30	5.30
Book value	7.83	7.43	7.06	5.71	5.45
Tangible book value	6.35	5.89	5.04	5.71	5.45
Weighted average shares outstanding					
Basis	6,913,534	6,364,336	4,912,256	4,236,564	3,854,078
Diluted	7,171,413	6,819,523	5,513,361	4,315,951	3,861,653
Selected Year-End Balance Sheet Data:					
Loans	$ 370,431	$ 332,708	$ 307,988	$ 204,533	$ 165,366
Allowance for loan losses	5,628	4,331	3,488	2,529	2,375
Intangible assets	10,403	10,510	10,617		
Total assets	494,658	436,671	399,458	281,253	215,105
Deposits	401,137	345,401	306,665	208,163	174,315
Borrowings	37,085	38,464	54,169	48,319	16,781
Shareholders equity	55,068	50,886	36,972	24,189	23,076
Selected Average Balances:					
Total assets	$ 468,908	$ 420,941	$ 366,668	$ 246,042	$ 200,457
Loans	351,401	317,986	275,011	182,108	146,530
Total interest-earning assets	428,679	385,919	337,292	230,747	189,228
Interest-bearing deposits	314,932	278,473	239,294	168,307	144,790
Total interest-bearing liabilities	355,362	320,230	292,402	196,469	158,694

Shareholders equity	52,924	45,937	32,275	23,501	19,850

(1) All share and per share amounts reflect the effects of the 10 % stock dividend paid by the Company during 2001 and the 50% stock dividend paid in 2006.

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AMERICAN COMMUNITY BANCSHARES, INC.

Selected Financial Information and Other Data

($ in thousands, except per share data)

	At or for the Year Ended December 31,				
	2006	2005	2004	2003	2002
Selected Performance Ratios:					
Return on average assets	0.91%	1.07%	0.74%	0.56%	0.65%
Return on average equity	8.08%	9.81%	8.50%	5.91%	6.55%
Net interest margin	4.39%	4.25%	3.56%	3.42%	3.26%
Noninterest expense to average assets	2.74%	2.79%	2.84%	3.07%	3.03%
Efficiency ratio	57.71%	59.61%	67.82%	71.71%	74.00%
Asset Quality Ratios:					
Nonperforming loans to total loans	0.49%	0.29%	0.29%	0.16%	0.35%
Allowance for loan losses to period-end loans	1.52%	1.30%	1.13%	1.24%	1.44%
Allowance for loan losses to nonperforming loans	311%	455%	396%	766%	409%
Nonperforming assets to total assets	0.41%	0.33%	0.30%	0.17%	0.48%
Net loan charge-offs (recoveries) to average loans	0.37%	(0.01%)	0.11%	0.35%	0.19%

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

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

OVERVIEW

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

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

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

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

Comparison of Financial Condition at December 31, 2006 and 2005

Total assets at December 31, 2006 increased by $58.0 million or 13.3% to $494.7 million compared to $436.7 million at December 31, 2005. Bancshares had earning assets of $454.8 million at year-end December 31, 2006 consisting of $370.4 million in gross loans, $67.1 million in investment securities and non-marketable equity securities, and $17.3 million in interest-bearing deposits with banks. Total deposits as of December 31, 2006 increased by $55.7 million or 16.1% to $401.1 million compared to $345.4 million at December 31, 2005. Total borrowings as of December 31, 2006 decreased by $1.4 million or 3.6% from $38.5 million to $37.1 million. Stockholders equity was $55.1 million at December 31, 2006 compared to $50.9 million at December 31, 2005 for an increase of $4.2 million or 8.2%.

Gross loans grew by $37.7 million or 11.3% from $332.7 million as of December 31, 2005 to $370.4 million at year-end 2006. The composition of the loan portfolio, by category, as of December 31, 2006 is as follows: 7% 1-4 family mortgage loans, 19% commercial mortgage real estate loans, 21% construction/development real estate loans, 7% home equity lines of credit, 34% commercial loans, 10% consumer and other loans to individuals and 2%

leases. The real estate category grew $16.8 million from $157.7 million to $174.5 million. Within the real estate category, 1-4 family loans decreased $2.0 million from $28.9 million to $26.9 million, commercial mortgage real estate loans decreased $14.1 million from $84.7 million to $70.6 million while construction/development loans increased $33.0 million from $44.0 million to $77.0 million. These construction/development loans are primarily single family residences and owner occupied commercial properties. Net increases in other loan categories included, $29.4 million in commercial and industrial loans, and $841,000 in consumer and other loans and net decreases of $3.3 million in home equity lines of credit and $5.9 million in leases. The composition of the loan portfolio at December 31, 2005, by category, was 9% 1-4 family mortgage loans, 26% commercial mortgage real estate loans, 13% construction/development real estate loans, 8% home equity lines of credit, 29% commercial loans, 11% consumer and other loans to individuals and 4% leases.

Bancshares recorded a $2.6 million provision for loan losses for the year ended December 31, 2006, representing an increase of $1.8 million from the $809,000 provision for the year ended December 31, 2005. Bancshares also experienced net charge-offs of $1.3 million in 2006 compared to a net recovery in 2005 of $34,000. The percentage of net loan charge-offs (recoveries) to average loans outstanding was 0.37% for the year ended December 31, 2006 as compared with (.01%) for the year ended December 31, 2005. Non-performing loans and leases totaled $1.8 million or .49% of total loans at December 31, 2006, up from $951,000 or .29% of total loans at December 31, 2005. The composition of non-performing loans and leases at December 31, 2006 by category was 17% real estate, 11% commercial loans, 1% home equity lines of credit, 2% consumer and other loans to individuals and 69% leases. This compares to 19% real estate, 24% commercial loans, and 6% consumer and other loans to individuals and 51% leases at December 31, 2005. All non-performing loans and leases have been reviewed for collectibility and any specific reserves necessary have been recorded. The allowance for loan losses at December 31, 2006 of $5.6 million represents 1.52% of total loans and 311% of non-performing loans. The allowance for loan losses at December 31, 2005 of $4.3 million represented 1.30% of total loans and 455% of non-performing loans. The increase in both the provision for loan losses and the increase in the allowance for loan losses in 2006 is primarily attributable to the increase in non-performing leases. Management believes that the allowance for loan losses as of December 31, 2006 is adequate to absorb losses inherent in the loan portfolio.

Bancshares had total investment securities of $65.2 million at December 31, 2006 of which $63.0 million are accounted for as available for sale under Statement of Financial Accounting Standards (SFAS) No. 115 and are presented at fair value, and $2.2 million are intended to be held to maturity. The investment securities portfolio increased by $885,000 from the $64.3 million balance at December 31, 2005. Additions to the investment portfolio included $13.3 million in new securities purchases, largely funded from $12.7 million in proceeds from investment maturities, calls, sales and principal re-payments. In 2003, the Company borrowed $15.0 million in repurchase agreements with six month maturities and invested the proceeds in 10 year mortgage backed securities to take advantage of increased spreads between short-term and long-term rates and provide protection against falling short-term interest rates. Due to rising short-term interest rates during the year, the interest rate spread on the securities purchased and the repurchase agreement used to fund the transaction narrowed. The $15.0 million in repurchase agreements were paid off during 2005 with proceeds from the exercise of the Company s warrants which expired in April of 2005.

Interest-earning deposits with banks increased by $12.8 million The Company holds funds in interest-earning deposits with banks to provide liquidity for future loan demand and to satisfy fluctuations in deposit levels.

Non interest-earning assets increased by $8.0 million from $37.5 million at December 31, 2005 to $45.5 million at December 31, 2006. The increase is primarily attributable to an increase of $737,000 in other assets and a $7.5 million increase in the cash and due from banks category. This includes cash on hand and customer deposits and other cash receipts that are in the process of collection and not available for overnight investment. Accrued interest receivable also increased $506,000 to $2.9 million at December 31, 2006 as a result of the increase in earning assets and also the increase in interest rates during the year. Bank premises and equipment was $9.1 million at December 31, 2006 a decrease of $555,000 from December 31, 2005 primarily due to depreciation of assets. Foreclosed real estate and repossessed assets were $195,000 and $6,000, respectively, at December 31, 2006 a decrease of $278,000 from the foreclosed real estate and repossessed asset balance of $479,000 at December 31, 2005. This decrease is primarily due to the sale of two 1-4 family foreclosed properties in 2006 and the sale of 19 repossessed vehicles, offset by the addition of four properties in 2006.

Total deposits increased $55.7 million or 16.1% from $345.4 million on December 31, 2005 to $401.1 million on December 31, 2006. The composition of the deposit base, by category, at December 31, 2006 is as follows: 15% non-interest bearing demand deposits, 4% savings deposits, 25% money market and interest bearing demand deposits and 56% time deposits. All deposit categories experienced increases over the twelve-month period. Dollar and percentage increases by category were as follows: non-interest bearing demand deposits, $3.7 million or 6%; savings deposits, $3.6 million or 31%, money market and interest bearing demand deposits, $24.6 million or 33%, and time deposits, $23.8 million or 12%. Time deposits of $100,000 or more totaled $121.9 million, or 54% of time deposits at December 31, 2006. The composition of deposits at December 31, 2005 was 17% non-interest bearing demand deposits, 3% savings deposits, 21% money market and interest bearing demand deposits and 59% time deposits. Time deposits of $100,000 or more at December 31, 2005 were $114.1 million or 56% of time deposits.

At December 31, 2006, $6.0 million of advances were outstanding with maturity dates ranging from July 2012 through February 2013. The balance of FHLB advances at December 31, 2005 was $11.1 million. These advances are secured by a blanket lien on 1-4 family mortgage loans and certain loans secured by commercial property, Federal Home Loan Bank stock, and $1.0 million in investment securities. Bancshares also maintained the capital lease for its main office. The recorded obligation under this capital lease at December 31, 2006 was $1.7 million. Bancshares also maintained outstanding 9.0% junior subordinated debentures in the amount of $3,608,260. The entire $3.6 million was eligible for inclusion as Tier I capital for American Community Bancshares, Inc. in 2006. In 2003, Bancshares issued additional junior subordinated debentures in the amount of $10,310,000 million of which $6.8 million was eligible for inclusion as Tier 1 capital for American Community Bancshares, Inc. in 2006. The debentures have a maturity of thirty years with a five-year continuous call provision and are re-priced monthly based on 90 day LIBOR plus 280 basis points. The Bank also offers corporate customers the option to sweep excess checking account balances into one day maturity repurchase agreements which are collateralized by certain of the Bank s investment securities. The balance of these repurchase agreements at December 31, 2006 was $15.5 million. In 2003, the Company borrowed $15.0 million under repurchase agreements with six month maturities and invested the proceeds in 10 year mortgaged backed securities to take advantage of increased spreads between short-term and long-term rates and provide protection against falling short-term interest rates. The $15.0 million in repurchase agreements were paid off in 2005.

Other liabilities decreased by $551,000 to $1.4 million at December 31, 2006 from $1.9 million at December 31, 2005. The decrease was primarily due to the decrease in accrued income taxes for the year.

Bancshares began 2006 with total stockholders equity of $50.9 million. Total equity increased to $55.1 million at December 31, 2006. This $4.2 million increase was due to comprehensive income for 2006 of $4.4 million, which was offset by the $1.4 million payment of cash dividends of $.20 per share in 2006. In addition, 178,541 options to buy stock were exercised in 2006 resulting in $911,000 in net proceeds.

Net Interest Income

Like most financial institutions, the primary component of earnings for Bancshares is net interest income. Net interest income is the difference between interest income, principally from loan and investment securities portfolios, and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume, spread and margin. Volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities, as well as levels of non-interest-bearing liabilities. During the fiscal years ended December 31, 2006, 2005 and 2004, average interest-earning assets were $428.7 million, $385.9 million, and $337.3 million, respectively. During these same periods, Bancshares net yields on average interest-earning assets (net interest margin) were 4.39%, 4.25%, and 3.56%, respectively.

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

	Year Ended December 31, 2006			Year Ended December 31, 2005			Year Ended December 31, 2004		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
				(Dollars in thousands)					
Interest-earning assets:									
Loans	$ 351,401	$ 28,800	8.20%	$ 317,986	$ 23,062	7.25%	$ 275,011	$ 16,387	5.96%
Investments	66,446	2,990	4.50%	56,973	2,229	3.91%	53,499	1,740	3.25%
Interest-earning deposits	10,832	544	5.02%	10,960	293	2.67%	8,782	89	1.01%
Total interest-earning assets	428,679	32,334	7.54%	385,919	25,584	6.63%	337,292	18,216	5.40%
Other assets	40,229			35,022			29,376		
Total assets	$ 468,908			$ 420,941			$ 366,668		
Interest-bearing liabilities:									
Deposits:									
Savings	$ 11,612	40	.34%	$ 11,845	28	.24%	$ 11,071	26	.23%
Money Market and NOW	80,180	1,597	1.99%	70,425	1,021	1.45%	66,477	378	.57%
Time	223,140	9,620	4.31%	196,203	6,241	3.18%	161,746	4,058	2.51%
Borrowings (1)	40,430	2,264	5.60%	41,757	1,890	4.53%	53,108	1,758	3.31%
Total interest-bearing liabilities	355,362	13,521	3.80%	320,230	9,180	2.87%	292,402	6,220	2.13%
Non-interest-bearing deposits	58,705			53,753			39,861		
Other liabilities	1,917			1,021			2,130		
Stockholders equity	52,924			45,937			32,275		
Total liabilities and stockholders equity	$ 468,908			$ 420,941			$ 366,668		
Net interest income and interest rate spread		$ 18,813	3.74%		$ 16,404	3.76%		$ 11,996	3.27%
Net yield on average interest-earning assets			4.39%			4.25%			3.56%
Ratio of average interest-earning assets to average interest-bearing liabilities	120.63%			120.51%			115.35%		

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

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Rate/Volume Analysis

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

	December 31, 2006 vs. 2005 Increase (Decrease) Due to			December 31, 2005 vs. 2004 Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest income:						
Loans	$ 2,581	$ 3,157	$ 5,738	$ 2,839	$ 3,836	$ 6,675
Investment securities	359	402	761	124	365	489
Interest-earning deposits with banks	(5)	256	251	40	164	204
Total interest income	2,935	3,815	6,750	3,003	4,365	7,368
Interest expense:						
Deposits	1,176	2,791	3,967	1,022	1,806	2,828
Borrowings	(67)	441	374	(445)	577	132
Total interest expense	1,109	3,232	4,341	577	2,383	2,960
Net interest income	$ 1,826	$ 583	$ 2,409	$ 2,426	$ 1,982	$ 4,408

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Comparison of Results of Operations for the Years Ended December 31, 2006 and 2005

Net Income. Bancshares generated net income in 2006 of $4.3 million compared to net income in 2005 of $4.5 million. On a per share basis, fully diluted earnings were $.60 for 2006 compared to $.66 for 2005. Return on average assets was .91% and 1.07% and return on average equity was 8.08% and 9.81% for the years ended December 31, 2006 and 2005, respectively.

Earnings for the year ended December 31, 2006 were positively impacted by strong growth in average earning assets and by increases in net interest income. The impact of the growth in average earning assets was further enhanced by the increase in the yield on interest-earning assets, which increased to 7.54% in 2006 from 6.63% in 2005. Earnings were negatively impacted by a $1.8 million increase in the provision for loan losses. This increase in the provision was primarily a result of losses incurred within the leasing portfolio.

Net Interest Income. Net interest income increased $2.4 million from $16.4 million in 2005 to $18.8 million in 2006. Total interest income benefited from strong growth in average earning assets combined with an increase in net interest margin from 4.25% in 2005 to 4.39% in 2006.

Total average earning assets increased $42.8 million or 10.8% from an average of $385.9 million in 2005 to an average of $428.7 million in 2006. Bancshares experienced solid loan growth during 2006 with average loan balances increasing by $33.4 million. The increase in the average balances for investment securities and interest-earning deposits was $9.3 million. Total interest income increased $6.8 million due to an increase in average earning assets of $42.8 million, complemented by an increase in yield on earning assets from 6.63% in 2005 to 7.54% in 2006. Average total interest-bearing liabilities increased by $35.1 million during 2006, consisting of a $36.5 million increase in average interest-bearing deposits while average borrowings decreased $1.3 million.

Net interest margin is interest income earned on loans, securities and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the year ended 2006 was 4.39% compared to 4.25% for 2005. The increase in net interest margin resulted from the differences between the terms and conditions of earning assets and interest-bearing liabilities. Interest rates on a significant portion of our earning assets, such as certain loans and short-term investments, are tied to index rates, including the prime lending rate and the Federal Funds rate. Conversely, rates on a significant portion of interest-bearing liabilities such as certificates of deposits and borrowings remain fixed until maturity. During 2006, the Federal Reserve Open Market Committee increased short-term interest rates four times for a total of 100 basis points. When an interest rate increase occurs, yields on certain assets are increased immediately while the impact on deposits and borrowings is delayed until such time as these instruments mature and are replaced with instruments that reflect the interest rate increase. The average yield on earning assets for 2006 was 7.54% or 91 basis points higher than the 6.63% for 2005. The 2006 average cost of interest-bearing liabilities was 3.80% or 93 basis points higher than the 2.87% for 2005. As a result, the interest rate spread, which is the difference between the average yield on earning assets and the cost of interest-bearing funds, decreased to 3.74% in 2006 from 3.76% in 2005.

Provision for Loan Losses. Bancshares provision for loan losses for 2006 was $2.6 million, representing a $1.8 million or 14.7% increase from the $809,000 recorded for 2005. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management based on factors discussed under Analysis of Loan Losses. The allowance for loan losses was $5.6 million at December 31, 2006, representing 1.52% of total outstanding loans and 311% of non-performing loans. The allowance for loan losses at December 31, 2005 was $4.3 million, representing 1.30% of total outstanding loans at that date and 455% of non-performing loans. The increase in provision for 2006 was primarily related to an increase in net charge-offs in the leasing portfolio during the year. Net lease charge-offs totaled $1.2 million in 2006 as compared to $24,000 in 2005. In addition, non-accrual loans and leases increased $858,000 from $951,000 at December 31, 2005 to $1.8 million at December 31, 2006. Management has provided individual reserves for these leases and is aggressively pursuing collection and liquidating any underlying collateral as necessary.

Non-interest Income. Non-interest income increased by $59,000 or 1.8% to $3.4 million for the year ended December 31, 2006. The largest components of non-interest income were service charges on deposit accounts of $2.4 million in 2006, an increase of $88,000 from 2005, fees from mortgage banking operations of $352,000 in 2006 as compared to $385,000 in 2005, a $33,000 or 8.6% decrease, and fees from accounts receivable financing of $102,000 in 2006 as compared to $110,000 in 2005, a 7.3% decrease. Fees from mortgage banking operations decreased as long-term rates increased in 2006.

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Non-interest Expenses. Total non-interest expense increased $1.1 million from $11.7 million in 2005 to $12.8 million in 2006. This 9.3% increase was primarily due to increases in compensation associated with the addition of two branches in 2005 in operation for all of 2006 and other growth and increases in occupancy and equipment expenses related to branch growth. Salaries and benefits expense was $6.5 million for the year ended December 31, 2006, representing a $735,000 or 12.8% increase over the $5.7 million recorded for the prior year. Occupancy and equipment costs were $2.3 million for the year ended December 31, 2006 representing a $111,000 or 5.2% increase over the $2.2 million for the prior year. Other expenses increased $250,000 or 6.5% from 2005 primarily due to increases in office expenses, advertising and promotion, and professional fees related to the new branches in operation for all of 2006.

Provision for Income Taxes. Bancshares had tax expense of $2.4 million, or 36.3% of income before income taxes, for the year ended December 31, 2006 compared to an income tax expense of $2.6 million in 2005 or 36.9% of income before income taxes.

Comparison of Results of Operations for the Years Ended December 31, 2005 and 2004

Net Income. Bancshares generated net income in 2005 of $4.5 million compared to net income in 2004 of $2.7 million. On a per share basis, fully diluted earnings were $.66 for 2005 compared to $.50 for 2004. Return on average assets was 1.07% and .74% and return on average equity was 9.81% and 8.50% for the years ended December 31, 2005 and 2004, respectively.

Earnings for the year ended December 31, 2005 were positively impacted by strong growth in average earning assets and by increases in net interest income. The impact of the growth in average earning assets was further enhanced by the increase in the yield on interest-earning assets, which increased to 6.63% in 2005 from 5.40% in 2004.

Net Interest Income. Net interest income increased $4.4 million from $12.0 million in 2004 to $16.4 million in 2005. Total interest income benefited from strong growth in average earning assets combined with an increase in net interest margin from 3.56% in 2004 to 4.25% in 2005.

Total average earning assets increased $48.6 million or 14.4% from an average of $337.3 million in 2004 to an average of $385.9 million in 2005. Bancshares experienced solid loan growth during 2005 with average loan balances increasing by $43.0 million. The increase in the average balances for investment securities and interest-earning deposits was $5.7 million. Total interest income increased $7.4 million due to an increase in average earning assets of $48.6 million, complemented by an increase in yield on earning assets from 5.40% in 2004 to 6.63% in 2005. Average total interest-bearing liabilities increased by $27.8 million during 2005, consisting of a $39.2 million increase in average interest-bearing deposits while average borrowings decreased $11.4 million.

Net interest margin is interest income earned on loans, securities and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the year ended 2005 was 4.25% compared to 3.56% for 2004. The increase in net interest margin resulted from the differences between the terms and conditions of earning assets and interest-bearing liabilities. Interest rates on a significant portion of our earning assets, such as certain loans and short-term investments, are tied to index rates, including the prime lending rate and the Federal Funds rate. Conversely, rates on a significant portion of interest-bearing liabilities such as certificates of deposits and borrowings remain fixed until maturity. During the second half of 2005, the Federal Reserve Open Market Committee increased short-term interest rates eight times for a total of 200 basis points. When an interest rate increase occurs, yields on certain assets are increased immediately while the impact on deposits and borrowings is delayed until such time as these instruments mature and are replaced with instruments that reflect the interest rate increase. The average yield on earning assets for 2005 was 6.63% or 123 basis points higher than the 5.40% for 2004. The 2005 average cost of interest-bearing liabilities was 2.87% or 74 basis points higher than the 2.13% for 2004. As a result, the interest rate spread, which is the difference between the average yield on earning assets and the cost of interest-bearing funds, increased 49 basis points from 3.27% in 2004 to 3.76% in 2005.

Provision for Loan Losses. Bancshares provision for loan losses for 2005 was $809,000, representing a $235,000 or 40.9% increase from the $574,000 recorded for 2004. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management based on factors discussed under Analysis of Loan Losses. The allowance for loan losses was $4.3 million at December 31, 2005, representing 1.30% of total outstanding loans and 455% of non-performing loans. The allowance for loan losses at December 31, 2004 was $3.5 million, representing 1.13% of total outstanding loans at that date and 396% of non-performing loans.

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Non-interest Income. Non-interest income decreased by $44,000 or 1.3% to $3.3 million for the year ended December 31, 2005. The largest components of non-interest income were service charges on deposit accounts of $2.3 million in 2005 unchanged from 2004, fees from mortgage banking operations of $385,000 in 2005 as compared to $365,000 in 2004, a 5.5% increase, and fees from accounts receivable financing of $110,000 in 2005 as compared to $85,000 in 2004, a 29% increase. Even though deposit transaction accounts increased from $126.2 million at December 31, 2004 to $143.3 million at December 31, 2005 there was no change in deposit account charges. The Bank implemented an overdraft privilege program to certain customers in 2003. The Bank discouraged customers who were over utilizing the program from doing so in 2005 which resulted in a decrease in deposit account charges directly relating to the overdraft privilege program. Fees from mortgage banking operations increased as the local economy remained strong and long-term rates remained favorable in 2005. Fees from accounts receivable financing increased due to an increase in average balances outstanding from $595,000 in 2004 to $940,000 in 2005, or a 58.0% increase.

Non-interest Expenses. Total non-interest expense increased $1.3 million from $10.4 million in 2004 to $11.7 million in 2005. This 12.5% increase was primarily due to increases in compensation associated with the addition of two branches in 2005 and other growth and increases in occupancy and equipment expenses related to branch growth. Salaries and benefits expense was $5.7 million for the year ended December 31, 2005, representing an $878,000 or 18.1% increase over the $4.9 million recorded for the prior year. Occupancy and equipment costs were $2.2 million for the year ended December 31, 2005 representing a $395,000 or 22.5% increase over the $1.8 million for the prior year. Non-interest expense in 2004 included a $600,000 charge for the settlement of a customer lawsuit. Absent this charge, other expenses increased $668,000 or 21.0% from 2004 primarily due to increases in office expenses, advertising and promotion, and professional fees related to the new branches and inclusion of First National expenses for all of 2005.

Provision for Income Taxes. Bancshares had tax expense of $2.6 million, or 36.9% of income before income taxes, for the year ended December 31, 2005 compared to an income tax expense of $1.6 million in 2004 or 37.1% of income before income taxes. The effective tax rate decreased primarily as a result of an increase in tax-free municipal bond investments from $2.2 million in 2004 to $6.5 million in 2005.

Liquidity and Capital Resources

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

As of December 31, 2006, liquid assets (cash and due from banks, interest-earning deposits with banks, and investment securities available for sale) were approximately $100.3 million, which represents 20% of total assets and 23% of total deposits and borrowings. Supplementing this liquidity, Bancshares has lines of credit from correspondent banks of approximately $29.5 million and an additional line of credit with the FHLB equal to 15% of assets (subject to available qualified collateral, with borrowings of $6.0 million outstanding from the FHLB at December 31, 2006). At December 31, 2006, outstanding commitments to extend credit were $4.5 million and available line of credit balances totaled $70.1 million. Management believes that the combined aggregate liquidity position of Bancshares is sufficient to meet the funding requirements of loan demand and deposit maturities and withdrawals in the near term.

Certificates of deposit represented 56.3% of Bancshares total deposits at December 31, 2006 a slight decrease from 58.5% at December 31, 2005. Bancshares growth strategy will include efforts focused on increasing the relative volume of transaction deposit accounts. Certificates of deposit of $100,000 or more represented 30.4% of Bancshares total deposits at December 31, 2006. These deposits are generally considered rate sensitive, but management believes most of them are relationship-oriented. While Bancshares will need to pay competitive rates to retain these deposits at maturity, there are other subjective factors that will determine Bancshares continued retention of those deposits.

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

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assets in accordance with these guidelines. At December 31, 2006, Bancshares maintained capital levels exceeding the minimum levels for adequately capitalized bank holding companies and banks.

Capital Ratios

Bancshares and the Bank are subject to minimum capital requirements. As the following table indicates, at December 31, 2006, we exceeded our regulatory capital requirements.

	At December 31, 2006		
	Actual Ratio	Minimum Requirement	Well-Capitalized Requirement
American Community Bank:			
Total risk-based capital ratio	11.74%	8.00%	10.00%
Tier 1 risk-based capital ratio	10.49%	4.00%	5.00%
Leverage ratio	9.04%	4.00%	5.00%
American Community Bancshares:			
Total risk-based capital ratio	16.18%	8.00%	NA
Tier 1 risk-based capital ratio	14.93%	4.00%	NA
Leverage ratio	12.88%	4.00%	NA

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

Asset/Liability Management

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

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

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The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2006, which are projected to reprice or mature in each of the future time periods shown. Except as stated below, the amounts of assets and liabilities shown which reprice or mature within a particular period were determined in accordance with the contractual terms of the assets or liabilities. Loans with adjustable rates are shown as being due at the end of the next upcoming adjustment period. Money market deposit accounts and negotiable order of withdrawal or other transaction accounts are assumed to pay out over a decay schedule. In making the gap computations, standard assumptions regarding prepayment rates and deposit decay rates have been used for interest-earning assets and interest-bearing liabilities. In addition, the table reflects scheduled principal payments, which will be received throughout the lives of the loans. The interest rate sensitivity of Bancshares assets and liabilities illustrated in the following table would vary substantially if different assumptions were used or if actual experience differs from that indicated by such assumptions.

	Terms to Repricing at December 31, 2006				
	3 Months or Less	More Than 3 Months to 6 Months	More Than 6 Months to 12 Months	Over 12 Months	Total
	(Dollars in thousands)				
INTEREST EARNING-ASSETS					
Loans receivable:					
Real estate mortgage loans	$ 96,425	$ 2,330	$ 6,707	$ 69,024	$ 174,486
Home equity lines of credit	24,388				24,388
Commercial and industrial loans	78,329	3,830	5,514	38,930	126,603
Loans to individuals	15,645	3,270	2,976	14,891	36,782
Lease financing, net	2,413	1,006	735	4,162	8,316
Interest earning deposits with banks	17,295				17,295
Investment securities	2,003	2,482	6,536	54,171	65,192
Non-marketable equity securities				1,879	1,879
Total interest-earning assets	$ 236,498	$ 12,918	$ 22,468	$ 183,057	$ 454,941
INTEREST-BEARING LIABILITIES					
Deposits:					
Interest-bearing demand	$ 31,789	$ 794	$ 1,589	$ 79,272	$ 113,444
Time	51,049	70,264	73,067	31,578	225,958
Borrowings (1)	15,473			7,694	23,167
Junior subordinated debentures	13,918				13,918
Total interest-bearing liabilities	$ 112,229	$ 71,058	$ 74,656	$ 118,544	$ 376,487
INTEREST SENSITIVITY GAP PER PERIOD	$ 124,269	$ (58,140)	$ (52,188)	$ 64,513	$ 78,454
CUMULATIVE INTEREST SENSITIVITY GAP	$ 124,269	$ 66,129	$ 13,941	$ 78,454	$ 78,454
CUMULATIVE GAP AS A PERCENTAGE OF TOTAL INTEREST-EARNING ASSETS	27.32%	14.54%	3.06%	17.24%	17.24%
CUMULATIVE INTEREST-EARNING ASSETS AS A PERCENTAGE OF CUMULATIVE INTEREST BEARING LIABILITIES	210.73%	136.08%	105.40%	120.84%	120.84%

(1) Includes advances from the Federal Home Loan Bank, securities sold under agreement to repurchase, federal funds purchased and capital lease obligations.

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In order to assist in achieving a desired level of interest rate sensitivity, the Company has entered into off-balance sheet contracts that are considered derivative financial instruments. As of December 31, 2006, the Company had cash flow hedges with a notional amount of $45.0 million. These derivative instruments consist of two interest rate floor contracts that are used to hedge future cash flows of the first $45.0 million of certain variable rate loans against the downward effects of their repricing in the event of a decreasing rate environment for a period of three years ending in February 2009 and June 2009. If the prime rate falls below 7.25% during the term of the contract on the first floor, the Company will receive payments based on the $30.0 million notional amount times the difference between 7.25% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.25% or higher. The Company paid a premium of $228,000 on this contact. If the prime rate falls below 7.75% during the term of the contract on the second floor, the Company will receive payments based on the $15.0 million notional amount times the difference between 7.75% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.75% or higher. The Company paid a premium of $95,250 on this contract. No payments were received in 2006 on either contract.

Critical Accounting Policies and Estimates

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

Bancshares significant accounting policies are described in Note 1 to the consolidated financial statements. Bancshares considers the following accounting policies to be most critical in their potential effect on its financial position or results of operations:

Allowance for Loan Losses

The most critical estimate concerns Bancshares allowance for loan losses. Bancshares records provisions for loan losses based upon known problem loans and estimated deficiencies in the existing loan portfolio. Bancshares methodology for assessing the appropriations of the allowance for loan losses consists of two key components, which are a specific allowance for identified problem or impaired loans and a formula allowance for the remainder of the portfolio.

Identified problem and impaired loans are measured for impairment based on the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s observable market price or the fair value of the collateral, if the loan is collateral dependent. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change. The adequacy of the allowance is also reviewed by management based upon its evaluation of then-existing economic and business conditions affecting the key lending areas of Bancshares and other conditions, such as new loan products, collateral values, loan concentrations, changes in the mix and volume of the loan portfolio; trends in portfolio credit quality, including delinquency and charge-off rates; and current economic conditions that may affect a borrower s ability to repay. Although management believes it has established and maintained the allowance for loan losses at appropriate levels, future adjustments may be necessary if economic, real estate and other conditions differ substantially from the current operating environment.

Interest Income Recognition

Interest on loans is included in income as earned based upon interest rates applied to unpaid principal. Interest is generally not accrued on loans 120 days or more past due unless the loans are adequately secured and in the process of collection. Interest is not accrued on other loans when management believes collection is doubtful. All loans considered impaired are non-accruing. Interest on non-accruing loans is recognized as payments are received when the ultimate collectibility of interest is no longer considered doubtful. When a loan is placed on non-accrual status, all interest previously accrued is reversed against current-period interest income.

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Goodwill and Other Intangible Assets

Goodwill arose from the 2004 purchase of First National Bank of the Carolinas. Pursuant to Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets,* goodwill acquired will not be amortized but will be subject to an annual impairment test. The impairment test is a two-step process that begins with a comparison of book value and stock price. If the initial evaluation suggests that an impairment of the asset value exists, the second step would determine the amount of the impairment, if any. If the tests conclude that goodwill is impaired, the carrying value would be adjusted, and an impairment loss would be recorded. As of December 31, 2006 goodwill was not impaired. The Company reviews other identified intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment loss is recognized.

Contractual Obligations

The following table reflects the contractual obligations of the Company outstanding as of December 31, 2006.

	Payments Due by Period				
	On Demand or Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
	(Dollars in thousands)				
Borrowings	$	$	$	$ 6,000	$ 6,000
Securities sold under agreement to repurchase and federal funds sold	15,473				15,473
Capital lease obligation	9	20	46	1,619	1,694
Junior subordinated deferrable interest debentures				13,918	13,918
Operating leases	785	1,549	849	2,368	5,551
Other contractual obligations	525	386	408	433	1,752
Total contractual cash obligations, excluding deposits	16,792	1,955	1,303	24,338	44,388
Deposits	369,559	26,480	5,098		401,137
Total contractual cash obligations, including deposits	$ 386,351	$ 28,435	$ 6,401	$ 24,338	$ 445,525

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

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Commitments, Contingencies and Off-Balance Sheet Arrangements

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

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

	Amount of Commitment Expiration Per Period (Dollars in thousands)				
	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
Capital South Partnership commitment	$ 125	$	$	$	$ 125
Standby letters of credit	2,247				2,247
Commitments to extend credit	4,474				4,474
Undisbursed lines of credit	34,139	5,770	3,627	26,594	70,130
Undisbursed portion of construction loans	26,564				26,564
Total off-balance sheet commitments	$ 67,549	$ 5,770	$ 3,627	$ 26,594	$ 103,540

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

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

Related Party Transactions

Bancshares related party transactions have been limited to 1) loans made to executive officers and directors in the ordinary course of business and 2) the lease of certain buildings at prevailing market rates. At December 31, 2006, Bancshares had loans outstanding to executive officers and directors totaling approximately $2.6 million. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other non-related borrowers. Management does not believe these loans involve more than the normal risk of collectibility or present other unfavorable features. The $2.6 million in outstanding related party loans represents 0.7% of Bancshares total loan portfolio. Bancshares has never charged-off a loan to a related party.

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Recent Accounting Pronouncements

SFAS 156

In the first quarter of 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 156, Accounting or Servicing of Financial Assets (SFAS No. 156). SFAS No. 156 sets accounting requirements for separately recognizing a servicing asset or a servicing liability when a company undertakes an obligation to service a financial asset under a servicing contract in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to choose one of two methods when subsequently measuring its servicing assets and servicing liabilities: (I) the amortization method or (2) the fair value measurement method. The amortization method existed under Statement 140 and remains unchanged in (1) allowing entities to amortize their servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and (2) requiring the assessment of those servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date. The fair value measurement method allows entities to measure their servicing assets or servicing liabilities at fair value each reporting date and report changes in fair value in earnings in the period the change occurs. SFAS No. 156 permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights upon initial adoption, provided certain criteria are met The Company adopted SFAS No. 156 in the first quarter of 2007 and does not expect the adoption of SFAS No. 156 to have a material impact on its financial position and results of operations, including the valuation methods and support for the assumptions that underlie the valuation.

FIN 48

In July 2006, the FASB issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in its financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of the Company s 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of FIN 48 will not have a material impact on the consolidated financial statements.

FAS 157

In September 2006, the Financial Accounting Standards Board issued FASB Statement No. 157, Fair Value Measurements (FASB No. I57), which enhances existing guidance for measuring assets and liabilities using fair value and requires additional disclosure about the use of fair value for measurement. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will be required to adopt SFAS No. 157 in the first quarter of 2008, and is currently evaluating the impact of the adoption of SFAS No. 157 on its financial position and results of operations, including the valuation methods and support for the assumptions that underlie the valuation.

SAB 108

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in the Current Year Financial Statements (SAB No. 108). SAB No. 108 addresses the diversity in practice by regiments when quantifying the effect of an error on the financial statements. SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements and is effective for annual periods ending after November 15, 2006. The Company adopted the provisions of SAB No. 108 effective December 31, 2006. The adoption of SAB 108 does not have a material impact on the consolidated financial statements.

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

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ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk reflects the risk of economic loss resulting from adverse changes in market price and interest rates. This risk of loss can be reflected in diminished current market values and/or reduced potential net interest income in future periods. Our market risk arises primarily from interest rate risk inherent in our lending and deposit-taking activities. The structure of our loan and deposit portfolios is such that a significant decline in interest rates may adversely impact net market values and net interest income. We do not maintain a trading account nor are we subject to currency exchange risk or commodity price risk. Interest rate risk is monitored as part of the Bank s asset/liability management functions. The following table presents information about the contractual maturities, average interest rates and estimated fair values of our financial instruments that are considered market risk sensitive at December 31, 2006.

	2007	2008	2009	2010	2011	Beyond Five Years	Total	Average Interest Rate	Estimated Fair Value
					(Dollars in thousands)				
FINANCIAL ASSETS									
Investment securities									
Available for sale	$ 659	$ 3,103	$ 4,000	$ 7,214	$ 507	$ 48,436	$ 63,919	4.60%	$ 63,018
Held to maturity						2,174	2,174	3.98%	2,192
Non-marketable equity						1,879	1,879		1,879
Loans	145,008	52,776	51,086	38,496	45,444	37,765	370,575	8.13%	364,082
Total	$ 145,667	$ 55,879	$ 55,086	$ 45,710	$ 45,951	$ 90,254	$ 438,547		$ 431,171
FINANCIAL LIABILITIES									
Interest-bearing demand accounts	$ 53,072	$ 2,119	$ 2,119	$ 2,119	$ 2,119	$ 51,896	$ 113,444	2.33%	$ 94,243
Time deposits	194,380	18,202	8,278	4,391	707		225,958	4.81%	223,304
Borrowings	19,090	10	10	22	24	17,929	37,085	3.98%	36,868
Total	$ 266,542	$ 20,331	$ 10,407	$ 6,532	$ 2,850	$ 69,825	$ 376,487		$ 354,415

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ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

AMERICAN COMMUNITY BANCSHARES, INC.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

American Community Bancshares, Inc.

Charlotte, North Carolina

We have audited the accompanying consolidated balance sheets of American Community Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2006 and 2005 and the related consolidated statements of operations, comprehensive income, stockholders equity and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Community Bancshares, Inc. and subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of American Community Bancshares, Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 28, 2007 expressed unqualified opinions on both management s assessment of the Company s internal control over financial reporting and the effectiveness of the Company s internal control over financial reporting.

Charlotte, North Carolina

March 28, 2007

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

	2006	2005
	(Amounts in thousands)	
ASSETS		
Cash and due from banks	$ 19,950	$ 12,495
Interest-earning deposits with banks	17,295	4,454
Investment securities available for sale, at fair value (cost of $63,920 and $63,325 at December 31, 2006 and 2005, respectively)	63,018	62,127
Investment securities held to maturity, at cost (fair value approximates $2,192 and $2,173 at December 31, 2006 and 2005, respectively)	2,174	2,180
Loans	370,431	332,708
Allowance for loan losses	(5,628)	(4,331)
NET LOANS	364,803	328,377
Accrued interest receivable	2,938	2,432
Bank premises and equipment	9,105	9,660
Foreclosed real estate	195	386
Non-marketable equity securities, at cost	1,879	1,996
Goodwill	9,838	9,838
Other assets	3,463	2,726
TOTAL ASSETS	$ 494,658	$ 436,671
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits		
Demand noninterest-bearing	$ 61,735	$ 58,054
Savings	15,111	11,510
Money market and NOW	98,333	73,699
Time	225,958	202,138
TOTAL DEPOSITS	401,137	345,401
Borrowings	6,000	11,111
Securities sold under agreement to repurchase and federal funds purchased	15,473	11,733
Capital lease obligation	1,694	1,703
Accrued expenses and other liabilities	1,368	1,919
Junior subordinated deferrable interest debentures	13,918	13,918
TOTAL LIABILITIES	439,590	385,785
Stockholders Equity		
Preferred stock, no par value, 1,000,000 shares authorized; none issued		
Common stock, $1 par value, 25,000,000 shares authorized, 7,008,081 and 4,568,673 shares issued and outstanding at December 31, 2006 and 2005, respectively	7,008	4,569
Additional paid-in capital	37,637	38,882
Retained earnings	11,072	8,178
Accumulated other comprehensive loss	(649)	(743)

TOTAL STOCKHOLDERS EQUITY	55,068	50,886
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 494,658	$ 436,671

See accompanying notes to these consolidated financial statements.

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2004
	(Amounts in thousands, except share and per share data)		
INTEREST INCOME			
Loans, including fees	$ 28,800	$ 23,062	$ 16,387
Investment securities:			
Taxable	2,702	2,051	1,618
Tax-exempt	288	178	122
Interest-earning deposits with banks	544	293	89
TOTAL INTEREST INCOME	32,334	25,584	18,216
INTEREST EXPENSE			
Money market, NOW and savings deposits	1,637	1,049	404
Time deposits	9,620	6,241	4,058
Borrowings	452	484	545
Securities sold under agreement to repurchase and federal funds purchased	523	301	292
Capital lease obligation	140	140	141
Junior subordinated debentures	1,149	965	780
TOTAL INTEREST EXPENSE	13,521	9,180	6,220
NET INTEREST INCOME	18,813	16,404	11,996
PROVISION FOR LOAN LOSSES	2,612	809	573
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	16,201	15,595	11,423
NON-INTEREST INCOME			
Service charges on deposit accounts	2,393	2,305	2,306
Mortgage banking operations	352	385	365
Accounts receivable financing	102	110	85
Gain on sale of investment securities	60	10	106
Gain on sale of assets	79	68	27
Rental income	99	94	80
Other	268	322	368
TOTAL NON-INTEREST INCOME	3,353	3,294	3,337
NON-INTEREST EXPENSE			
Salaries and employee benefits	6,474	5,739	4,860
Occupancy and equipment	2,261	2,150	1,755
Other	4,103	3,853	3,785
TOTAL NON-INTEREST EXPENSE	12,838	11,742	10,400
INCOME BEFORE INCOME TAXES	6,716	7,147	4,360

INCOME TAXES		2,440		2,639		1,617
NET INCOME	$	4,276	$	4,508	$	2,743
NET INCOME PER COMMON SHARE						
Basic	$	.62	$	.71	$	.56
Diluted	$	.60	$	.66	$	.50
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING						
Basic		6,913,534		6,364,336		4,912,256
Diluted		7,171,413		6,819,523		5,513,361

See accompanying notes to these consolidated financial statements.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2004
	(Amounts in thousands)		
NET INCOME	$ 4,276	$ 4,508	$ 2,743
Other comprehensive income (loss):			
Securities available for sale:			
Unrealized holding gains/(losses) on available-for-sale securities	350	(1,018)	(208)
Tax effect	(133)	385	79
Reclassification adjustment for gains realized in income	(60)	(10)	(106)
Tax effect	23	3	41
Net of tax amount	180	(640)	(194)
Cash flow hedging activities:			
Unrealized holding losses on cash flow hedging activities	(139)		
Tax effect	53		
Reclassification adjustment for gains realized in income			
Tax effect			
Net of tax amount	(86)		
Total other comprehensive income (loss)	94	(640)	(194)
Total comprehensive income	$ 4,370	$ 3,868	$ 2,549

See accompanying notes to these consolidated financial statements.

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Years Ended December 31, 2006, 2005 and 2004

	Common stock Shares	Common stock Amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders equity
	(Amounts in thousands, except share data)					
Balance, January 1, 2004	2,825,709	$ 2,826	$ 19,201	$ 2,071	$ 91	$ 24,189
Comprehensive income:						
Net income				2,743		2,743
Other comprehensive loss, net of tax					(194)	(194)
Total comprehensive income						2,549
Cash dividends of $.10 per share				(283)		(283)
Purchase of FNB Bancshares, Inc.	617,343	617	9,572			10,189
Common stock issued pursuant to:						
Exercise of stock options	34,997	35	175			210
Exercise of warrants	11,200	11	107			118
Balance, December 31, 2004	3,489,249	3,489	29,055	4,531	(103)	36,972
Comprehensive income:						
Net income				4,508		4,508
Other comprehensive loss, net of tax					(640)	(640)
Total comprehensive income						3,868
Cash dividends of $.20 per share				(861)		(861)
Common stock issued pursuant to:						
Exercise of stock options	91,612	92	443			535
Exercise of warrants	987,812	988	9,384			10,372
Balance, December 31, 2005	4,568,673	4,569	38,882	8,178	(743)	50,886
Comprehensive income:						
Net income				4,276		4,276
Other comprehensive income, net of tax					94	94
Total comprehensive income						4,370
Stock split effected in the form of a 50% stock dividend	2,284,567	2,284	(2,284)			
Cash dividends of $.20 per share				(1,382)		(1,382)
Shares repurchased	(23,700)	(24)	(239)			(263)
Expense recognized in connection with stock options			375			375
Common stock issued pursuant to:						
Exercise of stock options	178,541	179	733			912
Tax benefit from the exercise of stock options			170			170
Balance, December 31, 2006	7,008,081	$ 7,008	$ 37,637	$ 11,072	$ (649)	$ 55,068

See accompanying notes to these consolidated financial statements.

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2004
	(Amounts in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 4,276	$ 4,508	$ 2,743
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,072	1,219	1,202
Provision for loan losses	2,612	809	573
Deferred income taxes	(899)	559	37
Gain on sale of investment securities	(60)	(10)	(106)
Loss on sale of foreclosed real estate	144	116	7
(Gain) loss on disposal of fixed assets	7		(27)
Recognition of hedge ineffectiveness	(10)		
Increase (decrease) in capital lease obligation	(9)	(8)	2
Equity compensation expense	375		
Change in assets and liabilities:			
Increase in accrued interest receivable	(506)	(735)	(320)
Decrease (increase) in other assets	(136)	(723)	633
Increase (decrease) in accrued expenses and other liabilities	(551)	268	35
NET CASH PROVIDED BY OPERATING ACTIVITIES	6,315	6,003	4,779
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of securities available for sale	(13,299)	(25,574)	(22,300)
Purchases of securities held to maturity			(300)
Proceeds from sales of securities available for sale	3,909	2,801	10,837
Proceeds from maturities, calls and principal re-payments of securities available for sale	8,763	11,228	16,594
Net increase in loans from originations and repayments	(39,375)	(25,168)	(47,207)
Purchases of bank premises and equipment	(326)	(1,867)	(1,151)
Proceeds from sale of bank premises and equipment	6		149
Proceeds from sale of foreclosed real estate	384	365	89
Investment in non-marketable equity securities	(191)	(99)	(582)
Redemption of non-marketable equity securities	308	143	
Net cash disbursed in business combination			(2,707)
NET CASH USED BY INVESTING ACTIVITIES	(39,821)	(38,171)	(46,578)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in demand deposits	31,916	17,092	24,313
Net increase in time deposits	23,820	21,644	12,922
Proceeds from issuance of common stock	912	10,907	328
Repurchase of common stock	(263)		
Repayment of Federal Home Loan Bank advances	(5,111)	(1,667)	(2,667)
Excess tax benefits from stock options exercised	170		
Cash dividends paid on common stock	(1,382)	(861)	(283)
Net increase (decrease) in securities sold under agreement to repurchase and federal funds purchased	3,740	(14,030)	4,876
NET CASH PROVIDED BY FINANCING ACTIVITIES	53,802	33,085	39,489

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	20,296	917	(2,310)
CASH AND CASH EQUIVALENTS, BEGINNING	16,949	16,032	18,342
CASH AND CASH EQUIVALENTS, ENDING	$ 37,245	$ 16,949	$ 16,032

See accompanying notes to these consolidated financial statements.

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2006, 2005 and 2004

	2006	2005	2004
	(Amounts in thousands)		
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Purchase of FNB Bancshares, Inc.			
Loans, net of reserves	$	$	$ (56,156)
Investment securities available for sale			(7,421)
Non-marketable equity securities			(416)
Bank premises and equipment			(3,071)
Deferred tax asset			(108)
Other assets acquired			(1,409)
Goodwill			(9,838)
Deposits			61,268
Securities sold under agreement to repurchase			1,220
Borrowings			2,000
Other liabilities assumed			1,035
Fair value of options exchanged			1,616
Issuance of stock			8,573
Net cash distributed in business combination	$	$	$ (2,707)
Cash paid during the year for:			
Interest	$ 13,725	$ 9,047	$ 6,046
Income taxes	3,992	1,572	1,169
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Transfer of loans to foreclosed assets	$ 337	$ 483	291
Change in unrealized gain on available-for-sale Securities and cash flow hedging activities, net of tax	(94)	(640)	(194)

See accompanying notes to these consolidated financial statements.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 1 ORGANIZATION AND OPERATIONS

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

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

First National Bank of the Carolinas (First National) commenced operations on October 18, 1996 and was purchased by Bancshares on April 15, 2004. First National was merged into American Community on April 1, 2005.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses.

Cash Equivalents

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

Investment Securities

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

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

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

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

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

Allowance for Loan Losses

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

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

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

Foreclosed Real Estate

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

Bank Premises and Equipment

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

Non-marketable equity securities

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

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Intangible Assets

The Company s acquisition of FNB Bancshares, Inc. generated goodwill of $9,838,173 and core deposit intangible assets of $854,329. The Company uses a non-amortization approach to account for purchased goodwill. Intangible assets with finite useful lives are amortized over their useful lives. The carrying value of the core deposit intangible asset totaled $565,079, net of amortization of $289,250, as of December 31, 2006. This intangible asset was determined by management to meet the criteria for recognition apart from goodwill and to have a finite life of 8 years. Amortization expense associated with the core deposit intangible asset was $106,800, $106,800, and $75,650 for the years ended December 31, 2006, 2005, and 2004, respectively. In accordance with the Company s estimate of approximate lives of the acquired deposit relationships, an 8 year straight-line amortization schedule has been established for the core deposit intangible assets. Projected amortization expense for the years ended December 31, 2007, 2008, 2009, 2010 and 2011 is $106,800 per year.

Under generally accepted accounting principles, the Company reviews its amortizable intangible assets for impairment when events or changes in circumstances indicated the carrying value may not be recoverable. Goodwill is required to be tested for impairment annually as of April 15th and on an interim basis when events or circumstances change. Management completed the annual goodwill impairment tests as of April 15, 2006, which indicated that no impairment had occurred. Management does not believe that events and circumstances subsequent to that date indicated that goodwill has been impaired.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized.

Stock Compensation Plans

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

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

Derivative Financial Instruments and Hedging Activities

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

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

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Comprehensive Income

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

At December 31, 2006, accumulated other comprehensive income consisted of net unrealized gains on securities available for sale of $180,000 and net unrealized losses on derivatives of $86,000. At December 31, 2005, accumulated other comprehensive loss consisted of net unrealized losses on securities available for sale of $640,000.

Per Share Results

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

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

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

	2006	**2005**	**2004**
Weighted average number of common shares used in computing basic net income per share	6,913,534	6,364,336	4,912,256
Effect of dilutive stock options and warrants	257,879	455,187	601,105
Weighted average number of common shares and dilutive potential common shares used in computing diluted net income per share	7,171,413	6,819,523	5,513,361

For the year ended December 31, 2006, there were 93,000 options that were anti-dilutive since the exercise price exceeded the average market price for the year. For the years ended December 31, 2005 and 2004, there were no options or warrants that were anti-dilutive for the year. Anti-dilutive options are omitted from the calculation of diluted earnings per share.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Segment Reporting

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

Recent Accounting Pronouncements

SFAS 156

In the first quarter of 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 156, Accounting or Servicing of Financial Assets (SFAS No. 156). SFAS No. 156 sets accounting requirements for separately recognizing a servicing asset or a servicing liability when a company undertakes an obligation to service a financial asset under a servicing contract in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. SFAS No. 156 also allows an entity to choose one of two methods when subsequently measuring its servicing assets and servicing liabilities: (I) the amortization method or (2) the fair value measurement method. The amortization method existed under Statement 140 and remains unchanged in (1) allowing entities to amortize their servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and (2) requiring the assessment of those servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date. The fair value measurement method allows entities to measure their servicing assets or servicing liabilities at fair value each reporting date and report changes in fair value in earnings in the period the change occurs. SFAS No. 156 permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights upon initial adoption, provided certain criteria are met The Company adopted SFAS No. 156 in the first quarter of 2007 and does not expect the adoption of SFAS No. 156 to have a material impact on its financial position and results of operations, including the valuation methods and support for the assumptions that underlie the valuation.

FIN 48

In July 2006, the FASB issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in its financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of the Company s 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of FIN 48 will not have a material impact on the consolidated financial statements.

FAS 157

In September 2006, the Financial Accounting Standards Board issued FASB Statement No. 157, Fair Value Measurements (FASB No. I57), which enhances existing guidance for measuring assets and liabilities using fair value and requires additional disclosure about the use of fair value for measurement. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company will be required to adopt SFAS No. 157 in the first quarter of 2008, and is currently evaluating the impact of the adoption of SFAS No. 157 on its financial position and results of operations, including the valuation methods and support for the assumptions that underlie the valuation.

SAB 108

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in the Current Year Financial Statements (SAB No. 108). SAB No. 108 addresses the diversity in practice by regiments when quantifying the effect of an error on the financial statements. SAB No. 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements and is effective for annual periods ending after November 15, 2006. The Company adopted the provisions of SAB No. 108 effective December 31, 2006. The adoption of SAB 108 did not have a material impact on the consolidated financial statements.

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications

Certain amounts in the 2005 and 2004 consolidated financial statements have been reclassified to conform to the 2006 presentation. The reclassifications had no effect on net income or stockholders equity as previously reported.

NOTE 3 INVESTMENT SECURITIES

The following is a summary of the securities portfolio by major classification at December 31, 2006 and 2005:

	2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U. S. Government agencies	$ 20,201,650	$ 43,825	$ 116,431	$ 20,129,043
Mortgage-backed securities	37,047,130	10,303	835,828	36,221,606
State and municipal bonds	6,264,804	32,437	42,130	6,255,111
	63,513,584	86,565	994,389	62,605,760
Marketable equity securities	406,808	5,055		411,863
Total securities available for sale	$ 63,920,392	$ 91,620	$ 994,389	$ 63,017,623

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities held to maturity:				
State and municipal bonds	$ 2,174,255	$ 17,789	$ 174	$ 2,191,870
Total securities held to maturity	$ 2,174,255	$ 17,789	$ 174	$ 2,191,870

	2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U. S. Government agencies	$ 15,769,977	$ 21,373	$ 129,351	$ 15,661,999
Mortgage-backed securities	42,791,059	15,899	1,082,183	41,724,775
State and municipal bonds	4,357,064	17,361	44,081	4,330,344

	62,918,100	54,633	1,255,615	61,717,118
Marketable equity securities	406,808	3,340		410,148
Total securities available for sale	$ 63,324,908	$ 57,973	$ 1,255,615	$ 62,127,266

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities held to maturity:				
State and municipal bonds	$ 2,180,222	$ 7,634	$ 14,595	$ 2,173,261
Total securities held to maturity	$ 2,180,222	$ 7,634	$ 14,595	$ 2,173,261

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 3 INVESTMENT SECURITIES (Continued)

The amortized cost and fair values of securities (excluding marketable equity securities) at December 31, 2006 by contractual maturity are shown below. Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	At December 31, 2006	
	Amortized Cost	Fair Value
Due within one year	$ 659,379	$ 651,173
Due after one year through five years	14,824,489	14,718,878
Due after five years through ten years	15,035,349	14,845,091
Due after ten years	35,168,622	34,582,488
Total	$ 65,687,839	$ 64,797,630

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

For the year ended December 31, 2006, proceeds from sales of investment securities available for sale amounted to $3,908,955. Gross realized gains in 2006 from these sales amounted to $60,072. For the year December 31 2005 and 2004, proceeds from sales of investment securities available for sale amounted to $2,801,183 and $10,837,401 respectively. Gross realized gains in 2005 and 2004 from these sales amounted to $10,200 and $106,290, respectively.

Available for sale securities, consisting of US government agencies, mortgage-backed securities and state and municipal bonds, with carrying values of $6,253,410 and $4,832,475 at December 31, 2006 and 2005, respectively, were pledged to secure public monies on deposit as required by law. Available for sale securities, consisting of US government agencies and mortgage-backed securities, with carrying values of $17,272,040 and $10,474,560 were pledged to secure securities sold under agreements to repurchase at December 31, 2006 and 2005, respectively.

The following tables show investment gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2006 and 2005. The unrealized losses relate to debt securities that have incurred fair value reductions due to higher market interest rates since the securities were purchased. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased. Since none of the unrealized losses relate to the marketability of the securities or the issuer s ability to honor redemption obligations, none of the securities are deemed to be other than temporarily impaired.

	2006					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Securities available for sale:						
U.S. government agencies	$ 5,919,809	$ 26,768	$ 9,015,999	$ 89,663	$ 14,935,808	$ 116,431

Mortgage-backed securities	3,321,711	3,472	30,906,519	832,356	34,228,230	835,828
State and municipal bonds	394,027	10,973	1,853,324	31,157	2,247,351	42,130
Held to maturity:						
State and municipal bonds	238,661	174			238,661	174
Total temporarily impaired securities	$ 9,874,208	$ 41,387	$ 41,775,842	$ 953,176	$ 51,650,051	$ 994,563

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AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2006, 2005 and 2004

NOTE 3 INVESTMENT SECURITIES (Continued)

	2005					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Securities available for sale:						
U.S. government agencies	$ 12,246,249	$ 103,701	$ 974,350	$ 25,650	$ 13,220,599	$ 129,351
Mortgage-backed securities	15,800,761	353,295	23,460,919	728,888	39,261,680	1,082,183
State and municipal bonds	3,168,349	44,081			3,168,349	44,081
Held to maturity:						
State and municipal bonds	1,412,188	14,595			1,412,188	14,595
Total temporarily impaired securities	$ 32,627,547	$ 515,672	$ 24,435,269	$ 754,538	$ 57,062,816	$ 1,270,210

NOTE 4 NON-MARKETABLE EQUITY SECURITIES CARRIED AT COST

The aggregate cost of the Company s cost method investments totaled $1,879,074 at December 31, 2006. Investments with an aggregate cost of $652,738 were not evaluated for impairment because (a) the Company did not estimate the fair value of those investments in accordance with paragraphs 14 and 15 of Statement 107 and (b) the Company did not identify any events or changes in circumstances that may have had a significant adverse effect on the fair value of those investments. Of the remaining $1,226,336 of investments, securities in the Federal Home Loan Bank and The Bankers Bank amounted to $1,142,100 and $84,236, respectively, at December 31, 2006. Because of the redemption provisions of issuers, the Company estimated that the fair value equaled or exceeded the cost of these investments and the investments were not impaired.

NOTE 5 LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Following is a summary of loans at December 31, 2006 and 2005:

	2006		2005	
	Amount	Percent	Amount	Percent
Real estate mortgage loans:				
1-4 family	$ 26,896,668	7.26%	$ 28,933,026	8.70%
Commercial mortgage	70,584,938	19.05%	84,693,502	25.45%
Construction/development	77,004,824	20.78%	44,036,858	13.24%
Home equity lines of credit	24,387,694	6.58%	27,732,430	8.33%
Commercial and industrial loans	126,602,767	34.16%	97,196,672	29.21%
Loans to individuals	36,782,098	9.93%	35,941,401	10.80%
Lease financing, net	8,316,062	2.24%	14,193,124	4.27%
Subtotal	370,575,051	100.00%	332,727,013	100.00%
Allowance for loan losses	(5,628,170)		(4,331,154)	

Net unamortized deferred costs	(144,127)	(19,368)
Total	$ 364,802,754	$ 328,376,491

Loans are primarily made in Union and Mecklenburg Counties of North Carolina and Cherokee and York Counties of South Carolina. Real estate loans can be affected by the condition of the local real estate market. Commercial and installment loans can be affected by the local economic conditions.

At December 31, 2006 and 2005, respectively, there were $291,362 and $1,402,001 of loans past due 90 days or more which were still accruing interest. Impaired loans which aggregated $1,914,839 and $528,828 and had related allowances for loan losses of $1,134,875 and $296,095 at December 31, 2006 and 2005, respectively, consisted primarily of non-accrual loans and leases. The average recorded investment in impaired loans during the years ended December 31, 2006 and 2005 was $1,425,121 and $475,932, respectively. Non-accrual loans did not materially affect interest income for the years ended December 31, 2006, 2005 and 2004.

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NOTE 5 LOANS AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

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

Loans to directors and officers as a group at January 1, 2006	$ 9,974,764
Disbursements during the year ended December 31, 2006	841,055
Amounts collected during the year ended December 31, 2006	(8,215,534)
Loans to directors and officers as a group at December 31, 2006	$ 2,600,285

At December 31, 2006, the Company had pre-approved but unused lines of credit totaling $906,912 to directors, executive officers and their related interests.

An analysis of the allowance for loan losses follows:

	2006	2005	2004
Balance at beginning of year	$ 4,331,154	$ 3,487,548	$ 2,528,825
Provision charged to operations	2,612,232	809,248	573,502
Charge-offs	1,349,709	80,848	339,980
Recoveries	(34,493)	(115,206)	(40,124)
Net charge-offs (recoveries)	1,315,216	(34,358)	299,856
Allowance acquired from First National merger			685,077
Balance at end of year	$ 5,628,170	$ 4,331,154	$ 3,487,548

NOTE 6 BANK PREMISES AND EQUIPMENT

Following is a summary of bank premises and equipment at December 31, 2006 and 2005:

	2006	2005
Land	$ 1,667,740	$ 1,667,740
Buildings and leasehold improvements	7,129,483	7,129,445
Furniture and equipment	3,894,801	4,029,610

	12,692,024	12,826,795
Accumulated depreciation and amortization	(3,586,579)	(3,166,898)
Total	$ 9,105,445	$ 9,659,897

Depreciation and amortization expense amounting to $867,768, $873,658 and $769,584 for the years ended December 31, 2006, 2005 and 2004, respectively, is included in occupancy and equipment expense.

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NOTE 7 DEPOSITS

Time deposits in denominations of $100,000 or more were $121,900,815 and $114,102,020 at December 31, 2006 and 2005, respectively. Brokered deposits totaled $8,628,000 and $19,418,560 at December 31, 2006 and 2005, respectively.

At December 31, 2006, the scheduled maturities of certificates of deposit were as follows:

	Less than $100,000	$100,000 or more	Total
2007	$ 90,683,043	$ 103,696,678	$ 194,379,721
2008	9,325,342	8,877,001	18,202,343
2009	2,349,755	5,928,135	8,277,890
2010	1,296,586	3,094,153	4,390,739
2011	402,503	304,848	707,351
Thereafter			
Total	$ 104,057,229	$ 121,900,815	$ 225,958,044

NOTE 8 BORROWINGS

Borrowings consist of advances from the Federal Home Loan Bank of Atlanta, securities sold under agreements to repurchase, federal funds purchased, and obligations under a capitalized lease for the Bank s main office facility. At December 31, 2006 and 2005, Federal Home Loan Bank advances were as follows:

2006	Call Feature	Amount	Rate
Due on July 16, 2012	Callable quarterly	$ 1,000,000	3.90% Fixed
Due on February 25, 2013	Callable quarterly	5,000,000	3.45% Fixed
Total FHLB borrowings/ weighted average rate		$ 6,000,000	3.53%

2005	Call Feature	Amount	Rate
Due on February 24, 2006	None	$ 111,111	2.16% Fixed
Due on December 19, 2011	Callable by FHLB on December 19, 2006	5,000,000	4.85% Fixed
Due on July 16, 2012	Callable by FHLB on January 18, 2005	1,000,000	3.90% Fixed
Due on February 25, 2013	Callable by FHLB on February 25, 2005	5,000,000	3.45% Fixed
Total FHLB borrowings/weighted average rate		$ 11,111,111	4.11%

Pursuant to a collateral agreement with the FHLB, advances are collateralized by all the Company s FHLB stock of $1,142,100, qualifying first mortgage loans and qualifying commercial real estate. The balance of qualifying first mortgage loans and qualifying commercial real estate as of December 31, 2006 was approximately $13,247,000. This agreement with the FHLB provides for a line of credit up to 15% of the Bank s assets.

The Company also had available lines of credit totaling $29.5 and $24.7 million, respectively, from correspondent banks at December 31, 2006 and 2005.

Federal funds purchased and securities sold under agreements to repurchase, which generally mature 1 to 4 days from the transaction date, at December 31, 2006 and 2005 are summarized below:

	2006	**2005**
Outstanding balance at December 31	$ 15,473,065	$ 11,732,738
Year-end weighted average rate	3.69%	3.15%
Average outstanding during the year	14,666,826	13,916,300
Average rate for the year	3.51%	2.16%
Maximum outstanding at any month-end during the year	19,429,667	25,882,233

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 8 BORROWINGS (Continued)

Available for sale securities, consisting of US government agencies and mortgage-backed securities, with carrying values of $17,272,040 and $10,474,560 were pledged to secure securities sold under agreements to repurchase at December 31, 2006 and 2005, respectively and are held at an independent correspondent bank.

NOTE 9 LEASES

Operating Leases

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

	Total
2007	$ 784,793
2008	779,471
2009	770,090
2010	496,598
2011	352,504
2012 - thereafter	2,367,818
Total	$ 5,551,273

Total rent expense under operating leases was approximately $783,000, $721,000 and $623,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Capital Lease Obligation

The Company leases its main office facility under a capital lease. Leases that meet the criteria for capitalization are recorded as assets and the related obligations are reflected as capital lease obligations on the accompanying balance sheets. Amortization of property under capital lease is included in depreciation expense. Included in premises and equipment at December 31, 2006 and 2005 is $1.7 million as the capitalized cost of the Company s main office and accumulated amortization of $305,186 and $261,588 at December 31, 2006 and 2005, respectively.

At December 31, 2006, aggregate future minimum lease payments due under this capital lease obligation are as follows:

2007	$ 148,057
2008	148,057
2009	148,057
2010	158,421
2011	158,421
2012 - 2029	3,200,071

Total minimum lease payments	3,961,084
Less amount representing interest	(2,266,924)
Present value of net minimum lease payments	$ 1,694,160

Both the land lease and capital leases for the Company s main office discussed above are leased from a former director. Prior to the main facility being completed in November 2000, the Company leased land for its temporary banking facility from that same director. In addition, the Marshville facility is leased from another former director. In January 2003, the Company signed an operating lease for a new branch facility in Mint Hill, North Carolina, with a former director. The lease has an initial term of ten years with two renewal options for five years each. Total lease payments of $494,515, $457,002, and $419,553 were paid to these former directors under these leases during 2006, 2005 and 2004, respectively.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 10 JUNIOR SUBORDINATED DEFERRABLE INTEREST DEBENTURES

On December 31, 2001 and March 1, 2002, $2.0 million and $1.5 million, respectively, of trust preferred securities were placed through American Community Capital Trust I (Capital Trust I). The preferred securities pay cumulative cash distributions quarterly at an annual rate of 9%. The dividends paid to holders of the capital trust preferred securities, which will be recorded as interest expense, are deductible for income tax purposes. The quarterly distributions may, at the option of the Company, be deferred up to five years. Unpaid distributions will be accrued as a component of interest expense. The preferred securities issued in 2001 and 2002 are redeemable on March 1, 2007 or afterwards at the par of $1,000 per share. It is anticipated that these shares will be redeemed at such time. Redemption is mandatory at March 1, 2032. The proceeds of the preferred securities were invested by Capital Trust I in $3.5 million principal amount of 9% junior subordinated debentures of the Company due March 1, 2032. Subsequent to year end, the Company paid off the preferred securities of $3.5 million. See Note 25 for further discussion.

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

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

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

Issuing Entity	Date of Issuance	Shares Issued	Interest Rate	Maturity Date	Principal Amount 2006	2005
American Community Capital Trust I	12/31/2001	2,000	9.00%	03/01/2032	$ 2,061,863	$ 2,061,863
American Community Capital Trust I	03/01/2002	1,500	9.00%	03/01/2032	1,546,397	1,546,397
American Community Capital Trust II, Ltd.	12/15/2003	10,000	6.82%	12/15/2033	10,310,000	10,310,000
Total					$ 13,918,260	$ 13,918,260

NOTE 11 OTHER CONTRACTS

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

2007	$ 525,000
2008	386,000
2009	408,000
2010	433,000

Total	$ 1,752,000

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

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 12 INCOME TAXES

The significant components of the provision for income taxes for the periods ended December 31, 2006, 2005 and 2004 are as follows:

	2006	2005	2004
	(Dollars in thousands)		
Current tax provision:			
Federal	$ 2,899	$ 1,657	$ 1,300
State	479	423	280
	3,378	2,080	1,580
Deferred tax provision (benefit):			
Federal	(848)	557	61
State	(90)	2	(24)
	(938)	559	37
Provision for income taxes	$ 2,440	$ 2,639	$ 1,617

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

	2006	2005	2004
	(Dollars in thousands)		
Income tax expense computed at statutory rate of 34%	$ 2,283	$ 2,430	$ 1,482
Effect of state income taxes	270	280	169
Tax exempt interest	(102)	(75)	(57)
Other	(11)	4	23
Net provision for income taxes	$ 2,440	$ 2,639	