

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
(State or Other Jurisdiction of

Incorporation or Organization)

56-2179531
(I.R.S. Employer

Identification No.)

4500 Cameron Valley Parkway, Suite 150

28211

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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 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 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. 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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes 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%.

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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

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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

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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					