UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended October 2, 2011.

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number 001-14962

CIRCOR INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3477276**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
c/o Circor, Inc.	
25 Corporate Drive, Suite 130, Burlington, MA	**01803-4238**
(Address of principal executive offices)	**(Zip Code)**

(781) 270-1200

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of October 20, 2011, there were 17,264,712 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

Table of Contents

CIRCOR INTERNATIONAL, INC.

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION.

ITEM 1. FINANCIAL STATEMENTS.

CIRCOR INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	October 2, 2011 (Unaudited)	December 31, 2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 39,254	$ 45,752
Short-term investments	98	101
Trade accounts receivable, less allowance for doubtful accounts of $898 and $822, respectively	142,369	138,860
Inventories	213,824	167,797
Income taxes refundable	113	1,625
Prepaid expenses and other current assets	14,137	5,749
Deferred income tax asset	17,146	20,111
Insurance receivables	0	38
Assets held for sale	542	542
Total Current Assets	427,483	380,575
PROPERTY, PLANT AND EQUIPMENT, NET	103,252	95,768
OTHER ASSETS:		
Goodwill	77,152	63,175
Intangibles, net	59,997	62,322
Deferred income tax asset	13,035	11,829
Other assets	4,540	2,526
TOTAL ASSETS	$ 685,459	$ 616,195
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 83,439	$ 80,577
Accrued expenses and other current liabilities	65,284	51,248
Accrued compensation and benefits	24,581	22,305
Leslie asbestos and bankruptcy related liabilities	1,200	79,831
Income taxes payable	0	38
Notes payable and current portion of long-term debt	16,679	851
Total Current Liabilities	191,183	234,850
LONG-TERM DEBT, NET OF CURRENT PORTION	86,818	684
DEFERRED INCOME TAXES	2,292	0
OTHER NON-CURRENT LIABILITIES	20,870	23,841
CONTINGENCIES AND COMMITMENTS (See Note 10)		
SHAREHOLDERS EQUITY:		
Preferred stock, $0.01 par value; 1,000,000 shares authorized; no shares issued and outstanding	0	0

Common stock, $0.01 par value; 29,000,000 shares authorized; 17,252,650 and 17,112,688 shares issued and outstanding at October 2, 2011 and December 31, 2010, respectively		173		171
Additional paid-in capital		257,309		254,154
Retained earnings		120,773		96,389
Accumulated other comprehensive income		6,041		6,106
Total Shareholders Equity		384,296		356,820
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	685,459	$	616,195

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

Table of Contents

CIRCOR INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
Net revenues	$ 209,961	$ 177,577	$ 605,239	$ 491,851
Cost of revenues	154,774	126,096	439,218	348,109
GROSS PROFIT	55,187	51,481	166,021	143,742
Selling, general and administrative expenses	39,448	35,648	124,083	109,024
Leslie asbestos and bankruptcy (recoveries) charges	(201)	2,343	676	30,603
OPERATING INCOME	15,940	13,490	41,262	4,115
Other expense (income):				
Interest income	(69)	(69)	(166)	(162)
Interest expense	956	803	3,058	2,036
Other expense (income), net	354	(853)	1,830	(646)
TOTAL OTHER EXPENSE (INCOME)	1,241	(119)	4,722	1,228
INCOME BEFORE INCOME TAXES	14,699	13,609	36,540	2,887
Provision (benefit) for income taxes	3,752	3,210	10,191	(2,005)
NET INCOME	$ 10,947	$ 10,399	$ 26,349	$ 4,892
Earnings per common share:				
Basic	$ 0.63	$ 0.61	$ 1.53	$ 0.29
Diluted	$ 0.63	$ 0.60	$ 1.51	$ 0.28
Weighted average number of common shares outstanding:				
Basic	17,266	17,123	17,226	17,095
Diluted	17,423	17,258	17,412	17,238
Dividends paid per common share	$ 0.0375	$ 0.0375	$ 0.1125	$ 0.1125

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

Table of Contents

CIRCOR INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	October 2, 2011	**October 3, 2010**
OPERATING ACTIVITIES		
Net income	$ 26,349	$ 4,892
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	11,265	9,509
Amortization	3,293	3,065
(Payment) Provision for Leslie bankruptcy settlement	(76,625)	24,974
Compensation expense of share-based plans	3,007	2,445
Tax effect of share-based compensation	(649)	(114)
(Gain) loss on sale/disposal of property, plant and equipment	(68)	248
Changes in operating assets and liabilities, net of effects from business acquisitions:		
Trade accounts receivable	(1,249)	(20,256)
Inventories	(43,901)	(26,090)
Prepaid expenses and other assets	(9,453)	5,031
Accounts payable, accrued expenses and other liabilities	17,353	13,406
Net cash (used in) provided by operating activities	(70,678)	17,110
INVESTING ACTIVITIES		
Additions to property, plant and equipment	(11,254)	(11,400)
Proceeds from the disposal of property, plant and equipment	84	75
Business acquisitions, net of cash acquired	(20,221)	(34,401)
Proceeds from the sale of investments	0	21,427
Net cash used in investing activities	(31,391)	(24,299)
FINANCING ACTIVITIES		
Proceeds from borrowings	224,455	91,750
Payments of borrowings	(126,269)	(60,202)
Debt issuance costs	(2,001)	0
Dividends paid	(1,987)	(1,982)
Proceeds from the exercise of stock options	496	329
Tax effect of share-based compensation	649	114
Net cash provided by financing activities	95,343	30,009
Effect of exchange rate changes on cash and cash equivalents	228	(644)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(6,498)	22,176
Cash and cash equivalents at beginning of period	45,752	46,350

CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 39,254	$ 68,526
Supplemental Cash Flow Information:		
Cash paid during the nine months for:		
Income taxes	$ 6,476	$ 4,713
Interest	$ 3,576	$ 1,947

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

Table of Contents

CIRCOR INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Basis of Presentation

The accompanying unaudited, consolidated financial statements have been prepared according to the rules and regulations of the United States Securities and Exchange Commission (SEC) and, in the opinion of management, reflect all adjustments, which include normal recurring adjustments, necessary for a fair presentation of the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows of CIRCOR International, Inc. (CIRCOR , the Company , us , we or our) for the periods presented. We prepare our interim financial information using the same accounting principles as we use for our annual audited financial statements. Certain information and note disclosures normally included in the annual audited financial statements have been condensed or omitted in accordance with prescribed SEC rules. We believe that the disclosures made in our consolidated financial statements and the accompanying notes are adequate to make the information presented not misleading.

The consolidated balance sheet at December 31, 2010 is as reported in our audited financial statements as of that date. Our accounting policies are described in the notes to our December 31, 2010 financial statements, which were included in our Annual Report filed on Form 10-K. We recommend that the financial statements included in this Quarterly Report on Form 10-Q be read in conjunction with the financial statements and notes included in our Annual Report filed on Form 10-K for the year ended December 31, 2010.

We operate and report financial information using a 52-week fiscal year ending December 31. The data periods contained within our Quarterly Reports on Form 10-Q reflect the results of operations for the 13-week, 26-week and 39-week periods which generally end on the Sunday nearest the calendar quarter-end date. Operating results for the three and nine months ended October 2, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Reclassifications

Certain items in the prior period financial statements have been reclassified to conform to currently reported presentations.

(2) Summary of Significant Accounting Policies

New Accounting Standards

The FASB issued ASU 2011-04 in May 2011 to amend fair value measurements and related disclosures; the guidance becomes effective on a prospective basis at the beginning of the 2012 fiscal year. This new guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between International Financial Reporting Standards (IFRS) and U.S. GAAP. The new guidance also changes some fair value measurement principles and enhances disclosure requirements related to activities in Level 3 of the fair value hierarchy. The adoption of this updated authoritative guidance is not expected to have any impact on our consolidated financial statements.

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05 to amend the presentation of comprehensive income in financial statements. This guidance allows companies the option to present other comprehensive income in either a single continuous statement or in two separate but consecutive statements. Under both alternatives, companies will be required to present each component of net income and comprehensive income. The adoption of this updated authoritative guidance will impact the presentation of our consolidated financial statements, but it will not change the items that must be reported in other comprehensive income. The guidance must be applied retrospectively and is effective for the first quarter of 2012. We are in the process of evaluating the presentation options required by this ASU.

In the third quarter of 2011, the FASB issued an ASU aimed at simplifying entities annual goodwill impairment test. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. However, early adoption is allowed. We have elected to adopt this standard early and will apply the provisions of this ASU to our 2011 analysis of goodwill. The adoption of this updated authoritative guidance is not expected to have a significant impact on our consolidated financial statements.

(3) Share-Based Compensation

As of October 2, 2011, we have one share-based compensation plan. The Amended and Restated 1999 Stock Option and Incentive Plan (the 1999 Stock Plan), which was adopted by our Board of Directors and approved by our shareholders, permits the granting of the following types of awards to our officers, other employees and non-employee directors: incentive stock options; non-qualified stock options; deferred stock awards; restricted stock awards; unrestricted stock awards; performance share awards; cash-based

Table of Contents

awards; stock appreciation rights and dividend equivalent rights. The 1999 Stock Plan provides for the issuance of up to 3,000,000 shares of common stock (subject to adjustment for stock splits and similar events). New options granted under the 1999 Stock Plan could have varying vesting provisions and exercise periods. Options granted vest in periods ranging from one to six years and expire ten years after the grant date. Restricted stock units granted generally vest from three to six years. Vested restricted stock units will be settled in shares of our common stock. As of October 2, 2011, there were 156,014 stock options and 395,794 restricted stock units outstanding. In addition, there were 528,816 shares available for grant under the 1999 Stock Plan as of October 2, 2011. As of October 2, 2011, there were 13,566 outstanding restricted stock units that contain rights to nonforfeitable dividend equivalents and are considered participating securities that are included in our computation of basic and fully diluted earnings per share. There is no difference in the earnings per share amounts between the two class method and the treasury stock method, which is why we continue to use the treasury stock method.

For all of our stock option grants, the fair value of each grant was estimated at the date of grant using the Black-Scholes option pricing model. Black-Scholes utilizes assumptions related to volatility, the risk-free interest rate, the dividend yield and employee exercise behavior. Expected volatilities utilized in the model are based on the historic volatility of the Company s stock price. The risk free interest rate is derived from the U.S. Treasury Yield curve in effect at the time of the grant. During the first nine months of 2011, we granted 64,755 stock options.

The fair value of stock options granted during the nine months ended October 2, 2011 of $16.96 was estimated using the following weighted-average assumptions:

Risk-free interest rate	1.2%
Expected life (years)	5.8
Expected stock volatility	46.4%
Expected dividend yield	0.4%

We account for Restricted Stock Unit (RSU) Awards by expensing the weighted average fair value to selling, general and administrative expenses ratably over vesting periods ranging from three to six years. During the nine months ended October 2, 2011 and October 3, 2010, we granted 66,027 and 130,226 RSU Awards with approximate fair values of $38.68 and $30.91 per RSU Award, respectively.

The CIRCOR Management Stock Purchase Plan, which is a component of the 1999 Stock Plan, provides that eligible employees may elect to receive restricted stock units in lieu of all or a portion of their pre-tax annual incentive bonus and, in some cases, make after-tax contributions in exchange for restricted stock units (RSU MSPs). In addition, non-employee directors may elect to receive restricted stock units in lieu of all or a portion of their annual directors fees. Each RSU MSP represents a right to receive one share of our common stock after a three-year vesting period. RSU MSPs are granted at a discount of 33% from the fair market value of the shares of our common stock on the date of grant. This discount is amortized as compensation expense, to selling, general and administrative expenses, over a four year period. A total of 43,734 and 13,505 RSUs with per unit discount amounts representing fair values of $12.87 and $10.20 were granted under the CIRCOR Management Stock Purchase Plan during the nine months ended October 2, 2011 and October 3, 2010, respectively.

Compensation expense related to our share-based plans for the nine month periods ended October 2, 2011, and October 3, 2010 was $3.0 million and $2.6 million, respectively, and was recorded as selling, general and administrative expense. As of October 2, 2011, there was $5.5 million of total unrecognized compensation costs related to our outstanding share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of approximately 3.0 years.

A summary of the status of all stock options granted to employees and non-employee directors as of October 2, 2011 and changes during the nine month period then ended is presented in the table below (Options in thousands):

	Options	Weighted Average Exercise Price
Options outstanding at beginning of period	135	$ 23.29
Granted	65	$ 38.27
Exercised	(27)	$ 18.68
Forfeited	(17)	$ 36.07
Options outstanding at end of period	156	$ 28.89

Options exercisable at end of period	74	$	21.44

The weighted average contractual term for stock options outstanding and options exercisable as of October 2, 2011 was 6.0 years and 2.5 years, respectively. The aggregate intrinsic value of stock options exercised during the nine months ended October 2, 2011 was $0.6 million and the aggregate intrinsic value of stock options outstanding and options exercisable as of October 2, 2011 was $0.6 million and $0.6 million, respectively.

Table of Contents

A summary of the status of all RSU Awards granted to employees and non-employee directors as of October 2, 2011 and changes during the nine month period then ended is presented in the table below (RSUs in thousands):

	RSUs	Weighted Average Grant Date Fair Value
RSU Awards outstanding at beginning of period	340	$ 30.79
Granted	66	$ 38.68
Settled	(130)	$ 29.81
Cancelled	(34)	$ 30.93
RSU Awards outstanding at end of period	242	$ 33.46
RSU Awards vested and deferred at end of period	12	$ 34.55

The aggregate intrinsic value of RSU Awards settled during the nine months ended October 2, 2011 was $5.5 million and the aggregate intrinsic value of RSU Awards outstanding and RSU Awards vested and deferred as of October 2, 2011 was $7.1 million and $0.4 million, respectively.

A summary of the status of all RSU MSPs granted to employees and non-employee directors as of October 2, 2011 and changes during the nine month period then ended is presented in the table below (RSUs in thousands):

	RSUs	Weighted Average Exercise Price
RSU MSPs outstanding at beginning of period	173	$ 18.63
Granted	44	$ 26.13
Settled	(45)	$ 27.76
Cancelled	(18)	$ 17.22
RSU MSPs outstanding at end of period	154	$ 18.26
RSU MSPs vested and deferred at end of period	1	$ 32.60

The aggregate intrinsic value of RSU MSPs settled during the nine months ended October 2, 2011 was $0.5 million and the aggregate intrinsic value of RSU MSPs outstanding and RSU MSPs vested and deferred as of October 2, 2011 was $1.7 million and less than $0.1 million, respectively.

(4) Inventories

Inventories consist of the following (In thousands):

	October 2, 2011	December 31, 2010
Raw materials	$ 70,418	$ 49,451
Work in process	98,276	80,402
Finished goods	45,130	37,944
	$ 213,824	$ 167,797

(5) Goodwill and Intangible Assets

The following table presents goodwill, by segment, as of October 2, 2011 (In thousands):

	Energy	Aerospace	Flow Technologies	Consolidated Total
Goodwill as of December 31, 2010	$ 39,423	$ 19,430	$ 4,322	$ 63,175
Acquisitions	12,568	0	0	12,568
Adjustments to preliminary purchase price allocation	(126)	2,713	(19)	2,568
Currency translation adjustments	(966)	22	(215)	(1,159)
Goodwill as of October 2, 2011	$ 50,899	$ 22,165	$ 4,088	$ 77,152

Table of Contents

The table below presents the gross intangible assets and the related accumulated amortization as of October 2, 2011 (In thousands):

	Gross Carrying Amount	Accumulated Amortization
Patents	$ 6,084	$ (5,551)
Trademarks and trade names	29,908	0
Land use rights	455	(66)
Customer relationships	38,462	(13,520)
Backlog	1,623	(1,138)
Other	7,143	(3,403)
Total	$ 83,675	$ (23,678)
Net carrying value of intangible assets	$ 59,997	

The table below presents estimated remaining amortization expense for intangible assets recorded as of October 2, 2011 (In thousands):

	2011	2012	2013	2014	2015	After 2015
Estimated amortization expense	$ 1,056	$ 3,749	$ 3,703	$ 3,573	$ 3,543	$ 14,465

Table of Contents

(6) Segment Information

The following table presents certain reportable segment information (In thousands):

	Energy	Aerospace	Flow Technologies	Corporate/ Eliminations	Consolidated Total
Three Months Ended October 2, 2011					
Net revenues	$ 103,300	$ 32,681	$ 73,980	$ 0	$ 209,961
Intersegment revenues	297	0	60	(357)	0
Operating income (loss)	7,441	1,846	10,008	(3,355)	15,940
Interest income					(69)
Interest expense					956
Other expense, net					354
Income before income taxes					$ 14,699
Identifiable assets	363,976	193,992	193,791	(66,300)	685,459
Capital expenditures	1,610	1,295	408	479	3,792
Depreciation and amortization	1,858	1,280	1,446	283	4,867
Three Months Ended October 3, 2010					
Net revenues	$ 80,613	$ 28,316	$ 68,648	$ 0	$ 177,577
Intersegment revenues	174	20	(372)	178	0
Operating income (loss)	8,968	2,726	6,966	(5,170)	13,490
Interest income					(69)
Interest expense					803
Other income, net					(853)
Income before income taxes					$ 13,609
Identifiable assets	256,809	191,292	186,863	19,916	654,880
Capital expenditures	1,425	816	338	634	3,213
Depreciation and amortization	1,639	1,201	1,368	80	4,288
Nine Months Ended October 2, 2011					
Net revenues	$ 284,464	$ 100,820	$ 219,955	$ 0	$ 605,239
Intersegment revenues	941	10	227	(1,178)	0
Operating income (loss)	18,208	9,593	28,416	(14,955)	41,262
Interest income					(166)
Interest expense					3,058
Other expense, net					1,830
Income before income taxes					$ 36,540
Identifiable assets	363,976	193,992	193,791	(66,300)	685,459
Capital expenditures	5,022	3,037	1,842	1,353	11,254
Depreciation and amortization	5,751	3,712	4,483	612	14,558
Nine Months Ended October 3, 2010					
Net revenues	$ 215,641	$ 83,401	$ 192,809	$ 0	$ 491,851
Intersegment revenues	461	20	114	(595)	0
Operating income (loss)	17,417	10,400	(7,580)	(16,122)	4,115
Interest income					(162)
Interest expense					2,036
Other income, net					(646)

Income before income taxes					$ 2,887
Identifiable assets	256,809	191,292	186,863	19,916	654,880
Capital expenditures	4,299	3,771	1,899	1,431	11,400
Depreciation and amortization	4,960	3,253	4,126	235	12,574

Table of Contents

Each reporting segment is individually managed and has separate financial results that are reviewed by our chief operating decision-maker. Each segment contains related products and services particular to that segment. For further discussion of the products included in each segment refer to Note 1 of the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010.

In calculating operating income for each reporting segment, substantial administrative expenses incurred at the corporate level for the benefit of other reporting segments were allocated to the segments based upon specific identification of costs, employment related information or net revenues.

Corporate / Eliminations are reported on a net after allocations basis. Inter-segment intercompany transactions affecting net operating profit have been eliminated within the respective operating segments.

The operating loss reported in the Corporate / Eliminations column in the preceding table consists primarily of the following corporate expenses: compensation and fringe benefit costs for executive management and other corporate staff; corporate development costs (relating to mergers and acquisitions); human resource development and benefit plan administration expenses; legal, accounting and other professional and consulting fees; facilities, equipment and maintenance costs; and travel and various other administrative costs. The above costs are incurred in the course of furthering the business prospects of the Company and relate to activities such as: implementing strategic business growth opportunities; corporate governance; risk management; treasury; investor relations and shareholder services; regulatory compliance; and stock transfer agent costs.

The total of assets for each operating segment has been reported as the Identifiable Assets for that segment, including inter-segment intercompany receivables, payables and investments in other CIRCOR companies. Identifiable assets reported in Corporate / Eliminations include both corporate assets, such as cash, deferred taxes, prepaid and other assets, fixed assets, as well as the elimination of all inter-segment intercompany assets. The elimination of intercompany assets results in negative amounts reported in Corporate / Eliminations for Identifiable Assets as of October 2, 2011. Corporate Identifiable Assets, after elimination of intercompany assets, were $35.4 million and $67.9 million as of October 2, 2011 and October 3, 2010, respectively.

(7) Earnings Per Common Share (In thousands, except per share amounts):

	00000000	00000000	00000000	00000000	00000000	00000000
	Three Months Ended					
	October 2, 2011			**October 3, 2010**		
	Net Income	**Shares**	**Per Share Amount**	**Net Income**	**Shares**	**Per Share Amount**
Basic Earnings per Common Share (EPS)	$ 10,947	17,266	$ 0.63	$ 10,399	17,123	$ 0.61
Dilutive securities, common stock options	0	157	0	0	135	(0.01)
Diluted EPS	$ 10,947	17,423	$ 0.63	$ 10,399	17,258	$ 0.60

	00000000	00000000	00000000	00000000	00000000	00000000
	Nine Months Ended					
	October 2, 2011			**October 3, 2010**		
	Net Income	**Shares**	**Per Share Amount**	**Net Income**	**Shares**	**Per Share Amount**
Basic EPS	$ 26,349	17,226	$ 1.53	$ 4,892	17,095	$ 0.29
Dilutive securities, common stock options	0	186	(0.02)	0	143	(0.01)
Diluted EPS	$ 26,349	17,412	$ 1.51	$ 4,892	17,238	$ 0.28

There were 179,021 and 282,504 anti-dilutive stock options and RSUs for the nine months ended October 2, 2011 and October 3, 2010, respectively.

(8) Financial Instruments

Fair Value

The carrying amounts of cash and cash equivalents, trade receivables and trade payables approximate fair value because of the short maturity of these financial instruments. Short-term investments (principally guaranteed investment certificates) are carried at cost which approximates fair value at the balance sheet date. The fair value of our variable rate debt approximates its carrying amount.

Table of Contents

Foreign Currency Exchange Risk

The Company is exposed to certain risks relating to its ongoing business operations, including foreign currency exchange rate risk and interest rate risk. The Company currently uses derivative instruments to manage foreign currency risk on certain business transactions denominated in foreign currencies. To the extent the underlying transactions hedged are completed, these forward contracts do not subject us to significant risk from exchange rate movements because they generally offset gains and losses on the related foreign currency denominated transactions. These forward contracts do not qualify as hedging instruments for accounting purposes and, therefore, do not qualify for fair value or cash flow hedge treatment. Any unrealized gains and losses on our contracts are recognized as a component of other expense in our consolidated statements of operations.

As of October 2, 2011, we had thirteen forward contracts with amounts as follows (in thousands):

Currency	Number	Contract Amount	
U.S. Dollar/GBP	5	3,376	U.S. Dollars
Euro/GBP	6	1,020	Euros
Brazilian Real/Euro	2	6,500	Brazilian Reals

This compares to eighteen forward contracts as of December 31, 2010. The fair value asset of the derivative forward contracts as of October 2, 2011 was approximately $0.1 million and is included in prepaid expenses and other current assets on our balance sheet. This compares to a fair value liability of approximately $1.7 million that was included in accrued expenses and other current liabilities on our balance sheet as of December 31, 2010.

We have determined that the majority of the inputs used to value our foreign currency forward contracts fall within Level 2 of the fair value hierarchy, found under Accounting Standards Codification (ASC) Topic 820.1. The credit valuation adjustments, such as estimates of current credit spreads to evaluate the likelihood of default by us and our counterparties, are Level 3 inputs. However, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our foreign currency forward contracts and determined that the credit valuation adjustments are not significant to the overall valuation. As a result, we have determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

(9) Comprehensive (Loss) Income

Comprehensive (loss) income for the three and nine months ended October 2, 2011 and October 3, 2010 consists of the following (In thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
Net income	$ 10,947	$ 10,399	$ 26,349	$ 4,892
Cumulative translation adjustments	(13,037)	17,510	(65)	(4,121)
Total comprehensive (loss) income	$ (2,090)	$ 27,909	$ 26,284	$ 771

(10) Contingencies and Commitments

Asbestos and Bankruptcy Litigation

Background

On July 12, 2010 (the Filing Date), our subsidiary Leslie Controls, Inc. (Leslie) filed a voluntary petition (the Bankruptcy Filing) under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware and, simultaneously, filed a pre-negotiated plan of reorganization (as amended, the Reorganization Plan or Plan) in an effort to permanently resolve Leslie s exposure to asbestos-related product liability actions. On February 7, 2011, the U.S. Federal District Court for the District of Delaware (the District Court) affirmed the Bankruptcy Court s earlier order confirming Leslie s Reorganization Plan, thus clearing the way for Leslie to emerge from bankruptcy. On April 28, 2011, pursuant to the terms of the Reorganization Plan, Leslie and CIRCOR contributed $76.6 million in cash and a $1 million promissory note (the Note) to fund the Leslie Controls Asbestos Trust (the Trust), and Leslie emerged from Chapter 11 bankruptcy protection. Under the terms of the Plan, all current and future asbestos related claims against Leslie, as well as all current and future derivative claims against CIRCOR, will now be permanently channeled to the Trust, and the only remaining financial obligation of Leslie and CIRCOR is payment of the Note. On September 30, 2011, the District Court entered an order for the final decree closing the Chapter 11 case. For a more detailed historical perspective on Leslie s asbestos related litigation and associated pre-bankruptcy liability accounting, see Item 3. Legal Proceedings in our Annual Report on Form 10-K for the Fiscal Year ended December 31, 2010.

12

Table of Contents

Accounting Indemnity and Defense Cost Liabilities and Assets

During 2010, as a result of Leslie s Bankruptcy Filing and Reorganization Plan, we accrued liabilities based on the terms of the Reorganization Plan. As of December 31, 2010, we therefore recorded net Leslie asbestos and bankruptcy liabilities for resolution of pending and future claims of $79.8 million (all classified as a current liability). As of October 2, 2011, the net liability decreased significantly with the funding of the Trust on April 28, 2011. A summary of Leslie s accrued liabilities, including contributions to the Trust under the Reorganization Plan for existing and future asbestos claims as well as incurred but unpaid asbestos defense cost liabilities and the related insurance recoveries, is provided below.

In Thousands	October 2, 2011	December 31, 2010
Existing claim indemnity liability	$ 0	$ 64
Amounts payable to 524(g) trust	1,000	77,625
Incurred defense cost liability	200	2,142
Insurance recoveries receivable	0	(38)
Net Leslie asbestos and bankruptcy liability	$ 1,200	$ 79,793

2011 and 2010 Experience and Financial Statement Impact

The following table provides information regarding the pre-tax Leslie asbestos and bankruptcy related costs (recoveries) for the three and nine months ended October 2, 2011. The $0.2 million recovery for the three month period ended October 2, 2011 is the result of lower actual defense related expenses partially offset by additional bankruptcy related costs incurred for the three month period ended October 2, 2011 compared to amounts previously estimated.

	Three Months Ended		Nine Months Ended	
In Thousands	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
Indemnity costs accrued (cases filed)	$ 0	$ 0	$ 0	$ 2,496
Adverse verdict appealed	0	0	0	(2,390)
Defense (recoveries) cost incurred	(306)	16	(306)	7,182
Insurance recoveries adjustment	0	0	0	(3,652)
Insurance recoveries accrued	0	0	0	(2,626)
Bankruptcy related costs	105	2,327	982	29,593
Net pre-tax Leslie asbestos and bankruptcy (recoveries) charges	$ (201)	$ 2,343	$ 676	$ 30,603

Other Matters

Smaller numbers of asbestos-related claims have also been filed against two of our other subsidiaries Spence Engineering Company, Inc. (Spence), the stock of which we acquired in 1984; and Hoke Handelsgesellschaft GmbH (Hoke), the stock of which we acquired in 1998. Due to the nature of the products supplied by these entities, the markets they serve and our historical experience in resolving these claims, we do not believe that asbestos-related claims will have a material adverse effect on the financial condition, results of operations or liquidity of Spence or Hoke, or the financial condition, consolidated results of operations or liquidity of the Company.

During the third quarter of 2011, we commenced arbitration proceedings against T.M.W. Corporation (TMW), the seller from which we acquired the assets of Castle Precision Industries in August 2010, seeking to recover damages from TMW for breaches of certain representations and warranties made by TMW in the Asset Purchase Agreement.

Standby Letters of Credit

We execute standby letters of credit, which include bid bonds and performance bonds, in the normal course of business to ensure our performance or payments to third parties. The aggregate notional amount of these instruments was $50.9 million at October 2, 2011. Our historical experience with these types of instruments has been good and no claims have been paid in the current or past five fiscal years. We believe that the likelihood of demand for payments relating to the outstanding instruments is remote. These instruments have expiration dates ranging from less than one month to six years as of October 2, 2011.

Table of Contents

The following table contains information related to standby letters of credit instruments outstanding as of October 2, 2011 (In thousands):

Term Remaining	Maximum Potential Future Payments
0 12 months	$ 28,953
Greater than 12 months	21,985
Total	$ 50,938

(11) Defined Benefit Pension Plans

We maintain two pension benefit plans, a qualified noncontributory defined benefit plan and a nonqualified, noncontributory defined benefit supplemental plan that provides benefits to certain highly compensated officers and employees. To date, the supplemental plan remains an unfunded plan. These plans include significant pension benefit obligations which are calculated based on actuarial valuations. Key assumptions are made in determining these obligations and related expenses, including expected rates of return on plan assets and discount rates. Benefits are based primarily on years of service and employee compensation.

As of July 1, 2006, in connection with a revision to our retirement plan, we froze the pension benefits of our qualified noncontributory plan participants. Under the revised plan, such participants generally do not accrue any additional benefits under the defined benefit plan after July 1, 2006.

During the three and nine months ended October 2, 2011, we made cash contributions of $0.4 million and $2.5 million, respectively, to our qualified defined benefit pension plan. For the remainder of 2011, we expect to make voluntary cash contributions of approximately $0.4 million to our qualified defined benefit pension plan, although global capital market and interest rate fluctuations may impact future funding requirements.

Additionally, substantially all of our U.S. employees are eligible to participate in a 401(k) savings plan. Under this plan, we make a core contribution and match a specified percentage of employee contributions, subject to certain limitations.

The components of net pension benefit expense are as follows (In thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
Service cost-benefits earned	$ 108	$ 100	$ 323	$ 300
Interest cost on benefits obligation	540	534	1,621	1,603
Estimated return on assets	(610)	(506)	(1,829)	(1,519)
Prior service cost amortization	0	0	0	0
Loss amortization	85	73	256	221
Net periodic cost of defined benefit pension plans	$ 123	$ 201	$ 371	$ 605

(12) Income Taxes

As required by the Income Tax Topic of the ASC, we had $1.3 million and $1.6 million of unrecognized tax benefits at October 2, 2011 and December 31, 2010, respectively, all of which would affect our effective tax rate if recognized in any future period.

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of October 2, 2011, we have approximately $0.3 million of accrued interest related to uncertain tax positions.

The Company files income tax returns in the U.S. federal jurisdiction and in various state, local and foreign jurisdictions. The Internal Revenue Service has concluded its examination of the Company for 2007. The Company is no longer subject to examination by the Internal Revenue Service for years prior to 2008 and is no longer subject to examination by the tax authorities in foreign and state jurisdictions prior to 2005. The Company is currently under examination for income tax filings in various state and foreign jurisdictions.

(13) Guarantees and Indemnification Obligations

As permitted under Delaware law, we have agreements whereby we indemnify certain of our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. However, we have directors and officers liability insurance policies that limit our exposure for events covered under the policies and should enable us to substantially recover any future amounts paid. As a result of the coverage under these insurance policies, we believe the estimated fair value of these indemnification agreements based on Level 3 criteria as described under ASC Topic 820.1 is minimal and, therefore, have no liabilities recorded from those agreements as of October 2, 2011.

Table of Contents

We record provisions for the estimated cost of product warranties, primarily from historical information, at the time product revenue is recognized. While we engage in extensive product quality programs and processes, our warranty obligation is affected by product failure rates, utilization levels, material usage, service delivery costs incurred in correcting a product failure, and supplier warranties on parts delivered to us. Should actual product failure rates, utilization levels, material usage, service delivery costs or supplier warranties on parts differ from our estimates, revisions to the estimated warranty liability would be required.

The following table sets forth information related to our product warranty reserves for the nine months ended October 2, 2011 (In thousands):

Balance beginning December 31, 2010	$ 2,508
Provisions	2,210
Claims settled	(1,590)
Currency translation adjustments	20
Balance ending October 2, 2011	$ 3,148

(14) Business Acquisitions

On February 4, 2011, we acquired the stock of Valvulas S.F. Industria e Comercio Ltda. (SF Valves), a Sao Paulo, Brazil based manufacturer of valves for the energy market. SF Valves is reported in our Energy segment. In connection with this acquisition, as of October 2, 2011, we have recorded estimated fair values of $5.7 million of current assets, $7.6 million of fixed assets, $6.4 million of current liabilities, $3.8 million of long-term liabilities, and $4.2 million of intangible assets. The preliminary excess of the purchase price over the fair value of the net identifiable assets of $12.4 million is recorded as goodwill and may be deductible for Brazilian tax purposes. We are currently assessing income tax (including uncertain income tax positions), working capital, and indemnification items and anticipate finalizing our purchase price allocation during the fourth quarter of 2011.

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

This Quarterly Report on Form 10-Q contains certain statements that are forward-looking statements as that term is defined under the Private Securities Litigation Reform Act of 1995 (the Act) and releases issued by the SEC. The words may, hope, should, expect, plan, anticipate, intend, believe, estimate, predict, potential, continue, and other expressions which are predictions of or indicate future events and trends and which do not relate to historical matters, identify forward-looking statements. We believe that it is important to communicate our future expectations to our stockholders, and we, therefore, make forward-looking statements in reliance upon the safe harbor provisions of the Act. However, there may be events in the future that we are not able to accurately predict or control and our actual results may differ materially from the expectations we describe in our forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, the cyclicality and highly competitive nature of some of our end markets which can affect the overall demand for and pricing of our products, changes in the price of and demand for oil and gas in both domestic and international markets, variability of raw material and component pricing, changes in our suppliers performance, fluctuations in foreign currency exchange rates, our ability to continue operating our manufacturing facilities at efficient levels including our ability to continue to reduce costs, our ability to generate increased cash by reducing our inventories, our prevention of the accumulation of excess inventory, our ability to successfully implement our acquisition strategy, fluctuations in interest rates, our ability to continue to successfully defend product liability actions including asbestos-related claims, as well as the uncertainty associated with the current worldwide economic conditions and the continuing impact on economic and financial conditions in the United States and around the world as a result of terrorist attacks, current Middle Eastern conflicts and related matters. ***We advise you to read further about certain of these and other risk factors set forth in Part I, Item 1A, Risk Factors of our Annual Report filed on Form 10-K for the year ended December 31, 2010, together with subsequent reports we have filed with the SEC on Forms 10-Q and 8-K, which may supplement, modify, supersede, or update those risk factors.*** *We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.*

Overview

CIRCOR International, Inc. designs, manufactures and markets valves and other highly engineered products and sub-systems used in the energy, aerospace and industrial markets. Within our major product groups, we develop, sell and service a portfolio of fluid-control products, subsystems and technologies that enable us to fulfill our customers unique fluid-control application needs.

Table of Contents

We have organized our business segment reporting structure into three segments: Energy, Aerospace, and Flow Technologies. Our Energy segment primarily serves large international energy projects, short-cycle North American energy markets, and the pipeline transmission equipment and services end markets. Our Aerospace segment primarily serves the commercial and military aerospace markets. Our Flow Technologies segment serves our broadest variety of end-markets, including power generation, industrial and commercial HVAC/steam, industrial and process markets and chemical and refining. The Flow Technologies segment also provides products specifically designed for U.S. and international navy applications.

We have been transforming our worldwide operations and culture through the development of lean manufacturing techniques (Lean) and the implementation of the CIRCOR Business System. The CIRCOR Business System is defined by our commitment to attracting, developing and refining the best talent and pursuing continuous improvement in all aspects of our business and operations. The CIRCOR Business System promotes improved shareholder value through a commitment to core competencies across all of our business units, including talent acquisition and retention, operational excellence, business integration and repositioning, global business development, and new product development.

Our primary objective is to enhance shareholder value through profitable growth of our diversified, multi-national company utilizing the CIRCOR Business System. We strive to be a global growth company with great operational execution. We are working to accomplish these objectives by focusing on key end-markets that have above average growth with highly engineered product and project opportunities, including the up-stream and mid-stream oil and gas, power generation, process and aerospace markets. In these markets we are using the CIRCOR Business System to excel at:

- Talent Acquisition, Development and Retention;
- Lean Enterprise, Six Sigma and Continuous Improvement;
- Acquisition Integration and Repositioning;
- Global Manufacturing and Supply Chain Management;
- Global Business Development; and
- New Product Development.

Through organic and acquisition-based growth, our three to five year objectives are to double the revenue of CIRCOR, gain significant market positions in our key end-markets and build a global capability in high-growth emerging markets.

Basis of Presentation

All significant intercompany balances and transactions have been eliminated in consolidation. We monitor our business in three segments: Energy, Aerospace, and Flow Technologies.

We operate and report financial information using a 52-week fiscal year ending December 31. The data periods contained within our Quarterly Reports on Form 10-Q reflect the results of operations for the 13-week, 26-week and 39-week periods, which generally end on the Sunday nearest the calendar quarter-end date.

Reclassifications

Certain items in the prior period financial statements have been reclassified to conform to currently reported presentations.

Critical Accounting Policies

The following discussion of accounting policies is intended to supplement the section Summary of Significant Accounting Policies presented in Note 2 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010. These policies were selected because they are broadly applicable within our operating units. The expenses and accrued liabilities or allowances related to certain of these policies are initially based on our best estimates at the time of original entry in our accounting records. Adjustments are recorded when our actual experience, or new information concerning our expected experience, differs from underlying initial estimates. These adjustments could be material if our actual or expected experience were to change significantly in a short period of time. We make frequent comparisons of actual experience and expected experience in order to mitigate the likelihood of material adjustments.

There have been no significant changes from the methodology applied by management for critical accounting estimates previously disclosed in our most recent Annual Report on Form 10-K.

Revenue Recognition

Revenue is recognized when products are delivered, title and risk of loss have passed to the customer, no significant post-delivery obligations remain and collection of the resulting receivable is reasonably assured. Shipping and handling costs invoiced to customers are recorded as components of revenues and the associated costs are recorded as cost of sales.

Cash, Cash Equivalents, and Short-term Investments

Cash and cash equivalents consist of amounts on deposit in checking and savings accounts with banks and other financial institutions. Short-term investments primarily consist of guaranteed investment certificates which generally have short-term maturities and are carried at cost which generally approximates fair value.

Allowance for Inventory

We typically analyze our inventory aging and projected future usage on a quarterly basis to assess the adequacy of our inventory allowances. We provide inventory allowances for excess, slow-moving, and obsolete inventories primarily determined by estimates of future demand. The allowance is measured on an item-by-item basis determined based on the difference between the cost of the inventory and estimated market value. The provision for inventory allowance is a component of our cost of revenues. Assumptions about future demand are among the primary factors utilized to estimate market value. Future demand is generally based on actual usage of inventory on a line item basis over the past two years and is adjusted for forecasted future demand, current backlog levels and/or existing market conditions. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

Our net inventory balance was $213.8 million as of October 2, 2011, compared to $167.8 million as of December 31, 2010. Our inventory allowance as of October 2, 2011 was $16.7 million, compared with $16.7 million as of December 31, 2010. Our provision for inventory obsolescence was $2.8 million and $4.1 million for the first nine months of 2011 and 2010, respectively. For the nine months ended October 2, 2011, we have experienced increases in organic revenue, orders, and backlog. We believe our inventory allowances remain adequate with the net realizable value of our inventory being higher than our current inventory cost.

If there were to be a sudden and significant decrease in demand for our products, significant price reductions, or if there were a higher incidence of inventory obsolescence because of changing technology and customer requirements, we could be required to increase our inventory allowances and our gross profit could be adversely affected.

Penalty Accruals

Some of our customer agreements, primarily in our project-related businesses, contain late shipment penalty clauses whereby we are contractually obligated to pay consideration to our customers if we do not meet specified shipment dates. The accrual for estimated penalties is shown as a reduction of revenue and is based on several factors including limited historical customer settlement experience and management s assessment of specific shipment delay information. As of October 2, 2011 and December 31, 2010, we had accrued $9.2 million and $7.9 million, respectively, related to these potential late shipment penalties. As we conclude performance under these agreements, the actual amount of consideration paid to our customers may vary significantly from the amounts we currently have accrued.

Acquisition Accounting

In connection with our acquisitions, we assess and formulate a plan related to the future integration of the acquired entity. This process begins during the due diligence process and is generally concluded within twelve months of the acquisition. Our methodology for determining the fair values relating to acquisitions is determined through established valuation techniques for industrial manufacturing companies and we typically utilize third party valuation firms to assist in the valuation of certain tangible and intangible assets.

Legal Contingencies

We are currently involved in various legal claims and legal proceedings, some of which may involve substantial dollar amounts. Periodically, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure can be reasonably estimated. Because of uncertainties related to these matters, accruals are based on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions in the estimates of the potential liabilities could have a material adverse effect on our business, results of operations and financial position. For more information related to our outstanding legal proceedings, see Contingencies and Commitments in Note 10 of the accompanying unaudited consolidated financial statements as well as Legal Proceedings in Part II, Item 1 hereof.

Table of Contents

Impairment Analysis

As required by ASC Topic 350.1-3, Goodwill and Intangible Assets, we perform an annual assessment as to whether there was an indication that goodwill and certain intangible assets are impaired. We also perform impairment analyses whenever events and circumstances indicate that goodwill or certain intangibles may be impaired. In assessing the fair value of goodwill, we use our best estimates of future cash flows of operating activities and capital expenditures of the reporting unit, the estimated terminal value for each reporting unit and a discount rate based on the weighted average cost of capital.

If our estimates or related projections change in the future due to changes in industry and market conditions, we may be required to record additional impairment charges. The goodwill recorded on the consolidated balance sheet as of October 2, 2011 increased $14.0 million to $77.2 million compared to $63.2 million as of December 31, 2010. This increase is primarily due to the acquisition of SF Valves. There were no indicators of impairment as of October 2, 2011.

Income Taxes

For 2011, we expect an effective income tax rate of approximately 29.0%. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and vice versa. Changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws or interpretations thereof may also adversely affect our future effective tax rate. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

The Company has a net foreign deferred tax liability and a domestic deferred income tax asset. With regard to deferred income tax assets, we maintained a total valuation allowance of $9.2 million and $10.1 million at October 2, 2011 and December 31, 2010, respectively, due to uncertainties related to our ability to utilize certain of these assets, primarily consisting of certain foreign tax credits, state net operating losses and state tax credits carried forward. The valuation allowance is based on estimates of taxable income in each of the jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable. If market conditions improve and future results of operations exceed our current expectations, our existing tax valuation allowances may be adjusted, resulting in future tax benefits. Alternatively, if market conditions deteriorate or future results of operations are less than expected, future assessments may result in a determination that some or all of the deferred tax assets are not realizable. Consequently, we may need to establish additional tax valuation allowances for all or a portion of the gross deferred tax assets, which may have a material adverse effect on our business, results of operations and financial condition. The Company has had a history of domestic taxable income, is able to avail itself of federal tax carryback provisions, has future taxable temporary differences and projects future domestic taxable income. We believe that after considering all of the available objective evidence, it is more likely than not that the results of future operations will generate sufficient taxable income to realize the remaining deferred tax assets.

Pension Benefits

We maintain two pension benefit plans, a qualified noncontributory defined benefit plan and a nonqualified, noncontributory defined benefit supplemental plan that provides benefits to certain highly compensated officers and employees. To date, the supplemental plan remains an unfunded plan. These plans include significant pension benefit obligations which are calculated based on actuarial valuations. Key assumptions are made in determining these obligations and related expenses, including expected rates of return on plan assets and discount rates. Benefits are based primarily on years of service and employees compensation. As of July 1, 2006, in connection with a revision to our retirement plan, we froze the pension benefits of our qualified noncontributory plan participants. Under the revised plan, such participants generally do not accrue any additional benefits under the defined benefit plan after July 1, 2006 and instead receive enhanced benefits associated with our defined contribution 401(k) plan in which substantially all of our U.S. employees are eligible to participate.

During the three and nine months ended October 2, 2011, we made cash contributions of $0.4 million and $2.5 million, respectively, to our qualified defined benefit pension plan. For the remainder of 2011, we expect to make voluntary cash contributions of approximately $0.4 million to our qualified defined benefit pension plan, although global capital market and interest rate fluctuations may impact future funding requirements.

Table of Contents

Results of Operations for the Three Months Ended October 2, 2011 Compared to the Three Months Ended October 3, 2010.

The following tables set forth the results of operations, percentage of net revenue and the period-to-period percentage change in certain financial data for the three months ended October 2, 2011 and October 3, 2010:

	Three Months Ended				
	October 2, 2011		October 3, 2010		% Change
	(Dollars in thousands)				
Net revenues	$ 209,961	100.0%	$ 177,577	100.0%	18.2%
Cost of revenues	154,774	73.7%	126,096	71.0%	22.7%
Gross profit	55,187	26.3%	51,481	29.0%	7.2%
Selling, general and administrative expenses	39,448	18.8%	35,648	20.1%	10.7%
Leslie asbestos and bankruptcy (recoveries) charges	(201)	(0.1)%	2,343	1.3%	(108.6)%
Operating income	15,940	7.6%	13,490	7.6%	18.2%
Other expense (income):					
Interest expense, net	887	0.4%	734	0.4%	20.8%
Other expense (income), net	354	0.2%	(853)	(0.5)%	(141.5)%
Total other expense (income)	1,241	0.6%	(119)	(0.1)%	(1,142.9)%
Income before income taxes	14,699	7.0%	13,609	7.7%	8.0%
Provision for income taxes	3,752	1.8%	3,210	1.8%	16.9%
Net income	$ 10,947	5.2%	$ 10,399	5.9%	5.3%

Net Revenues

Net revenues for the three months ended October 2, 2011 increased by $32.4 million, or 18%, to $210.0 million from $177.6 million for the three months ended October 3, 2010. The increase in net revenues for the three months ended October 2, 2011 was attributable to the following:

Segment	Three Months Ended October 2, 2011	October 3, 2010	Total Change	Acquisitions	Operations	Foreign Exchange
			(In thousands)			
Energy	$ 103,300	$ 80,613	$ 22,687	$ 3,046	$ 17,051	$ 2,590
Aerospace	32,681	28,316	4,365	0	3,929	436
Flow Technologies	73,980	68,648	5,332	0	4,216	1,116
Total	$ 209,961	$ 177,577	$ 32,384	$ 3,046	$ 25,196	$ 4,142

The Energy segment accounted for 49% of net revenues for the three months ended October 2, 2011 compared to 45% for the three months ended October 3, 2010. The Aerospace segment accounted for 16% of net revenues for the three months ended October 2, 2011 compared to 16% for the three months ended October 3, 2010. The Flow Technologies segment accounted for 35% of net revenues for the three months ended October 2, 2011 compared to 39% for the three months ended October 3, 2010.

Energy segment revenues increased by $22.7 million, or 28%, for the quarter ended October 2, 2011 compared to the quarter ended October 3, 2010. The increase was driven by $17.1 million of organic growth in all areas led by growth in our short-cycle North American businesses. The first quarter 2011 acquisition of SF Valves added an additional $3.0 million in revenue and favorable foreign currency fluctuations added $2.6 million. Orders for this segment decreased $4.9 million to $93.6 million for the three months ended October 2, 2011, compared to $98.5 million for the three months ended October 3, 2010, due to fewer large international projects, partially offset by continued increases in North American short-cycle businesses and the favorable impact of the SF Valves acquisition. Backlog has increased by $49.0 million to $202.0 million as of October 2, 2011 compared to the same period in 2010.

Aerospace segment revenues increased by $4.4 million, or 15%, for the quarter ended October 2, 2011 compared to the quarter ended October 3, 2010. The increase was primarily driven by organic growth of $3.9 million due to higher volume shipments across most areas with the exception of military aftermarket. Favorable foreign currency fluctuations added an additional $0.4 million. Orders for this segment increased $31.5 million to $62.8 million for the three months ended October 2, 2011 compared to $31.3 million for the three months ended October 3, 2010. This order increase was largely due to a significant multi-year military landing gear order. Backlog increased by $7.6 million to $160.4 million as of October 2, 2011 compared to the same period in 2010. We believe that the commercial aerospace markets will see year over year improvement during 2011, however, we continue to see softness in overall military spending, especially in the aftermarket segment due to budget constraints and the winding down of military activities in Iraq and Afghanistan.

Flow Technologies segment revenues increased by $5.3 million, or 8%, for the quarter ended October 2, 2011 compared to the quarter ended October 3, 2010. The revenue increase was due to organic growth of $4.2 million and an increase of $1.1 million due to

Table of Contents

favorable foreign currency fluctuations. With the exception of Light-emitting diode equipment (LED equipment) revenues, the organic revenue across most markets increased as compared to the three months ended October 3, 2010. Orders for this segment decreased $6.6 million to $70.8 million for the three months ended October 2, 2011 compared to $77.4 million for the three months ended October 3, 2010 primarily due to a reduction of LED equipment market orders. Backlog has decreased by $8.1 million to $77.8 million as of October 2, 2011 compared to the same period in 2010, driven by lower LED equipment and maritime backlog, partially offset by increases in other Flow Technology markets.

Gross Profit

Consolidated gross profit increased $3.7 million, or 7%, to $55.2 million for the quarter ended October 2, 2011 compared to $51.5 million for the quarter ended October 3, 2010. Consolidated gross margin decreased 270 basis points to 26.3% for the quarter ended October 2, 2011 from 29.0% for the quarter ended October 3, 2010.

Gross profit for the Energy segment increased $2.5 million, or 13%, for the quarter ended October 2, 2011 compared to the quarter ended October 3, 2010. The gross profit increase was due to organic increases of $2.5 million primarily from short-cycle North American businesses and a $0.5 million positive impact from foreign currency fluctuations, partially offset by a $0.5 million decrease from the SF Valves acquisition. Gross margins declined 290 basis points from 24.3% for the quarter ended October 3, 2010 to 21.4% for the quarter ended October 2, 2011. The decline was primarily driven by the dilutive impact of the SF Valves acquisition and unfavorable pricing in large international projects, partially offset by higher volume and favorable mix and short-cycle pricing.

Gross profit for the Aerospace segment decreased $0.3 million, or 4%, for the quarter ended October 2, 2011 compared to the quarter ended October 3, 2010. Gross margins declined by 570 basis points from 34.4% for the quarter ended October 3, 2010 to 28.7% for the quarter ended October 2, 2011 primarily due to the ongoing integration of the August 2010 acquisition of Castle Precision Industries (Castle), unfavorable product mix and increased costs including those associated with new programs.

Gross profit for the Flow Technologies segment increased $1.6 million, or 7%, for the quarter ended October 2, 2011 compared to the quarter ended October 3, 2010. Organic growth in most markets, partially offset by declines in LED equipment revenue, resulted in a $1.2 million increase in gross profit, while favorable foreign currency fluctuations added $0.4 million. Gross margins declined 30 basis points from 32.3% for the quarter ended October 3, 2010 to 32.0% for the quarter ended October 2, 2011 primarily due to unfavorable mix, mostly offset by favorable volume and productivity improvements.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased $3.8 million, or 11%, to $39.4 million for the quarter ended October 2, 2011 compared to $35.6 million for the three months ended October 3, 2010. Selling, general and administrative expenses as a percentage of revenues decreased 130 basis points to 18.8% for the three months ended October 2, 2011 compared to 20.1% for the three months ended October 3, 2010.

Selling, general and administrative expenses for the Energy segment increased 38%, or $4.0 million, compared to the third quarter 2010. Organic increases inclusive of higher selling resources and increased commissions accounted for $2.5 million of the total increase. In addition, the SF Valves acquisition in the first quarter of 2011 added $1.2 million in expenses and foreign currency fluctuations added $0.4 million.

Selling, general and administrative expenses for the Aerospace segment increased 8%, or $0.5 million, compared to the third quarter 2010 primarily due to expenses to support future programs. Foreign currency fluctuations and organic increases contributed $0.2 million and $0.3 million in expenses, respectively.

Selling, general and administrative expenses for the Flow Technologies segment increased 4%, or $0.5 million, compared to the third quarter 2010 primarily due to investments in power market growth initiatives offset by productivity. Organic increases of $0.2 million and foreign currency fluctuations of $0.3 million accounted for the increase.

Corporate selling, general and administrative expenses decreased 27%, or $1.3 million, in the third quarter of 2011 from the same period in 2010. The decrease was primarily due to the $1.6 million payment of a settlement for a long-standing litigation matter, partially offset by higher incentive costs.

Leslie Asbestos and Bankruptcy Related Charges, Net

Asbestos and bankruptcy related charges are primarily associated with our Leslie subsidiary in the Flow Technologies segment. Net asbestos and bankruptcy related costs decreased $2.5 million to a net recovery of $0.2 million for the three months ended October 2, 2011 compared to charges of $2.3 million for the three months ended October 3, 2010. The $0.2 million recovery of bankruptcy related costs for the three month period ended October 2, 2011 was a result of lower actual costs incurred as of October 2, 2011 compared to amounts previously estimated. For more information related to our Leslie absbestos and bankruptcy related charges, see Legal Proceedings in Part II, Item 1 hereof.

Table of Contents

Operating Income

The change in operating income for the three months ended October 2, 2011 compared to the three months ended October 3, 2010 was as follows:

Segment	Three Months Ended October 2, 2011	October 3, 2010	Total Change	Acquisitions	Operations	Foreign Exchange
	(In thousands)					
Energy	$ 7,441	$ 8,968	$ (1,527)	$ (1,696)	$ 32	$ 137
Aerospace	1,846	2,726	(880)	0	(752)	(128)
Flow Technologies	10,008	6,966	3,042	0	2,918	124
Corporate	(3,355)	(5,170)	1,815	0	1,822	(7)
Total	$ 15,940	$ 13,490	$ 2,450	$ (1,696)	$ 4,020	$ 126

Operating income increased 18%, or $2.5 million, for the three months ended October 2, 2011 compared to the three months ended October 3, 2010, on an 18% increase in revenues.

Operating income for the Energy segment decreased $1.5 million, or 17%, for the third quarter 2011, as operating margin decreased 390 basis points to 7.2% on an organic revenue increase of 28%, compared to the third quarter 2010. These decreases were primarily driven by the dilutive impact of the SF Valves acquisition and continued unfavorable pricing in large international projects, partially offset by favorable mix and expenses.

Operating income for the Aerospace segment decreased $0.9 million, or 32%, for the third quarter of 2011 compared to the third quarter of 2010. The decrease in operating income was primarily due to the ongoing integration of the Castle acquisition and increased cost to support new programs, partially offset by favorable volume.

Operating income for the Flow Technologies segment increased $3.0 million, or 44%, for the third quarter of 2011 compared to the third quarter of 2010. The most significant factors contributing to this increase were the $2.5 million decrease in Leslie bankruptcy related charges, additional income from organic revenue increases and favorable foreign exchange fluctuations.

Corporate operating expenses decreased $1.8 million for the third quarter 2011 compared to the third quarter 2010, primarily due to the payment of a settlement of a long-standing litigation matter.

Interest Expense, Net

Interest expense, net, increased $0.2 million for the three months ended October 2, 2011 from the three months ended October 3, 2010. This increase in interest expense was primarily due to higher periodic interest charges due to higher debt borrowings.

Other Expense, Net

The Company reported other expense of $0.4 million for the three months ended October 2, 2011 compared to other income of $0.9 for the three months ended October 3, 2010. The increase in expense was largely the result of the remeasurement of foreign currency balances.

Provision for Taxes

The effective income tax rate was 25.5% and 23.6% for the third quarters of 2011 and 2010, respectively. The increase in the income tax rate for the third quarter of 2011 compared to the third quarter of 2010 was primarily due to a higher proportion of U.S. domestic income versus foreign income taxed at lower income tax rates, partially offset by certain discrete items including a change in the UK tax rate and foreign credit utilization.

Net Income

Net income increased $0.5 million to $10.9 million in the third quarter 2011 on 18% higher revenues, compared to the same quarter in 2010. The increase in net income was primarily the result of a decrease in Leslie bankruptcy-related charges and a corporate litigation settlement, partially offset by lower segment operating income during the third quarter of 2011.

Table of Contents

Results of Operations for the Nine Months Ended October 2, 2011 Compared to the Nine Months Ended October 3, 2010.

The following tables set forth the results of operations, percentage of net revenue and the period-to-period percentage change in certain financial data for the nine months ended October 2, 2011 and October 3, 2010:

	Nine Months Ended				
	October 2, 2011		October 3, 2010		% Change
	(Dollars in thousands)				
Net revenues	$ 605,239	100.0%	$ 491,851	100.0%	23.1%
Cost of revenues	439,218	72.6%	348,109	70.8%	26.2%
Gross profit	166,021	27.4%	143,742	29.2%	15.5%
Selling, general and administrative expenses	124,083	20.5%	109,024	22.2%	13.8%
Leslie asbestos and bankruptcy charges	676	0.1%	30,603	6.2%	(97.8)%
Operating income	41,262	6.8%	4,115	0.8%	902.7%
Other expense (income):					
Interest expense, net	2,892	0.5%	1,874	0.4%	54.3%
Other expense (income), net	1,830	0.3%	(646)	(0.1)%	(383.3)%
Total other expense	4,722	0.8%	1,228	0.2%	284.5%
Income before income taxes	36,540	6.0%	2,887	0.6%	1,165.7%
Provision (benefit) for income taxes	10,191	1.7%	(2,005)	(0.4)%	(608.3)%
Net income	$ 26,349	4.4%	$ 4,892	1.0%	438.6%

Net Revenues

Net revenues for the nine months ended October 2, 2011 increased by $113.3 million, or 23%, to $605.2 million from $491.9 million for the nine months ended October 3, 2010. The increase in net revenues for the nine months ended October 2, 2011 was attributable to the following:

	Nine Months Ended					
Segment	October 2, 2011	October 3, 2010	Total Change	Acquisitions	Operations	Foreign Exchange
			(In thousands)			
Energy	$ 284,464	$ 215,641	$ 68,823	$ 9,392	$ 51,624	$ 7,807
Aerospace	100,820	83,401	17,419	8,571	6,953	1,895
Flow Technologies	219,955	192,809	27,146	1,739	20,602	4,805
Total	$ 605,239	$ 491,851	$ 113,388	$ 19,702	$ 79,179	$ 14,507

The Energy segment accounted for 47% of net revenues for the nine months ended October 2, 2011 compared to 44% for the nine months ended October 3, 2010. The Aerospace segment accounted for 17% of net revenues for the nine months ended October 2, 2011 compared to 17% for the nine months ended October 3, 2010. The Flow Technologies segment accounted for 36% of net revenues for the nine months ended October 2, 2011 compared to 39% for the nine months ended October 3, 2010.

Energy segment revenues increased by $68.8 million, or 32%, for the nine months ended October 2, 2011 compared to the nine months ended October 3, 2010. The increase was primarily driven by $51.6 million of organic growth across the segment, particularly from the short-cycle North American businesses. This increase is also due to $9.4 million in revenue from the first quarter 2011 acquisition of SF Valves and $7.8 million of favorable foreign currency fluctuations. Orders for this segment increased $66.5 million to $310.6 million for the nine months ended

October 2, 2011 compared to $244.1 million for the nine months ended October 3, 2010 due to strength in all areas, including large international projects, which have rebounded from the low order intake recorded during 2010.

Aerospace segment revenues increased by $17.4 million, or 21%, for the nine months ended October 2, 2011 compared to the nine months ended October 3, 2010. $8.6 million of the increase was driven by acquisitions, primarily the August 2010 acquisition of Castle. Additional increases were due to organic growth of $7.0 million across most areas with the exception of military aftermarket and favorable foreign currency fluctuations of $1.9 million. Orders for this segment increased $36.0 million to $129.1 million for the nine months ended October 2, 2011 compared to $93.1 million for the nine months ended October 3, 2010. This order increase was primarily due to the positive impact of acquisitions and a large multi-year military landing gear order placed in the third quarter of 2011.

Table of Contents

Flow Technologies segment revenues increased by $27.1 million, or 14%, for the nine months ended October 2, 2011 compared to the nine months ended October 3, 2010. The revenue increase was due to organic growth across most businesses of $20.6 million, including maritime and process and industrial markets. An additional increase of $4.8 million was due to favorable foreign currency fluctuations. Mazda Ltd. (Mazda), which we acquired in the second quarter of 2010 added $1.7 million in revenues. Orders for this segment increased $11.8 million to $222.6 million for the nine months ended October 2, 2011 compared to $210.8 million for the nine months ended October 3, 2010, with improvement in most markets excluding the LED equipment market.

Gross Profit

Consolidated gross profit increased $22.3 million to $166.0 million for the nine months ended October 2, 2011 compared to $143.7 million for the nine months ended October 3, 2010. Consolidated gross margin decreased 180 basis points to 27.4% for the nine months ended October 2, 2011 compared to 29.2% for the nine months ended October 3, 2010.

Gross profit for the Energy segment increased $10.9 million, or 21%, for the nine months ended October 2, 2011 compared to the nine months ended October 3, 2010. The gross profit increase was primarily due to $9.4 million of organic revenue increases and $1.5 million in higher foreign exchange rates compared to the U.S. dollar. Gross margins declined 200 basis points from 23.9% for the nine months ended October 3, 2010 to 21.9% for the nine months ended October 2, 2011. This decline was primarily driven by pricing pressures, especially in large international projects, partially offset by favorable volume and the associated leverage, especially in our North American businesses.

Gross profit for the Aerospace segment increased $2.2 million, or 7%, for the nine months ended October 2, 2011 compared to the nine months ended October 3, 2010. This gross profit increase was primarily due to $1.8 million from the August 2010 acquisition of Castle and $0.5 million due to favorable foreign currency fluctuations, partially offset by organic decreases of $0.1 million. Gross margins declined by 430 basis points from 37.3% for the nine months ended October 3, 2010 to 33.0% for the nine months ended October 2, 2011 primarily due to the dilution from the Castle acquisition, unfavorable product mix and increased cost including those associated with new programs, partially offset by the increased volume and associated leverage.

Gross profit for the Flow Technologies segment increased $9.3 million, or 15%, for the nine months ended October 2, 2011 compared to the nine months ended October 3, 2010. Organic growth in most markets resulted in a $7.0 million increase in gross profit, while our recently acquired Mazda business added $0.7 million and favorable foreign currency fluctuations added another $1.6 million. Gross margins improved 30 basis points from 31.7% for the nine months ended October 3, 2010 to 32.0% for the nine months ended October 2, 2011 primarily due to increased volume and the associated leverage, partially offset by unfavorable product mix.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased $15.1 million, or 14%, to $124.1 million for the nine months ended October 2, 2011 compared to $109.0 million for the nine months ended October 3, 2010. Consolidated selling, general and administrative expenses as a percentage of revenues decreased 170 basis points to 20.5% for the nine months ended October 2, 2011 compared to 22.2% for the nine months ended October 3, 2010.

Selling, general and administrative expenses for the Energy segment increased 29%, or $10.1 million, compared to the first nine months of 2010. Organic increases, inclusive of higher commissions, increased selling resources and higher acquisition-related expenses accounted for $5.8 million of the total increase. In addition, the SF Valves acquisition in the first quarter of 2011 added $2.8 million in expenses and foreign currency fluctuations added $1.5 million.

Selling, general and administrative expenses for the Aerospace segment increased 15%, or $3.0 million, for the first nine months of 2011 compared to the first nine months of 2010. This increase was due to acquisitions that added $2.0 million in expenses, primarily from the Castle acquisition, organic increases of $0.5 million and foreign currency fluctuations that added $0.5 million in expenses.

Selling, general and administrative expenses for the Flow Technologies segment increased 5%, or $1.9 million, for the first nine months of 2011 compared to the first nine months of 2010 primarily due to a $0.7 million increase attributable to the Mazda acquisition and a $0.9 million increase due to foreign currency fluctuations.

Corporate selling, general and administrative expenses increased 1%, or $0.1 million, for the first nine months of 2011 compared to the same period in 2010. The increase was primarily due to higher incentive costs and share based compensation, partially offset by a 2011 $1.6 million payment of a settlement of a long-standing litigation matter.

Leslie Asbestos and Bankruptcy Related Charges, Net

Asbestos and bankruptcy related charges are primarily associated with our Leslie subsidiary in the Flow Technologies segment. Net asbestos and bankruptcy related costs decreased $29.9 million to $0.7 million for the nine months ended October 2, 2011

23

Table of Contents

compared to $30.6 million for the nine months ended October 3, 2010. This decrease was due to the bankruptcy filing of our Leslie subsidiary and its emergence from bankruptcy during the nine months ended October 3, 2010. For more information related to our Leslie absbestos and bankruptcy related charges, see Legal Proceedings in Part II, Item 1 hereof.

Operating Income

The change in operating income for the nine months ended October 2, 2011 compared to the nine months ended October 3, 2010 was as follows:

	Nine Months Ended					
Segment	October 2, 2011	October 3, 2010	Total Change	Acquisitions	Operations	Foreign Exchange
			(In thousands)			
Energy	$ 18,208	$ 17,417	$ 791	$ (2,879)	$ 3,629	$ 41
Aerospace	9,593	10,400	(807)	(200)	(576)	(31)
Flow Technologies	28,416	(7,580)	35,996	(72)	35,361	707
Corporate	(14,955)	(16,122)	1,167	0	1,178	(11)
Total	$ 41,262	$ 4,115	$ 37,147	$ (3,151)	$ 39,592	$ 706

Operating income increased $37.2 million, or 903%, to $41.3 million for the nine months ended October 2, 2011 from $4.1 million for the nine months ended October 3, 2010.

Operating income for the Energy segment increased $0.8 million, or 5%, for the first nine months of 2011, compared to the same period in 2010. The increase in operating income was primarily due to the significant volume increase and the associated leverage in our North American businesses, offset by the impact of pricing pressures, especially in large international projects, and the costs associated with the SF Valves acquisition.

Operating income for the Aerospace segment decreased $0.8 million, or 8%, for the first nine months of 2011 compared to the same period in 2010. The decrease in operating income was primarily due to the ongoing costs associated with the integration of Castle and other increased costs, including those associated with new programs, partially offset by favorable volume.

Operating income for the Flow Technologies segment increased $36.0 million, or 475%, for the first nine months of 2011 compared to the same period in 2010. The most significant factor contributing to this increase was a $28.6 million decrease in Leslie asbestos and bankruptcy related charges, as well as $5.5 million of additional income from organic revenue increases at most businesses during the first nine months of 2011.

Corporate operating expenses decreased $1.2 million, or 8%, for the first nine months of 2011 compared to the same period in 2010, largely due to a 2011 payment of a litigation settlement and lower Leslie bankruptcy related charges.

Interest Expense, Net

Interest expense, net, increased $1.0 million for the nine months ended October 2, 2011 from the nine months ended October 3, 2010. This increase in interest expense was primarily due to higher interest charges from higher borrowings associated with our revolving credit facility and other borrowings.

Other Expense, Net

The Company reported other expense of $1.8 million for the nine months ended October 2, 2011 compared to other income of $0.6 for the nine months ended October 3, 2010. The $2.4 million difference was largely the result of the remeasurement of foreign currency balances.

Provision (Benefit) for Taxes

The effective income tax rate was 27.9% and (69.5%) for the nine month periods ended October 2, 2011 and October 3, 2010, respectively. The 27.9% tax rate in 2011 includes offsets by discrete items including a change in the UK tax rate and foreign tax credit utilization. The rate for the nine months ended October 3, 2010 would have been 24.4% without the one-time cost recognized in association with the Leslie bankruptcy. The primary driver of the lower 2010 calculation was the higher mix of lower tax foreign income.

Table of Contents

Net Income

Net income increased $21.4 million to $26.3 million for the nine months ended October 2, 2011 compared to $4.9 million for the nine months ended October 3, 2010. The increase in net income was primarily the result of the decrease in Leslie bankruptcy related charges.

Liquidity and Capital Resources

Our liquidity needs arise primarily from capital investment in machinery, equipment and the improvement of facilities, funding working capital requirements to support business growth initiatives, acquisitions, dividend payments, and debt service costs. Excluding our first quarter results in 2010 and 2009, as well as our second and third quarters of 2011, we have historically generated cash from operations. We believe we remain in a strong financial position, with resources available for reinvestment in existing businesses, strategic acquisitions and managing our capital structure on a short and long-term basis.

The following table summarizes our cash flow activities for the nine months ended October 2, 2011 (In thousands):

Cash flow provided by (used in):	
Operating activities	$ (70,678)
Investing activities	(31,391)
Financing activities	95,343
Effect of exchange rates on cash and cash equivalents	228
Decrease in cash and cash equivalents	$ (6,498)

During the nine months ended October 2, 2011, we used $70.7 million in cash from operating activities compared to generating $17.1 million during the nine months ended October 3, 2010. The higher amount of cash used in operating activities was primarily due to the payment of $76.6 million in April 2011 to fund the Leslie Controls Asbestos Trust (as described in more detail in Part II, Item I, Legal Proceedings hereof), partially offset by higher net income compared to the first nine months of 2010. The $31.4 million used in investing activities primarily consisted of fixed asset additions and cash used to acquire SF Valves in the first quarter 2011. Financing activities provided $95.3 million, which included a net $98.2 million of proceeds from borrowings that were used to partially fund the Leslie Controls Asbestos Trust in April 2011, the SF Valves acquisition in the first quarter of 2011 and for working capital purposes. Financing activities also include $2.0 million used to pay dividends to shareholders and $2.0 million in debt issuance costs related to the new five year unsecured credit agreement we entered into in May 2011.

As of October 2, 2011, total debt was $103.5 million compared to $1.5 million as of December 31, 2010. During February 2011, we borrowed $25.5 million from our existing credit facilities for the acquisition of SF Valves. In April 2011, we borrowed an additional $76.6 million to fund the Leslie Controls Asbestos Trust. Total debt as a percentage of total shareholders equity was 27% as of October 2, 2011 compared to less than 1% as of December 31, 2010.

On May 2, 2011, we entered into a five year unsecured credit agreement (2011 Credit Agreement) that provides for a $300.0 million revolving line of credit. The 2011 Credit Agreement includes a $150.0 million accordion feature for a maximum facility size of $450.0 million. The 2011 Credit Agreement also allows for additional indebtedness not to exceed $80 million. We anticipate using the 2011 Credit Agreement to fund potential acquisitions, to support our organic growth initiatives and working capital needs, and for general corporate purposes. As of October 2, 2011, we had borrowings of $85.0 million outstanding under our credit facility and $50.9 million was allocated to support outstanding letters of credit.

Certain of our loan agreements contain covenants that require, among other items, maintenance of certain financial ratios and also limit our ability to: enter into secured and unsecured borrowing arrangements; issue dividends to shareholders; acquire and dispose of businesses; invest in capital equipment; transfer assets among domestic and international entities; participate in certain higher yielding long-term investment vehicles; and issue additional shares of our stock. The two primary financial covenants are leverage ratio and interest coverage ratio. We were in compliance with all financial covenants related to our existing debt obligations at October 2, 2011 and December 31, 2010 and we believe it is reasonably likely that we will continue to meet such covenants in the near future.

The ratio of current assets to current liabilities was 2.24:1 at October 2, 2011, compared to 1.62:1 at December 31, 2010. Cash and cash equivalents were $39.3 million as of October 2, 2011, compared to $45.8 million as of December 31, 2010. A majority of this cash is located at our foreign subsidiaries and may not be repatriated to the United States or other jurisdictions without significant tax implications.

On November 4, 2010, we filed with the SEC a shelf registration statement on Form S-3 under which we may issue up to $400 million of securities including debt securities, common stock, preferred stock, warrants to purchase any such securities and units comprised of any such securities (the Securities). The registration statement was declared effective by the SEC on December 17,

Table of Contents

2010. We may offer these Securities from time to time in amounts, at prices and on terms to be determined at the time of sale. We believe that with this registration statement, we will have greater flexibility to take advantage of financing opportunities, acquisitions and other business opportunities when and if such opportunities arise. Depending on market conditions, we may issue securities under this or future registration statements or in private offerings exempt from registration requirements.

In 2011, excluding the April transaction to fund the Leslie Asbestos Trust, we expect to generate positive cash flow from operating activities sufficient to support our capital expenditures and pay dividends approximating $2.6 million based on our current dividend practice of paying $0.15 per share annually. Based on our expected cash flows from operations and contractually available borrowings under our credit facilities, we expect to have sufficient liquidity to fund working capital needs and future growth. We continue to search for strategic acquisitions; a larger acquisition may require additional borrowings and/or the issuance of our common stock.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements, other than operating leases, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Sensitivity Risk

As of October 2, 2011, our primary interest rate risk is related to borrowings under our revolving credit facility. The interest rate for our revolving credit facility fluctuates with changes in short-term interest rates. We had $85.0 million borrowed under our revolving credit facility as of October 2, 2011. Based upon expected levels of borrowings under our credit facility in 2011, an increase in variable interest rates of 100 basis points would have an effect on our annual results of operations and cash flows of $0.2 million.

Foreign Currency Exchange Risk

The Company is exposed to certain risks relating to its ongoing business operations, including foreign currency exchange rate risk and interest rate risk. The Company currently uses derivative instruments to manage foreign currency risk on certain business transactions denominated in foreign currencies. To the extent the underlying transactions hedged are completed, these forward contracts do not subject us to significant risk from exchange rate movements because they generally offset gains and losses on the related foreign currency denominated transactions. These forward contracts do not qualify as hedging instruments for accounting purposes and, therefore, do not qualify for fair value or cash flow hedge treatment. Any unrealized gains and losses on our contracts are recognized as a component of other expense in our consolidated statements of operations.

As of October 2, 2011, we had thirteen forward contracts with amounts as follows (in thousands):

Currency	Number	Contract Amount	
U.S. Dollar/GBP	5	3,376	U.S. Dollars
Euro/GBP	6	1,020	Euros
Brazilian Real/Euro	2	6,500	Brazilian Reals

This compares to eighteen forward contracts as of December 31, 2010. The fair value asset of the derivative forward contracts as of October 2, 2011 was approximately $0.1 million and is included in prepaid expenses and other current assets on our balance sheet. This compares to a fair value liability of approximately $1.7 million that was included in accrued expenses and other current liabilities on our balance sheet as of December 31, 2010.

We have determined that the majority of the inputs used to value our foreign currency forward contracts fall within Level 2 of the fair value hierarchy, found under ASC Topic 820.1. The credit valuation adjustments, such as estimates of current credit spreads to evaluate the likelihood of default by ourselves and our counterparties are Level 3 inputs. However, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our foreign currency forward contracts and determined that the credit valuation adjustments are not significant to the overall valuation. As a result, we have determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this report on

Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures were designed and were effective to give reasonable assurance that information we disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure and that such information is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

Changes in Internal Controls Over Financial Reporting

We have made no changes in our internal controls over financial reporting during the quarter ended October 2, 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION.

ITEM 1. LEGAL PROCEEDINGS.

Asbestos and Bankruptcy Litigation

Background

On July 12, 2010 (the Filing Date), our subsidiary Leslie Controls, Inc. (Leslie) filed a voluntary petition (the Bankruptcy Filing) under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware and, simultaneously, filed a pre-negotiated plan of reorganization (as amended, the Reorganization Plan or Plan) in an effort to permanently resolve Leslie s exposure to asbestos-related product liability actions. On February 7, 2011, the U.S. Federal District Court for the District of Delaware (the District Court) affirmed the Bankruptcy Court s earlier order confirming Leslie s Reorganization Plan, thus clearing the way for Leslie to emerge from bankruptcy. On April 28, 2011, pursuant to the terms of the Reorganization Plan, Leslie and CIRCOR contributed $76.6 million in cash and a $1 million promissory note (the Note) to fund the Leslie Controls Asbestos Trust (the Trust), and Leslie emerged from Chapter 11 bankruptcy protection. Under the terms of the Plan, all current and future asbestos related claims against Leslie, as well as all current and future derivative claims against CIRCOR, will now be permanently channeled to the Trust, and the only remaining financial obligation of Leslie and CIRCOR is payment of the Note. On September 30, 2011, the District Court entered an order for the final decree closing the Chapter 11 case. For a more detailed historical perspective on Leslie s asbestos related litigation and associated pre-bankruptcy liability accounting, see Item 3. Legal Proceedings in our Annual Report on Form 10-K for the Fiscal Year ended December 31, 2010.

Accounting Indemnity and Defense Cost Liabilities and Assets

During 2010, as a result of Leslie s Bankruptcy Filing and Reorganization Plan, we accrued liabilities based on the terms of the Reorganization Plan. As of December 31, 2010, we therefore recorded net Leslie asbestos and bankruptcy liabilities for resolution of pending and future claims of $79.8 million (all classified as a current liability). As of October 2, 2011, the net liability decreased significantly with the funding of the Trust on April 28, 2011. A summary of Leslie s accrued liabilities, including contributions to the Trust under the Reorganization Plan for existing and future asbestos claims as well as incurred but unpaid asbestos defense cost liabilities and the related insurance recoveries, is provided below.

In Thousands	October 2, 2011	December 31, 2010
Existing claim indemnity liability	$ 0	$ 64
Amounts payable to 524(g) trust	1,000	77,625
Incurred defense cost liability	200	2,142
Insurance recoveries receivable	0	(38)
Net Leslie asbestos and bankruptcy liability	$ 1,200	$ 79,793

2011 and 2010 Experience and Financial Statement Impact

The following table provides information regarding the pre-tax Leslie asbestos and bankruptcy related costs (recoveries) for the three and nine months ended October 2, 2011. The $0.2 million recovery for the three month period ended October 2, 2011 is the result of lower actual defense related expenses partially offset by additional bankruptcy related costs incurred for the three month period ended October 2, 2011 compared to amounts previously estimated.

	Three Months Ended		Nine Months Ended	
In Thousands	October 2, 2011	October 3, 2010	October 2, 2011	October 3, 2010
Indemnity costs accrued (cases filed)	$ 0	$ 0	$ 0	$ 2,496
Adverse verdict appealed	0	0	0	(2,390)
Defense (recoveries) cost incurred	(306)	16	(306)	7,182
Insurance recoveries adjustment	0	0	0	(3,652)
Insurance recoveries accrued	0	0	0	(2,626)
Bankruptcy related costs	105	2,327	982	29,593
Net pre-tax Leslie asbestos and bankruptcy (recoveries) charges	$ (201)	$ 2,343	$ 676	$ 30,603

Other Matters

Smaller numbers of asbestos-related claims have also been filed against two of our other subsidiaries Spence, the stock of which we acquired in 1984; and Hoke, the stock of which we acquired in 1998. Due to the nature of the products supplied by these entities, the markets they serve and our historical experience in resolving these claims, we do not believe that asbestos-related claims will have a material adverse effect on the financial condition, results of operations or liquidity of Spence or Hoke, or the financial condition, consolidated results of operations or liquidity of the Company.

During the third quarter of 2011, we commenced arbitration proceedings against T.M.W. Corporation (TMW), the seller from which we acquired the assets of Castle Precision Industries in August 2010, seeking to recover damages from TMW for breaches of certain representations and warranties made by TMW in the Asset Purchase Agreement.

ITEM 1A. RISK FACTORS.

We have not identified any material changes from the risk factors as previously disclosed in Item 1A. to Part I of our Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

Working Capital Restrictions and Limitations upon Payment of Dividends

Certain of our loan agreements contain covenants that require, among other items, maintenance of certain financial ratios and also limit our ability to: enter into secured and unsecured borrowing arrangements; issue dividends to shareholders; acquire and dispose of businesses; invest in capital equipment; transfer assets among domestic and international entities; participate in certain higher yielding long-term investment vehicles; and issue additional shares of our stock. The two primary financial covenants are leverage ratio and interest coverage ratio. We were in compliance with all covenants related to our existing debt obligations at October 2, 2011 and December 31, 2010. We believe it is reasonably likely that we will continue to meet such covenants in the near future.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. (REMOVED AND RESERVED).

ITEM 5. OTHER INFORMATION.

None.

Table of Contents

ITEM 6. EXHIBITS.

Exhibit No.	Description and Location
2	Plan of Acquisition, Reorganization, Arrangement, Liquidation or Succession:
2.1	Distribution Agreement by and between Watts Industries, Inc. and CIRCOR International, Inc., dated as of October 1, 1999, is incorporated herein by reference to Exhibit 2.1 to Amendment No. 2 to CIRCOR International, Inc. s Registration Statement on Form 10-12B, File No. 000-26961, filed with the Securities and Exchange Commission on October 6, 1999.
3	Articles of Incorporation and By-Laws:
3.1	Amended and Restated Certificate of Incorporation of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.1 to CIRCOR International, Inc. s Form 10-Q, File No. 001-14962, filed with the Securities and Exchange Commission on October 29, 2009.
3.2	Amended and Restated By-Laws of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.2 to CIRCOR International, Inc. s Form 10-K, File No. 001-14962, filed with the Securities and Exchange Commission on February 26, 2009.
3.3	Certificate of Amendment to the Amended and Restated Bylaws of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.3 to CIRCOR International, Inc. s Form 10-K, File No. 001-14962, filed with the Securities and Exchange Commission on February 26, 2009.
3.4	Amended and Restated Certificate of Designations of Series A Junior Participating Cumulative Preferred Stock of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.4 to CIRCOR International, Inc. s Form 10-Q, File No. 001-14962, filed with the Securities and Exchange Commission on October 29, 2009.
4	Instruments Defining the Rights of Security Holders, Including Indentures:
4.1	Shareholder Rights Agreement, dated as of September 23, 2009, between CIRCOR International, Inc. and American Stock Transfer & Trust Company LLC, is incorporated herein by reference to Exhibit 4.1 to CIRCOR International, Inc. s Form 8-A, File No. 001-14962, filed with the Securities and Exchange Commission on September 28, 2009.
4.2	Specimen certificate representing the Common Stock of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 4.1 to Amendment No. 1 to CIRCOR International, Inc. s Registration Statement on Form 10-12B, File No. 000-26961, filed with the Securities and Exchange Commission on September 22, 1999.
10	Material Contracts:
10.1*	Executive Change of Control Agreement between CIRCOR, Inc. and Michael Dill, dated August 2, 2011.
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101§	The following financial statements from Circor International, Inc. s Quarterly Report on Form 10-Q for the quarter ended October 2, 2011, as filed with the SEC on November 3, 2011, formatted in XBRL (eXtensible Business Reporting Language), as follows:
	(i) Consolidated Balance Sheets as of October 2, 2011 (unaudited) and December 31, 2010
	(ii) Consolidated Statement of Operations for the Three and Nine Months Ended October 2, 2011 and October 3, 2010 (Unaudited)
	(iii) Consolidated Statements of Cash Flows for the Nine Months Ended October 2, 2011 and October 3, 2010 (Unaudited)
	(iv) Notes to Consolidated Financial Statements (Unaudited)

* Filed with this report.

** Furnished with this report.

Table of Contents

Indicates management contract or compensatory plan or arrangement.

§ As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

30

Table of Contents

SIGNATURES

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

CIRCOR INTERNATIONAL, INC.

Date: November 3, 2011	**/s/ A. William Higgins** **A. William Higgins** **President and Chief Executive Officer** ***Principal Executive Officer***
Date: November 3, 2011	**/s/ Frederic M. Burditt** **Frederic M. Burditt** **Vice President, Chief Financial Officer and Treasurer** ***Principal Financial Officer***
Date: November 3, 2011	**/s/ John F. Kober** **John F. Kober** **Vice President, Corporate Controller** ***Principal Accounting Officer***

;text-indent:-9pt;"> Interest and fees on loans $67,459,499 $68,224,654 $61,798,938

Interest on federal funds sold

56,121 298,233 191,342

Interest and dividends on securities:

Taxable

5,118,353 5,285,770 4,093,326

Non-taxable

1,516,705 1,235,727 1,130,512

Interest-bearing deposits

375,996 148,466 91,772

TOTAL INTEREST INCOME

74,526,674 75,192,850 67,305,890

INTEREST EXPENSE:

Time deposits of $100,000 or more

11,735,000 11,984,295 8,569,185

Other time and savings deposits

18,526,120 19,008,193 15,277,302

Borrowed funds

4,275,134 2,308,248 2,582,857

TOTAL INTEREST EXPENSE

34,536,254 33,300,736 26,429,344

NET INTEREST INCOME

39,990,420
41,892,114
40,876,546

PROVISION FOR LOAN LOSSES

11,109,183
2,488,620
2,165,000

NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES

28,881,237
39,403,494
38,711,546

NON-INTEREST INCOME:

Service charges on deposit accounts

4,394,241 3,945,533 3,758,369

Other service fees

3,378,058 3,560,456 3,400,043

Net gain on sales of mortgage loans

7,679,275 5,882,495 6,025,837

Net gain (loss) on sales of investment securities

(26) 45,418 (85,596)

Impairment losses on investments

(1,015,694)

Income on investment in bank-owned life insurance

927,534 1,045,482 698,434

Mortgage banking income

189,976 451,287 257,185

Bank owned life insurance death benefits

563,907

Other income (loss)

(52,220) (50,419) 290,886

TOTAL NON-INTEREST INCOME

15,501,144 15,444,159 14,345,158

NON-INTEREST EXPENSES:

Salaries and employee benefits

19,920,421 19,160,711 18,693,212

Occupancy and equipment expenses

4,701,158 3,916,852 3,900,516

Printing and supplies

889,417 550,386 591,200

Data processing

786,312 398,961 418,056

Amortization of core deposit intangible

876,978 776,594 813,117

Communications expense

1,034,871 1,127,422 1,031,131

Advertising expense	1,299,018	550,048	496,248
Other expense	9,766,175	6,478,129	6,149,367
TOTAL NON-INTEREST EXPENSES	39,274,350	32,959,103	32,092,847
INCOME BEFORE INCOME TAXES	5,108,031	21,888,550	20,963,856
INCOME TAXES	1,241,403	7,200,818	7,171,959
NET INCOME	$3,866,628	$14,687,732	$13,791,897
INCOME PER COMMON SHARE:			
Basic	$0.34	$1.39	$1.30
Diluted	$0.34	$1.37	$1.28
CASH DIVIDENDS PER COMMON SHARE	$0.52	$0.51	$0.47

See notes to consolidated financial statements.

YADKIN VALLEY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
NET INCOME	$ 3,866,628	$ 14,687,733	$ 13,791,897
OTHER COMPREHENSIVE INCOME:			
Unrealized holding gains on securities available for sale	1,220,373	1,847,241	619,218
Tax effect	(470,318)	(716,070)	(238,419)
Unrealized holding gains on securities available for sale, net of tax amount	750,055	1,131,171	380,799
Reclassification adjustment for realized (gains) losses	26	(45,418)	85,596
Reclassification adjustment for impairment losses	1,015,694		
Tax effect	(391,052)	17,485	(32,955)
Reclassification adjustment for realized (gains) losses, net of tax amount	624,668	(27,933)	52,641
OTHER COMPREHENSIVE INCOME, NET OF TAX	1,374,723	1,103,238	433,440
COMPREHENSIVE INCOME	$ 5,241,351	$ 15,790,971	$ 14,225,337

See notes to consolidated financial statements.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2008, 2007 and 2006

	Common Stock				Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Amount	Surplus	Retained earnings		
BALANCE, JANUARY 1, 2006	10,680,061	10,680,061	71,993,212	34,554,032	(904,408)	116,322,897
Net income				13,791,897		13,791,897
Shares issued under stock option plan	18,111	18,111	150,804			168,915
Cash dividends declared				(4,997,731)		(4,997,731)
Shares repurchased	(87,085)	(87,085)	(992,425)	(240,810)		(1,320,320)
Fractional shares retired	(35)	(35)	35	43		43
Other comprehensive income					433,440	433,440
BALANCE, DECEMBER 31, 2006	10,611,052	10,611,052	71,151,626	43,107,431	(470,968)	124,399,141
Net income				14,687,732		14,687,732
Shares issued under stock option plan	72,076	72,076	495,306			567,382
Stock option compensation			69,165			69,165
Cash dividends declared				(5,400,775)		(5,400,775)
Shares repurchased	(119,772)	(119,772)	(729,413)	(1,307,704)		(2,156,889)
Other comprehensive income					1,103,238	1,103,238
BALANCE, DECEMBER 31, 2007	10,563,356	10,563,356	70,986,684	51,086,684	632,270	133,268,994
Cumulative effect of adoption of new accounting standard (Note 1)				(897,253)		(897,253)
Net income				3,866,628		3,866,628
Shares issued under stock option plan	89,455	89,455	533,308			622,763
Stock option compensation			66,787			66,787
Tax benefit from exercise of stock options			252,250			252,250
Cash dividends declared				(5,985,711)		(5,985,711)
Fractional shares retired	(58)	(58)	2			(56)
Shares issued in acquisition of Cardinal State Bank	883,747	883,747	16,191,450			17,075,197
Other comprehensive income					1,374,723	1,374,723
BALANCE, DECEMBER 31, 2008	11,536,500	$ 11,536,500	$ 88,030,481	$ 48,070,348	$ 2,006,993	$ 149,644,322

See notes to consolidated financial statements.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 3,866,628	$ 14,687,732	$ 13,791,897
Adjustments to reconcile net income to net cash provided by operating activities:			
Net amortization of premiums on investment securities	(52,215)	49,684	368,979
Provision for loan losses	11,109,183	2,488,620	2,165,000
Net gain on sales of mortgage loans	(7,679,275)	(5,882,495)	(6,025,837)
Impairment loss on available-for-sale securities	1,015,694		
Net (gain) loss on sale of available-for-sale securities	26	(45,418)	85,596
Increase in cash surrender value of life insurance	(927,534)	(1,045,482)	(698,434)
Gain on bank-owned life insurance		(563,907)	
Depreciation and amortization	2,012,514	1,854,608	1,948,901
(Gain) loss on sale of premises and equipment	49,628	(66,680)	50,299
Net loss on sale of other real estate owned	363,353	286,730	
Amortization of core deposit intangible	876,978	776,594	813,117
Deferred tax (benefit) provision	(3,291,615)	(1,196,351)	(958,870)
Stock based compensation expense	66,787	69,165	13,622
Originations of mortgage loans held-for-sale	(1,045,770,325)	(908,549,045)	(865,992,983)
Proceeds from sales of mortgage loans	1,056,274,132	904,028,548	861,094,634
(Increase) decrease in accrued interest receivable	1,247,846	(258,532)	(993,560)
Increase in other assets	(4,499,999)	(1,850,926)	(292,041)
Increase (decrease) in accrued interest payable	(481,729)	459,735	1,159,292
Increase in other liabilities	140,089	54,398	442,293
NET CASH PROVIDED BY OPERATING ACTIVITIES	14,320,166	5,296,978	6,971,905
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of available-for-sale securities	(33,672,373)	(55,248,915)	(50,674,494)
Proceeds from sales of available-for-sale securities	15,497,926	35,648,265	15,180,679
Proceeds from maturities of available-for-sale securities	24,624,095	6,435,000	21,940,000
Net increase in loans	(140,095,518)	(86,070,781)	(78,189,581)
Acquisition of Sidus Financial, LLC, net of cash received			(560,717)
Acquisition of Cardinal State Bank, net of cash paid	11,979,969		
Purchases of premises and equipment	(3,156,863)	(3,064,340)	(1,753,356)
Purchase of Federal Home Loan Bank stock	(7,923,100)		(3,213,700)
Proceeds from redemption of Federal Home Loan Bank stock	3,154,800	1,075,300	3,879,100
Proceeds from sales of premises and equipment	287,536	1,594,943	28,791
Proceeds from the sale of foreclosed real estate	1,143,543	1,041,246	
Proceeds from bank-owned life insurance	2,561	1,723,618	
Investment in bank-owned life insurance			(5,500,000)
NET CASH USED IN INVESTING ACTIVITIES	(128,157,424)	(96,865,664)	(98,863,278)

A-71

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase (decrease) in checking, NOW, money market and savings accounts	$ (16,399,722)	$ 3,024,078	$ (2,491,140)
Net increase in time certificates	36,419,283	52,571,106	95,985,451
Net increase (decrease) in borrowed funds	98,625,114	25,136,532	(6,927,114)
Purchases of common stock		(2,156,889)	(1,320,320)
Dividends paid	(5,985,711)	(5,303,782)	(4,997,731)
Tax benefit from exercise of stock options	252,250		35,914
Retired fractional shares	(56)		43
Proceeds from exercise of stock options	622,763	567,382	168,915
NET CASH PROVIDED BY FINANCING ACTIVITIES	113,533,921	73,838,427	80,454,018
NET DECREASE IN CASH AND CASH EQUIVALENTS	(303,337)	(17,730,259)	(11,437,355)
CASH AND CASH EQUIVALENTS:			
Beginning of year	26,325,875	44,056,134	55,493,489
End of year	$ 26,022,538	$ 26,325,875	$ 44,056,134
SUPPLEMENTARY CASH FLOW INFORMATION:			
Cash paid for interest	$ 34,416,564	$ 32,832,851	$ 25,270,052
Cash paid for income taxes	$ 4,865,264	$ 8,386,742	$ 9,322,595
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Transfer from loans to foreclosed real estate	$ 3,916,919	$ 1,355,631	$ 868,171
Unrealized gain (loss) on investment securities available for sale, net	$ 1,374,723	$ 1,103,328	$ 443,440
Issuance of shares in acquisition of Cardinal	$ 16,792,390		

See notes to consolidated financial statements.

A-72

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2008, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization Yadkin Valley Financial Corporation (the "Company") was formed July 1, 2006 as a holding company for Yadkin Valley Bank and Trust Company (the "Bank"). The Bank has three wholly owned subsidiaries, Main Street Investment Services, Inc., which provides investment services to the Company's customers, Sidus Financial LLC, which provides mortgage brokerage services throughout North Carolina and surrounding states, and PBRE, Inc. PBRE, Inc. is a shell company that serves as a trustee on real estate loans. The Bank's state charter was incorporated in North Carolina on September 16, 1968, and the Bank is a member of the Federal Deposit Insurance Corporation ("FDIC"). As a result, the Bank is regulated by the state and the FDIC. The Bank is also a member of the Federal Home Loan Bank of Atlanta. The Company is headquartered in Elkin, North Carolina and the Bank provides consumer and commercial banking services in northwestern North Carolina through 29 full-service banking offices. Sidus offers mortgage-banking services to its customers in North Carolina, South Carolina, Virginia, Georgia, Maryland, Alabama, Florida, Kentucky, Louisiana, West Virginia, Delaware, Mississippi, Arkansas, Tennessee, Pennsylvania, Vermont, New Hampshire, Rhode Island, Maine, Massachusetts and Connecticut. The Company and its subsidiaries are collectively referred to herein as the "Company." Yadkin Valley Financial Corporation formed Yadkin Valley Statutory Trust I (the "Trust") during November 2007 in order to facilitate the issuance of trust preferred securities. The Trust is a statutory business trust formed under the laws of the state of Delaware. All of the common securities of the Trust are owned by Yadkin Valley Financial Corporation. On March 31, 2008, Yadkin Valley Bank acquired Cardinal State Bank ("Cardinal"), headquartered in Durham, NC (refer to Note 2). Cardinal stockholders received $17.62 per share in a total transaction value of approximately $41.7 million.

Basis of Presentation The consolidated financial statements include the accounts of Yadkin Valley Financial Corporation and its wholly owned subsidiary, Yadkin Valley Bank and Trust Company. Yadkin Valley Bank and Trust Company includes its wholly owned subsidiaries, Main Street Investment Services, Inc., PBRE, Inc. and Sidus Financial, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation. The investment in Yadkin Valley Statutory Trust I, in accordance with FIN 46R, has been recorded by the Company in other assets with the corresponding increase to long-term debt. The Company records the income from the trust as a noninterest income item and the expense as additional interest expense.

Cash and Cash Equivalents Cash and cash equivalents include cash on hand, amounts due from banks, interest bearing deposits, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Investment Securities Debt securities that the Bank has the positive intent and ability to hold to maturity are classified as "held to maturity" securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling in the near term are classified as "trading" securities and reported at fair value with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held to maturity or trading securities are classified as "available for sale" securities and reported at fair value with unrealized gains and losses excluded from earnings and reported, net of related tax effects, as a separate component of equity and as an item of 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 result in write-downs of the

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

individual securities to their fair value. The related write-downs are included in earnings as realized losses. Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Transfers of securities between classifications are accounted for at fair value. All securities held at December 31, 2008 and 2007 are classified as available for sale.

Loans and Allowance for Loan Losses Loans that management has the intent and ability to hold for the foreseeable future are stated at their outstanding principal balances adjusted for any deferred fees and costs. Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Loan origination and other fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Loans that are deemed to be impaired (i.e. probable that the Bank will be unable to collect all amounts due according to the existing loan repayment terms) are measured based on fair value of the collateral if the loan is collateral dependent, the carrying value of the loan or, alternatively, probable cash flows. A specific reserve is established as part of the allowance for loan losses to record the difference between the stated principal amount and the present value or market value of the impaired loan. Impaired loans may be valued on a loan-by-loan basis (e.g., loans with risk characteristics unique to an individual borrower). The company discontinues the accrual of interest income when the loans are either at least 90 days past due or less than 90 days past due but the collectability of such interest and principal becomes doubtful. Interest on nonaccrual loans is accounted for on the cash-basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all principle and interest amounts contractually due are brought current, the loan has performed for six months, and future payments are probable. The Bank may continue to identify such loans for a short term period and other loans as impaired for various reasons, even though performance is probable. The total of the impaired loans, impaired loans on non-accrual basis, the related allowance for loan losses and interest income recognized on impaired loans is disclosed in Note 5.

The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb potential losses in the portfolio resulting from events that occurred as of the balance sheet date. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, current economic conditions, historical loan loss experience and other risk factors. Recovery of the carrying value of loans is dependent to some extent on future economic, operating and other conditions that may be beyond the control of the Bank. Unanticipated future adverse changes in such conditions could result in material adjustments to the allowance for loan losses. In addition, regulatory examiners may require the 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 Held for Sale Loans held for sale primarily consist of one to four family residential loans originated for sale in the secondary market and are carried at the lower of cost or fair value determined on an aggregate basis. Gains and losses on sales of loans held for sale are included in other income in the consolidated statements of income. Gains and losses on loan sales are determined by the difference between the selling price and the carrying value of the loans sold.

Foreclosed Real Estate Foreclosed real estate is stated at the lower of carrying amount or fair value less estimated cost to sell. Any initial losses at the time of foreclosure are charged against the

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

allowance for loan losses with any subsequent losses or write-downs included in the consolidated statements of income as a component of other expenses.

Business Combinations The Company accounts for all business combinations by the purchase method of accounting whereby acquired assets and liabilities are recorded at fair value on the date of acquisition with the remainder of the purchase price allocated to identified intangible assets and goodwill.

Mortgage Banking Activities When the Bank retains the right to service a sold mortgage loan, the previous book-carrying amount is allocated between the loan sold and the retained mortgage servicing right based on their relative fair values on the date of transfer. The Bank adopted Statement of Financial Accounting Standards 156, "Accounting for Servicing of Financial Assets" in the first quarter of 2007 using the fair value method.

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Mortgage servicing rights are carried at fair value.

At December 31, 2008, 2007 and 2006, the Bank was servicing loans for others of approximately $184,603,881, $207,072,346 and $231,189,795, respectively. The Bank carries fidelity bond insurance coverage of $8,000,000 and errors and omissions insurance coverage of $1,000,000 per occurrence. Custodial escrow balances maintained in connection with the loan servicing were $86,881 and $77,946 at December 31, 2008 and 2007, respectively Mortgage servicing rights with a fair value of $1,745,466 and $2,000,770 at December 31, 2008 and 2007, respectively, are included in other assets. Amortization/market value adjustments related to mortgage servicing rights were $384,062, $120,532 and $343,420 for 2008, 2007 and 2006, respectively and recorded with the mortgage banking income. A valuation of the fair value of the mortgage servicing rights is performed using a pooling methodology. Similar loans are "pooled" together and evaluated on a discounted earnings basis to determine the present value of future earnings. The present value of future earnings is the estimated market value for the pool, calculated using consensus assumptions that a third party purchaser would utilize in evaluating potential acquisition of the servicing.

Premises and Equipment Premises and equipment are stated at cost less accumulated depreciation and amortization. Additions and major replacements or betterments, which extend the useful lives of premises and equipment, are capitalized. Maintenance, repairs and minor improvements are expensed as incurred. Depreciation and amortization is provided based on the estimated useful lives of the assets using both straight-line and accelerated methods. The estimated useful lives for computing depreciation and amortization are 10 years for land improvements, 30 to 40 years for buildings, and 3 to 10 years for furniture and equipment. Gains or losses on dispositions of premises and equipment are reflected in income.

The Company reviews long-lived 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.

Goodwill and Other Intangibles Goodwill represents the excess of the cost of an acquisition in a business combination over the fair value of the net assets acquired. The company allocates goodwill to

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

the segment that receives significant benefits from the acquisition. Other intangible assets represent purchased intangible assets that can be separately distinguished from goodwill. Goodwill is not amortized but is tested for impairment annually, or more frequently if events or circumstances indicate possible impairment. The goodwill impairment analysis is a two step test. The first step requires comparing each reporting segment's estimated fair value to its carrying value, including goodwill. Goodwill is not impaired if the estimated fair value of the segment exceeds its carrying value.If the first step indicates an impairment then step two is performed. Step two requires calculation of the implied fair value of goodwill, which involves aggregating the fair values of the individual assets, liabilities and identifiable intangibles as if the segment was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the segment, no impairment is recorded. An impairment loss cannot exceed the carrying value of goodwill. Reversal of impairment charges of goodwill is not permitted. No impairment was identified as a result of the testing performed during 2008 and 2007. The purchase of Cardinal added $20.8 million to Goodwill in 2008 as detailed in Note 2. Intangible assets with finite lives include core deposits. Intangible assets are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Core deposit intangibles are amortized on the sum-of-years digits method (intangibles acquired in 2002) and the straight-line method (intangibles acquired in 2004) over a period not to exceed 20 years.

The Company's stock price has historically traded above its book value and was trading above its book value and tangible book value as of December 31, 2008. The Company tests its reporting segements annually: Yadkin Valley Bank on April 30, and Sidus Financial on October 1.Should the Company determine in the future that the goodwill recorded in connection with these business segments were impaired, it would result in a charge against earnings in the period that the determination was made.

The Bank's projected amortization expense for the core deposit intangible for the years ending December 31, 2009, 2010, 2011, 2012 and 2013 is $863,451, $798,128, 744,170, $704,676, and $229,170, respectively. The weighted average amortization period is 8.0 years.

Income Taxes Provisions for income taxes are based on amounts reported in the statements of income and include changes in deferred taxes. Deferred taxes are computed using the asset and liability approach. The tax effects of differences between the tax and financial accounting basis of assets and liabilities are reflected in the balance sheets at the tax rates expected to be in effect when the differences reverse.

Net Income Per Common Share Basic net income per common share is calculated on the basis of the weighted average number of shares outstanding. Potential common stock arising from stock options outstanding are included in diluted net income per common share.

Stock Based Compensation The Company's policy 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) under SFAS Mo. 123(R.) "Share Based Payment". SFAS No. 123(R) 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.The Company is required to record compensation expense for all

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

awards granted after the date of adoption (effective January 1, 2006) 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.

Non-marketable equity securities As a requirement for membership, the Bank invests in stock of Federal Home Loan Bank of Atlanta ("FHLB"), and Silverton Bank, formerly Bankers Bank. Due to the redemption provisions of the FHLB and Silverton Bank, the Bank estimated that fair value of the stocks equal their respective costs and that these investments were not impaired at December 31, 2008. In addition, the Company holds equity investments in several other entities. These investments are discussed further in Note 4.

Comprehensive Income (Loss) SFAS No. 130, "Reporting Comprehensive Income" describes comprehensive income as the total of all components of comprehensive income including net income. Other comprehensive income refers to revenues, expenses, gains and losses that under U.S. generally accepted accounting principles are included in comprehensive income but excluded from net income. Currently, the company's other comprehensive income consists of unrealized gains and losses, net of deferred income taxes, on available-for-sale securities.

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 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. Such estimates include, for example, the allowance for loan losses, valuation of certain level 2 and level 3 investment securities, evaluation of securities for other than temporary impairment and goodwill testing impairment. Actual results could differ from those estimates.

New Accounting Standards

Fair Value Measurement

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities" (SFAS No. 159). SFAS No. 159 allows an entity to elect to measure certain financial assets and liabilities at fair value with changes in fair value recognized in the income statement each period. The statement also requires additional disclosures to identify the effects of an entity's fair value election on its earnings. The Company did not elect the fair value option as of January 1, 2008 for any of its financial assets or financial liabilities and, accordingly, the adoption of the statement did not have a material impact on the Company's consolidated financial statements.

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," (SFAS 157), which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. The Company elected to delay the application of SFAS 157 to nonfinancial assets and nonfinancial liabilities, as allowed by FASB Staff Position SFAS 157-2. In

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," ("FSP 157-3"). FSP 157-3 clarifies the application of SFAS No. 157 in determining the fair value of a financial asset during periods of inactive markets. FSP 157-3 was effective as of September 30, 2008 and did not have a material impact on the Company's consolidated financial statements. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value and, therefore, does not expand the use of fair value in any new circumstances. Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 clarifies that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. SFAS 157 requires fair value measurements to be separately disclosed by level within the fair value hierarchy. For assets and liabilities recorded at fair value, it is the Company's policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy in SFAS 157. Fair value measurements for assets and liabilities where there exists limited or no observable market data and, therefore, are based primarily upon estimates, are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, the Company believes there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values. See note 16 for SFAS 157 disclosures.

Recently Adopted Accounting Standards

In November 2007, the SEC issued Staff Accounting Bulletin (SAB) No. 109, which addresses the valuation of written loan commitments accounted for at fair value through earnings. The guidance in SAB No. 109 expresses the staff's view that the measurement of fair value for a written loan commitment accounted for at fair value through earnings should incorporate the expected net future cash flows related to the associated servicing of the loan. Previously, under SAB No. 105, Application of Accounting Principles to Loan Commitments, this component of value was not incorporated into the fair value of the loan commitment. The Company adopted the provisions of SAB 109 for written loan commitments entered into or modified after December 31, 2007 related to residential loans held for sale that are accounted for as derivatives under SFAS 133. The Company does not account for any other written loan commitments at fair value through earnings. The impact of adopting SAB 109 to noninterest income and total assets for the twelve-month period ended December 31, 2008 was an increase of $290,069 to accelerate the recognition of the estimated fair value of the servicing inherent in the loan to the commitment date.

New Accounting Standards

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations". SFAS No. 141(R) will significantly change how entities apply the acquisition method to business

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

combinations. The most significant changes affecting how the Company will account for business combinations under this Statement include: the date on which consideration paid is measured will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS No. 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, non-controlling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. Since the merger with Amercian Community Bancshares did not occur prior to December 31, 2008, the acquisition will be accounted for under SFAS No. 141(R), and the Company's financial statements will be materially impacted by the adoption of this standard on January 1, 2009. At December 31, 2008 the Company had deferred $454,000 in merger related expenses included in other assets.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities' (Statement 161). Statement 161 requires enhanced disclosures about how and why derivative instruments are used, how derivative instruments and related hedged items are accounted for under Statement 133 and how derivative instruments and related hedged items affect the balance sheet, income statement and statement of cash flows. Staement 161 is effective for the Company on January 1, 2009, will result in expanded disclosures, but will not have a material impact on financial condition, results of operations or liquidity.

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 Corporation and monitors the status of changes to and proposed effective dates of exposure drafts.

Reclassifications Advertising expenses have been reclassified to conform to the 2008 presentation. The reclassifications had no effect on net income or stockholders' equity, as previously reported.

2. BUSINESS COMBINATION

At opening of business on March 31, 2008, the Company completed the merger with Cardinal State Bank ("Cardinal"), headquartered in Durham, NC. Cardinal had $193.9 million in tangible assets, excluding fair value adjustments, but including $149.2 million in gross loans and $18.1 million in tangible equity at the closing date. Pursuant to the agreement, for each share of Cardinal stock, Cardinal shareholders received either $17.62 in cash or 0.91771 shares of Company stock, subject to an

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

2. BUSINESS COMBINATION (Continued)

overall allocation of 58% cash and 42% stock. The overall acquisition cost was approximately $41.7 million based on the issuance of 0.9 million shares of Company stock at a two-week average stock price of $19.00 around the date of the merger agreement, cash payment of $23.5 million to Cardinal shareholders, and $1.5 million in other transaction costs. Other transaction costs included $0.3 million for the fair market value of Cardinal stock options assumed by the Company and converted into 140,277 options to buy shares of Company stock.

The purchase price was allocated to the net assets acquired at fair value, as follows:

	Fair Value
Assets:	
Cash and cash equivalents	$ 18,028,591
Federal funds sold	18,047,000
Loans, net	149,947,952
Premises and equipment, net	6,312,841
Other assets acquired	4,955,928
Goodwill	20,805,986
Core deposit intangible	1,275,979
Liabilities:	
Deposits	(170,689,695)
Other liabilities	(6,945,466)
Total net assets acquired/consideration given	$ 41,739,116

Results of operations of Cardinal, subsequent to March 30, 2008, are included in the Company's results of operations for the twelve months ended December 31, 2008. The unaudited proforma combined present and historical results, as if Cardinal had been acquired at January 1, 2007 and January 1, 2008 after adjustments for amortization of intangibles are presented below:

	Twelve Months Ended	
	December 31, 2007	December 31, 2008
Net interest income	$ 48,156,208	$ 41,312,536
Noninterest income	15,966,159	15,626,778
Total revenue	64,122,367	56,939,314
Provision for loan losses	2,711,620	11,074,183
Other noninterest expense	40,275,500	40,769,607
Income before taxes	21,135,247	5,095,524
Income tax expense	5,161,818	1,237,151
Net income	$ 15,973,429	$ 3,858,373
Basic earnings per share	$ 1.39	$ 0.34
Diluted earnings per share	$ 1.37	$ 0.34

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

2. BUSINESS COMBINATION (Continued)

The proforma results are not necessarily indicative of what actually would have occurred if the acquisition had been completed as of the beginning of each fiscal period presented, nor are they necessarily indicative of future consolidated results.

On September 10, 2008, the Company announced that it had entered into a definitive agreement whereby the Company would acquire American Community Bancshares, Inc., and its subsidiary, American Community Bank, in a transaction with a total value of approximately $92 million. American Community Bancshares shareholders will have the right to receive either $12.35 in cash or .8517 of the Company's shares of common stock for each American Community share, subject to the limitations that 19.5% of total consideration is to be paid in cash and 80.5% in Yadkin Valley Financial shares. Those American Community shares exchanged for stock will convert to Yadkin Valley Financial shares in a tax-free exchange. Cash will also be paid in lieu of fractional shares. Closing of the transaction, which is expected to occur during the second quarter of 2009, is subject to certain conditions, including approval by Yadkin Valley shareholders and American Community shareholders.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

3. INVESTMENT SECURITIES

Investment securities at December 31, 2008 and 2007 are summarized as follows:

	2008			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale, securities:				
Securities of other U.S. government agencies due:				
Within 1 year	$ 3,998,265	$ 59,235	$	$ 4,057,500
After 1 but within 5 years	26,892,399	865,391		27,757,790
After 5 but within 10 years	10,976,867	858,320		11,835,187
	41,867,531	1,782,946		43,650,477
Mortgage-backed securities due:				
Within 1 year	1,011,391	3,825	2	1,015,214
After 1 but within 5 years	2,169,311	5,814	7,597	2,167,528
After 5 but within 10 years	2,994,894	105,554		3,100,448
After 10 years	45,717,258	1,449,631	386,975	46,779,914
	51,892,854	1,564,824	394,574	53,063,104
State and municipal securities due:				
Within 1 year	1,325,459	7,922		1,333,381
After 1 but within 5 years	16,615,757	450,157	3,427	17,062,487
After 5 but within 10 years	9,777,202	201,711	42,335	9,936,578
After 10 years	13,013,444	53,169	321,722	12,744,891
	40,731,862	712,959	367,484	41,077,337
Other securities due:				
Within 1 year	1,171			1,171
After 10 years	39,924	4	18,488	21,440
	41,095	4	18,488	22,611
Total available-for-sale securities	$ 134,533,342	$ 4,060,733	$ 780,546	$ 137,813,529

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

3. INVESTMENT SECURITIES (Continued)

	2007			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale, securities:				
Securities of other U.S. government agencies due:				
Within 1 year	$ 18,994,000	$ 16,356	$ 18,793	$ 18,991,563
After 1 but within 5 years	24,512,338	557,037		25,069,375
After 5 but within 10 years	4,001,057	107,693		4,108,750
	47,507,395	681,086	18,793	48,169,688
U.S. Treasury securities due:				
After 1 but within 5 years	2,996,159	40,873		3,037,032
	2,996,159	40,873		3,037,032
Mortgage-backed securities due:				
Within 1 year	24,915	77		24,992
After 1 but within 5 years	3,823,586	2,206	39,633	3,786,159
After 5 but within 10 years	1,755,533	7,123	24,535	1,738,121
After 10 years	45,440,070	523,584	114,789	45,848,865
	51,044,104	532,990	178,957	51,398,137
State and municipal securities due:				
Within 1 year	1,753,611	4,330	572	1,757,369
After 1 but within 5 years	14,582,621	250,971	44,579	14,789,013
After 5 but within 10 years	9,711,166	128,557	63,606	9,776,117
After 10 years	11,904,178	45,532	123,641	11,826,069
	37,951,576	429,390	232,398	38,148,568
Other securities due:				
Within 1 year	1,143			1,143
After 1 but within 5 years	883,627		3,893	879,734
After 10 years	1,055,622	8,476	214,680	849,418
	1,940,392	8,476	218,573	1,730,295
Total available-for-sale securities	$ 141,439,626	$ 1,692,815	$ 648,721	$ 142,483,720

Mortgage-backed securities are included in maturity groups based upon stated maturity date. At December 31, 2008 and 2007, the Bank's mortgage-backed securities were pass-through securities. Actual maturity will vary based on repayment of the underlying mortgage loans.

Gross realized gains on sales of available for sale securities in 2008, 2007 and 2006 were $25,100, $127,168, and $18,602, respectively. Gross realized losses on sales of available-for-sale securities in 2008, 2007 and 2006 were $25,126, $81,750, and $104,198, respectively. Impairment losses recorded in 2008 were $1,015,694.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

3. INVESTMENT SECURITIES (Continued)

Investment securities with carrying values of approximately $68,086,225 and $57,433,049 at December 31, 2008 and 2007, respectively, were pledged as collateral for public deposit and for other purposes as required or permitted by law.

If management determines that an investment has experienced an OTTI, the loss is recognized in the income statement. During the third quarter of 2008, the market for preferred stock issued by the Federal Home Loan Mortgage Corporation ("Freddie Mac") deteriorated significantly after Freddie Mac was placed under conservatorship by the U.S. government and consequently management recorded an OTTI charge of $972,800 (pre-tax) against earnings. During the fourth quarter of 2008, management recorded an OTTI charge of $42,894 on 2,000 shares of Federal Agricultural Mortgage Corporation ("Farmer Mac Stock") after management determined that it was its impairment was unlikely to be temporary. Management believes that the market prices of these equity securities will not recover in the immediate future due to the current economic environment.

The following table shows the gross unrealized losses and fair value of investment securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2008 and 2007. Securities that have been in a loss position for twelve months or more at December 31, 2008 include two mortgage-backed securities. Securities that have been in a loss position for twelve months or more at December 31, 2007 include twenty-four mortgage-backed securities, six federal agency bonds, two corporate securities and forty-nine municipal bonds. The unrealized losses relate to securities that have incurred fair value reductions due to a shift in demand from non-governmental securities and municipals to Treasury bonds and governmental agencies due to credit market concerns. 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. Management has the intent and the ability to hold these securities until their maturity or recovery of their fair value.

	Less Than 12 Months		12 Months or More		Total	
December 31, 2008	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**
Securities available for sale:						
Mortgage backed securities	4,671,466	381,601	720,914	12,973	5,392,380	394,574
State and municipal securities	12,113,871	367,484			12,113,871	367,484
Other securities	21,440	18,488			21,440	18,488
Total temporarily impaired securities	$ 16,806,777	$ 767,573	$ 720,914	$ 12,973	$ 17,527,691	$ 780,546

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

3. INVESTMENT SECURITIES (Continued)

	Less Than 12 Months		12 Months or More		Total	
December 31, 2007	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**
Securities available for sale:						
U.S. government agencies	$	$	$11,983,438	$ 18,793	$11,983,438	$ 18,793
Mortgage backed securities	818,793	604	12,052,785	178,353	12,871,578	178,957
State and municipal securities	4,465,758	82,493	13,509,346	149,906	17,975,104	232,398
Other securities	800,000	200,000	879,734	18,572	1,679,734	218,573
Total temporarily impaired securities	$6,084,551	$ 283,097	$38,425,303	$ 365,624	$44,509,854	$ 648,721

4. NON-MARKETABLE EQUITY SECURITIES CARRIED AT COST

The aggregate cost of the Company's cost method investments totaled $9,827,724 at December 31, 2008. All equity investments were evaluated for impairment at December 31, 2008. The Company estimated that the fair value equaled or exceeded the cost of each of these investments (that is, the investments were not impaired) on the basis of the redemption provisions of the issuing entities with one exception. The Company's investment in a trust company was considered to be other than temporarily impaired and $69,430 was charged off in the fourth quarter of 2008. The investment is now carried at cost at $115,743. The other remaining investments are carried at cost and total $9,711,981.

Investment Category	**Investment Type**	**Original Cost**	**OTTI charge**	**Current Balance**
Federal Home Loan Bank of Atlanta	Common stock	$ 7,876,800		$7,876,800
Yadkin Valley Statutory Trust	Common stock	774,000		774,000
Limited partnerships providing lending services to middle-market companies	Limited Partner	770,679		770,679
Bankers banks	Common stock	253,722		253,722
Companies providing various financial services	Common stock	342,266	$ 189,743	152,523
Total		$10,017,467	$ 189,743	$9,827,724

A-85

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

5. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans at December 31, 2008 and 2007 classified by type are as follows:

	2008	2007
Commercial, financial and agricultural	$ 642,474,624	$ 515,354,445
Real estate construction	227,989,487	155,043,145
Real estate mortgage	283,331,954	196,329,911
Installment loans to individuals	34,284,124	33,305,008
Total	1,188,080,189	900,032,509
Less: Net deferred loan origination fees	(511,244)	(1,279,453)
Allowance for loan losses	(22,355,231)	(12,445,555)
Loans, net	$ 1,165,213,714	$ 886,307,501

Substantially all of the Company's loans have been granted to customers in the piedmont, foothills, northwestern mountains, and the research triangle regions of North Carolina.

In the normal course of business, the Company has made loans to directors and officers of the Company and its subsidiaries. All loans and commitments made to such officers and directors and to companies in which they are officers, or have significant ownership interest, have been made on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers. In the opinion of management, they do not involve more than the normal credit risk or present other unfavorable features. An analysis of these related party loans for the year ended December 31, 2008 is as follows:

Balance at beginning of year	$ 9,603,687
New loans	1,991,452
Repayments	(1,623,779)
Balance at end of year	$ 9,971,360

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

5. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Changes in the allowance for loan losses for the years ended December 31, 2008, 2007 and 2006 are as follows:

(in thousands)	**2008**	**2007**	**2006**
Balance, beginning of year	$ 12,445	$ 10,828	$ 9,473
Charge-offs:			
Commercial, financial and agricultural	(963)	(351)	(280)
Real estate construction	(542)	(118)	
Real estate mortgage	(1,178)	(210)	(418)
Installment loans to individuals	(639)	(423)	(302)
	(3,322)	(1,102)	(1,000)
Recoveries:			
Commercial, financial and agricultural	181	55	58
Real estate construction	1		
Real estate mortgage	134	63	69
Installment loans to individuals	148	112	63
	464	230	190
Net charge-offs	(2,858)	(872)	(810)
Provision for loan losses	11,109	2,489	2,165
Allowance acquired from Cardinal State Bank	1,659		
Balance, end of year	$ 22,355	$ 12,445	$ 10,828

	2008	**2007**	**2006**
Ratio of net charge-offs during the year to average loans outstanding during the year	0.26%	0.10%	0.10%

The following table shows the impaired loans for which specific allowances are assigned as well as impaired loans for which it is probable that the outstanding principal amount will be collected fully by converting collateral to cash or by some other source of repayment:

	December 31,	
	2008	**2007**
Impaired loans without a related allowance for loan loss	$ 6,942,036	$ 1,610,836
Impaired loans with a related allowance for loan loss	7,496,309	6,191,025
Total impaired loans	$ 14,438,345	$ 7,801,861
Allowance for loan losses related to impaired loans	$ 3,663,409	$ 2,022,764

Average impaired loans for 2008 totaled $10,517,093.

Loans on which the accrual of interest has been discontinued amounted to approximately $13,647,000, $1,962,000, and $1,829,000 at December 31, 2008, 2007 and 2006, respectively. For the

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

5. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

years ended December 31, 2008, 2007 and 2006 the Company recognized interest income on nonaccrual loans of $93,378, $77,000, and $46,000, respectively. If interest on those loans had been accrued in accordance with the original terms, interest income would have increased by approximately $268,726, $170,000, and $82,000 for 2008, 2007 and 2006, respectively.

6. PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2008 and 2007 are as follows:

	Cost	Accumulated depreciation and amortization	Net book value
December 31, 2008:			
Land	$10,975,925	$	$10,975,925
Land improvements	2,618,690	1,195,546	1,423,144
Buildings	19,372,592	4,298,317	15,074,275
Furniture and equipment	16,608,944	11,922,164	4,686,780
Construction in process	1,739,791		1,739,791
Total	$51,315,942	$17,416,027	$33,899,915
December 31, 2007:			
Land	$ 8,809,153	$	$ 8,809,153
Land improvements	1,441,664	610,902	830,762
Buildings	16,809,336	3,477,700	13,331,636
Furniture and equipment	13,099,651	9,464,026	3,635,625
Construction in process	172,713		172,713
Total	$40,332,517	$13,552,628	$26,779,889

Depreciation and amortization expense for the years ended December 31, 2008, 2007 and 2006 were $2,012,514, $1,854,608, and $1,948,901, respectively.

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

7. LOAN SERVICING

Mortgage loans serviced for others, consisting of loans sold to Fannie Mae and Freddie Mac, are not included in the accompanying statements of financial condition. Mortgage loan portfolios serviced for Fannie Mae were $184,603,881 and $207,072,346 at December 31, 2008 and 2007, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and foreclosure processing. The carrying value of mortgage servicing rights is included as other assets in the Consolidated Balance Sheets. At December 31, 2008 and 2007, mortgage servicing rights were $1,745,466 and $2,000,770, respectively and included in other assets on the balance sheet. Servicing rights recorded on loans originated and sold by the Bank and the change in the fair value were recorded on the income statement in mortgage banking income.

	2008	2007	2006
Mortgage servicing asset, beginning of year	$2,000,770	$2,070,689	$2,320,839
Capitalized	128,758	50,613	93,270
Change in fair value	(384,062)	(120,532)	(343,420)
Mortgage servicing assets, end of year	$1,745,466	$2,000,770	$2,070,689

8. DEPOSITS

At December 31, 2008, the scheduled maturities of time certificates are as follows:

2009	$580,694,564
2010	101,394,358
2011	30,151,689
2012	2,136,138
2013	3,201,082
Total	$717,577,831

9. BORROWED FUNDS

Short term borrowings at December 31, 2008 and 2007, are illustrated within the tables below. Borrowings from the Federal Reserve are payable on demand and are collateralized by state, county and municipal securities (see Note 3). Interest under this arrangement is payable monthly at 25 basis points below the average federal funds rate as quoted by the Federal Reserve Board. Unused lines of credit from various correspondent banks totaled $56.8 million at December 31, 2008.

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

9. BORROWED FUNDS (Continued)

Short-Term Borrowings Excluding Federal Home Loan Bank ("FHLB") Advances

December 31, 2008	Balance at year end	Weighted average interest rate at year end	Maximum amount outstanding at any month-end	Average Daily Balance outstanding during year	Average annual interest rate paid
Overnight borrowings from the Federal Reserve Bank	$ 488,004	0.00%	$ 1,553,119	$ 580,000	1.34%
Securities sold under agreement to repurchase	34,779,415	1.46%	38,535,769	34,753,000	2.11%
Federal Funds Purchased	23,230,000	0.82%	38,230,000	9,060,000	2.63%
Total short-term borrowings excluding FHLB advances	$58,497,419				

December 31, 2007	Balance at year end	Weighted average interest rate at year end	Maximum amount outstanding at any month-end	Average Daily Balance outstanding during year	Average annual interest rate paid
Overnight borrowings from Federal Reserve Bank	$ 235,746	4.00%	$ 1,577,353	$ 788,000	4.11%
Securities sold under agreement to repurchase	25,987,583	3.07%	31,401,809	29,667,000	3.03%
Federal Funds Purchased	35,202,000	4.52%	35,202,000	1,505,000	5.56%
Wholesale securities sold under agreement to repurchase	4,999,800	4.80%	4,999,800	4,999,800	4.42%
Total short-term borrowings excluding FHLB advances	$66,425,129				

Short term advances from the Federal Home Loan Bank of Atlanta consist of the following at December 31, 2008 and 2007:

Maturity	Interest Rate	2008	2007
12/10/2008	3.90%	$	$5,000,000
12/10/2009	4.06%	5,000,000	
1/07/2009	0.46%	103,600,000	
12/21/2009	5.07%	2,014,540	
		$110,614,540	$5,000,000

Long-term Borrowings

Long-term borrowings at December 31, 2008 consisted of the junior subordinated debentures of $25,774,000 with an average annual interest rate of 4.64% and an average daily balance of the same amount, $25,774,000. The long-term FHLB advances are listed below. Also, included in long-term borrowings was a structured wholesale repurchase agreement with a balance of $4,999,800 at year end,

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

9. BORROWED FUNDS (Continued)

an average daily balance of $4,999,800, an average interest rate of 3.17%, and a year end interest rate of 2.60%.

Pursuant to a collateral agreement with the FHLB, advances are collateralized by all of the Bank's FHLB stock and qualifying first mortgage, commercial, and home equity line loans. The balance of the lendable collateral value of all loans as of December 31, 2008 was approximately $135 million with $16 million remaining available. This agreement with the FHLB provides for a line of credit up to 20% of the Bank's assets.

Long term advances from the FHLB consist of the following at December 31, 2008 and 2007:

Maturity	Interest Rate	2008	2007
12/10/2009	4.06%	$	$5,000,000
2/28/2011	5.37%	2,000,000	2,000,000
1/11/2015	3.57%	5,000,000	
10/29/2018	0.25%	767,536	
12/19/2023	2.00%	308,459	
		$8,075,995	$7,000,000

Federal Home Loan Bank advances, both short and long term, had average annual interest rate paid during the year for 2008 and 2007 of 1.46% and 4.64%, respectively. The weighted average interest rate at year end 2008 and 2007 was 0.91% and 4.21%, respectively. Maximum amount outstanding during the years at any month end for 2008 and 2007 was $118,675,994 and $22,000,000, respectively. The fair market value adjustment associated with the short term advances acquired in the Cardinal acquisition was $ 14,540 at December 31, 2008.

On November 1, 2007, the Company created Yadkin Valley Statutory Trust I ("the Trust") to issue trust preferred securities in conjunction with the Company issuing junior subordinated debentures to the Trust. The terms of the junior subordinated debentures are substantially the same as the terms of the trust preferred securities. The interest rate in effect is the three-month LIBOR plus 1.32%. At December 31, 2008, the effective interest rate was 3.32%. The Company's obligations under the debentures and a separate guarantee agreement constitute a full and unconditional guarantee by the Company of the obligations of the Trust.

On November 1, 2007, the Trust completed the sale of $25,000,000 of trust preferred securities. The trust preferred securities mature in 30 years, and can be called by the Trust without penalty after five years. Yadkin Valley Statutory Trust I used the proceeds from the sale of the securities to purchase the Company's junior subordinated deferrable interest notes due 2037 (the "Debenture"). The net proceeds from the offering were used by the Company in connection with the acquisition of Cardinal State Bank, and for general corporate purposes. Currently, regulatory capital rules allow trust preferred securities to be included as a component of regulatory capital for the Company up to certain limits. This treatment has continued despite the deconsolidation of these instruments for financial reporting purposes.

Under FIN 46R the Company's $774,000 investment in the common equity of the trust is included in the consolidated balance sheets as other assets and funded by long-term debt. The income and

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

9. BORROWED FUNDS (Continued)

interest expense received from and paid to the trust, respectively, is being included in the consolidated statements of income and comprehensive income as other noninterest income and interest expense.

10. INCOME TAXES

The provision for income taxes for the years ended December 31, 2008, 2007, and 2006 is summarized as follows:

	2008	2007	2006
Current:			
Federal	$ 3,776,291	$ 7,164,609	$ 6,850,497
State	756,727	1,232,560	1,280,332
	4,533,018	8,397,169	8,130,829
Deferred:			
Federal	(2,656,853)	(1,028,985)	(820,119)
State	(634,762)	(167,366)	(138,751)
	(3,291,615)	(1,196,351)	(958,870)
Total Income Taxes	$ 1,241,403	$ 7,200,818	$ 7,171,959

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

10. INCOME TAXES (Continued)

The tax effects of significant items comprising the Company's net deferred tax assets as of December 31, 2008 and 2007 are as follows:

	2008	2007
Deferred tax assets:		
Allowance for loan losses	$ 8,792,489	$ 4,918,699
Premiums on deposits acquired	480,602	
Deferred loan costs		2,127
Core deposit amortization	60,779	93,930
State tax credits		40,653
Other than temporary impairment	461,417	
Net operating loss	824,308	
Other	1,014,140	488,701
	11,633,735	5,544,110
Deferred tax liabilities:		
Unrealized gain on purchased securities	$ (147,526)	$ (148,164)
Unrealized gain on available for sale securities	(1,295,344)	(411,825)
Depreciation	(1,131,606)	(877,123)
Prepaid expenses	(245,428)	(226,275)
Core deposit intangible	(1,840,279)	(1,682,713)
Premiums on loans acquired	(762,332)	
Other	(512,098)	(378,029)
	(5,934,613)	(3,724,129)
Net deferred tax asset	$ 5,699,122	$ 1,819,981

A reconciliation of applicable income taxes for the years ended December 31, 2008, 2007 and 2006 to the amount of tax expense computed at the statutory federal income tax rate of 35% is as follows:

	2008	2007	2006
Tax expense at statutory rate on income before income taxes	$ 1,787,811	$ 7,660,993	$ 7,337,349
Increases (decreases) resulting from:			
Tax-exempt interest on investments	(572,293)	(476,415)	(441,541)
State income tax, net of federal benefits	79,181	692,376	742,028
Income from bank-owned life insurance	(323,741)	(563,286)	(244,452)
Other	270,445	(112,850)	(221,425)
Total income taxes	$ 1,241,403	$ 7,200,818	$ 7,171,959

The Company has adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48 ("FIN 48"). There was no material impact from the adoption of FIN 48. It is the Company's policy to recognize interest and penalties associated with uncertain tax positions as components of income taxes. The Company's federal tax returns are subject to examination for years

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

10. INCOME TAXES (Continued)

2005, 2006 and 2007. The Company's state income tax returns are subject to examination for years 2006 and 2007.

The interest associated with the uncertain tax positions amounts to approximately $44,000 at December 31, 2008. The Company recognizes interest and penalties associated with uncertain tax positions in income tax expense.

11. EARNINGS PER SHARE

Basic earnings per share ("EPS") are computed by dividing net income by the weighted-average number of common shares outstanding for the year. Diluted EPS includes the effect of dilutive potential common stock. Following is the reconciliation of EPS for the years ended December 31, 2008, 2007 and 2006:

	2008	2007	2006
Basic earnings per share:			
Net income	$ 3,866,628	$ 14,687,732	$ 13,791,897
Weighted average shares outstanding	11,235,943	10,594,567	10,640,819
Basic earnings per share	$ 0.34	$ 1.39	$ 1.30
Diluted earnings per share:			
Net income	$ 3,866,628	$ 14,687,732	$ 13,791,897
Weighted average shares outstanding-basic	11,235,943	10,594,567	10,640,819
Dilutive effect of stock options	70,799	118,100	147,979
Weighted average shares, as adjusted	11,306,742	10,712,667	10,788,798
Diluted earnings per share	$ 0.34	$ 1.37	$ 1.28

On December 31, 2008 there were 189,319 options to purchase shares of common stock at a range of $14.24 to $19.07 that were not included in the computation of diluted EPS for the year. The non-dilutive options held for the whole year were priced above the 2008 average market price of $14.236. The non-dilutive options granted during the year and outstanding at year end were priced above the average market prices ranging from $14.101 to $ 14.325 for the various periods that they were held. On December 31, 2007 there were 52,500 options to purchase shares of common stock at of $19.07 that were not included in the computation of diluted EPS because the options' exercise price was greater than the average market price of $17.70 per common share. On December 31, 2006 there were 47,975 options to purchase shares at $15.50-17.10 that were not included in the computation of diluted EPS.

12. BENEFIT PLANS

401(K) PLAN

The Company maintains profit-sharing and 401(k) plans for substantially all employees. Contributions to the profit-sharing plan are at the discretion of the Board of Directors but are limited to amounts deductible in accordance with the Internal Revenue Code. Under the Company's 401(k) plan, employees are permitted to contribute up to 60% of pre-tax compensation. The Company will match 50% of an employee's contribution, up to a maximum of 3% of pre-tax employee compensation.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

12. BENEFIT PLANS (Continued)

The Company's policy is to fund the profit-sharing/401(k) costs as incurred. Employer contributions in 2008, 2007 and 2006 to the 401(k) plan were $334,537, $306,150, and $291,716, respectively. There were no contributions to the profit-sharing plan for the years ended December 31, 2008, 2007 and 2006.

STOCK APPRECIATION RIGHTS

In 2005, the Company paid $26,826 in stock appreciation rights under a High Country Financial Corporation plan for one participant following the merger with High Country Financial Corporation in 2004. There are no other stock appreciation rights.

BANK OWNED LIFE INSURANCE

In September 2006, the Emerging Issues Task Force (EITF) issued EITF Issue 06-04, "Accounting for Deferred Compensation and Post-retirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("EITF Issue 06-4"). EITF Issue 06-04 requires that for endorsement split-dollar insurance arrangements that provide a benefit to an employee that extends to post-retirement periods, an employer should recognize a liability for future benefits in accordance with FASB Statement No. 106 or Accounting Principles Board (APB) Opinion No. 12 based on the substantive agreement of the employee. If the employer has effectively agreed to maintain a life insurance policy during post-retirement periods, the costs of the life insurance policy during the post-retirement periods should be accrued in accordance with either FASB Statement No. 106 or APB Opinion No. 12. EITF Issue 06-04 is effective for fiscal years beginning after December 15, 2007. The effect of the adoption of EITF Issue 06-04 was a reduction to retained earnings of $897,253 on January 1, 2008. The following table shows the accumulated post retirement liability accrued at December 31, 2008.

Beginning balance, adjustment to retained earnings	$ 897,253
Post-retirement benefit expense in 2008	350,349
Post-retirement liability accrued	$ 1,247,602

During 2001 and 2000, the Company created an Officer Supplemental Insurance Plan ("OSIP") and entered into Life Insurance Endorsement Method Split Dollar Agreements with certain officers. Under the plan, upon death of the officer, the Company first recovers the cash surrender value of the contract and then shares the remaining death benefits from insurance contracts, which are written with different carriers, with the designated beneficiaries of the officers. The death benefit to the officer's beneficiaries is a multiple of base salary at the time of the agreements. The Company, as owner of the policies, retains an interest in the life insurance proceeds and a 100% interest in the cash surrender value of the policies. The OSIP contains a five-year vesting requirement and certain provisions relating to change of control and termination of service.

The Company funded the OSIP through the purchase of bank-owned life insurance ("BOLI") during the first quarter of 2000 and the second quarter of 2001 with initial investments of $4,807,000 and $5,000,000, respectively. Additional investments in BOLI were made in August of 2006 in the amount of $5,500,000. The corresponding cash surrender values of BOLI policies as of December 31, 2008 and 2007 was $23,607,675 and $22,682,702, respectively.

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

12. BENEFIT PLANS (Continued)

During 2007 the Company created the 2007 Group Term Carve Out Plan and entered into Life Insurance Endorsement Method Split Dollar Agreements with certain officers who did not participate in the 2001 Plan discussed in the previous paragraph. Under the plan, upon death of the officer, the Company first recovers the cash surrender value of the contract and then shares the remaining death benefits from the insurance contracts which are written with New York Life Insurance and Annuity Corporation, with the designated beneficiaries of the officers.

The death benefit to the officer's beneficiaries is a multiple of base salary at the time of the agreements, subject to the limit of total death proceeds less cash surrender value. The Company, as owner of the policies, retains an interest in the life insurance proceeds and a 100% interest in the cash surrender value of the policies. The 2007 plan contains a five-year vesting requirement and certain provisions related to change of control and termination of service.

NON-EQUITY INCENTIVE PLAN

Incentive compensation is provided for certain officers of the Bank based on defined levels of earnings performance. Expenses related to such compensation during 2008, 2007 and 2006 totaled approximately $170,000, $425,664, and $513,341, respectively. Incentive compensation is provided for certain officers of Sidus based on pre-tax income. Expenses related to such compensation during 2008, 2007, and 2006 totaled approximately $295,00, $141,000 and $130,000, respectively.

13. STOCK OPTIONS

The Company has stock option plans for directors, selected executive officers and other key employees. The plans provide for the granting of options to purchase shares of the Company's common stock at a price not less than the fair market value at the time of grant of the option. Option exercise prices are established at market value on the grant date. Vesting schedules are determined by the Board of Directors. Upon termination, unexercised options held by employees are forfeited and made available for future grants.

On May 22, 2008, the shareholders approved the 2008 Omnibus Stock Ownership and Long Term Incentive Plan (the "Omnibus Plan"). An aggregate of 700,000 shares has been reserved for issuance by the Company under the terms of the Omnibus Plan pursuant to the grant of incentive stock options (not to exceed 200,000 shares), non-statutory stock options, restricted stock and restricted stock units, long-term incentive compensation units and stock appreciation rights.

During 2008, 15,284 options were vested, 7,993 unvested shares were forfeited and 79,500 options were granted resulting in 116,800 unvested options at December 31, 2008. There was no intrinsic value of 2008 and 2007 option grants since options are granted at the market price of the stock on date of grant. The intrinsic values of options exercised in 2008, 2007 and 2006 were $630,098, $751,649 and $167,453, respectively. The Bank recorded compensation expense totaling $66,787 in 2008 and $69,165 in 2007 and $ 13,622 in 2006 for the options in the process of vesting based on amortization of the fair value of options granted (See "Stock Based Compensation" under Note 1). Deferred expense totaling $252,469 will be recognized over the remaining vesting period, 2009 through 2013. During the year ended December 31, 2008, 53,724 shares were forfeited. Of the shares forfeited in 2008, 4,800 shares were available to be reissued until they expired in April of 2008. During the year ended December 31,

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

13. STOCK OPTIONS (Continued)

2007, there were 52,500 shares granted and 3,511 shares were forfeited. Of the shares forfeited in 2007, 3,463 shares were available to be reissued. There are also stock options available for grants under the Omnibus Plan approved in 2008 as described in Note 1.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2008, 2007, and 2006: dividend yield of 3.77, 2.52 and 3.07 percent, respectively; expected volatility of 22.72, 11.80 and 11.50 percent, respectively; risk-free interest rate of 2.80, 5.25 and 5.25 percent, respectively, and expected life of 5.4, 7 and 7 years, respectively.

The weighted-average fair value of options granted during 2008, 2007 and 2006 was approximately $2.03, $3.53, and $2.49 respectively, at the grant date. Certain option information for the year ended December 31, 2008 follows:

		OUTSTANDING OPTIONS		EXERCISABLE OPTIONS	
	SHARES AVAILABLE FOR FUTURE GRANTS	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
At December 31, 2007	91,107	430,118	$ 12.20	369,533	$ 11.19
Options Authorized					
Options Granted/Vested	(79,500)	79,500	14.06	15,284	17.79
Options Exercised		(89,455)	6.96	(89,455)	6.96
Options Expired	(5,554)	(39,714)	14.91	(39,706)	14.91
Options Forfeited	4,800	(53,724)	14.83	(45,731)	14.54
Acquired Cardinal stock options		140,277	13.04	140,277	13.04
At December 31, 2008	10,853	467,002	$ 13.24	350,202	$ 12.41

At December 31, 2008, the weighted average remaining contractual life of outstanding options was 5.06 years and of exercisable options was 3.83 years. At December 31, 2007, the weighted average remaining contractual life of outstanding options was 3.93 years and of exercisable options was 3.16 years.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

13. STOCK OPTIONS (Continued)

The aggregate intrinsic values of options outstanding and exercisable at December 31, 2008 and 2007 were $0.6 million and $1.5 million, respectively. The table below segregates the shares outstanding at December 31, 2008 into meaningful ranges:

Shares	Option price per share	Weighted average remaining contractual life (years)	Weighted average exercise price	Shares exercisable December 31, 2008
44,931	6.86	0.70	6.86	44,931
33,039	7.44 - 7.85	2.57	7.70	33,039
12,061	8.66	1.33	8.66	12,061
62,552	10.75 - 11.99	2.96	11.78	62,552
97,424	12.79 - 13.91	7.84	13.82	12,096
161,490	14.00 - 14.97	5.36	14.79	49,881
500	15.65	7.71	15.65	118,642
7,500	17.10	4.01	17.10	7,500
47,500	19.07	8.05	19.07	9,500
467,002				350,202

No option may be exercised more than ten years after the date of grant.

14. LEASES

Rental expense was approximately $738,000 in 2008, $532,000 in 2007 and $498,000 in 2006 and primarily represents rentals of real estate. Future minimum lease payments for the next five years are as follows:

2009	$ 732,669
2010	636,520
2011	477,815
2012	393,677
2013	344,188
	$2,584,869

15. OFF-BALANCE SHEET RISK, COMMITMENTS AND CONTINGENCIES

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

15. OFF-BALANCE SHEET RISK, COMMITMENTS AND CONTINGENCIES (Continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, upon extension of credit is based on management's credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds, and certificates of deposit.

A summary of the contract amount of the Bank's exposure to off-balance sheet risk as of December 31, 2008 and 2007 is as follows:.

	2008	2007
Financial instruments whose contract amounts represent credit risk:		
Loan commitments and undisbursed lines of credit	$228,345,021	$217,761,148
Undisbursed standby letters of credit	6,777,193	4,434,128
Undisbursed portion of construction loans	33,263,609	36,108,631
Commitments to close first mortgages	246,248,000	92,374,000
Commitments to sell first mortgages	245,831,000	92,374,000

The Company is a party to legal proceedings and potential claims arising in the normal conduct of business. The Company has been sued for damages in excess of $850,000 for 3.99 years of severance, continued benefits and fringe benefits by two former employees who allege breach of contract. In addition, the plaintiffs seek liquidated damages and costs (including reimbursement for reasonable attorney fees) under their wage and hour claims. They also assert that non-compete provisions of the employment agreements do not apply to their separation. Both plaintiffs filed for judgment on the pleadings in state court and prevailed. The Company appealed the orders before the trial court had determined damages. The Company's appeal to the NC Supreme Count was denied and the case was remanded to the trial court for a determination of damages. The Company maintains a reserve for these claims that it considers to be adequate and does not believe that the outcome will have a material adverse effect on our financial position or results of operations. However the Company cannot make any assurances regarding the final amount of damages.

16. FAIR VALUE

The Company utilizes fair value measurements to record fair value adjustments for certain assets and liabilities and to determine fair value disclosures. Available-for-sale securities, mortgage servicing rights, interest rate lock commitments and forward loan sale commitments are recorded at fair value on a monthly basis. Additionally, from time to time, the Company may be required to record other assets at fair value, such as loans held for investment and certain other assets. These nonrecurring fair value adjustments usually involve writing the asset down to lower of cost or market.

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

16. FAIR VALUE (Continued)

Fair Value Hierarchy

Under SFAS 157, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Available-for-Sale Investment Securities

Available-for-sale investment securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities.

Interest Rate Locks and Forward Loan Sale Commitments

Sidus, the Company's mortgage lending subsidiary, enters into interest rate lock commitments and commitments to sell mortgages on a best efforts basis. The amount of fair value associated with these interest rate lock commitments and sale commitments is considered immaterial for purposes of reporting under SFAS 157.

Mortgage Servicing Rights

A valuation of mortgage servicing rights is performed using a pooling methodology. Similar loans are pooled together and evaluated on a discounted earnings basis to determine the present value of future earnings. The present value of the future earnings is the estimated market value for the pool, calculated using consensus assumptions that a third party purchaser would utilize in evaluating a potential acquisition of the servicing. As such, the Company classifies loan servicing rights as Level 3.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

16. FAIR VALUE (Continued)

Assets subjected to recurring fair value adjustments are as follows:

	Fair Value	Level 1	Level 2	Level 3
Available for sale securities	$137,813,529	$22,596	$137,813,529	$
Mortgage servicing rights	$ 1,745,466	$	$	$1,745,466

The following table presents a rollforward of mortgage servicing rights from December 31, 2007 to December 31, 2008.

	Fair Value	Level 3
Balance, beginning of period	$2,000,770	$2,000,770
Losses included in mortgage banking income	(384,062)	(384,062)
Net transfers	128,758	128,758
Balance, end of period	$1,745,466	$1,745,466

Mortgage Loans Held for Sale

Loans held for sale are carried at lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies loans subjected to nonrecurring fair value adjustments as Level 2. At December 31, 2008 the cost of the Company's mortgage loans held for sale was less than the market value. Accordingly, at year end the Company's loans held for sale were carried at cost.

Loans Held for Investment

The Company does not record loans held for investment at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, "Accounting by Creditors for Impairment of a Loan," (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2008, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

16. FAIR VALUE (Continued)

Asset subjected to nonrecurring fair value adjustments are as follows:

	Fair Value	Level 1	Level 2	Level 3
Impaired loans	$7,864,055			$7,864,055

17. REGULATORY REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes that, as of December 31, 2008, the Company meets all capital adequacy requirements to which it is subject.

As of December 31, 2008, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Company must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

17. REGULATORY REQUIREMENTS (Continued)

management believes have changed in the Company's category. Dollar amounts in the table below are in thousands:

	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Yadkin Valley Bank and Trust						
As of December 31, 2008:						
Total Capital (to risk-weighted assets)	$129,323	10.1%	$101,430	8.0%	$126,787	10.0%
Tier I Capital (to risk-weighted assets)	113,366	8.9%	50,951	4.0%	76,427	6.0%
Tier I Capital (to average assets)	113,366	8.0%	56,683	4.0%	70,854	5.0%
As of December 31, 2007:						
Total Capital (to risk-weighted assets)	$107,225	10.4%	$ 82,481	8.0%	$103,101	10.0%
Tier I Capital (to risk-weighted assets)	94,779	9.2%	41,208	4.0%	61,812	6.0%
Tier I Capital (to average assets)	94,779	8.4%	45,133	4.0%	56,416	5.0%
Yadkin Valley Financial Corporation						
As of December 31, 2008:						
Total Capital (to risk-weighted assets)	$131,712	10.2%	$101,317	8.0%	$126,646	10.0%
Tier I Capital (to risk-weighted assets)	116,529	9.0%	51,221	4.0%	76,832	6.0%
Tier I Capital (to average assets)	116,529	8.1%	46,843	4.0%	71,054	5.0%
As of December 31, 2007:						
Total Capital (to risk-weighted assets)	$131,944	12.7%	$ 83,114	8.0%	$103,893	10.0%
Tier I Capital (to risk-weighted assets)	120,273	11.6%	41,473	4.0%	62,210	6.0%
Tier I Capital (to average assets)	120,273	10.7%	44,962	4.0%	56,202	5.0%

The Bank, as a North Carolina banking corporation, may pay dividends only out of undivided profits as determined pursuant to North Carolina General Statutes Section 53-87. At December 31, 2008 and 2007, $48,070,348 and $51,086,684, respectively was legally available for dividend payments.

For the reserve maintenance period in effect at December 31, 2008, the Bank was required by the Federal Reserve Bank to maintain average daily reserves of $250,000 on deposit.

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

18. FINANCIAL INSTRUMENTS

The Company adopted SFAS No. 157 effective January 1, 2008. SFAS No. 157 groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following is a summary of the carrying amounts and fair values of the Companies financial assets and liabilities at December 31:

	2008		2007	
(in thousands)	**Carrying amount**	**Estimated fair value**	**Carrying amount**	**Estimated fair value**
Financial assets:				
Cash and cash equivalents	$ 26,023	$ 26,023	$ 26,325	$ 26,326
Investment securities	137,814	137,814	142,484	142,484
Loans and loans held for sale, net	1,215,143	1,266,545	939,061	962,883
Accrued interest receivable	5,442	5,442	6,055	6,055
Federal Home Loan Bank Stock	7,877	7,877	2,557	2,557
Investment in Bank owned life insurance	23,608	23,608	22,683	22,683
Financial liabilities:				
Demand deposits, NOW, savings and money market accounts	$ 437,464	$ 437,464	$ 387,868	$ 387,868
Time deposits	717,578	734,012	575,575	582,593
Borrowed funds	207,962	207,344	104,199	101,146
Accrued interest payable	3,554	3,554	3,434	3,434

The carrying amounts of cash and cash equivalents approximate their fair value.

The fair value of marketable securities is based on quoted market prices and prices obtained from independent pricing services.

For certain categories of loans, such as installment and commercial loans, the fair value is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The cost of fixed rate mortgage loans held-for-sale approximates the fair values as these loans are typically sold within 60 days of origination. Fair values for adjustable-rate mortgages are based on quoted market prices of similar loans adjusted for differences in loan characteristics.

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

18. FINANCIAL INSTRUMENTS (Continued)

The carrying value of Federal Home Loan Bank Stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank Stock.

The investment in bank owned life insurance represents the cash value of the policies at December 31, 2008 and 2007. The rates are adjusted annually thereby minimizing market fluctuations

The fair value of demand deposits and savings accounts is the amount payable on demand at December 31, 2008 and 2007, respectively. The fair value of fixed-maturity certificates of deposit and individual retirement accounts is estimated using the present value of the projected cash flows using rates currently offered for similar deposits with similar maturities.

The fair values of borrowings are based on discounting expected cash flows at the interest rate for debt with the same or similar remaining maturities and collateral requirements. Short-term borrowings, including overnight, securities sold under agreements to repurchase, federal funds purchased and FHLB advances, are carried at approximate fair value because of the short maturities of those instruments.

The fair value of accrued interest receivable and accrued interest payable approximates their book values because of their short-term duration.

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

19. PARENT COMPANY CONDENSED FINANCIAL INFORMATION

During the May 24, 2006 annual meeting, the shareholders approved the formation of a holding company, Yadkin Valley Financial Corporation, ("the Company") whereby each share of Yadkin Valley Bank was automatically converted to one share of Yadkin Valley Financial Corporation. The Company's authorized capital consists of 20,000,000 shares of common stock, par value $1.00 per share, and 1,000,000 shares of preferred stock, no par value, whose rights, privileges, and preferences will be established by the Board of Directors on issuance. As of the conversion date, 10,648,300 common shares and no preferred shares were issued and outstanding. Condensed financial data for Yadkin Valley Financial Corporation (parent company only) follows:

Condensed Balance Sheets	**2008**	**2007**
Assets:		
Cash on deposit with bank subsidiary	$ 757,472	$ 25,127,841
Investment in subsidiary	172,869,539	132,775,398
Other investments	1,061,181	429,530
Other assets	2,275,491	2,150,191
Total	$ 176,963,683	$ 160,482,960
Liabilities and Shareholders' Equity:		
Dividends payable	$ 1,499,329	1,373,236
Other liabilities	25,820,032	$ 25,840,730
Shareholders' equity	149,644,322	133,268,994
Total	$ 176,963,683	$ 160,482,960

Condensed Results of Operations	**2008**	**2007**	**2006**
Equity in earnings of subsidiary bank:			
Dividends received	$ 5,858,681	$ 6,505,448	$ 5,673,328
Undistributed earnings	(1,169,728)	8,374,106	8,196,649
Income (expenses), net	(822,325)	(191,822)	(78,080)
Net Income	$ 3,866,628	$ 14,687,732	$ 13,791,897

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

19. PARENT COMPANY CONDENSED FINANCIAL INFORMATION (Continued)

Condensed Statements of Cash Flows	2008	2007	2006
Cash flows from operating activities:			
Net income (loss) from continuing operations	$ 3,866,628	$ 14,687,732	$ 13,791,897
Adjustments to reconcile net income (loss) to net cash from operating activities:			
Equity in undistributed earnings of subsidiaries	1,169,728	(8,374,106)	(8,196,649)
Gain from sale of assets			(35,044)
Change in other assets	(125,302)	2,653,946	(1,428,483)
Change in other liabilities	170,817	(2,737,957)	1,425,048
	5,081,871	6,229,615	5,556,769
Cash flows from investing activities:			
Purchase of investments	(631,650)	(1,051,808)	(217,018)
Additional investment in bank subsidiary	(23,457,642)		
Proceeds from sale of investment			252,062
	(24,089,292)	(1,051,808)	35,044
Cash flows from financing activities:			
Long-term borrowings		25,774,000	
Purchases of common stock		(2,156,889)	(804,257)
Dividends paid	(5,985,711)	(5,303,782)	(3,824,414)
Proceeds from exercise of stock options	622,763	567,382	106,181
	(5,362,948)	18,880,711	(4,522,490)
Net increase (decrease) in cash	(24,370,369)	24,058,518	1,069,323
Cash at beginning of year	25,127,841	1,069,323	
Cash at end of year	$ 757,472	$ 25,127,841	$ 1,069,323

20. BUSINESS SEGMENT INFORMATION

The Company has three reportable business segments, the Bank, Sidus, and other. The Bank encompasses the four regional banks, Yadkin Valley Bank and Trust, Piedmont Bank, High Country Bank, and Cardinal State Bank. Sidus Financial, LLC ("Sidus") was acquired October 1, 2004 as a single member LLC with the Bank as the single member. Sidus is headquartered in Greenville, North Carolina and offers mortgage banking services to its customers in North Carolina, South Carolina, Virginia, Georgia, Maryland, Alabama, Florida, Kentucky, Louisiana, West Virginia, Delaware, Mississippi, Arkansas, Pennsylvania, Maine, Tennessee, Massachusetts, Vermont, Connecticut, New Hampshire and Rhode Island. The other segment represents the Holding Company and the Trust and also includes the eliminations necessary to accurately report each segments' operations.

On September 10, 2008 the Company announced that it had entered into a definitive agreement with American Community Bancshares, Inc and its subsidiary American Community Bank. The company expects this will increase its assets by an estimated $500 million during 2009 its segment. The pending acquisition is expected to increase earnings after an initial period in which the expenses related to the merger will increase due to the impact of SFAS 141(R.). See Note 1 for additional information concerning SFAS 141(R.)

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

20. BUSINESS SEGMENT INFORMATION (Continued)

The following table details the results of operations for the twelve months of 2008 and 2007 for the Bank and Sidus using the purchase method of accounting.

December 31, 2008	**Bank**	**Sidus**	**Other**	**Total**
Interest income	$ 71,996,715	$ 2,529,959	$	$ 74,526,674
Interest expense	32,467,837	873,032	1,195,385	34,536,254
Net interest income	39,528,878	1,656,927	(1,195,385)	39,990,420
Provision for loan losses	11,109,183			11,109,183
Net interest income after provision for loan losses	28,419,695	1,656,927	(1,195,385)	28,881,237
Net loss on investment securities	(1,015,720)			(1,015,720)
Other income	8,450,833	7,518,451	547,580	16,516,864
Other expense	32,713,349	6,386,480	174,521	39,274,350
Income before income taxes	3,141,459	2,788,898	(822,326)	5,108,031
Income taxes	153,733	1,087,670		1,241,403
Net Income	$ 2,987,726	$ 1,701,228	$ (822,326)	$ 3,866,628
Total Assets	$ 1,555,684,328	$ 54,153,215	$ (85,549,522)	$ 1,524,288,021
Net Loans	1,165,213,714			1,165,213,714
Loans held for sale	172,000	49,757,375		49,929,375
Goodwill	48,559,015	4,943,872		53,502,887

December 31, 2007	**Bank**	**Sidus**	**Other**	**Total**
Interest income	$ 72,710,866	$ 2,481,984	$	$ 75,192,850
Interest expense	31,259,750	1,972,077	68,909	33,300,736
Net interest income	41,451,116	509,907	(68,909)	41,892,114
Provision for loan losses	2,488,620			2,488,620
Net interest income after provision for loan losses	38,962,496	509,907	(68,909)	39,403,494
Net gain on sales of investment securities	45,418			45,418
Other income	9,512,056	5,882,495	4,190	15,398,741
Other expense	27,926,428	4,905,514	127,161	32,959,103
Income before income taxes	20,593,542	1,486,888	(191,880)	21,888,550
Income taxes	6,620,932	579,886		7,200,818
Net Income	$ 13,972,610	$ 907,002	$ (191,880)	$ 14,687,732

Total Assets	$1,214,088,722	$60,102,587	$(63,114,068)	$1,211,077,241
Net Loans	886,307,501			886,307,501
Loans held for sale		52,753,907		52,753,907
Goodwill	28,026,028	4,943,872		32,696,900

A-108

Table of Contents

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

21. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table presents unaudited, summarized quarterly data for the years ended December 31, 2008 and 2007 (in thousands):

	Three Months Ended			
2008	**December 31**	**September 30**	**June 30**	**March 31**
Interest income	$ 18,084	$ 19,438	$ 19,101	$ 17,903
Interest expense	8,449	8,813	8,728	8,546
Net interest income	9,635	10,625	10,373	9,357
Provision for loan losses	7,617	1,334	1,708	450
Net interest income after provision for loan losses	2,018	9,291	8,665	8,907
Net gain (loss) on sales of investment securities	(80)	(966)	(6)	
Other income	4,547	4,023	4,053	3,929
Other expense	10,718	9,760	10,153	8,643
Income before income taxes	(4,233)	2,588	2,559	4,193
Income taxes	(1,666)	795	832	1,279
Net income (loss)	$ (2,567)	$ 1,793	$ 1,727	$ 2,914
Net income (loss) per common share basic	$ (0.22)	$ 0.16	$ 0.19	$ 0.28
Net income (loss) per common share diluted	$ (0.22)	$ 0.15	$ 0.19	$ 0.27

	Three Months Ended			
2007	**December 31**	**September 30**	**June 30**	**March 31**
Interest income	$ 19,339	$ 19,231	$ 18,647	$ 17,975
Interest expense	8,800	8,504	8,238	7,759
Net interest income	10,539	10,727	10,409	10,216
Provision for loan losses	1,689	300	200	300
Net interest income after provision for loan losses	8,850	10,427	10,209	9,916
Net gain (loss) on sales of investment securities	1	45		
Other income	3,695	3,511	4,112	4,078
Other expense	7,995	8,016	8,683	8,264
Income before income taxes	4,551	5,967	5,638	5,730
Income taxes	1,485	2,045	1,852	1,818
Net income	$ 3,066	$ 3,922	$ 3,786	$ 3,912
Net income per common share basic	$ 0.29	$ 0.37	$ 0.36	$ 0.37
Net income per common share diluted	$ 0.29	$ 0.37	$ 0.35	$ 0.36

22. SUBSEQUENT EVENTS

On February 27, 2009, the Board of Directors of the Federal Deposit Insurance Corporation ("FDIC") took action to ensure the continued strength of the insurance fund by imposing a special

YADKIN VALLEY FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2008, 2007 and 2006

22. SUBSEQUENT EVENTS (Continued)

assessment on insured institutions of 20 basis points, by implementing changes to the risk-based assessment system, and by increasing overall rates. The special assessment rate will be applied to balances on June 30, 2009 and will be collected by the FDIC on September 30, 2009. The Bank projects that its FDIC assessment expense will increase from 2008 to 2009 by $3.4 million, of which $2.4 million is attributed to the special assessment.

On March 5, 2009, the FDIC Chairman indicated that the special assessment would be lowered if Congress would pass a bill allowing the FDIC to borrow more than the current limit of $30 billion. A bill has been introduced in Congress to permanently increase the FDIC's borrowing limit to $100 billion and allow the FDIC to borrow temporarily up to $500 billion. Thus far, no reductions to the special assessment have been authorized by the Board of Directors of the FDIC.

The assessment rates, including the special assessment, are subject to change at the discretion of the Board of Directors of the FDIC.

On January 16, 2009, as part of the Capital Purchase Program established by the U.S. Department of the Treasury ("Treasury") under the Emergency Economic Stabilization Act of 2008 (the "EESA"), Company entered into a Letter Agreement (including the Securities Purchase Agreement with Treasury dated January 16, 2009 pursuant to which the Company issued and sold to Treasury (i) 36,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series T, having a liquidation preference of $1,000 per share (the "Series T Preferred Stock"), and (ii) a ten-year warrant to purchase up to 385,990 shares of the Company's common stock, par value $1.00 per share ("Common Stock"), at an initial exercise price of $13.99 per share (the "Warrant"), for an aggregate purchase price of $36,000,000 in cash.

The Series T Preferred Stock will qualify as Tier 1 capital and will be entitled to cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. Yadkin must consult with the Commission before it may redeem the Series T Preferred Stock but, contrary to the original restrictions in the EESA, will not necessarily be required to raise additional equity capital in order to redeem this stock. Any redemption is subject to the consent of the Board of Governors of the Federal Reserve System.

Prior to January 16, 2012, unless we have redeemed the Series T Preferred Stock or the Treasury Department has transferred the Series T Preferred Stock to a third party, the consent of the Treasury Department will be required for us to (1) declare or pay any dividend or make any distribution on our common stock (other than regular quarterly cash dividends of not more than $0.13 per share of common stock) or (2) redeem, purchase or acquire any shares of our common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Purchase Agreement filed with form 8-K on January 20, 2009.

Preferred stock may be issued. The Company has agreed to register the resale of the Series T Preferred Stock and the Depositary Shares, if any, and the Warrant, and the issuance of shares of Common Stock upon exercise of the Warrant (the "Warrant Shares"), as soon as practicable after the date of the issuance of the Series T Preferred Stock and the Warrant. Neither the Series T Preferred Stock nor the Warrant are subject to any contractual restrictions on transfer, except that Treasury may only transfer or exercise an aggregate of one-half of the Warrant Shares prior to the earlier of (i) the date on which the Company has received aggregate gross proceeds of not less than $36,000,000 from one or more Qualified Equity Offerings and (ii) December 31, 2009.

The Warrant is immediately exercisable. In the event the Company completes one or more Qualified Equity Offerings on or prior to December 31, 2009 that result in the Company receiving aggregate gross proceeds of not less than $36,000,000, the number of the shares of Common Stock underlying the portion of the Warrant then held by Treasury will be reduced by one-half of the shares of Common Stock originally covered by the Warrant.

In the Purchase Agreement, the Company agreed that, until such time as Treasury ceases to own any debt or equity securities of the Company acquired pursuant to the Purchase Agreement, the Company will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of EESA as implemented by any guidance or regulation under the EESA that has been issued and is in effect as of the date of issuance of the Series T Preferred Stock and the Warrant.

Item 9 Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of December 31, 2008, the end of the period covered by this Annual Report on Form 10-K, an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13(a)-15(e) and 15(d)-15(e)promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and(ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were not effective as of December 31, 2008, because of the material weakness in internal control over financial reporting discussed in the report below.

Management's Annual Report on Internal Control Over Financial Reporting

Management of Yadkin Valley Financial Corporation and subsidiaries ("The Company") is responsible for preparing the Company's annual consolidated financial statements and for establishing and maintaining adequate internal control over financial reporting for the Company. Management has evaluated the effectiveness of the Company's internal control over financial reporting, including controls over the preparation of financial statements in accordance with the instructions to the

Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2008 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that its internal control over financial reporting as of December 31, 2008, was not effective because of the material weaknesses described below.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. Management identified the following material weaknesses as of December 31, 2008:

Control Environment

A control environment sets the tone of an organization, influences the control consciousness of its people, and is the foundation of all other components of internal control over financial reporting. The Company's control environment did not sufficiently promote effective internal control over financial reporting throughout the organization. Specifically, the following material weaknesses were identified in the Company's control environment at December 31, 2008:

Although management has taken steps to remediate deficiencies identified in the Annual Report on Form 10-K for the year ended December 31, 2007, management still needs to place greater emphasis on supporting effective application of policies, execution of procedures, and remediation of the deficiencies identified in previous periods.

Management needs additional financial reporting resources to ensure appropriate accounting, presentation, and disclosure in Company filings.

These deficiencies in the control environment contributed to the material weaknesses described below, and resulted in a reasonable possibility that a material error in the Company's interim or annual financial statements would not be prevented or detected.

Accounting for Significant Estimates

The Company did not maintain sufficient internal controls over the preparation and review of its allowance for loan losses model, including obtaining approval and documented support for changes in the underlying assumptions being used for the estimation. In addition, the Company did not maintain policies and procedures to ensure that identification of impaired loans and estimates of valuation allowances required under SFAS 114, *Accounting by Creditors for Impairment of a Loan* (as amended), are made timely and accurately, and are subject to a detailed supervisory review. These deficiencies contributed to various mathematical errors and inappropriate assumptions being made in the estimation of the allowance for loan losses. Material adjustments were subsequently made to the Company's preliminary consolidated financial statements.

Credit Administration

While management has committed substantial additional resources to credit administration in 2008, the Company needs to make further improvement to its internal control over certain areas involving credit administration, in order to reduce the possibility of material errors in the estimation of the allowance for loan losses. Specifically, the Company needs further internal controls over documentation of underwriting practices over renewals and extensions, collateral inspection on construction loans before approval of advances, monitoring of interest reserves on certain acquisition and development loans, and independent review of appraisals.

Table of Contents

Preparation of Financial Reports

The Company did not maintain sufficient internal controls over the preparation and review of its financial reports for use in Company filings. In addition, the lack of adequate financial reporting resources prevented the Company from being able to properly prepare financial reports on a timely basis in accordance with generally accepted accounting principles. As a result, material errors and inadequate disclosures were made in the Company's preliminary financial statements that required adjustments prior to completion of the Form 10-K.

The Company's independent registered public accounting firm that audited the Company's consolidated financial statements included in this annual report has issued an attestation report on the effectiveness of the Company's internal control over financial reporting, which is included elsewhere herein. Management is also responsible for compliance with laws and regulations relating to safety and soundness, which are designated by the FDIC and the appropriate federal banking agency. Management assessed its compliance with these designated laws and regulations relating to safety and soundness and believes that the Company complied, in all significant respects, with such laws and regulations during the year ended December 31, 2008.

Remediation Plan

In response to the material weaknesses identified, we have developed the following remediation plan to address the material weaknesses, and we are proceeding expeditiously with the following measures to enhance internal controls.

We continue to emphasize the importance of following existing procedures for underwriting, lien perfection, and documentation for new and existing loans.

We continue to emphasize the importance of accurate risk grades on loans and will continue to develop our Credit Risk Review with our Regional Credit Officer staff to ensure proper grading of loans at origination, as well as throughout the life of the loan. Lenders and loan operations personnel have been informed of the requirement to assign risk grades to loans upon origination. The importance of periodic review of risk grades has been emphasized to ensure that changes are made as warranted due to the changes in the condition of the borrower, the collateral, or general economic conditions. The controls over pre-and post origination review of loans in loan operations have been strengthened to ensure the accuracy and completeness of loan data, including assignment of risk grades. Our Credit Risk Review staff will perform periodic risk grades reviews on selected loans to ensure risk grading accuracy.

We will develop a formal procedure for recommending and approving any changes to the allowance for loan loss model to ensure that such changes are appropriate. Procedures and controls over accuracy and completeness of impaired loan data including the specific allowances for probable losses will be documented and implemented during the first quarter of 2009.

We will continue to assess and strengthen current lending and credit administration policies and procedures, and are revising them as necessary to develop and implement policies and procedures that will promote a culture that expects reliability and integrity of data.

We expect to enhance financial reporting resources by adding personnel from the proposed merger with American Community Bancshares, Inc. In addition, a review of the staffing and technology resources that are needed to support accurate, complete, and timely financial reporting according to generally accepted accounting principles is underway. A proposal for remediation is expected to be completed and submitted to the audit committee in April 2009. This proposal will include documentation of the process enhancements and personnel responsible for both preparation and review. Implementation will begin immediately thereafter, and is expected to be completed during the second quarter of 2009.

Table of Contents

Our Board of Directors is actively monitoring these remediation efforts and may direct additional measures as deemed appropriate from time to time. We cannot be certain how long it will take to fully implement the remediation plan, whether the remediation plan will be effective to maintain adequate controls over our financial reporting process in the future, or whether the remediation plan will be sufficient to address and eliminate the material weaknesses.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal controls over financial reporting during the fourth quarter of 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting, except as mentioned above. The only changes in our internal control over financial reporting that occurred subsequent to the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, relate to the material weaknesses in internal control over financial reporting described above.

March 31, 2009

/s/ WILLIAM A. LONG	/s/ EDWIN E. LAWS
William A. Long	Edwin E. Laws
President & Chief Executive Officer	*Executive Vice President & Chief Financial Officer*

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors
Yadkin Valley Financial Corporation
Elkin, North Carolina

We have audited Yadkin Valley Financial Corporation and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because management's assessment and our audit were conducted to also meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (form FR Y-9 C). A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Table of Contents

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

Management identified the following material weaknesses as of December 31, 2008:

Control Environment

A control environment sets the tone of an organization, influences the control consciousness of its people, and is the foundation of all other components of internal control over financial reporting. The Company's control environment did not sufficiently promote effective internal control over financial reporting throughout the organization. Specifically, the following material weaknesses were identified in the Company's control environment at December 31, 2008:

Although management has taken steps to remediate deficiencies identified in the Annual Report on Form 10-K for the year ended December 31, 2007, management still needs to place greater emphasis on supporting effective application of policies, execution of procedures, and remediation of the deficiencies identified in previous periods.

Management needs additional financial reporting resources to ensure appropriate accounting, presentation, and disclosure in Company filings.

These deficiencies in the control environment contributed to the material weaknesses described below, and resulted in a reasonable possibility that a material error in the Company's interim or annual financial statements would not be prevented or detected.

Accounting for Significant Estimates

The Company did not maintain sufficient internal controls over the preparation and review of its allowance for loan losses model, including obtaining approval and documented support for changes in the underlying assumptions being used for the estimation. In addition, the Company did not maintain policies and procedures to ensure that identification of impaired loans and estimates of valuation allowances required under SFAS 114, *Accounting by Creditors for Impairment of a Loan* (as amended), are made timely and accurately, and are subject to a detailed supervisory review. These deficiencies contributed to various mathematical errors and inappropriate assumptions being made in the estimation of the allowance for loan losses. Material adjustments were subsequently made to the Company's preliminary consolidated financial statements.

Credit Administration

While management has committed substantial additional resources to credit administration in 2008, the Company needs to make further improvement to its internal control over certain areas involving credit administration, in order to reduce the possibility of material errors in the estimation of the allowance for loan losses. Specifically, the Company needs further internal controls over documentation of underwriting practices over renewals and extensions, collateral inspection on construction loans before approval of advances, monitoring of interest reserves on certain acquisition and development loans, and independent review of appraisals.

Preparation of Financial Reports

The Company did not maintain sufficient internal controls over the preparation and review of its financial reports for use in Company filings. In addition, the lack of adequate financial reporting resources prevented the Company from being able to properly prepare financial reports on a timely basis in accordance with generally accepted accounting principles. As a result, material errors and inadequate disclosures were made in the Company's preliminary financial statements that required adjustments prior to completion of the Form 10-K.

In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, Yadkin Valley Financial Corporation and subsidiaries has not maintained effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Yadkin Valley Financial Corporation and subsidiaries as of and for the year ended December 31, 2008, and our report dated March 31, 2009 expressed an unqualified opinion on those consolidated financial statements.

We do not express an opinion or any other form of assurance on management's statement referring to compliance with designated laws and regulations related to safety and soundness.

Charlotte, North Carolina
March 31, 2008

Table of Contents

Item 9B Other Information

None.

PART III

Item 10 Directors and Executive Officers and Corporate Governance

and

Item 11 Executive Compensation

and

Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Omitted, per general instruction G. The information required by Part III is incorporated by reference from the Registrant's definitive proxy statement pursuant to Regulation 14A for the annual shareholder's meeting to be held May 28, 2009, to be mailed to shareholders within 120 days of December 31, 2008, as filed with the SEC, which is incorporated herein by reference.

The following table sets forth equity compensation plan information at December 31, 2008.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column(a))
	(a)	(b)	(c)
Equity compensation plans approved by shareholders	467,002	$ 13.24	10,858
Equity compensation plans not approved by shareholders	NA	NA	NA
Total	467,002	$ 13.24	10,858

A description of Yadkin's equity compensation plans is presented in Note 11 to the accompanying consolidated financial statements.

Item 13 Certain Relationships and Related Transactions, and Director Independence

and

Item 14 Principal Accounting Fees and Services

Omitted, per general instruction G. The information required by Part III is incorporated by reference from the Registrant's definitive proxy statement pursuant to Regulation 14A for the annual shareholder's meeting to be held May 28, 2009, to be mailed to shareholders within 120 days of December 31, 2008, as filed with the SEC, which is incorporated herein by reference.

PART IV

Item 15 Exhibits, Financial Statement Schedules

Financial Statements. The following financial statements and supplementary data are included in Item 8 of this report.

Financial Statement Schedules. All applicable financial statement schedules required under Regulation S-X have been included in the Notes to the Consolidated Financial Statements.

Exhibits. The exhibits required by Item 601 of Regulation S-K are listed below.

Exhibit No.	Description
Exhibit 2.1	Agreement and Plan of Merger by and between Yadkin Valley Financial Corporation and American Community Bancshares, Inc. dated as of September 9, 2008 (incorporated by reference to 2.1 of the Form 8-K filed on September 10, 2008)
Exhibit 3.1	Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3(i) to the Current Report on Form 8K dated July 1, 2006)
Exhibit 3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 of the Form 8-K filed on December 19, 2008)
Exhibit 3.3	Articles of Amendment to the Company's Restated Articles of Incorporation establishing the terms of the Series T Preferred Stock (incorporated by reference to Exhibit 3.1 to the Form 8-K filed on January 20, 2009).
Exhibit 4.1	Specimen certificate for Common Stock (incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10K for the year ended December 31, 2006)
Exhibit 4.2	Form of Series T Preferred Stock Certificate issued to The United States Department of the Treasury (incorporated by reference to Exhibit 4.2 to the Form 8-K filed January 20, 2009).
Exhibit 4.3	Warrant to Purchase up to 385,990 shares of Common Stock (incorporated by reference to Exhibit 4.1 to the Form 8-K filed on January 20, 2009).

Table of Contents

Exhibit No.	Description
Exhibit 10.1	Yadkin Valley Financial Corporation 1998 Employees Incentive Stock Option Plan (incorporated by reference to Exhibit 4 to Registration Statement on Form S-8 filed August 8, 2006 (file number 333-136967))
Exhibit 10.2	Yadkin Valley Financial Corporation 1999 Stock Option Plan (incorporated by reference to Exhibit 4 to Registration Statement on Form S-8 filed August 8, 2006 (file number 333-136968))
Exhibit 10.3	Yadkin Valley Financial Corporation 1998 Non-Statutory Stock Option Plan (incorporated by reference to Exhibit 4 to Registration Statement on Form S-8 filed August 8, 2006 (file number 333-136969))
Exhibit 10.4	Yadkin Valley Financial Corporation 1998 Incentive Stock Option Plan (incorporated by reference to Exhibit 4 to Registration Statement on Form S-8 filed August 8, 2006 (file number 333-136970))
Exhibit 10.5	Employment Agreement with William A. Long
Exhibit 10.6	Employment Agreement with Edwin E. Laws
Exhibit 10.7	Employment Agreement with Stephen S. Robinson
Exhibit 10.8	2007 Group Term Carve Out Plan (incorporated by reference to Exhibit 10.7 to the Annual Report on Form 10-K for the year ended December 31, 2007).
Exhibit 10.9	Letter Agreement, dated January 16, 2009, including Securities Purchase Agreement Standard Terms incorporated by reference therein, between the Company and the United States Department of the Treasury (incorporated by reference to Exhibit 10.1 to the Form 8-K filed on January 20, 2009).
Exhibit 10.10	Form of Waiver, executed by each of Messrs. John M. Brubaker, Joe K. Johnson, Edwin E. Laws, William A. Long, John W. Mallard, Jr., Edward L. Marxen, Steven S. Robinson, and Joseph H. Towell (incorporated by reference to Exhibit 10.2 to the Form 8-K filed on January 20, 2009).
Exhibit 10.11	Form of Letter Agreement, executed by each of Messrs. John M. Brubaker, Joe K. Johnson, Edwin E. Laws, William A. Long, John W. Mallard, Jr., Edward L. Marxen, Steven S. Robinson, and Joseph H. Towell with the Company (incorporated by reference to Exhibit 10.3 to the Form 8-K filed on January 20, 2009).
Exhibit 21	Subsidiaries of the Registrant
Exhibit 23	Consent of Independent Registered Public Accounting Firm
Exhibit 31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
Exhibit 31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
Exhibit 32	Section 1350 Certification

Table of Contents

Signatures

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

YADKIN VALLEY FINANCIAL CORPORATION

By: /s/ WILLIAM A. LONG — Date: March 31, 2009

William A. Long
President and Chief Executive Officer

By: /s/ EDWIN E. LAWS — Date: March 31, 2009

Edwin E. Laws
Executive Vice President and
Chief Financial Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ WILLIAM A. LONG — Date: March 31, 2009

William A. Long
President, Chief Executive Officer, and
Director

/s/ RALPH L. BENTLEY — Date: March 31, 2009

Ralph L. Bentley
Director

/s/ J. T. ALEXANDER, JR.. — Date: March 31, 2009

J.T. Alexander, Jr.
Director

/s/ NOLAN G. BROWN — Date: March 31, 2009

Nolan G. Brown
Director

/s/ FAYE COOPER — Date: March 31, 2009

Faye Cooper
Director

Table of Contents

	Date: March 31, 2009
Harry M. Davis *Director*	
/s/ JAMES A. HARRELL, JR.	Date: March 31, 2009
James A. Harrell, Jr. *Director*	
/s/ DAN W. HILL, III	Date: March 31, 2009
Dan W. Hill, III *Director*	
	Date: March 31, 2009
Daniel J. Park *Director*	
/s/ JAMES L. POINDEXTER	Date: March 31, 2009
James L. Poindexter *Director*	
/s/ MORRIS L. SHAMBLEY	Date: March 31, 2009
Morris L. Shambley *Director*	
/s/ JAMES N. SMOAK	Date: March 31, 2009
James N. Smoak *Director*	
/s/ HARRY C. SPELL	Date: March 31, 2009
Harry C. Spell *Director*	
/s/ C. KENNETH WILCOX	Date: March 31, 2009
C. Kenneth Wilcox *Director*	

Exhibit 10.5

AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AMENDED AND RESTATED EMPLOYMENT AGREEMENT (this Agreement) is entered into as of December 31, 2008, by and between Yadkin Valley Financial Corporation, a North Carolina corporation (the Company), Yadkin Valley Bank and Trust (the Bank), a North Carolina state bank and wholly owned subsidiary of the Company (the Company and the Bank collectively referred to herein as the Employer) and William A. Long of Statesville, North Carolina (the Officer). This Agreement amends and restates that certain employment agreement dated April 1, 2000.

For and in consideration of their mutual promises, covenants and conditions hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which hereby is acknowledged, the parties agree as follows:

1. **Employment.** The Employer agrees to continue to employ the Officer and the Officer agrees to continue to accept employment upon the terms and conditions stated herein as the President and Chief Executive Officer of the Company and the Bank. The Officer shall render such administrative and management services to the Employer as are customarily performed by persons situated in a similar executive capacity. The Officer shall promote the business of the Employer and perform such other duties as shall, from time to time, be reasonably assigned by the Board of Directors of the Company or the Bank (collectively, the Directors). Upon the request of the Directors, the Officer shall disclose all business activities or commercial pursuits in which Officer is engaged, other than Employer duties.

2. **Compensation.** The Employer shall pay the Officer during the term of this Agreement, as compensation for all services rendered by the Officer to the Employer, a base salary at the rate of $324,046 per annum, payable in cash in accordance with the Employer s standard payroll practices, which for purposes of this Agreement shall mean not less frequently than monthly. The rate of such salary shall be reviewed by the Directors not less often than annually and if increased, shall not be decreased during the term of this Agreement. Such rate of salary, or increased rate of salary, as the case may be, may be further increased from time to time in such amounts as the Directors, in their discretion, may decide. In determining salary increases, the Directors shall compensate the Officer for increases in the cost of living and may also provide for performance or merit increases. Participation in the Employer s incentive compensation, deferred compensation, discretionary bonus, profit-sharing, retirement and other employee benefit plans and participation in any fringe benefits shall not reduce the salary payable to the Officer under this Paragraph. In the event of a Change in Control (as defined in Paragraph 10), the Officer s rate of salary shall be increased not less than five percent annually during the term of this Agreement. Any payments made under this Agreement shall be subject to such deductions as are required by law or regulation or as may be agreed to by the Employer and the Officer.

3. **Discretionary Bonuses.** During the term of this Agreement, the Officer shall be entitled to such discretionary bonuses as may be authorized, declared and paid by the Directors to the Employer s key management employees. All such bonuses authorized and declared by the Directors shall be paid in cash at the latest within sixty days of the earlier of such authorization or declaration. No other compensation provided for in this Agreement shall be deemed a substitute for the Officer s right to such discretionary bonuses when and as declared by the Directors.

4. **Participation in Retirement and Employee Benefit Plans; Fringe Benefits.**

(a) The Employer shall provide family medical and dental coverage and disability insurance for the Officer and the Officer shall also be entitled to participate in any plan relating to deferred compensation, stock options, stock purchases, pension, thrift, profit sharing, group life insurance, education, or other retirement or employee benefits that the Employer has adopted, or may, from time to time adopt, for the benefit of its executive employees or for employees generally, subject to the eligibility rules of such plans. Any options or similar awards shall be issued to the Officer at an exercise price of not less than the stock s current fair market value (as determined in compliance with Treasury Regulation § 1.409A-1(b)(5)(iv)) as of the date of grant, and the number of shares subject to such grant shall be fixed on the date of grant.

(b) The Employer shall provide the Officer with the use of a late model automobile suitable to the status of the chief executive officer of the Employer of a type and for lease terms to be approved the Executive Committee of the Employer. The Employer shall pay for all reasonable expenses, including, but not limited to, insurance coverage and gasoline, by the Officer in connection with the operation and maintenance of such automobile. Replacement of the automobile shall be made only with the approval of the Directors and in accordance with the policies of the Bank in effect from time to time relating to the replacement of automobiles.

(c) The Officer shall be insured by the Employer under a term insurance policy providing a death benefit of up to $250,000 with such members of the Officer s family named as beneficiaries as the Officer may determine.

(d) The Employer shall pay the expenses of the Officer for membership and dues in the Statesville Country Club and The Point Country Club, in one civic club, and for a family membership in a health facility.

(e) The Officer shall also be entitled to participate in any other fringe benefits which are now or may be or become applicable to the Employer s executive employees, including the payment of reasonable expenses for attending annual and periodic meetings of trade associations, and any other benefits which are commensurate with the duties and responsibilities to be performed by the Officer under this Agreement. Additionally, the Officer shall be entitled to such vacation and sick leave as shall be established under uniform employee policies promulgated by the Directors. The Employer shall reimburse the Officer

for all out-of-pocket reasonable and necessary business expenses which the Officer may incur in connection with the Officer s services on behalf of the Employer. The Employer shall reimburse the Officer for such expenses described in this Paragraph 4 within 60 days of Officer s incurring such expense.

5. **Term.** The initial term of employment under this Agreement shall be for the period commencing upon the effective date of this Agreement and ending three calendar years from the effective date of this Agreement. On each anniversary of the effective date of this Agreement, the term of this Agreement shall automatically be extended for an additional one year period beyond the then effective expiration date unless written notice from the Employer or the Officer is received 90 days prior to an anniversary date advising the other that this Agreement shall not be further extended; provided that the Directors shall review the Officer s performance annually and make a specific determination pursuant to such review to renew this Agreement prior to the 90 days notice.

6. **Loyalty; Noncompetition.**

(a) The Officer shall devote his full efforts and entire business time to the performance of the Officer s duties and responsibilities under this Agreement.

(b) During the term of this Agreement, or any renewals thereof, and for a period of one year after termination, the Officer agrees he will not, within Iredell County, North Carolina, or within 30 miles of any Bank office opened during the term of this Agreement, directly or indirectly, own, manage, operate, join, control or participate in the management, operation or control of, or be employed by or connected in any manner with any business which competes with the Employer or any of its subsidiaries without the prior written consent of the Employer; provided, however, that the provisions of this Paragraph shall not apply in the event the Officer s employment is unilaterally terminated by the Employer for Cause, (as such term is defined in Paragraph 8(c) hereof) or in the event the Officer terminates his employment with the Employer for good reason (as such term is defined in Paragraph 10(b) hereof) following a Change in Control (as such term is defined in Paragraph 10(d) hereof). Notwithstanding the foregoing, the Officer shall be free, without such consent, to purchase or hold as an investment or otherwise, up to five percent of the outstanding stock or other security of any corporation which has its securities publicly traded on any recognized securities exchange or in any over-the counter market.

(c) The Officer agrees he will hold in confidence all knowledge or information of a confidential nature with respect to the business of, the Employer or any subsidiary received by the Officer during the term of this Agreement and will not disclose or make use of such information without the prior written consent of the Bank. The Officer agrees that he will be liable to the Employer for any damages caused by unauthorized disclosure of such information. Upon termination of his employment, the Officer agrees to return all records or copies thereof of the Employer or any subsidiary in his possession or under his control which relate to the activities of the Employer or any subsidiary.

3

(d) The Officer acknowledges that it would not be possible to ascertain the amount of monetary damages in the event of a breach by the Officer under the provisions of this Paragraph 6. The Officer agrees that, in the event of a breach of this Paragraph 6, injunctive relief enforcing the terms of this Paragraph 6 is an appropriate remedy. If the scope of any restriction contained in this Paragraph 6 is determined to be too broad by any court of competent jurisdiction, then such restriction shall be enforced to the maximum extent permitted by law and the Officer consents that the scope of this restriction may be modified judicially.

7. **Standards.** The Officer shall perform his duties and responsibilities under this Agreement in accordance with such reasonable standards expected of employees with comparable positions in comparable organizations and as may be established from time to time by the Directors. The Employer will provide the Officer with the working facilities and staff customary for similar executives and necessary for the Officer to perform his duties.

8. **Termination and Termination Pay.** For purposes of this Agreement, the term terminate or termination shall mean as separation from service as defined by Treasury Regulation § 1.409A-1(h).

(a) The Officer s employment under this Agreement shall be terminated upon the death of the Officer during the term of this Agreement, in which event, the Officer s estate shall be entitled to receive the compensation due the Officer through the last day of the calendar month in which the Officer s death shall have occurred and for a period of one month thereafter. All such payments due under this Paragraph shall be paid to the estate within 30 days of the date of death of the Officer.

(b) The Officer s employment under this Agreement may be terminated at any time by the Officer upon 60 days written notice to the Directors. Upon such termination, the Officer shall be entitled to receive compensation through the effective date of such termination. All such payments due under this Paragraph shall be paid to the Officer within 30 days of the date of written notice to the Directors.

(c) The Directors may terminate the Officer s employment at any time, but any termination by the Directors, other than termination for Cause, shall not prejudice the Officer s right to compensation or other benefits under this Agreement. The Employer shall provide written notice specifying the grounds for termination for Cause. The Officer shall have no right to receive compensation or other benefits for any period after termination for Cause. Termination for Cause shall include termination because of the Officer s personal dishonesty or moral turpitude, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of this Agreement. Subject to Paragraph 11(b) below, any amount of compensation or other benefit that the Officer has a right to as of the date of termination shall be paid within 30 days of such termination. Notwithstanding such

termination, the obligations under Paragraph 6(c) shall survive any termination of employment.

(d) Subject to the Employer s obligations and the Officer s rights under (i) Title I of the Americans with Disabilities Act, §504 of the Rehabilitation Act, and the Family and Medical Leave Act, and to (ii) the vacation leave, disability leave, sick leave and any other leave policies of the Employer, the Officer s employment under this Agreement automatically shall be terminated in the event that the Employer determines that the Officer has become disabled (as defined by Treasury Regulation § 1.409A-3(i)(4)) during the term of this Agreement. Upon any such termination, the Officer shall be entitled to receive any compensation the Officer shall have earned prior to the date of termination but which remains unpaid, and all such amounts shall be paid to the Officer within 30 days of such termination. The Officer shall also be entitled to receive any payments provided under any disability income plan of the Employer which is applicable to the Officer.

In the event of any disagreement between the Officer and the Employer as to whether the Officer is physically or mentally disabled such as will result in the termination of the Officer s employment pursuant to this Paragraph 8(d), the question of such disability shall be submitted to an impartial physician licensed to practice medicine in North Carolina for determination and who will be selected by mutual agreement of the Officer and the Employer, or failing such agreement, by two (2) physicians (one (1) of whom shall be selected by the Employer and the other by the Officer), and such determination of the question of such disability by such physician or physicians shall be final and binding on the Officer and the Employer. The Employer shall pay the reasonable fees and expenses of such physician or physicians in making any determination required under this Paragraph 8(d).

9. **<u>Additional Regulatory Requirements</u>.** Notwithstanding anything contained in this Agreement to the contrary, it is understood and agreed that the Employer (or any of its successors in interest) shall not be required to make any payment or take any action under this Agreement if:

(a) the Bank is declared by any governmental agency having jurisdiction over the Bank (hereinafter referred to as Regulatory Authority) to be insolvent, in default or operating in an unsafe or unsound manner; or,

(b) in the reasonable opinion of counsel to the Employer, such payment or action (i) would be prohibited by or would violate any provision of state or federal law applicable to the Employer, including, without limitation, the Federal Deposit Insurance Act as now in effect or hereafter amended, (ii) would be prohibited by or would violate any applicable rules, regulations, orders or statements of policy, whether now existing or hereafter promulgated, of any Regulatory Authority, or (iii) otherwise would be prohibited by any Regulatory Authority.

10. **Change in Control.**

(a) In the event of a termination of the Officer s employment in connection with, or within twenty-four (24) Months after, a Change in Control (as defined in Subparagraph (d) below) of the Employer other than for Cause (as defined in Paragraph 8), the Officer shall be entitled to receive liquidated damages as set forth in Subparagraph (c) below. Such sum shall be payable as provided in Subparagraph (e) below.

(b) In addition to any rights the Officer might have to terminate this Agreement contained in Paragraph 8, the Officer shall have the right to terminate this Agreement for good reason , as such term is defined by Treasury Regulation § 1.409A-1(n)(2), within twenty-four months following a Change in Control of the Bank.

(c) In the event that the Officer terminates this Agreement pursuant to this Paragraph 10, the Employer will be obligated to pay or cause to be paid to Officer liquidated damages in an amount equal to 2.99 times the Officer s base amount as defined in Section 280G(b)(3) of the Internal Revenue Code of 1986, as amended (the Code).

(d) For the purposes of this Agreement, the term Change in Control shall mean as defined by Treasury Regulation § 1.409A-3(i)(5). Notwithstanding the other provisions of this Paragraph 10, a transaction or event shall not he considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, Officer and Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

(e) Subject to Paragraph 11(b) below, such amounts payable pursuant to this Paragraph 10 shall be paid in one lump sum payment within fifteen (15) days following termination of this Agreement.

(f) Following an event constituting good reason for termination which gives rise to Officer s rights hereunder, the Officer shall have twelve (12) months from the date of occurrence of such event to terminate this Agreement pursuant to this Paragraph 10. Any such termination shall be deemed to have occurred only upon delivery to the Employer (or to any successor corporation) of written notice of termination which describes the Change in Control and the event constituting good reason. If Officer does not so terminate this Agreement within such twelve-month period, he shall thereafter have no further rights hereunder with respect to the event constituting good reason, but shall retain rights, if any, hereunder with respect to any other event constituting good reason as to which such period has not expired.

(g) It is the intent of the parties hereto that all payments made pursuant to this Agreement be deductible by the Employer for federal income tax purposes and not result in the imposition of an excise tax on the Officer.

Notwithstanding anything contained in this Agreement to the contrary, any payments to be made to or for the benefit of the Officer which are deemed to be parachute payments as that term is defined in Section 280G of the Code, shall be modified or reduced to the extent deemed to be necessary by the Directors to avoid the imposition of excise taxes on the Officer under Section 4999 of the Code or the disallowance of a deduction to the Bank under Section 280(a) of the Code.

(h) In the event any dispute shall arise between the Officer and the Employer as to the terms or interpretation of this Agreement, including this Paragraph 10, whether instituted by formal legal proceedings or otherwise, including any action taken by the Officer to enforce the terms of this Paragraph 10 or in defending against any action taken by the Employer, the Employer shall reimburse the Officer for all costs and expenses, proceedings or actions, in the event the Officer prevails in any such action.

11. Conditions to any Payment of Severance Amounts.

(a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Employer which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Employer.

(b) If: (1) when the Officer s employment terminates under this Agreement he is a specified employee, as defined in Section 409A of the Code or the regulations promulgated thereunder; (2) the Officer s employment did not terminate because of his death; (3) any payments under this Agreement will result in additional tax or interest to the Officer because of Section 409A or the regulations promulgated thereunder; and (4) an exemption from the six-month delay requirement of Section 409A(a)(2)(B)(i) is not available, then despite any provision of this Agreement to the contrary the Officer will not be entitled to such payments until the earlier of: (1) six months and one day after termination of the Officer s employment; or (2) his death. Payments that would have otherwise been paid during such six month and one day period shall be accumulated and paid on the earlier of: (1) the first day of the seventh month after such termination of employment; or (2) death of the Officer; and the remaining amount of any such payment due under this Agreement shall be paid as set forth elsewhere in this Agreement without regard to this Paragraph.

12. Successors and Assigns.

(a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Employer which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Employer.

(b) Since the Employer is contracting for the unique, and personal skills of the Officer, the Officer shall be precluded from assigning or delegating his rights or duties hereunder without first obtaining the written consent of the Employer.

13. Modification; Wavier; Amendments. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing, signed by the Officer and on behalf of the Employer by such officer as may be specifically designated by the Directors. No waiver by either party hereto, at any time, of any breach by the other party hereto of, or compliance with, any condition or provision of this

Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No amendment or addition to this Agreement shall be binding unless in writing and signed by both parties, except as herein otherwise provided.

14. **Applicable Law.** This Agreement shall be governed in all respects whether as to validity, construction, capacity, performance or otherwise, by the laws of North Carolina, except to the extent that federal law shall be deemed to apply.

15. **Severability.** The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

16. **Compliance with Internal Revenue Code Section 409A.** The Employer and the Officer intend that their exercise of authority or discretion under this Agreement shall comply with section 409A of the Internal Revenue Code of 1986. If any provision of this Agreement does not satisfy the requirements of section 409A, such provision shall nevertheless be applied in a manner consistent with those requirements. If any provision of this Agreement would subject the Officer to additional tax or interest under section 409A, the Employer shall reform the provision. However, the Employer shall maintain to the maximum extent practicable the original intent of the applicable provision without subjecting the Officer to additional tax or interest, and the Officer shall not be required to incur any additional compensation expense as a result of the reformed provision. References in this Agreement to section 409A of the Internal Revenue Code of 1986 include rules, regulations, and guidance of general application issued by the Department of the Treasury under Internal Revenue Code section 409A.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first hereinabove written.

YADKIN VALLEY FINANCIAL CORPORATION

ATTEST:

By:	/s/ Patricia Wooten	By:	/s/ Edwin E. Laws
Name:	Patricia Wooten	Name:	Edwin E. Laws
		Title:	Chief Financial Officer

YADKIN VALLEY BANK AND TRUST

ATTEST:

By:	/s/ Patricia Wooten	By:	/s/ Edwin E. Laws
Name:	Patricia Wooten	Name:	Edwin E. Laws
		Title:	Chief Financial Officer

OFFICER

/s/ William A. Long
William A. Long

9

Exhibit 10.6

AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AMENDED AND RESTATED EMPLOYMENT AGREEMENT (this Agreement) is entered into as of December 31, 2008, by and between Yadkin Valley Financial Corporation, a North Carolina corporation (the Company), Yadkin Valley Bank and Trust (the Bank), a North Carolina state bank and wholly owned subsidiary of the Company (the Company and the Bank collectively referred to herein as the Employer) and Edwin E. Laws of Statesville, North Carolina (the Officer). This Agreement amends and restates that certain employment agreement dated February 1, 1999.

For and in consideration of their mutual promises, covenants and conditions hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which hereby is acknowledged, the parties agree as follows:

1. **Emp1oyment.** The Employer agrees to continue to employ the Officer and the Officer agrees to continue to accept employment upon the terms and conditions stated herein as the Chief Financial Officer and Treasurer of the Company and the Bank. The Officer shall render such administrative and management services to the Employer as are customarily performed by persons situated in a similar executive capacity. The Officer shall promote the business of the Employer, including being active in at least one civic organization in Iredell County, and perform such other duties as shall, from time to time, be reasonably assigned by the Board of Directors of the Company or the Bank (collectively, the Directors). Upon the request of the Directors, the Officer shall disclose all business activities or commercial pursuits in which Officer is engaged, other than Employer duties.

2. **Compensation.** The Employer shall pay the Officer during the term of this Agreement, as compensation for all services rendered by the Officer to the Employer, a base salary at the rate of $144,213 per annum, payable in cash in accordance with the Employer s standard payroll practices, which for purposes of this Agreement shall mean not less frequently than monthly. Participation in the Employer s incentive compensation, deferred compensation, discretionary bonus, profit-sharing, retirement and other employee benefit plans and participation in any fringe benefits shall not reduce the salary payable to the Officer under this Paragraph. In the event of a Change in Control (as defined in Paragraph 10), the Officer s rate of salary shall be increased not less than five percent annually during the term of this Agreement. Any payments made under this Agreement shall be subject to such deductions as are required by law or regulation or as may be agreed to by the Bank and the Officer.

3. **Discretionary Bonuses.** During the term of this Agreement, the Officer shall be entitled, in an equitable manner with all other key management personnel of the Employer, to such discretionary bonuses as may be authorized, declared and paid by the Directors to the Employer s key management employees. All such bonuses authorized and declared by the Directors shall be paid in cash at the latest within sixty days of the earlier of such authorization or declaration. No other compensation provided for in this Agreement shall be

deemed a substitute for the Officer s right to such discretionary bonuses when and as declared by the Directors.

4. Participation in Retirement and Employee Benefit Plans; Fringe Benefits.

(a) The Employer shall provide family medical coverage for the Officer and the Officer shall also be entitled to participate in any plan relating to deferred compensation, stock options, stock purchases, pension, thrift, profit sharing, group life insurance, disability coverage, education, or other retirement or employee benefits that the Employer has adopted, or may, from time to time adopt, for the benefit of its executive employees or for employees generally, subject to the eligibility rules of such plans. Any options or similar awards shall be issued to the Officer at an exercise price of not less than the stock s current fair market value (as determined in compliance with Treasury Regulation § 1.409A-1(b)(5)(iv)) as of the date of grant, and the number of shares subject to such grant shall be fixed on the date of grant.

(b) The Employer shall pay the expenses of the Officer for membership and dues in one country club and in one civic club in Statesville.

(c) The Officer shall also be entitled to participate in any other fringe benefits which are now or may be or become applicable to the Employer s executive employees, including the payment of reasonable expenses for continuing education to maintain professional designations, and any other benefits which are commensurate with the duties and responsibilities to be performed by the Officer under this Agreement. Additionally, the Officer shall be entitled to such vacation and sick leave as shall be established under uniform employee policies promulgated by the Directors. The Employer shall reimburse the Officer for all out-of-pocket reasonable and necessary business expenses which the Officer may incur in connection with the Officer s services on behalf of the Employer. The Employer shall reimburse the Officer for such expenses described in this Paragraph 4 within 60 days of Officer s incurring such expense.

5. **Term.** The initial term of employment under this Agreement shall be for the period commencing upon the effective date of this Agreement and ending one calendar years from the effective date of this Agreement. On each anniversary of the effective date of this Agreement, the term of this Agreement shall automatically be extended for an additional one year period beyond the then effective expiration date unless written notice from the Employer or the Officer is received 90 days prior to an anniversary date advising the other that this Agreement shall not be further extended; provided that the Directors shall review the Officer s performance annually and make a specific determination pursuant to such review to renew this Agreement prior to the 90 days notice.

6. Loyalty; Noncompetition.

(a) The Officer shall devote his full efforts and entire business time to the performance of his duties and responsibilities under this Agreement.

(b) During the term of this Agreement, or any renewals thereof, and for a period of [two] years after termination, the Officer agrees he will not, within Iredell County, North Carolina, or within 15 miles of any Bank office opened during the term of this Agreement, directly or indirectly, own, manage, operate, join, control or participate in the management, operation or control of, or be employed by or connected in any manner with any business which competes with the Employer or any of its subsidiaries without the prior written consent of the Employer; provided, however, that the provisions of this Paragraph shall not apply in the event the Officer s employment is unilaterally terminated by the Employer for Cause, (as such term is defined in Paragraph 8(c) hereof) or in the event the Officer terminates his employment with the Employer for good reason (as such term is defined in Paragraph 10(b) hereof) following a Change in Control (as such term is defined in Paragraph 10(d) hereof). Notwithstanding the foregoing, the Officer shall be free, without such consent, to purchase or hold as an investment or otherwise, up to five percent of the outstanding stock or other security of any corporation which has its securities publicly traded on any recognized securities exchange or in any over the counter market.

(c) The Officer agrees he will hold in confidence all knowledge or information of a confidential nature with respect to the business of the Employer or any subsidiary received by the Officer during the term of this Agreement and will not disclose or make use of such information without the prior written consent of the Employer. The Officer agrees that he will be liable to the Employer for any damages caused by unauthorized disclosure of such information. Upon termination of his employment, the Officer agrees to, return all records or copies thereof of the Employer or any subsidiary in his possession or under his control which relate to the activities of the Employer or any subsidiary.

(d) The Officer acknowledges that it would not be possible to ascertain the amount of monetary damages in the event of a breach by the Officer under the provisions of this Paragraph 6. The Officer agrees that, in the event of a breach of this Paragraph 6, injunctive relief enforcing the terms of this Paragraph 6 is an appropriate remedy. If the scope of any restriction contained in this Paragraph 6 is determined to be too broad by any court of competent jurisdiction, then such restriction shall be enforced to the maximum extent permitted by law and the Officer consents that the scope of this restriction may be modified judicially.

7. **Standards.** The Officer shall perform his duties and responsibilities under this Agreement in accordance with such reasonable standards expected of employees with comparable positions in comparable organizations and as may be established from time to time by the Directors. The Employer will provide the Officer with the working facilities and staff customary for similar executives and necessary for the Officer to perform his duties.

8. **Termination and Termination Pay.** For purposes of this Agreement, the term terminate or termination shall mean a separation from service as defined by Treasury Regulation § 1.409A-1(h).

(a) The Officer s employment under this Agreement shall be terminated upon the death of the Officer during the term of this Agreement, in which event, the Officer s estate shall be entitled to receive the compensation due the Officer through the last day of the calendar month in which the Officer s death shall have occurred and for a period of one month thereafter. All such payments due under this Paragraph 8(a) shall be paid to the estate within 30 days of the date of death of the Officer.

(b) The Officer s employment under this Agreement may be terminated at any time by the Officer upon 60 days written notice to the Directors. Upon such termination, the Officer shall be entitled to receive compensation through the effective date of such termination. All such payments due under this Paragraph 8(b) shall be paid to the Officer within 30 days of the date of written notice to the Directors.

(c) The Directors may terminate the Officer s employment at any time, but any termination by the Directors, other than termination for Cause, shall not prejudice the Officer s right to compensation or other benefits under this Agreement. The Employer shall provide written notice specifying the grounds for termination for Cause. The Officer shall have no right to receive compensation or other benefits for any period after termination for Cause. Termination for Cause shall include termination because of the Officer s personal dishonesty or moral turpitude, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of this Agreement. Subject to Paragraph 11(b) below, any amount of compensation or other benefit that the Officer has a right to as of the date of termination shall be paid within 30 days of such termination. Notwithstanding such termination, the obligations under Paragraph 6(c) shall survive any termination of employment.

(d) Subject to the Employer s obligations and the Officer s rights under (i) Title I of the Americans with Disabilities Act, §504 of the Rehabilitation Act, and the Family and Medical Leave Act, and to (ii) the vacation leave, disability leave, sick leave and any other leave policies of the Employer, the Officer s employment under this Agreement automatically shall be terminated in the event that the Employer determines that the Officer has become disabled (as defined by Treasury Regulation § 1.409A-3(i)(4)) during the term of this Agreement. Upon any such termination, the Officer shall be entitled to receive any compensation the Officer shall have earned prior to the date of termination but which remains unpaid, and all such amounts shall be paid to the Officer within 30 days of such termination. The Officer shall also be entitled to receive any payments provided under any disability income plan of the Employer which is applicable to the Officer.

In the event of any disagreement between the Officer and the Employer as to whether the Officer is physically or mentally disabled such as will result in the termination of the Officer s employment pursuant to this Paragraph 8(d), the question of such disability shall be submitted to an impartial physical licensed to practice medicine in North Carolina for determination and who will be selected by mutual agreement of the Officer and the Employer, or failing such agreement, by two (2) physicians (one (1) of whom shall be selected by the Employer and the other by the Officer), and such determination of the question of such disability by such physician or physicians shall be final and binding on the Officer and the Employer. The Employer shall pay the reasonable fees and expenses of such physician or physicians in making any determination required under this Paragraph 8(d).

9. **Additional Regulatory Requirements.** Notwithstanding anything contained in this Agreement to the contrary, it is understood and agreed that the Employer (or any of its successors in interest) shall not be required to make any payment or take any action under this Agreement if:

(a) the Bank is declared by any governmental agency having jurisdiction over the Bank (hereinafter referred to as Regulatory Authority) to be insolvent, in default or operating in an unsafe or unsound manner; or,

(b) in the opinion of counsel to the Employer, such payment or action (i) would be prohibited by or would violate any provision of state or federal law applicable to the Employer, including, without limitation, the Federal Deposit Insurance Act as now in effect or hereafter amended, (ii) would be prohibited by or would violate any applicable rules, regulations, orders or statements of policy, whether now existing or hereafter promulgated, of any Regulatory Authority, or (iii) otherwise would be prohibited by any Regulatory Authority.

10. **Change in Control.**

(a) In the event of a termination of the Officer s employment in connection with, or within twenty-four (24) months after, a Change in Control (as defined in Subparagraph (d) below) of the Employer other than for Cause (as defined in Paragraph 8), the Officer shall be entitled to receive liquidated damages as set forth in Subparagraph (c) below. Such sum shall be payable as provided in Subparagraph (e) below.

(b) In addition to any rights the Officer might have to terminate this Agreement contained in Paragraph 8, the Officer shall have the right to terminate this Agreement for good reason , as such term is defined by Treasury Regulation § 1.409A-1(n)(2), within twenty-four months following a Change in Control of the Bank.

(c) In the event that the Officer terminates this Agreement pursuant to this Paragraph 10, the Employer will be obligated to pay or cause to be paid to Officer liquidated damages in an amount equal to 2.99 times the Officer s base amount as defined in Section 280G(b)(3) of the Internal Revenue Code of 1986, as amended (the Code).

(d) For the purposes of this Agreement, the term Change in Control shall mean as defined by Treasury Regulation § 1.409A-3(i)(5). Notwithstanding the other provisions of this Paragraph 10, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, Officer and

Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

(e) Subject to Paragraph 11(b) below, such amounts payable pursuant to this Paragraph 10 shall be paid in one lump sum payment within fifteen (15) days following termination of this Agreement.

(f) Following an event constituting good reason for termination which gives rise to Officer s rights hereunder, the Officer shall have twelve (12) months from the date of occurrence of such event to terminate this Agreement pursuant to this Paragraph 10. Any such termination shall be deemed to have occurred only upon delivery to the Employer (or to any successor corporation) of written notice of termination which describes the Change in Control and the event constituting good reason. If Officer does not so terminate this Agreement within such twelve-month period, he shall thereafter have no further rights hereunder with respect to the event constituting good reason, but shall retain rights, if any, hereunder with respect to any other event constituting good reason as to which such period has not expired.

(g) It is the intent of the parties hereto that all payments made pursuant to this Agreement be deductible by the Employer for federal income tax purposes and not result in the imposition of an excise tax on the Officer. Notwithstanding anything contained in this Agreement to the contrary, any payments to be made to or for the benefit of the Officer which are deemed to be parachute payments as that term is defined in Section 280G of the Code, shall be modified or reduced to the extent deemed to be necessary by the Directors to avoid the imposition of excise taxes on the Officer under Section 4999 of the Code or the disallowance of a deduction to the Employer under Section 280(a) of the Code.

(h) In the event any dispute shall arise between the Officer and the Employer as to the terms or interpretation of this Agreement, including this Paragraph 10, whether instituted by formal legal proceedings or otherwise, including any action taken by the Officer to enforce the terms of this Paragraph 10 or in defending against any action taken by the Employer, the Employer shall reimburse the Officer for all costs and expenses, proceedings or actions, in the event the Officer prevails in any such action.

11. **Conditions to any Payment of Severance Amounts.**

(a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Employer which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Employer.

(b) If: (1) when the Officer s employment terminates under this Agreement he is a specified employee, as defined in Section 409A of the Code or the regulations promulgated thereunder; (2) the Officer s employment did not terminate because of his death; (3) any payments under this Agreement will result in additional tax or interest to the Officer because of Section 409A or the regulations promulgated thereunder; and (4) an exemption from the six-month delay requirement of Section 409A(a)(2)(B)(i) is not available, then despite any provision of this Agreement to the contrary the Officer will not be entitled to such payments until the earlier of: (1) six months and one day after termination of the Officer s employment; or (2) his death. Payments that would have otherwise been paid during such six month and one day period shall be accumulated and paid on the earlier of: (1) the first day of the seventh month after such termination of employment; or (2) death of the Officer; and the remaining amount of any such payment due under this Agreement shall be paid as set forth elsewhere in this Agreement without regard to this Paragraph.

12. **Successors and Assigns.**

(a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Employer which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Employer.

(b) Since the Employer is contracting for the unique and personal skills of the, Officer, the Officer shall be precluded from assigning or delegating his rights or duties hereunder without first obtaining the written consent of the Employer.

13. **Modification; Wavier; Amendments.** No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing, signed by the Officer and on behalf of the Employer by such officer as may be specifically designated by the Directors. No waiver by either party hereto, at any time, of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No amendment or addition to this Agreement shall be binding unless in writing and signed by both parties, except as herein otherwise provided.

14. **Applicable Law.** This Agreement shall be governed in all respects whether as to validity, construction, capacity, performance or otherwise, by the laws of North Carolina, except to the extent that federal law shall be deemed to apply.

15. **Severability.** The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

16. **Entire Agreement.** This Agreement constitutes the entire agreement of the parties pertaining to the employment of the Officer and supersedes all prior and contemporaneous agreements, representations, and understandings of the parties. Officer agrees that no promises, representations, or inducements have been made which caused Officer to sign this Agreement other than those which are expressly set forth above.

17. **Compliance with Internal Revenue Code Section 409A.** The Employer and the Officer intend that their exercise of authority or discretion under this Agreement shall comply with section 409A of the Internal Revenue Code of 1986. If any provision of this Agreement does not satisfy the requirements of section 409A, such provision shall nevertheless be applied in a manner consistent with those requirements. If any provision of this Agreement would subject the Officer to additional tax or interest under section 409A, the Employer shall reform the provision. However, the Employer shall maintain to the maximum extent practicable the original intent of the applicable provision without subjecting the Officer to additional tax or interest, and the Officer shall not be required to incur any additional compensation expense as a result of the reformed provision. References in this Agreement to section 409A of the Internal Revenue Code of 1986 include rules, regulations, and guidance of general application issued by the Department of the Treasury under Internal Revenue Code section 409A.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first hereinabove written.

YADKIN VALLEY FINANCIAL CORPORATION

ATTEST:			
By:	/s/ Patricia Wooten	By:	/s/William A. Long
Name:	Patricia Wooten	Name:	William A. Long
		Title:	President and Chief Executive Officer

YADKIN VALLEY BANK AND TRUST

ATTEST:			
By:	/s/ Patricia Wooten	By:	/s/ William A. Long
Name:	Patricia Wooten	Name:	William A. Long
		Title:	President and Chief Executive Officer

OFFICER

/s/ Edwin E. Laws

Edwin E. Laws

Exhibit 10.7

AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AMENDED AND RESTATED EMPLOYMENT AGREEMENT (this Agreement) is entered into as of December 31, 2008, by and between **YADKIN VALLEY BANK AND TRUST COMPANY**, a North Carolina banking corporation (hereinafter referred to as the Bank) and **STEPHEN S. ROBINSON**, an individual resident of North Carolina (hereinafter referred to as the Officer). This Agreement amends and restates that certain employment agreement dated January 1, 2008.

For and in consideration of their mutual promises, covenants and conditions hereinafter set forth, and other good and valuable consideration, the receipt and sufficiency of which hereby is acknowledged, the parties agree as follows:

1. Employment. The Bank agrees to continue to employ the Officer and the Officer agrees to continue to accept employment upon the terms and conditions stated herein as an Executive Vice President of the Bank. The Officer shall render such administrative and management services to the Bank as are customarily performed by persons situated in a similar executive capacity. The Officer shall promote the business of the Bank, including being active in at least one civic organization in Iredell County, and perform such other duties as shall, from time to time, be reasonably assigned by the President of the Bank. Upon the request of the President, the Officer shall disclose all business activities or commercial pursuits in which Officer is engaged, other than Bank duties.

2. Compensation. The Bank shall pay the Officer during the term of this Agreement, as compensation for all services rendered by the Officer to the Bank, a base salary at the rate of $192,551 per annum, payable in cash not less frequently than monthly. The rate of such salary shall be reviewed by the Bank not less often than annually and the Bank may increase, but shall not decrease, such rate during the term of this Agreement. Such rate of salary, or increased rate of salary, as the case may be, may be further increased from time to time in such amounts as the Bank, in its discretion, may decide. In determining salary increases, the Bank shall compensate the Officer for increases in the cost of living and may also provide for performance or merit increases. Participation in the Bank s incentive compensation, deferred compensation, discretionary bonus, profit-sharing, retirement and other employee benefit plans and participation in any fringe benefits shall not reduce the salary payable to the Officer under this Paragraph. In the event of a Change in Control (as defined in Paragraph 10), the Officer s rate of salary shall be increased not less than five percent annually during the term of this Agreement. Any payments made under this Agreement shall be subject to such deductions as are required by law or regulation or as may be agreed to by the Bank and the Officer.

3. Discretionary Bonuses. During the term of this Agreement, the Officer shall be entitled to such discretionary bonuses as may be authorized, declared and paid by the Bank to the Bank s key management employees. All such bonuses authorized and declared by the

Bank shall be paid in cash at the latest within sixty days of the earlier of such authorization or declaration. No other compensation provided for in this Agreement shall be deemed a substitute for the Officer s right to such discretionary bonuses when and as declared by the Bank.

4. Participation in Retirement and Employee Benefit Plans; Fringe Benefits.

(a) The Bank shall provide family medical coverage and disability insurance for the Officer and the Officer shall also be entitled to participate in any plan relating to deferred compensation, stock options, stock purchases, pension, thrift, profit sharing, group life insurance, education, or other retirement or employee benefits that the Bank has adopted, or may, from time to time adopt, for the benefit of its executive employees or for employees generally, subject to the eligibility rules of such plans. Any options or similar awards shall be issued to the Officer at an exercise price of not less than the stock s current fair market value (as determined in compliance with Treasury Regulation § 1.409A-1(b)(5)(iv)) as of the date of grant, and the number of shares subject to such grant shall be fixed on the date of grant.

(b) The Officer shall also be entitled to participate in any other fringe benefits which are now or may be or become applicable to the Bank s executive employees, including the payment of reasonable expenses for attending annual and periodic meetings of trade associations, and any other benefits which are commensurate with the duties and responsibilities to be performed by the Officer under this Agreement. Additionally, the Officer shall be entitled to such vacation and sick leave as shall be established under uniform employee policies promulgated by the Bank. The Bank shall reimburse the Officer for all out-of-pocket reasonable and necessary business expenses which the Officer may incur in connection with the Officer s services on behalf of the Bank. The Bank shall reimburse the Officer for such expenses described in this Paragraph 4(b) within 60 days of Officer s incurring such expense.

(c) The Bank shall provide the Officer with the use of a late model automobile suitable to the status of the Officer of a type and for lease terms to be approved by the Bank. The Bank shall pay the dues of the Officer for membership in a country club of the Officer s choice located within the market area of the Bank; provided that the Officer shall be responsible for personal use of such club.

(d) After Officer s employment with the Bank is terminated for any reason other than Cause (as defined in Paragraph 8), the Bank shall continue to provide medical insurance coverage to the Officer and Officer s spouse until each has attained sixty-five (65) years of age, either, in the Bank s discretion, as part of the Bank s group medical insurance plan or through individual medical insurance policies. The Bank shall be responsible for paying directly all of the premiums required to meet its obligations under this Paragraph 4(d).

5. Term. The initial term of employment under this Agreement shall be for the period commencing upon the effective date of this Agreement and ending three calendar years from the effective date of this Agreement. On each anniversary of the effective date of this

Agreement, the term of this Agreement shall automatically be extended for an additional one-year period beyond the then effective expiration date unless written notice from the Bank or the Officer is received 90 days prior to an anniversary date advising the other that this Agreement shall not be further extended; provided that the Bank shall review the Officer s performance annually and make a specific determination pursuant to such review to renew this Agreement prior to the 90 days notice.

6. Loyalty; Noncompetition; Confidentiality.

(a) The Officer shall devote his full efforts and entire business time to the performance of the Officer s duties and responsibilities under this Agreement.

(b) For and in consideration of the benefit provided by Paragraph 4(d) of this Agreement, which the Officer agrees is adequate consideration, during the term of this Agreement, or any renewals thereof, and for a period of one year after termination, the Officer agrees he will not, within the Restricted Area, directly or indirectly, engage in any business that competes with the Bank or any of its subsidiaries without the prior written consent of the Bank; provided, however, that the provisions of this Paragraph shall not apply in the event the Officer s employment is unilaterally terminated by the Bank for Cause (as such term is defined in Paragraph 8(c) hereof), or in the event the Officer terminates his employment with the Bank for good reason (as such term is defined in Paragraph 10(b) hereof) following a Change in Control (as such term is defined in Paragraph 10(d) hereof). The Restricted Area covers the following divisible list of territories: Iredell and Elkin Counties, North Carolina and within 25 miles of any Bank office operated during the term of this Agreement. The one-year restricted period, however, does not include any period of violation or period of time required for litigation to enforce the Officer s agreement not to compete against the Bank. Notwithstanding the foregoing, the Officer shall be free, without such consent, to purchase or hold as an investment or otherwise, up to five percent of the outstanding stock or other security of any corporation which has its securities publicly traded on any recognized securities exchange or in any over-the-counter market.

(c) The Officer agrees he will hold in confidence all knowledge or information of a confidential nature with respect to the business of the Bank or any subsidiary received by the Officer during the term of this Agreement and will not disclose or make use of such information without the prior written consent of the Bank. The Officer agrees that he will be liable to the Bank for any damages caused by unauthorized disclosure of such information. Upon termination of his employment, the Officer agrees to return all records or copies thereof of the Bank or any subsidiary in his possession or under his control which relate to the activities of the Bank or any subsidiary.

(d) The Officer acknowledges that it would not be possible to ascertain the amount of monetary damages in the event of a breach by the Officer under the provisions of this Paragraph 6. The Officer agrees that, in the event of a breach of this Paragraph 6, injunctive relief enforcing the terms of this Paragraph 6 is an appropriate remedy. If the scope of any restriction contained in this Paragraph 6 is determined to be too broad by any court of

competent jurisdiction, then such restriction shall be enforced to the maximum extent permitted by law and the Officer consents that the scope of this restriction may be modified judicially.

7. **Standards**. The Officer shall perform his duties and responsibilities under this Agreement in accordance with such reasonable standards expected of employees with comparable positions in comparable organizations and as may be established from time to time by the Bank. The Bank will provide the Officer with the working facilities and staff customary for similar executives and necessary for the Officer to perform his duties.

8. **Termination and Termination Pay**. For purposes of this Agreement, the term terminate or termination shall mean a separation from service as defined by Treasury Regulation § 1.409A-1(h).

(a) The Officer s employment under this Agreement shall be terminated upon the death of the Officer during the term of this Agreement, in which event, the Officer s estate shall be entitled to receive the compensation due the Officer through the last day of the calendar month in which the Officer s death shall have occurred and for a period of one month thereafter. All such payments due under this Paragraph 8(a) shall be paid to the estate within 30 days of the date of death of the Officer.

(b) The Officer s employment under this Agreement may be terminated at any time by the Officer upon 60 days written notice to the Bank. Upon such termination, the Officer shall be entitled to receive compensation through the effective date of such termination. All such payments due under this Paragraph 8(b) shall be paid to the Officer within 30 days of the date of written notice to the Bank.

(c) The Bank may terminate the Officer s employment at any time, but any termination by the Bank, other than termination for Cause, shall not prejudice the Officer s right to compensation or other benefits under this Agreement. The Bank shall provide written notice specifying the grounds for termination for Cause. The Officer shall have no right to receive compensation or other benefits for any period after termination for Cause. Termination for Cause shall include termination because of the Officer s personal dishonesty or moral turpitude, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of this Agreement. Subject to Paragraph 11(b) below, any amount of compensation or other benefit that the Officer has a right to as of the date of termination shall be paid within 30 days of such termination. Notwithstanding such termination, the obligations under Paragraph 6(c) shall survive any termination of employment.

(d) Subject to the Bank s obligations and the Officer s rights under (i) Title I of the Americans with Disabilities Act, §504 of the Rehabilitation Act, and the Family and Medical Leave Act, and to (ii) the vacation leave, disability leave, sick leave and any other leave policies of the Bank, the Officer s employment under this Agreement automatically shall

4

be terminated in the event that the Bank determines that the Officer has become disabled (as defined by Treasury Regulation § 1.409A-3(i)(4)) during the term of this Agreement. Upon any such termination, the Officer shall be entitled to receive any compensation the Officer shall have earned prior to the date of termination but which remains unpaid, and all such amounts shall be paid to the Officer within 30 days of such termination. The Officer shall also be entitled to receive any payments provided under any disability income plan of the Bank which is applicable to the Officer.

In the event of any disagreement between the Officer and the Bank as to whether the Officer is physically or mentally disabled such as will result in the termination of the Officer s employment pursuant to this Paragraph 8(d), the question of such disability shall be submitted to an impartial physician licensed to practice medicine in North Carolina for determination and who will be selected by mutual agreement of the Officer and the Bank, or failing such agreement, by two (2) physicians (one (1) of whom shall be selected by the Bank and the other by the Officer), and such determination of the question of such disability by such physician or physicians shall be final and binding on the Officer and the Bank. The Bank shall pay the reasonable fees and expenses of such physician or physicians in making any determination required under this Paragraph 8(d).

9. **Additional Regulatory Requirements.** Notwithstanding anything contained in this Agreement to the contrary, it is understood and agreed that the Bank (or any of its successors in interest) shall not he required to make any payment or take any action under this Agreement if:

(a) such payment or action is prohibited by any governmental agency having jurisdiction over the Bank (hereinafter referred to as Regulatory Authority) because the Bank is declared by such Regulatory Authority to be insolvent, in default or operating in an unsafe or unsound manner; or,

(b) in the reasonable opinion of counsel to the Bank, such payment or action (i) would be prohibited by or would violate any provision of state or federal law applicable to the Bank, including, without limitation, the Federal Deposit Insurance Act as now in effect or hereafter amended, (ii) would be prohibited by or would violate any applicable rules, regulations, orders or statements of policy, whether now existing or hereafter promulgated, of any Regulatory Authority, or (iii) otherwise would be prohibited by any Regulatory Authority.

10. **Change in Control.**

(a) In the event of a termination of the Officer s employment in connection with, or within twenty-four (24) months after, a Change in Control (as defined in Subparagraph (d) below) of Yadkin Valley Financial Corporation other than for Cause (as defined in Paragraph 8), the Officer shall be entitled to receive the amount set forth in Subparagraph (c) below. Such sum shall be payable as provided in Subparagraph (e) below.

(b) In addition to any rights the Officer might have to terminate this Agreement contained in Paragraph 8, the Officer shall have the right to terminate this Agreement for good reason , as such term is defined by Treasury Regulation § 1.409A-1(n)(2), within twenty-four months following a Change in Control of Yadkin Valley Financial Corporation.

(c) In the event that the Officer s employment is terminated pursuant to this Paragraph 10, the Bank will be obligated to pay or cause to be paid to Officer an amount equal to 2.99 times the Officer s base amount as defined in Section 280G(b)(3) of the Internal Revenue Code of 1986, as amended (the Code).

(d) For the purposes of this Agreement, the term Change in Control shall mean as defined by Treasury Regulation § 1.409A-3(i)(5). Notwithstanding the other provisions of this Paragraph 10, a transaction or event shall not be considered a Change in Control if, prior to the consummation or occurrence of such transaction or event, the Officer and the Bank agree in writing that the same shall not be treated as a Change in Control for purposes of this Agreement.

(e) Subject to Paragraph 11(b) below, such amounts payable pursuant to this Paragraph 10 shall be paid in thirty-six (36) equal monthly payments on the first day of each month beginning with the month following termination of this Agreement.

(f) Following an event constituting good reason for termination which gives rise to Officer s rights hereunder, the Officer shall have twelve (12) months from the date of occurrence of such event to terminate this Agreement pursuant to this Paragraph 10. Any such termination shall be deemed to have occurred only upon delivery to the Bank (or to any successor corporation) of written notice of termination which describes the Change in Control and the event constituting good reason. If Officer does not so terminate this Agreement within such twelve-month period, he shall thereafter have no further rights hereunder with respect to the event constituting good reason, but shall retain rights, if any, hereunder with respect to any other event constituting good reason as to which such period has not expired.

(g) In the event any dispute shall arise between the Officer and the Bank as to the terms or interpretation of this Agreement, including this Paragraph 10, whether instituted by formal legal proceedings or otherwise, including any action taken by the Officer to enforce the terms of this Paragraph 10 or in defending against any action taken by the Bank, the Bank shall reimburse the Officer for all costs and expenses, proceedings or actions, in the event the Officer prevails in any such action.

11. <u>Conditions to any Payment of Severance Amounts</u>.

(a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Bank which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Bank.

(b) If: (1) when the Officer s employment terminates under this Agreement he is a specified employee, as defined in Section 409A of the Code or the regulations promulgated thereunder; (2) the Officer s employment did not terminate because of his death; (3) any payments under this Agreement will result in additional tax or interest to the Officer because of Section 409A or the regulations promulgated thereunder; and (4) an exemption from the six-month delay requirement of Section 409A(a)(2)(B)(i) is not available, then despite any provision of this Agreement to the contrary the Officer will not be entitled to such payments until the earlier of: (1) six months and one day after termination of the Officer s employment; or (2) his death. Payments that would have otherwise been paid during such six month and one day period shall be accumulated and paid on the earlier of: (1) the first day of the seventh month after such termination of employment; or (2) death of the Officer; and the remaining amount of any such payment due under this Agreement shall be paid as set forth elsewhere in this Agreement without regard to this Paragraph.

12. Successors and Assigns.

(a) This Agreement shall inure to the benefit of and be binding upon any corporate or other successor of the Bank which shall acquire, directly or indirectly, by conversion, merger, purchase or otherwise, all or substantially all of the assets of the Bank.

(b) Since the Bank is contracting for the unique and personal skills of the Officer, the Officer shall be precluded from assigning or delegating his rights or duties hereunder without first obtaining the written consent of the Bank.

13. Modification; Wavier; Amendments. This Agreement represents, constitutes, and incorporates the entire, exclusive, and complete understanding of the parties hereto and replaces all previous agreements. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing, signed by the Officer and on behalf of the Bank by such officer as may be specifically designated by the Board of Directors. No waiver by either party hereto, at any time, of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No amendment or addition to this Agreement shall be binding unless in writing and signed by both parties, except as herein otherwise provided.

14. Applicable Law. This Agreement shall be governed in all respects whether as to validity, construction, capacity, performance or otherwise, by the laws of North Carolina, except to the extent that federal law shall be deemed to apply.

15. Severability. The provisions of this Agreement shall be deemed severable and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

7

16. **Compliance with Internal Revenue Code Section 409A.** The Bank and the Officer intend that their exercise of authority or discretion under this Agreement shall comply with section 409A of the Internal Revenue Code of 1986. If any provision of this Agreement does not satisfy the requirements of section 409A, such provision shall nevertheless be applied in a manner consistent with those requirements. If any provision of this Agreement would subject the Officer to additional tax or interest under section 409A, the Bank shall reform the provision. However, the Bank shall maintain to the maximum extent practicable the original intent of the applicable provision without subjecting the Officer to additional tax or interest, and the Officer shall not be required to incur any additional compensation expense as a result of the reformed provision. References in this Agreement to section 409A of the Internal Revenue Code of 1986 include rules, regulations, and guidance of general application issued by the Department of the Treasury under Internal Revenue Code section 409A.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first hereinabove written.

YADKIN VALLEY BANK AND TRUST COMPANY

By: /s/ William A. Long
William A. Long
President and Chief Executive Officer

Attest:

/s/ Patricia Wooten
Corporate Secretary

OFFICER

/s/Stephen S. Robinson (SEAL)
Stephen S. Robinson

8

EXHIBIT 21

SUBSIDIARIES

Name	**State of Incorporation**
Yadkin Valley Bank and Trust Company	North Carolina
Yadkin Valley Statutory Trust I	Delaware

EXHIBIT 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Form S-4 Registration Statement No. 333-156417, Form S-8 Registration Statements Nos. 333-136967, 333-136968, 333-136969, 333-136970, 333-150190 and 333-153339 and the Form S-3D Registration Statement No. 333-136050 of Yadkin Valley Financial Corporation of our reports dated March 31, 2009 with respect to the consolidated financial statements of Yadkin Valley Financial Corporation and the effectiveness of internal control over financial reporting, which reports appear in the December 31, 2008 annual report on Form 10-K of Yadkin Valley Financial Corporation.

Our report, dated March 31, 2009, on the effectiveness of internal control over financial reporting as of December 31, 2008, expresses our opinion that Yadkin Valley Financial Corporation did not maintain effective internal control over financial reporting as of December 31, 2008, because of the effect of material weaknesses on the achievement of objectives of the control criteria and contains explanatory paragraphs that outline material weaknesses in Yadkin Valley Financial Corporation's (1) control environment, (2) accounting for significant estimates, (3) credit administration, and (4) preparation of financial reports. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2008 consolidated financial statements, and did not affect our report dated March 31, 2009 on those consolidated financial statements.

Charlotte, North Carolina
March 31, 2009

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

Pursuant to Rule 13a-14(d)/15d-14(d)

I,

William A. Long, certify that:

1.

I have reviewed this Annual Report on Form 10-K of Yadkin Valley Bank Financial Corporation

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.

The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a)

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b)

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c)

Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;

d)

Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.

The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a)

All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b)

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 31, 2009 /s/ WILLIAM A. LONG

William A. Long,
Principal Executive Officer

Exhibit 31.2

CERTIFICATION OF PRINCIPAL ACCOUNTING OFFICER
Pursuant to Rule 13a-14(d)/15d-14(d)

I, Edwin E. Laws, certify that:

1. I have reviewed this Annual Report on Form 10-K of Yadkin Valley Financial Corporation

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 31, 2009 /s/ EDWIN E. LAWS

Edwin E. Laws
Principal Accounting Officer

Exhibit 32

Section 1350 Certifications

In connection with the Annual Report of Yadkin Valley Financial Corporation (the "Company") on Form 10-K for the annual period ended December 31, 2008 as filed with the U. S. Securities and Exchange Commission on the date hereof (the "Report"), I, William A. Long, Chief Executive Officer of the Company, and I, Edwin E. Laws, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that, to the best of my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of the Company.

/s/ WILLIAM A. LONG	/s/ EDWIN E. LAWS
William A. Long *President and Chief Executive Officer*	Edwin E. Laws *Executive Vice President and Chief Financial Officer*
Date: March 31, 2009	Date: March 31, 2009

Table of Contents

Appendix B

U.S. Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-K

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM to
Commission File Number 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 **Charlotte, North Carolina** (Address of principal executive offices)	**28211** (Zip Code)

(704) 225-8444
Registrant's telephone number, including area code:

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 o No ý

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 o No ý

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 ý No o

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 o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ý

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

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. $41,935,000

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date. 6,651,295 shares of Common Stock outstanding as of March 24, 2009:

Documents Incorporated by Reference.

Portions of the registrant's definitive proxy statement as filed with the Federal Deposit Insurance Corporation in connection with its 2009 annual meeting are incorporated into Part III of this report.

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.

On September 9, 2008, the Company entered into a definitive agreement to be acquired, subject to shareholder approval, by Yadkin Valley Financial Corporation ("Yadkin Valley"). The Bank will become a wholly-owned division of Yadkin Valley operating under its current name. Pursuant to the agreement, the Company will merge with and into Yadkin Valley and each of the Company's shareholders will be entitled to receive in exchange for each share of the Company's common stock one of the following: (i) .8517 shares of Yadkin Valley common stock, (ii) $12.35 in cash, or (iii) a combination of both stock and cash. In total, the merger consideration will be allocated as follows: 80.5% of the Company's outstanding shares of common stock will be exchanged for shares of Yadkin Valley common stock and 19.5% of the Company's outstanding shares of common stock will be exchanged for cash. The parties have received all regulatory approvals required for consummation of the merger, including approval of the Board of Governors of the Federal Reserve System, the North Carolina Commission of Banks and the Federal Deposit Insurance Corporation. The parties anticipate closing of the transaction during the second quarter of 2009.

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 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 2008 population of 191,000 and Mecklenburg County has an estimated 2008 population of 887,000. Both counties have a balanced and diversified economy. Monroe, with a population of approximately 36,000, is the largest city in Union County. Union County is currently one of the fastest growing counties in North Carolina and also one of the fastest growing counties in the country. The population of Union County has grown 42% since 2000. Charlotte, which is ranked 21st in U.S. 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 2006. The most recent unemployment rate was 8.1% for Union County and 8.3% for Mecklenburg County; both of which approximate the North Carolina state rate of 8.1%. 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 3%. York County, South Carolina is the one of the region's fastest growing county and has an estimated population of 213,000. York County also averaged a 21% growth rate between 2000 and 2006, ranking 4th in per capita income in South Carolina.

Strategy

American Community has expanded significantly 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, North Carolina. The Bank also offers four full-service banking offices located in York and Cherokee Counties, 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 due to the regulatory restrictions that prohibit most banks from branching into South Carolina.. 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. Variable rate loans accounted for 63% of the loan balances outstanding at December 31, 2008 while fixed rate loans accounted for 37% 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.

Table of Contents

Loan Composition. The following table sets forth at December 31 for the dates indicated the Bank's loan portfolio composition by type of loan:

	2008		2007		2006		2005		2004	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Real estate mortgage loans:										
1-4 family	$ 43,431	10.16%	$ 35,680	9.08%	$ 32,414	8.75%	$ 28,933	8.70%	$ 27,161	8.82%
Commercial mortgage	105,464	24.66%	104,209	26.51%	96,946	26.16%	84,694	25.45%	84,621	27.47%
Construction/development	157,230	36.76%	136,531	34.73%	93,643	25.27%	44,037	13.24%	39,844	12.93%
Home equity lines of credit	43,777	10.24%	34,784	8.85%	24,388	6.58%	27,732	8.33%	24,575	7.98%
Commercial and industrial loans	60,017	14.03%	57,958	14.74%	78,086	21.07%	97,197	29.21%	85,911	27.88%
Loans to individuals	15,844	3.70%	20,010	5.09%	36,782	9.93%	35,941	10.80%	30,813	10.00%
Lease financing, net	1,901	0.45%	3,941	1.00%	8,316	2.24%	14,193	4.27%	15,177	4.92%
Subtotal	427,664	100.00%	393,113	100.00%	370,575	100.00%	332,727	100.00%	308,102	100.00%
Less: allowance for loan losses	(9,124)		(5,740)		(5,628)		(4,331)		(3,488)	
Plus: net unamortized deferred fees and costs	(172)		(154)		(144)		(19)		(114)	
Total	$418,368		$387,219		$364,803		$328,377		$304,500	

B-3

Table of Contents

The following table sets forth the contractual maturity of loans at December 31, 2008:

	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	$ 14,650	$ 27,670	$ 1,111	$ 43,431
Commercial mortgage	28,504	72,182	4,778	105,464
Construction/development	116,867	38,287	2,076	157,230
Home equity lines of credit	3,774	4,127	35,876	43,777
Commercial and industrial loans	39,506	19,293	1,218	60,017
Loans to individuals	7,502	8,029	313	15,844
Lease financing, net	374	1,527		1,901
Total	$211,177	$ 171,115	$ 45,372	$427,664

The following table sets forth loans with fixed and variable rates having contractual maturities greater than one year at December 31, 2008:

	Fixed Rate	Variable Rate	Total
	(Dollars in thousands)		
Real estate mortgage loans	$110,895	$35,209	$146,104
Home equity lines of credit	120	39,883	40,003
Commercial and industrial loans	11,131	9,380	20,511
Loans to individuals	7,314	1,028	8,342
Lease financing, net	1,527		1,527
	$130,987	$85,500	$216,487

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 $43.4 million at December 31, 2008. 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 $259,000 for the year ended December 31, 2008. 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 totaled $105.5 million at December 31, 2008. 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.

Table of Contents

Another lending focus for the Bank is construction/development lending with balances outstanding as of December 31, 2008 of $157.2 million. The $157.2 million is principally comprised of $42.4 million in loans secured by land, $28.4 million in acquisition and development loans, $32.7 in non pre-sold construction loans, $22.5 million in 1-4 family pre-sold construction loans, $15.6 million in commercial construction loans and $15.6 million in miscellaneous other construction loans. The Bank originates one to four family residential construction loans for the 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 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. The Bank also makes commercial real estate construction loans, primarily for owner-occupied properties. The Bank further endeavors to limit its 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, 2008, the Bank's commercial loan portfolio totaled $60.0 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 $59.6 million at December 31, 2008. 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. At December 31, 2008 the Bank's lease portfolio totaled $1.9 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 had become extremely competitive and was dominated by a few large players. The Bank felt that leasing was 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.

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 associated with credit card accounts established through this agency arrangement.

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 position. This position is responsible for loan processing, loan underwriting and approval. In 2008, the Chief Credit Officer position was vacated by the incumbent. The Chief Executive Officer, Chief Banking Officer along with two senior credit officers assumed joint responsibility for loan review and loan underwriting while aggressively pursuing a search process to replace the Chief Credit Officer (hiring a Chief Credit Officer was delayed due to the pending merger with Yadkin Valley). On an annual basis, the Board of Directors of the Bank determines the President's and other officers lending authority. Authorities may include loans, letters of credit, overdrafts, uncollected funds and such other authorities as determined by the Board of Directors.

The President of American Community, and the Chief Credit Officer (currently vacant) each have the authority to approve loans up to the lending limits set by the Board of Directors, which were $2,000,000 and $1,500,000, respectively, at December 31, 2008. These limits are based upon the total credit exposure in a relationship and not based on loan transaction size. The President and Chief Credit Officer together can approve up to $3,000,000 of total customer credit exposure with the following exceptions. Any acquisition and development loan over $1,500,000, speculative construction loans over $1,500,000, land acquisition and hold transactions greater than $1,000,000 and any loans to non-profit organizations greater than $1,000,000 must be approved by the Loan Committee. All loans above the lending limit of the President and Chief Credit Officer are reviewed and approved by the Loan Committee, which consists of the President, the South Carolina Regional Executive, and six outside directors. In addition, the Chief Credit Officer serves as a non-voting member of this committee. A Senior Credit Committee consisting of the Chief Banking Officer, and the Bank's two Senior Credit Officers was approved by the Bank's Board of Directors due to the absence of the Chief Credit Officer in 2008. The Senior Credit Committee was granted the authority by the Board of Directors to approve loans up to $1,500,000 with unanimous concurrence of all three members. The President of American Community and the unanimous concurrence of the Senior Credit Committee were granted the authority by the Board of Directors to approve loans up to $3,000,000 secured and $1,000,000 unsecured at December 31, 2008. At December 31, 2008, the Loan Committee had the authority to approve loans up to the Bank's legal lending limit. The Bank's legal lending limit was $7.9 million at December 31, 2008. 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.

Table of Contents

Non-performing Assets

The table sets forth, for the periods 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,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Non-accrual loans	$6,599	$ 866	$ 563	$ 469	$ 881
Non-accrual leases	414	345	1,246	482	
Restructured loans	745	511			
Total non-performing loans	7,758	1,722	1,809	951	881
Foreclosed real estate and other repossessed assets		9	201	479	311
Total non-performing assets	$7,758	$1,731	$2,010	$1,430	$1,192
Accruing loans past due 90 days or more	$ 26	$	$ 291	$1,402	$1,117
Allowance for loan losses	9,124	5,740	5,628	4,331	3,488
Non-performing loans to period end loans	1.82%	0.44%	0.49%	0.29%	0.29%
Allowance for loan losses to period end loans	2.13%	1.46%	1.52%	1.30%	1.13%
Allowance for loan losses to non-performing loans	118%	333%	311%	455%	396%
Non-performing assets to total assets	1.45%	0.34%	0.41%	0.33%	0.30%

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. At December 31, 2008, the Bank had $7.0 million in non-accrual loans and leases. Interest foregone on non-accrual loans and leases was approximately $272,000 for the year ended December 31, 2008 and $44,000 for the year ended December 31, 2007.

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. In 2008, the Bank had five troubled debt restructured loans for $745,000. Due to the borrowers' inability to make the payments required under the original loan terms, the Bank modified the terms by granting a longer amortized repayment structure in exchange for obtaining real estate as collateral. 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 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, 2008, there were approximately $11.0 million in loans that had been identified as potential problem loans. All of these loans were still accruing interest at year end. There were eight leases totaling $305,000 that had been identified as potential problem leases as of December 31, 2008.

Table of Contents

The following table presents for the periods indicated a breakdown of non-performing loans and leases by type, which include non-accrual loans and leases and restructured loans:

	2008		2007		2006		2005		2004	
	Balance	% of Total Loans	Balance	% of Total Loans	Balance	% of Total Loans	Balance	% of Total Loans	Balance	% of Total Loans
Real estate mortgage loans:										
1-4 Family	1,373	0.32%	557	0.14%	$ 74	0.02%	$ 106	0.03%	$ 54	0.02%
Construction/development	4,246	1.00%		0.00%	151	0.04%	67	0.02%	54	0.02%
Commercial mortgage	914	0.22%	262	0.07%	77	0.02%	11	0.01%		0.00%
Home equity line of credit	175	0.04%	111	0.03%	29	0.01%	10	0.01%	10	0.00%
Commercial & Industrial	303	0.07%	341	0.09%	110	0.03%	140	0.04%	261	0.08%
Personal Loans	186	0.04%	106	0.03%	49	0.01%	56	0.02%	488	0.16%
Leases, net	414	0.10%	345	0.08%	1,246	0.34%	482	0.14%		0.00%
Other	147	0.03%		0.00%	73	0.02%	79	0.02%	14	0.01%
Total	$7,758	1.82%	$1,722	0.44%	$1,809	0.49%	$ 951	0.29%	$ 881	0.29%

Other real estate owned consists of foreclosed properties. At December 31, 2008, foreclosed real estate and other repossessed assets totaled $1,000 or less than .01% of total assets, and consisted of equipment. At December 31, 2007, foreclosed real estate and other repossessed assets totaled $9,000 or .01% of total assets, and consisted of equipment and one vehicle.

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 monthly. 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.

Table of Contents

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.

The increase in the allowance for loan losses and the resultant provision for loan losses necessary to provide for the increase includes growth in loans outstanding, the volume of net charge-offs experienced during the year and the current level of nonperforming loans. Loan growth has been spread among the major loan categories, with the concentrations of major loan categories being relatively consistent in recent years. For the five years ended December 31, 2008, the range of each major category of loans as a percentage of total loans outstanding is as follows: 1-4 family mortgage loans 8% to 10%, commercial mortgage loans 24% to 27%, construction/development real estate loans 13% to 37%; home equity loans 6% to 10%; commercial and industrial loans 14% to 29%; loans to individuals 4% to 11%; and lease financing 1% to 5%. For all full fiscal years through 2008, loan loss experience was similar to that of other banks our age, with net loan charge-offs in each year no greater than 0.40% of average loans outstanding. Non-performing loans and leases, as discussed in the previous section titled "Non-performing assets", were $7.8 million at December 31, 2008 as compared to $1.7 million at December 31, 2007. The allowance for loan losses at December 31, 2008 of $9.1 million represents 2.13% of total loans and 118% of non-performing loans.

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.

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,									
	2008		2007		2006		2005		2004	
	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	$ 6,631	72.68%	$ 3,450	60.10%	$ 2,340	41.58%	$ 2,155	49.76%	$ 2,149	61.61%
Home equity lines of credit	332	3.64%	177	3.08%	130	2.31%	137	3.16%	72	2.06%
Commercial and industrial loans	1,375	15.07%	1,121	19.53%	1,132	20.11%	929	21.45%	731	20.96%
Loans to individuals	310	3.40%	340	5.92%	405	7.20%	215	4.96%	232	6.65%
Lease financing, net	476	5.21%	652	11.36%	1,621	28.80%	895	20.67%	304	8.72%
Total	$ 9,124	100.00%	$ 5,740	100.00%	$ 5,628	100.00%	$ 4,331	100.00%	$ 3,488	100.00%

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

The recent economic recession and downturn in the real estate market has resulted in increased loan delinquencies, and in some cases defaults and foreclosures in our real estate portfolio. This downturn has resulted in impairment of the value of the collateral used to secure these loans and the ability to sell the collateral upon foreclosure. In response to this deterioration in real estate loan quality, management is aggressively monitoring its classified loans and is continuing to monitor credits with material weaknesses.

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,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Balance at beginning of period	$ 5,740	$ 5,628	$ 4,331	$ 3,488	$ 2,529
Charge-offs:					
Real estate loans	228	19	10		51
Home equity lines of credit	600		43		
Commercial and industrial loans	385	180	64	8	211
Lease financing, net	112	728	1,183	28	24
Loans to individuals	315	108	50	45	54
Total charge-offs	1,640	1,035	1,350	81	340
Recoveries:					
Real estate loans	1				1
Home equity lines of credit					
Commercial and industrial loans	9	5	1	100	12
Lease financing, net	8	91	26	4	
Loans to individuals	7	18	8	11	27
Total recoveries	25	114	35	115	40
Net charge-offs (recoveries)	1,615	921	1,315	(34)	300

Allowance acquired from First National merger					685
Provision for loan losses	4,999	1,033	2,612	809	574
Balance at end of period	$ 9,124	$ 5,740	$ 5,628	$ 4,331	$ 3,488
Total loans outstanding	$427,492	$392,959	$370,431	$332,708	$307,988
Average loans outstanding	$403,626	$370,832	$351,401	$317,986	$275,011
Allowance for loan losses to total loans outstanding	2.13%	1.46%	1.52%	1.30%	1.13%
Ratio of net loan charge-offs (recoveries) to average loans outstanding	0.40%	0.25%	0.37%	-0.01%	0.11%

B-10

Table of Contents

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:

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
U. S. Government agencies	$ 9,635	$ 211	$ 5	$ 9,841
Mortgage-backed securities	47,232	1,238	6	48,464
State and municipal bonds	12,143	42	202	11,983
	69,010	1,491	213	70,288
Marketable equity securities	974			974
Total securities available for sale	$69,984	$ 1,491	$ 213	$71,262

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
State and municipal bonds	$ 1,768	$	$ 8	$ 1,760
Total securities held to maturity	$ 1,768	$	$ 8	$ 1,760

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
U. S. Government agencies	$13,635	$ 341	$ 10	$13,966
Mortgage-backed securities	49,116	385	196	49,305
State and municipal bonds	10,762	109	44	10,827
	73,513	835	250	74,098
Marketable equity securities	907	7		914
Total securities available for sale	$74,420	$ 842	$ 250	$75,012

Table of Contents

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
State and municipal bonds	$ 1,770	$ 34	$	$ 1,804
Total securities held to maturity	$ 1,770	$ 34	$	$ 1,804

The following table summarizes the amortized cost and recorded market values of investment securities (excluding marketable equity securities) at December 31, 2008, 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 after one but within five years	$ 2,497	$ 2,534	5.28%
Due after five but within ten years	7,137	7,307	5.77%
	9,634	9,841	5.64%
Mortgage-backed securities			
Due after one but within five years	3,812	3,879	4.34%
Due after five but within ten years	6,485	6,611	4.54%
Due after ten years	36,936	37,975	5.56%
	47,233	48,465	5.32%
Municipal bonds			
Due after one but within five years	1,315	1,336	3.51%
Due after five but within ten years	3,628	3,622	3.93%
Due after ten years	8,968	8,785	4.17%
	13,911	13,743	5.70%
Total investment securities			
Due after one but within five years	7,625	7,749	4.50%
Due after five but within ten years	17,249	17,540	4.93%
Due after ten years	45,904	46,759	5.30%
	$70,778	$72,048	5.44%

(1) Yields on tax-exempt investments have been adjusted to tax equivalent basis using an assumed tax rate of 34% for 2008.

Table of Contents

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, 2008 the Bank had $36.1 million 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,					
	2008		2007		2006	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Interest bearing NOW, savings, and money market accounts	$ 87,785	1.17%	$100,047	2.24%	$ 91,792	1.78%
Other time deposits	139,295	4.20%	128,382	4.84%	102,697	3.76%
Time deposits greater than $100,000	137,334	4.21%	112,416	5.05%	120,443	4.78%
Total interest bearing deposits	364,414	3.49%	340,845	4.15%	314,932	3.57%
Demand and other non-interest bearing deposits	52,653		59,376		58,705	
Total average deposits	$417,067	3.04%	$400,221	3.53%	$373,637	3.01%

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, 2008.

	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	$62,077	3.11%	$17,767	3.21%	$ 70,082	4.06%	$28,974	4.26%	$178,900	3.68%
Certificates of less than $100,000	21,661	3.74%	14,778	2.99%	55,847	3.89%	23,080	3.97%	115,366	3.76%
Total	$83,738	3.27%	$32,545	3.11%	$125,929	3.98%	$52,054	4.13%	$294,266	3.71%

Table of Contents

Borrowings

Borrowed funds consist of advances from the Federal Home Loan Bank of Atlanta ("FHLB"), securities sold under agreement to repurchase, federal funds purchased, obligations under a capitalized lease for the Bank's main office facility and junior subordinated debentures. 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,		
	2008	2007	2006
	(Dollars in thousands)		
AMOUNTS OUTSTANDING AT END OF PERIOD:			
Advances from the FHLB			
Amount	$26,000	$ 6,000	$ 6,000
Weighted average rate	3.14%	3.53%	3.53%
Securities sold under agreement to repurchase			
Amount	$14,623	$18,193	$15,473
Weighted average rate	2.07%	2.88%	3.69%
Federal funds purchased			
Amount	$ 408	$13,316	$
Weighted average rate	0.95%	4.60%	
Capitalized lease obligation			
Amount	$ 1,676	$ 1,685	$ 1,694
Weighted average rate	8.24%	8.24%	8.24%
MAXIMUM AMOUNT OUTSTANDING AT ANY MONTH-END:			
Advances from the FHLB	$26,000	$ 6,000	$11,056
Securities sold under agreement to repurchase	19,931	25,531	17,058
Federal funds purchased	18,648	13,316	6,337
Capitalized lease obligation	1,685	1,694	1,702
AVERAGES DURING THE PERIOD:			
Advances from the FHLB			
Average balance	$23,391	$ 6,000	$10,834
Weighted average rate	3.21%	3.53%	4.17%
Securities sold under agreement to repurchase			
Average balance	$17,551	$20,977	$13,753
Weighted average rate	2.07%	3.70%	3.42%
Federal funds purchased			
Average balance	$ 4,103	$ 340	$ 913
Weighted average rate	3.32%	4.41%	4.84%
Capitalized lease obligation			
Average balance	$ 1,683	$ 1,692	$ 1,700
Weighted average rate	8.23%	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 $8.4 million at December 31, 2008, and a blanket lien on qualifying first mortgage loans. This agreement with the FHLB provides for a line of credit up to 15% of the Bank's assets. The unused portion of this line of credit is $54.4 million as of December 31, 2008.

Securities sold under agreement to repurchase are secured by investment securities. The carrying value of the investment securities at December 31, 2008 was $17.1 million.

Bancshares also has unused lines of credit totaling $35.1 million from correspondent banks at December 31, 2008.

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. The Trust Preferred Securities were paid off on March 9, 2007.

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 $10,310,000 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, 2008 was 6.56%. 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 10 different commercial banks (including the largest banks in North Carolina). In Mecklenburg County, there are currently 241 offices of 23 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, Regions Bancshares, from Birmingham, Alabama as well as California Based Wells Fargo and Ohio based Fifth Third, recently expanded their presence 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 10 offices of 5 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 2008 for outstanding contributions to the United Way Campaign for Union County. American Community is very active in the Special Olympics for all markets.

American Community entered into a revenue sharing agreement with Smith Barney in 2000, in which the Bank receives revenue for business generated by a broker located in our main office. 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. The Bank's deposits are insured up to applicable limits through the FDIC's Deposit Insurance Fund (DIF) generally up to a maximum of $100,000 per separately insured depositor and up to a maximum of $250,000 for self-directed retirement accounts. In October 2008, the FDIC temporarily increased the maximum to $250,000 per separately insured depositor until December 2009.

On February 27, 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund. The Board took action by imposing a special assessment on insured institutions of 20 basis points, implementing changes to the risk-based assessment system, and increased regular premium rates for 2009, which banks must pay on top of the special assessment. The 20 basis point special assessment on the industry will be as of June 30, 2009 payable on September 30, 2009. As a result of the special assessment and increased regular assessments, the Company projects it will experience an increase in FDIC assessment expense by approximately $1.8 million from 2008 to 2009. The 20 basis point special assessment represents $1.2 million of this increase.

On March 5, 2009, the FDIC Chairman announced that the FDIC intends to lower the special assessment from 20 basis points to 10 basis points. The approval of the cutback is contingent on whether Congress clears legislation that would expand the FDIC's line of credit with the Treasury to $100 billion. Legislation to increase the FDIC's borrowing authority on a permanent basis is also expected to advance to Congress, which should aid in reducing the burden on the industry. The assessment rates, including the special assessment, are subject to change at the discretion of the Board of Directors of the FDIC.

This increase was part of the Emergency Economic Stabilization Act of 2008. Additionally, The Bank has elected to participate in the FDIC's Temporary Liquidity Guarantee Program. Under this program, all non-interest bearing deposit transaction accounts at the Bank with balances over $250,000 will also be fully insured through December 31, 2009 at an additional cost to the Bank of 10 basis points per dollar over $250,000 on a per account basis. The FDIC has set a designated reserve ratio of 1.25% ($1.25 against $100 of insured deposits) for the DIF. The FDIC has the authority to set the ratio between 1.15% and 1.50%, and must adopt a restoration plan when the ratio falls below 1.15% and begin paying dividends when the reserve ratio exceeds 1.35%. There is no requirement to achieve a specific ratio within a given time frame. The DIF reserve ratio calculated by the FDIC that was in effect at December 31, 2008 was .76%. In October 2008, the FDIC adopted a restoration plan that would increase the reserve ratio to the 1.15% threshold within five years. As part of that plan, the FDIC increased risk-based assessment rates uniformly by seven cents, on an annual basis, for the first quarter of 2009 due to deteriorating financial conditions in the banking industry.

In addition to risk-based deposit insurance assessments, additional assessments may be imposed by the Financing Corporation, a separate U.S. government agency affiliated with the FDIC, on insured deposits to pay for the interest cost of Financing Corporation bonds. Financing Corporation assessment rates for 2008 ranged from $.0110 to $.0114 per $100 of deposits.

The FDIC can terminate a depository institution's deposit insurance if it finds that the institution is being operated in an unsafe and unsound manner or has violated any rule, regulation, order or condition administered by the institution's regulatory authorities. Any such termination of deposit insurance would likely have a material adverse effect on the Bank, the severity of which would depend on the amount of deposits affected by such a termination. The FDIC evaluates the risk of each financial institution based on its supervisory rating, its financial ratios, and its long-term debt issuer rating. Deposit insurance premium rates in 2008 for nearly all of the financial institution industry varied between five and seven cents every $100 of domestic deposits. The deposit insurance assessment rates are determined quarterly.

On December 16, 2008, the FDIC adopted a final rule increasing its risk-based deposit insurance assessment scale uniformly by seven (7) basis points for first quarter 2009. The assessment scale for first quarter 2009 will range from twelve (12) basis points of assessable deposits for the strongest institutions to fifty (50) basis points for the weakest. The FDIC attributes the assessment increase to recent failures of FDIC-insured institutions. The FDIC's action applies only to the first quarter of 2009. FDIC is considering further changes to the risk-based assessment scale effective April 1, 2009, designed to make the assessment system more risk sensitive and ensure that riskier institutions bear a greater share of the assessments. Proposed adjustments to the scale include: (i) adding a surcharge for certain institutions (institutions in the three riskiest categories for FDIC assessment purposes) that use brokered deposits to fund growth, (ii) providing a possible discount of up to two (2) basis points based on an institution's ratio of long-term unsecured debt, including senior unsecured and subordinated debt, to domestic deposits (for "small institutions" (generally, those with less than $10 billion in assets), the ratio could include a certain amount of Tier 1 capital) and (iii) adding a surcharge based upon an institution's ratio of secured liabilities (including Federal Home Loan Bank advances, securities sold under repurchase agreements, secured Federal Funds purchased and certain other secured borrowings) to domestic deposits, if greater than 15%.

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, 2008, Bancshares was well-capitalized with Tier 1 and Total Risk-Based Capital of 11.38% and 12.64%, 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 increased costs of regulatory compliance.

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.

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.

Table of Contents

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, 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" and "well managed" 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;

Table of Contents

- 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.

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

Table of Contents

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.

U.S. Treasury Capital Purchase Program. On November 5, 2008, pursuant to the U.S. Department of the Treasury's (the "U.S. Treasury") Capital Purchase Program (the "CPP"), the Company applied for Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value and liquidation preference of $1,000 per share. The CPP also grants the U. S. Treasury the right to receive warrants to purchase stock of the Company at a price to be determined upon sale of the preferred stock. As of March 24, 2009 the Company has neither been approved nor denied participation in the capital program. The securities purchase agreement pursuant to which the securities would be issued to the U.S. Treasury under the CPP would:

- Limit the payment of dividends on the Company's common stock without prior approval of the U.S. Treasury
- Limit the ability to repurchase shares of its common stock
- Grant the holders of the preferred stock, the warrant and the common stock of the Company to be issued under the warrants certain registration rights, and
- Subject the Company to certain executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 and the American Relief and Recovery Act of 2009.

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, 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 will likely be limited to amounts needed to pay any separate expenses of Bancshares, to pay dividends to shareholders and to make required payments on our debt obligations, including our outstanding debentures underlying trust preferred securities.

Table of Contents

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 tying 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 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 in the future or what regulations might be adopted, or if enacted or adopted, the effect thereof on our operations.

Employees

As of December 31, 2008, we had full-time 87 employees and 8 part-time employees. None of these employees are covered by a collective bargaining agreement. We consider relations with our employees to be good.

ITEM 1A RISK FACTORS

Not required for Smaller reporting companies

ITEM 1B UNRESOLVED STAFF COMMENTS

None

Table of Contents

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 Charlotte NC	2003	2,800	Leased
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	Leased
Chesnee Highway 626 Chesnee Highway Gaffney S.C 29341	2001	2,550	Leased
Tega Cay	2005	3,082	Owned

1738 Gold Hill Road
Tega Cay SC 29708

Table of Contents

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 former 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. In 1998 Mr. Morris was elected to the board of directors of American Community and retired from the board in 2006.

In 2008, American Community sold the Blacksburg and Highway 11 branches and leased them 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.

ITEM 3 LEGAL PROCEEDINGS

In the normal course of its operations, the Bank from time to time is party to various legal proceedings. Based upon information currently available, there are no legal proceedings to which Bancshares or the Bank is party that would have a material adverse effect on Bancshares business, financial position, or results of operations.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Table of Contents

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 Capital Market under the symbol "ACBA". It began trading on this market on July 17, 2000. There were 6,643,495 shares of our common stock outstanding at February 27, 2009 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 2008 and 2007, the Company paid quarterly dividends in the amount of $0.05 per share.

		Sale Price	
	Dividends Paid	Common Stock High	Common Stock Low
2008			
First Quarter	$ 0.05	$ 10.00	$ 7.09
Second Quarter	0.05	9.00	6.15
Third Quarter	0.05	11.25	5.00
Fourth Quarter	0.05	10.29	7.02
2007			
First Quarter	$ 0.05	$ 12.69	$ 10.60
Second Quarter	0.05	12.30	10.87
Third Quarter	0.05	12.50	10.15
Fourth Quarter	0.05	12.84	9.19

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.

Table of Contents

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,				
	2008	**2007**	**2006**	**2005**	**2004**
Operating Data:					
Total interest income	$ 30,411	$ 35,426	$ 32,334	$ 25,584	$ 18,217
Total interest expense	14,699	16,193	13,521	9,180	6,220
Net interest income	15,712	19,233	18,813	16,404	11,997
Provision for loan losses	4,999	1,033	2,612	809	574
Net interest income after provision for loan losses	10,713	18,200	16,201	15,595	11,423
Non-interest income	2,486	3,391	3,353	3,294	3,337
Non-interest expenses	17,209	13,702	12,838	11,742	10,400
Income (loss) before income taxes	(4,010)	7,889	6,716	7,147	4,360
Provision for income taxes	(1,353)	2,869	2,440	2,639	1,617
Net income (loss)	$ (2,657)	$ 5,020	$ 4,276	$ 4,508	$ 2,743
Per Share Data:(1)					
Earnings (loss) per share basic	$ (0.41)	$ 0.74	$ 0.62	$ 0.71	$ 0.56
Earnings (loss) per share diluted	(0.41)	0.72	0.60	0.66	0.50
Cash dividends per share	0.20	0.20	0.20	0.13	0.07
Market Price					
High	11.25	12.84	13.73	12.51	11.21
Low	5.00	9.19	11.00	9.46	7.58
Close	10.25	9.59	11.04	12.43	10.90
Book value	7.76	8.31	7.83	7.43	7.06
Tangible book value	6.20	6.73	6.35	5.89	5.04
Weighted average shares outstanding					
Basis	6,555,255	6,779,635	6,913,534	6,364,336	4,912,256
Diluted	6,555,255	6,938,259	7,171,413	6,819,523	5,513,361
Selected Year-End Balance Sheet Data:					
Loans	$ 427,492	$ 392,959	$ 370,431	$ 332,708	$ 307,988
Allowance for loan losses	9,124	5,740	5,628	4,331	3,488
Intangible assets	10,190	10,296	10,403	10,510	10,617
Total assets	535,679	505,595	494,658	436,671	399,458
Deposits	429,404	399,794	401,137	345,401	306,665
Borrowings	53,017	49,504	37,085	38,464	54,169
Shareholders' equity	51,282	54,024	55,068	50,886	36,972
Selected Average Balances:					
Total assets	$ 529,723	$ 496,816	$ 468,908	$ 420,941	$ 366,668
Loans	403,626	370,832	351,401	317,986	275,011
Total interest-earning assets	485,203	455,076	428,679	385,919	337,292
Interest-bearing deposits	364,415	340,845	314,932	278,473	239,294
Total interest-bearing liabilities	421,480	380,996	355,362	320,230	292,402
Shareholders' equity	53,972	54,836	52,924	45,937	32,275

(1)

All share and per share amounts reflect the effects of the 50% stock split paid in 2006

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC.
Selected Financial Information and Other Data
($ in thousands, except per share data)

	At or for the Year Ended December 31,				
	2008	**2007**	**2006**	**2005**	**2004**
Selected Performance Ratios:					
Return on average assets	(0.50)%	1.01%	0.91%	1.07%	0.74%
Return on average equity	(4.92)%	9.15%	8.08%	9.81%	8.50%
Net interest margin	3.24%	4.23%	4.39%	4.25%	3.56%
Net interest margin, fully taxable equivalent	3.32%(1)	4.29%	4.44%	4.28%	3.58%
Noninterest expense to average assets	3.26%	2.74%	2.74%	2.79%	2.84%
Efficiency ratio	93.55%	60.40%	57.71%	59.61%	67.82%
Equity to assets ratio	9.57%	10.69%	11.13%	11.65%	9.26%
Dividend payout ratio	NM(2)	27.78%	33.33%	19.70%	14.00%
Asset Quality Ratios:					
Nonperforming loans to total loans	1.82%	0.44%	0.49%	0.29%	0.29%
Allowance for loan losses to period-end loans	2.13%	1.46%	1.52%	1.30%	1.13%
Allowance for loan losses to nonperforming loans	118%	333%	311%	455%	396%
Nonperforming assets to total assets	1.45%	0.34%	0.41%	0.33%	0.30%
Net loan charge-offs (recoveries) to average loans	0.40%	0.25%	0.37%	(0.01)%	0.11%

(1) Yields related to investment securities and loans exempt from Federal income taxes on a fully tax-equivalent basis, assuming a Federal income tax rate of 34%.

(2) Not meaningful

Table of Contents

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 small-to-medium sized businesses 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, 2008 and 2007

Total assets at December 31, 2008 increased by $30.1 million or 6.0% to $535.7 million compared to $505.6 million at December 31, 2007. Bancshares had earning assets of $504.4 million at year-end December 31, 2008 consisting of $427.5 million in gross loans, $76.0 million in investment securities and non-marketable equity securities, and $894,000 in interest-bearing deposits with banks. Total deposits as of December 31, 2008 increased by $29.6 million or 7.4% to $429.4 million compared to $399.8 million at December 31, 2007. Total borrowings as of December 31, 2008 increased by

Table of Contents

$3.5 million or 7.1% from $49.5 million to $53.0 million. Stockholders' equity was $51.3 million at December 31, 2008 compared to $54.0 million at December 31, 2007 for a decrease of $2.7 million or 5.1%.

Gross loans grew by $34.5 million or 8.8% from $393.0 million as of December 31, 2007 to $427.5 million at year-end 2008. The composition of the loan portfolio, by category, as of December 31, 2008 is as follows: 10% 1-4 family mortgage loans, 25% commercial mortgage real estate loans, 37% construction/development real estate loans, 10% home equity lines of credit, 14% commercial loans, 4% consumer and other loans to individuals and less than 1% leases. The real estate category grew $29.7 million from $276.4 million to $306.1 million. Within the real estate category, 1-4 family loans increased $7.7 million from $35.7 million to $43.4 million, commercial mortgage real estate loans increased $1.3 million from $104.2 million to $105.5 million and construction/development loans increased $20.7 million from $136.5 million to $157.2 million. These construction/development loans are primarily single family residences and owner occupied commercial properties. Commercial and industrial loans and home equity lines of credit also increased $2.1 million and $9.0 million, respectively. Net decreases in other loan categories included $4.2 in consumer and other loans and $2.0 million in leases. The composition of the loan portfolio at December 31, 2007, by category, was 9% 1-4 family mortgage loans, 26% commercial mortgage real estate loans, 35% construction/development real estate loans, 9% home equity lines of credit, 15% commercial loans, 5% consumer and other loans to individuals and 1% leases.

Bancshares recorded a $5.0 million provision for loan losses for the year ended December 31, 2008, representing an increase of $4.0 million from the $1.0 million provision for the year ended December 31, 2007. Bancshares also experienced net charge-offs of $1.6 million in 2008 compared to net charge-offs of $921,000 in 2007. The percentage of net loan charge-offs (recoveries) to average loans outstanding was 0.40% for the year ended December 31, 2008 as compared with 0.25% for the year ended December 31, 2007. Non-performing loans and leases, including restructured loans and leases over 90 days past due and still accruing interest, totaled $7.8 million or 1.82% of total loans at December 31, 2008, up from $1.7 million or 0.44% of total loans at December 31, 2007. The composition of non-performing loans and leases at December 31, 2008 by category was 84% real estate, 4% commercial loans, 2% home equity lines of credit, 4% consumer and other loans to individuals and 6% leases. This compares to 48% real estate, 20% commercial loans, 6% home equity lines of credit, 6% consumer and other loans to individuals and 20% leases at December 31, 2007. 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, 2008 of $9.1 million represents 2.13% of total loans and 118% of non-performing loans and lease. The allowance for loan losses at December 31, 2007 of $5.7 million represented 1.46% of total loans and 333% of non-performing loans. The increase in the provision for loan losses from 2007 is primarily attributable to the increase in non-performing loan and leases and an increase in net charge-offs in 2008. Management believes that the allowance for loan losses as of December 31, 2008 is adequate to absorb known and expected losses inherent in the loan portfolio.

Bancshares had total investment securities of $76.8 million at December 31, 2008 of which $71.3 million are accounted for as available for sale under Statement of Financial Accounting Standards (SFAS) No. 115 and are presented at fair value, and $1.8 million are intended to be held to maturity. The investment securities portfolio decreased by $3.8 million from the $75.0 million balance at December 31, 2007. Additions to the investment portfolio included $10.2 million in new securities purchases, largely funded from $11.9 million in proceeds from investment maturities, calls, sales and principal re-payments.

Interest-earning deposits with banks decreased by $36,000. The Company holds funds in interest-earning deposits with banks to provide liquidity for future loan demand and to satisfy fluctuations in deposit levels.

Table of Contents

Non interest-earning assets increased by $1.9 million from $38.5 million at December 31, 2007 to $40.4 million at December 31, 2008. The increase is primarily attributable to an increase in the accrued income tax receivable and deferred tax assets of $4.6 million. This increase was offset by a decrease of $537,000 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 decreased $608,000 to $2.0 million at December 31, 2008 as a result of the decrease in interest rates during the year. Bank premises and equipment was $7.1 million at December 31, 2008 a decrease of $1.6 million from December 31, 2007 primarily due to the sale of two branches in a sale-leaseback transaction and depreciation of assets.

Total deposits increased $29.6 million or 7.4% from $399.8 million on December 31, 2007 to $429.4 million on December 31, 2008. The composition of the deposit base, by category, at December 31, 2008 is as follows: 11% non-interest bearing demand deposits, 3% savings deposits, 17% money market and interest bearing demand deposits and 69% time deposits. The money market and interest bearing demand deposits and time deposit categories experienced increases over the twelve-month period. Dollar and percentage increases by category were as follows: money market and interest bearing demand deposits, $4.5 million or 7%, and time deposits, $41.0 million or 16%. The non-interest bearing demand deposit and savings deposit categories both experienced decreases over the twelve-month period. Dollar and percentage decreases by category were as follows: non-interest bearing demand deposits, $5.6 million or 10%; and savings deposits, $10.3 million or 43%. Time deposits of $100,000 or more totaled $178.9 million, or 61% of time deposits at December 31, 2008. The composition of deposits at December 31, 2007 was 14% non-interest bearing demand deposits, 6% savings deposits, 17% money market and interest bearing demand deposits and 63% time deposits. Time deposits of $100,000 or more at December 31, 2007 were $143.7 million, or 57% of time deposits at December 31, 2007.

At December 31, 2008, $26.0 million of advances were outstanding with maturity dates ranging from July 2012 through February 2018. The balance of FHLB advances at December 31, 2007 was $6.0 million. These advances are secured by certain 1-4 family and commercial mortgage loans, Federal Home Loan Bank stock, and $8.4 million in investment securities. Bancshares also maintained the capital lease for its main office. The recorded obligation under this capital lease at December 31, 2008 was $1.7 million. In 2003, Bancshares issued junior subordinated debentures in the amount of $10.3 million all of which was eligible for inclusion as Tier 1 capital for American Community Bancshares, Inc. in 2008. 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, 2008 was $14.6 million. The Bank also utilizes federal fund lines from correspondent banks. The amount outstanding on these lines as of December 31, 2008 was $408,000.

Other liabilities decreased by $297,000 or 13.1% to $2.0 million at December 31, 2008 from $2.3 million at December 31, 2007. The decrease was primarily due to the decrease in accrued income taxes for the year as compared to 2007.

Bancshares began 2007 with total stockholders' equity of $54.0 million. Total equity decreased to $51.3 million at December 31, 2008. This $2.7 million decrease was due to a comprehensive loss of $2.3 million for the year ended December 31, 2008 and the $1.3 million payment of cash dividends of $.20 per share in 2008. This was partially offset by net proceeds of $650,000 from stock options exercised in 2008.

Table of Contents

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, 2008, 2007 and 2006, average interest-earning assets were $485.2 million, $455.1 million, and $428.7 million, respectively. During these same periods, Bancshares' net yields on average interest-earning assets (net interest margin) were 3.24%, 4.23%, and 4.39%, respectively.

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 of which is to lower the average rates shown.

	Year Ended December 31, 2008			Year Ended December 31, 2007			Year Ended December 31, 2006		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	(Dollars in thousands)								
Interest-earning assets:									
Loans	$403,626	$26,551	6.58%	$370,832	$31,374	8.46%	$351,401	$28,800	8.20%
Investments	78,267	3,805	4.86%	73,152	3,461	4.73%	66,446	2,990	4.50%
Interest-earning deposits	3,310	55	1.66%	11,092	591	5.33%	10,832	544	5.02%
Total interest-earning assets	485,203	30,411	6.27%	455,076	35,426	7.78%	428,679	32,334	7.54%
Other assets	44,520			41,740			40,229		
Total assets	$529,723			$496,816			$468,908		
Interest-bearing liabilities:									
Deposits:									
Savings	$ 18,798	182	0.97%	$ 24,209	606	2.50%	$ 11,612	40	0.34%
Money market and NOW	68,987	840	1.22%	75,839	1,634	2.15%	80,180	1,597	1.99%
Time	276,629	11,628	4.20%	240,797	11,901	4.94%	223,140	9,620	4.31%
Borrowings(1)	57,066	2,049	3.59%	40,151	2,052	5.11%	40,430	2,264	5.60%
Total interest-bearing liabilities	421,480	14,699	3.49%	380,996	16,193	4.25%	355,362	13,521	3.80%
Non-interest bearing deposits	52,653			59,376			58,705		
Other liabilities	1,618			1,608			1,917		
Stockholders' equity	53,972			54,836			52,924		
Total liabilities and stockholders' equity	$529,723			$496,816			$468,908		
Net interest income and interest rate spread		$15,712	2.78%		$19,233	3.53%		$18,813	3.74%
Net interest margin			3.24%			4.23%			4.39%
Ratio of average interest-earning assets to average interest-bearing liabilities	115.12%			119.44%			120.63%		

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

Table of Contents

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, 2008 vs. 2007 Increase (Decrease) Due to			December 31, 2007 vs. 2006 Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Loans	$ 2,466	$ (7,289)	$ (4,823)	$ 1,618	$ 956	$ 2,574
Investment securities	245	99	344	310	161	471
Interest-earning deposits with banks	(272)	(264)	(536)	13	34	47
Total interest income	2,439	(7,454)	(5,015)	1,941	1,151	3,092
Interest expense:						
Deposits	1,429	(2,920)	(1,491)	906	1,978	2,884
Borrowings	736	(739)	(3)	(15)	(197)	(212)
Total interest expense	2,165	(3,659)	(1,494)	891	1,781	2,672
Net interest income	$ 274	$ (3,795)	$ (3,521)	$ 1,050	$ (630)	$ 420

Comparison of Results of Operations for the Years Ended December 31, 2008 and 2007

Net Income. Bancshares generated a net loss in 2008 of $2.7 million, or $(0.41) per diluted share, as compared to net income in 2007 of $5.0 million, or $.72 per diluted share for 2007. Return on average assets was -0.50% and 1.01% and return on average equity was -4.92% and 9.15% for the years ended December 31, 2008 and 2007, respectively. Earnings for the year ended December 31, 2008 were negatively impacted by a $4.0 million increase in the provision for loan losses as well as a decrease of $3.5 million in net interest income during the year.

Net Interest Income. Net interest income decreased $3.5 million or 18.3% from $19.2 million in 2007 to $15.7 million in 2007. Total interest income suffered from a 400 basis point decrease in the target Federal Funds Rate during 2008.

Total average earning assets increased $30.1 million or 6.6% from an average of $455.1 million in 2007 to an average of $485.2 million in 2008. Bancshares experienced solid loan growth during 2008 with average loan balances increasing by $32.8 million. Average balances for investment securities and interest-earning deposits decreased $2.7 million. Total interest income decreased $5.0 million due to the decrease in yield on earning assets from 7.78% in 2007 to 6.27% in 2008. Average total interest-bearing liabilities increased by $40.5 million during 2008, consisting of a $23.6 million increase in average interest-bearing deposits and an increase in average borrowings of $16.9 million.

Table of Contents

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 2008 was 3.24% compared to 4.23% for 2007. The decrease in net interest margin resulted from the Federal Open Market Committee (FOMC) lowering the target Federal Funds Rate 400 basis points during the year ended December 31, 2008. Interest rates on a significant portion of our earning assets, such as certain loans and short-term investments, are tied to index rates, and conversely rates on a significant portion of interest-bearing liabilities such as certificates of deposits and borrowings remained fixed until maturity. This decrease in rates resulted in immediate decreases in income on loans while the cost of funding sources were slower to react. Deposit rates in particular are significantly affected by competitive pressures in the marketplace and did not decline as quickly as other market rates.

Provision for Loan Losses. Bancshares' provision for loan losses for 2008 was $5.0 million, representing a $4.0 million or 380% increase from the $1.0 million recorded for 2007. 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 $9.1 million at December 31, 2008, representing 2.13% of total outstanding loans and 118% of non-performing loans. The allowance for loan losses at December 31, 2007 was $5.7 million, representing 1.46% of total outstanding loans at that date and 333% of non-performing loans. The increase in provision for 2008 was primarily related to an increase in non-accrual loans and leases and an increase in net charge-offs in the loan portfolio during the year. This increase in non-performing loans and net charge-offs is related primarily to our residential construction and land development segments, and businesses that support the housing industry. Declines in these segments were brought on by weaknesses in the economy and the slowdown in new construction and housing starts. Net loan and lease charge-offs totaled $1.6 million in 2008 as compared to $921,000 in 2007. In addition, non-performing loans and leases increased $6.1 million from $1.7 million at December 31, 2007 to $7.8 million at December 31, 2008. Management has provided individual reserves related to these non-performing loans and leases in the amount of $1.6 million at December 31, 2008 and is aggressively pursuing collection and liquidating any underlying collateral as necessary. See the section entitled "Non Performing Assets" for more details on the breakdown of non-performing loans and leases.

Non-interest Income. Non-interest income decreased by $905,000 or 26.7% to $2.5 million for the year ended December 31, 2008. The largest components of non-interest income were service charges on deposit accounts of $2.3 million in 2008, a decrease of $102,000 from 2007, fees from mortgage banking operations of $259,000 in 2008 as compared to $326,000 in 2007, a $67,000 or 20.6% decrease, and a $593,000 loss on SERP investments which resulted primarily from investments held by the trust in Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) preferred stock. There were no gains or losses on SERP investments in 2007.

Non-interest Expenses. Total non-interest expense increased $3.5 million from $13.7 million in 2007 to $17.2 million in 2008. This 25.6% increase was primarily due to an other than temporary impairment recorded on equity investments held by the Bank of $2.9 million in FNMA and FHLMC preferred stock and $472,000 in merger expenses related to the proposed merger with Yadkin Valley. Salaries and benefits expense was $7.1 million for the year ended December 31, 2008, representing a $185,000 or 2.7% increase over the $6.9 million recorded for the prior year. Occupancy and equipment costs were $2.3 million for the year ended December 31, 2008 representing an $86,000 or 3.9% increase over the $2.2 million for the prior year. Other expenses decreased $41,000 or 0.9% from 2007 the majority of which was due to decreases in advertising expenses and professional fees in 2008. In addition, the Bank recorded an other than temporary loss on non-marketable equity securities of $59,000 in 2008 related to an investment in a trust company, whose primary shareholders are ten community banks located throughout North Carolina. There was a $76,000 other than temporary impairment charge taken on this same investment in 2007.

Provision for Income Taxes. Bancshares had an income tax benefit of $1.4 million, or 33.7% of loss before income taxes, for the year ended December 31, 2008 compared to an income tax expense of $2.9 million in 2007 or 36.4% of income before income taxes.

Comparison of Results of Operations for the Years Ended December 31, 2007 and 2006

Net Income. Bancshares generated net income in 2007 of $5.0 million compared to net income in 2006 of $4.3 million. On a per share basis, fully diluted earnings were $.72 for 2007 compared to $.60 for 2006. Return on average assets was 1.01% and 0.91% and return on average equity was 9.15% and 8.08% for the years ended December 31, 2007 and 2006, respectively.

Earnings for the year ended December 31, 2007 were positively impacted by solid growth in average earning assets and by a $1.6 million decrease in the provision for loan losses. 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 7.78% in 2007 from 7.54% in 2006. Earnings were negatively impacted by an increase in the average cost of interest-bearing liabilities from 3.80% in 2006 to 4.25% in 2007, as deposit cost increases outpaced increases in asset yields.

Net Interest Income. Net interest income increased $420,000 from $18.8 million in 2006 to $19.2 million in 2007. Total interest income benefited from strong growth in average earning assets.

Total average earning assets increased $26.4 million or 6.2% from an average of $428.7 million in 2006 to an average of $455.1 million in 2007. Bancshares experienced solid loan growth during 2007 with average loan balances increasing by $19.4 million. The increase in the average balances for investment securities and interest-earning deposits was $7.0 million. Total interest income increased $3.1 million due to the increase in average earning assets of $26.4 million, complemented by an increase in yield on earning assets from 7.54% in 2006 to 7.78% in 2007. Average total interest-bearing liabilities increased by $25.6 million during 2007, consisting of a $25.9 million increase in average interest-bearing deposits while average borrowings decreased $279,000.

Net interest margin is interest income earned on loans, securities and other earning assets, less interest expense paid on deposits and borrowings, expressed as a percentage of total average earning assets. The net interest margin for the year ended 2007 was 4.23% compared to 4.39% for 2006. The decrease 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. The Federal Open Market Committee (FOMC) raised the target Federal Funds Rate to a high in this interest rate cycle of 5.25% on June 6, 2006. The increases through that date resulted in immediate increases in the yield on our loans based on the bank prime rate resulting in an average rate in 2006 of 8.20%. The FOMC left the target Federal Funds Rate unchanged until September 17, 2007 and then reduced it 100 basis points through the end of December 31, 2007 resulting in an average rate on loans in 2007 of 8.46% or a 26 basis point increase. Investments and interest-earning deposits were also similarly affected by the change in rates. The rate on total interest-earning assets increased by 24 basis points from 7.54% in 2006 to 7.78% in 2007. Conversely, rates on a significant portion of interest-bearing liabilities such as certificates of deposits and borrowings remain fixed until maturity. While we benefited from the increase in rates through June of 2006, the stabilization of rates in late 2006 resulted in an increase in our funding costs as fixed rate liabilities matured and were re-priced at current higher rates. Time deposit cost was most affected as the average rate increased 63 basis points from 4.31% in 2006 to 4.94% for 2007. The overall cost of interest-bearing liabilities increased 45 basis points from 3.80% in 2006 to 4.25% in 2007. During the last half of 2007, the FOMC rate decreases resulted in immediate decreases in income on loans while the cost of funding sources remained relatively unchanged. Such interest rates are significantly affected by competitive pressures in the marketplace.

Provision for Loan Losses. Bancshares' provision for loan losses for 2007 was $1.0 million, representing a $1.6 million or 60.1% decrease from the $2.6 million recorded for 2006. 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 $5.7 million at December 31, 2007, representing 1.46% of total outstanding loans and 333% of non-performing loans. The allowance for loan losses at December 31, 2006 was $5.6 million, representing 1.52% of total outstanding loans at that date and 311% of non-performing loans. The decrease in provision for 2007 was primarily related to a decrease in net charge-offs in the leasing portfolio during the year. Net lease charge-offs totaled $637,000 in 2007 as compared to $1.2 million in 2006. In addition, non-accrual loans and leases decreased $858,000 from $1.8 million at December 31, 2006 to $1.2 million at December 31, 2007. 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 $38,000 or 1.1% to $3.4 million for the year ended December 31, 2007. The largest components of non-interest income were service charges on deposit accounts of $2.4 million in 2007, an increase of $26,000 from 2006, fees from mortgage banking operations of $326,000 in 2007 as compared to $352,000 in 2006, a $26,000 or 7.4% decrease, and a gain on derivative transactions of $214,000 as compared to a gain of $10,000 in 2006. There were no gains on derivative transactions in 2005.

Non-interest Expenses. Total non-interest expense increased $856,000 from $12.8 million in 2006 to $13.7 million in 2007. This 6.7% increase was primarily due to increases in compensation and increases in other expenses related to branch growth. Salaries and benefits expense was $6.9 million for the year ended December 31, 2007, representing a $419,000 or 6.5% increase over the $6.5 million recorded for the prior year. Occupancy and equipment costs were $2.2 million for the year ended December 31, 2007 representing a $67,000 or 3.0% decrease over the $2.3 million for the prior year. Other expenses increased $428,000 or 10.4% from 2006 the majority of which was due to increases in data processing and technology expenses and to professional fees in 2007. In addition, the Bank recorded an other than temporary loss on non-marketable equity securities of $76,000 in 2007 related to an investment in a trust company. There were no other than temporary impairments in 2006.

Provision for Income Taxes. Bancshares had tax expense of $2.9 million, or 36.4% of income before income taxes, for the year ended December 31, 2007 compared to an income tax expense of $2.4 million in 2006 or 36.3% of income before income taxes.

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, 2008, liquid assets (cash and due from banks, interest-earning deposits with banks, and investment securities available for sale) were approximately $86.0 million, which represents 16% of total assets and 18% of total deposits and borrowings. Supplementing this liquidity, Bancshares has lines of credit from correspondent banks of approximately $35.1 million and an additional line of

Table of Contents

credit with the FHLB equal to 15% of assets (subject to available qualified collateral, with borrowings of $26.0 million outstanding from the FHLB at December 31, 2008). At December 31, 2008, outstanding commitments to extend credit were $4.5 million and available line of credit balances totaled $52.5 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 68.5% of Bancshares' total deposits at December 31, 2008 an increase from 63.4% at December 31, 2007. 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 41.7% of Bancshares' total deposits at December 31, 2008. 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 assets in accordance with these guidelines. At December 31, 2008, 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, 2008, we exceeded our regulatory capital requirements.

	At December 31, 2008		
	Actual Ratio	Minimum Requirement	Well-Capitalized Requirement
American Community Bank:			
Total risk-based capital ratio	10.95%	8.00%	10.00%
Tier 1 risk-based capital ratio	9.69%	4.00%	5.00%
Leverage ratio	8.03%	4.00%	5.00%
American Community Bancshares:			
Total risk-based capital ratio	12.64%	8.00%	NA
Tier 1 risk-based capital ratio	11.38%	4.00%	NA
Leverage ratio	9.45%	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 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 1 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 required regulatory minimums for capital adequacy purposes.

Table of Contents

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."

The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2008, 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

Table of Contents

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, 2008				
	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	$ 175,533	$ 8,373	$ 18,377	$ 103,842	$ 306,125
Home equity lines of credit	43,777				43,777
Commercial and industrial loans	46,346	2,939	2,981	7,751	60,017
Loans to individuals	4,793	2,497	2,448	6,106	15,844
Lease financing, net	641	293	424	543	1,901
Interest earning deposits with banks	894				894
Investment securities	4,192	11,053	7,921	49,864	73,030
Non-marketable equity securities				2,980	2,980
Derivative financial instruments	(15,000)	15,000			
Total interest-earning assets	$ 261,176	$ 40,155	$ 32,151	$ 171,086	$ 504,568
INTEREST-BEARING LIABILITIES					
Deposits:					
Interest-bearing demand	$ 31,000	$ 700	$ 1,400	$ 53,212	$ 86,312
Time	83,738	32,545	125,929	52,054	294,266
Short-term borrowings	15,031				15,031
Long-term debt	10,310			27,676	37,986
Total interest-bearing liabilities	$ 140,079	$ 33,245	$ 127,329	$ 132,942	$ 433,595
INTEREST SENSITIVITY GAP PER PERIOD	$ 121,097	$ 6,910	$ (95,178)	$ 38,144	$ 70,973
CUMULATIVE INTEREST SENSITIVITY GAP	$ 121,097	$ 128,007	$ 32,829	$ 70,973	$ 70,973
CUMULATIVE GAP AS A PERCENTAGE OF TOTAL INTEREST-EARNING ASSETS	24.00%	25.37%	6.51%	14.07%	14.07%
CUMULATIVE INTEREST-EARNING ASSETS AS A PERCENTAGE OF CUMULATIVE INTEREST BEARING LIABILITIES	186.45%	173.85%	110.92%	116.37%	116.37%

Table of Contents

The Company entered into off-balance sheet contracts that are considered derivative financial instruments in order to assist in achieving a desired level of interest rate sensitivity. As of December 31, 2008, the Company had derivative instruments 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 contract. 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. The Company received payments of $374,167 and $3,229 in 2008 and 2007, respectively, on the 7.75% contract and received payments of $482,917 in 2008 on the 7.25% contract. There were no payments received on the 7.25% contract in 2007.

In 2008, the interest rate floors no longer qualified as a cash flow hedge and the hedge designation was removed. As a result, amounts accumulated in other accumulated comprehensive income were reclassified into earnings. Changes in fair value of the interest rate floors are now accounted for in earnings for the period of the change.

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 2 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 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 evident. 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 adjustments 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.

Other Than Temporary Impairment

The Company periodically evaluates its investments for any impairment which would be deemed other than temporary. As part of its evaluation, the Company determined that the fair value of its $2,902,265 investment in Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") preferred stock and its investment in a trust company were other than temporarily impaired. As a result, the Company wrote down its investment in FNMA and FHLMC stock by $2,822,756, to an estimated fair value of $67,100 as of December 31, 2008. In addition, the Company wrote down its investment of $201,991 in a trust company by an additional $59,082, to an estimated fair value of $142,909 as of December 31, 2008. An other than temporary impairment charge of $75,747 was taken on this same investment in 2007. The write downs were recorded as a charge to earnings in 2008 and 2007.

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 90 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.

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. The Company also 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. We performed an interim evaluation of our goodwill balances at December 31, 2008 and an annual goodwill impairment assessment as of April 15, 2008. No impairment has been recorded as a result of goodwill testing performed during 2008 or 2007. Given the substantial decline in our common stock price and the economic outlook for our industry, the excess of the fair value over carrying value has narrowed compared with previous assessments. If our stock price continues to decline, due to the termination of the impending merger with Yadkin Valley, if the Company does not produce anticipated

Table of Contents

cash flows, or if comparable banks begin selling at significantly lower prices than in the past, our goodwill may be impaired in the future.

Contractual Obligations

The following table reflects the contractual obligations of the Company outstanding as of December 31, 2008.

	Payments Due by Period				
	On Demand or Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
	(Dollars in thousands)				
Advances from FHLB	$	$	$ 16,000	$ 10,000	$ 26,000
Securities sold under agreement to repurchase and federal funds sold	15,030				15,030
Capital lease obligation	10	46	54	1,565	1,675
Junior subordinated deferrable interest debentures				10,310	10,310
Operating leases	873	1,057	699	2,394	5,023
Other contractual obligations	597	635			1,232
Total contractual cash obligations, excluding deposits	16,510	1,738	16,753	24,269	59,270
Deposits	377,370	39,703	12,331		429,404
Total contractual cash obligations, including deposits	$ 393,880	$ 41,441	$ 29,084	$ 24,269	$ 488,674

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.

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				
	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
	(Dollars in thousands)				
Capital South Partnership commitments	$ 825	$	$	$	$ 825
Standby letters of credit	3,101				3,101
Commitments to extend credit	4,526				4,526
Undisbursed lines of credit	22,091	2,402	3,696	24,298	52,487
Undisbursed portion of construction loans	16,114	5,109	1,980	759	23,962
Total off-balance sheet commitments	$ 46,657	$ 7,511	$ 5,676	$25,057	$84,901

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

Table of Contents

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, 2008, Bancshares had loans outstanding to executive officers and directors totaling approximately $5.2 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 $5.2 million in outstanding related party loans represents 1.2% of Bancshares' total loan portfolio. Bancshares has never charged-off a loan to a related party.

Recent Accounting Pronouncements

FAS 141R

In December 2007, the FASB issued SFAS 141(R), Business Combinations. SFAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this Statement include: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward.

The Company will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. Management is currently evaluating the effects that SFAS 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented in the consolidated financial statements.

Table of Contents

FAS 157

In September 2006, the Financial Accounting Standards Board issued FASB Statement No. 157, "Fair Value Measurements" ("FASB No. 157"), 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 adopted the provisions of SFAS 157, "Fair Value Measurements" effective January 1, 2008. The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

FAS 159

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* . This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This option is available to all entities. Most of the provisions in SFAS 159 are elective; however, the amendment to SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities,* applies to all entities with available-for-sale and trading securities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company did not elect the fair value option as of January 1, 2008 for any of its financial assets or financial liabilities and, accordingly, the adoption of the statement did not have a material impact on the Company's consolidated financial statements.

SFAS 161

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133". This statement applies to all derivatives and hedged items and is effective for periods beginning after November 15, 2008 prospectively, with comparative disclosures encouraged. This statement requires enhanced qualitative disclosures and tabular disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk contingent features in derivative agreements. The Company is currently evaluating the effects that SFAS 161 will have upon adoption as this standard will affect the presentation and disclosure in 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.

Table of Contents

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk reflects the risk of economic loss resulting from adverse changes in market price an d 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, 2008.

	2008	2009	2010	2011	2012	Beyond Five Years	Total	Average Interest Rate	Estimated Fair Value
					(Dollars in thousands)				
FINANCIAL ASSETS									
Investment securities									
Available for sale	$	$ 486	$ 504	$ 1,035	$ 5,600	$ 62,359	$ 69,984	5.12%	$ 71,262
Held to maturity						1,768	1,768	5.78%	1,760
Non-marketable equity						2,980	2,980		2,980
Loans	211,359	32,655	38,288	36,186	63,101	45,903	427,492	4.87%	426,123
Total	$211,359	$33,141	$38,792	$37,221	$68,701	$113,010	$502,224		$ 502,125
FINANCIAL LIABILITIES									
Interest-bearing demand accounts	$ 33,100	$ 2,801	$ 2,801	$ 4,201	$ 4,201	$ 39,208	$ 86,312	1.24%	$ 73,017
Time deposits	242,212	35,359	4,336	11,558	801		294,266	3.71%	305,135
Borrowings	15,041	22	24	1,026	15,028	21,876	53,017	3.21%	39,554
Total	$290,353	$38,182	$ 7,161	$16,785	$20,030	$ 61,084	$433,595		$ 417,706

B-47

Table of Contents

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

TABLE OF CONTENTS

Table of Contents

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 subsidiary (the "Company") as of December 31, 2008 and 2007 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, 2008. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. 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 subsidiary at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

Charlotte, North Carolina
February 19, 2009, except for Note 25, as to which the date is March 26, 2009

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 2008 and 2007

	2008	2007
	(Amounts in thousands)	
ASSETS		
Cash and due from banks	$ 13,809	$ 14,346
Interest-earning deposits with banks	894	930
Investment securities available for sale, at fair value (cost of $69,984 and $74,420 at December 31, 2008 and 2007, respectively)	71,262	75,012
Investment securities held to maturity, at cost (fair value approximates $1,760 and $1,804 at December 31, 2008 and 2007, respectively)	1,768	1,770
Loans	427,492	392,959
Allowance for loan losses	(9,124)	(5,740)
NET LOANS	418,368	387,219
Accrued interest receivable	2,032	2,640
Bank premises and equipment	7,125	8,694
Equity securities, at cost	2,980	2,119
Goodwill	9,838	9,838
Other assets	7,603	3,027
TOTAL ASSETS	$535,679	$505,595
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Demand non-interest bearing	$ 48,826	$ 54,459
Savings	13,903	24,181
Money market and NOW	72,409	67,877
Time	294,266	253,277
TOTAL DEPOSITS	429,404	399,794
Short-term borrowings	15,031	31,509
Long-term debt	37,986	17,995
Accrued expenses and other liabilities	1,976	2,273
TOTAL LIABILITIES	484,397	451,571
Stockholders' Equity		
Preferred stock, no par value, 1,000,000 shares authorized; none issued		
Common stock, $1 par value, 25,000,000 shares authorized, 6,633,169 and 6,502,288 shares issued and outstanding at December 31, 2008 and 2007, respectively	6,633	6,502
Additional paid-in capital	33,090	32,364
Retained earnings	10,775	14,744
Accumulated other comprehensive income	784	414
TOTAL STOCKHOLDERS' EQUITY	51,282	54,024
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$535,679	$505,595

See accompanying notes to these consolidated financial statements.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands, except share and per share data)		
INTEREST INCOME			
Loans, including fees	$ 25,501	$ 31,366	$ 28,800
Investment securities:			
Taxable	3,270	3,046	2,702
Tax-exempt	535	415	288
Interest-earning deposits with banks	55	591	544
Other interest income	1,050	8	
TOTAL INTEREST INCOME	30,411	35,426	32,334
INTEREST EXPENSE			
Money market, NOW and savings deposits	1,022	2,240	1,637
Time deposits	11,628	11,901	9,620
Borrowings	750	214	452
Securities sold under agreement to repurchase and federal funds purchased	499	793	523
Capital lease obligation	138	139	140
Junior subordinated debentures	662	906	1,149
TOTAL INTEREST EXPENSE	14,699	16,193	13,521
NET INTEREST INCOME	15,712	19,233	18,813
PROVISION FOR LOAN LOSSES	4,999	1,033	2,612
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,713	18,200	16,201
NON-INTEREST INCOME			
Service charges on deposit accounts	2,317	2,419	2,393
Mortgage banking operations	259	326	352
Gain on sale of investment securities		20	60
Gain on derivative transactions	331	214	
Gain on sale of assets	7	53	79
Loss on SERP investment	(593)		
Other	165	359	469
TOTAL NON-INTEREST INCOME	2,486	3,391	3,353
NON-INTEREST EXPENSE			
Salaries and employee benefits	7,078	6,893	6,474
Occupancy and equipment	2,280	2,194	2,261
Other than temporary impairment of equity securities	2,881	76	
Merger related expenses	472		
Other	4,498	4,539	4,103
TOTAL NON-INTEREST EXPENSE	17,209	13,702	12,838

INCOME (LOSS) BEFORE INCOME TAXES	(4,010)	7,889	6,716
INCOME TAX EXPENSE (BENEFIT)	(1,353)	2,869	2,440
NET INCOME (LOSS)	$ (2,657)	$ 5,020	$ 4,276
NET INCOME (LOSS) PER COMMON SHARE			
Basic	$ (.41)	$ .74	$ .62
Diluted	$ (.41)	$ .72	$ .60
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING			
Basic	6,555,255	6,779,635	6,913,534
Diluted	6,555,255	6,938,259	7,171,413

See accompanying notes to these consolidated financial statements.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands)		
NET INCOME (LOSS)	$(2,657)	$5,020	$4,276
Other comprehensive income:			
Securities available for sale:			
Unrealized holding gains (losses) on available-for-sale securities	(2,125)	1,514	350
Tax effect	819	(583)	(133)
Reclassification adjustment for losses (gains) realized in income	2,822	(20)	(60)
Tax effect	(1,088)	8	23
Net of tax amount	428	919	180
Cash flow hedging activities:			
Unrealized holding gains (losses) on cash flow hedging activities	167	240	(139)
Tax effect	(58)	(92)	53
Reclassification adjustment for gains realized in income	(271)	(6)	
Tax effect	104	2	
Net of tax amount	(58)	144	(86)
Total other comprehensive income	370	1,063	94
Total comprehensive income (loss)	$(2,287)	$6,083	$4,370

See accompanying notes to these consolidated financial statements.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2008, 2007 and 2006

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Amount				
			(Amounts in thousands, except share data)			
Balance, January 1, 2006	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 the 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
Comprehensive income:						
Net income				5,020		5,020
Other comprehensive income, net of tax					1,063	1,063
Total comprehensive income						6,083
Cash dividends of $.20 per share				(1,348)		(1,348)
Shares repurchased	(540,791)	(541)	(5,539)			(6,080)
Expense recognized in connection with stock options			52			52
Common stock issued pursuant to the exercise of stock options	34,998	35	176			211
Tax benefit from the exercise of stock options			38			38
Balance, December 31, 2007	6,502,288	6,502	32,364	14,744	414	54,024
Comprehensive loss:						
Net loss				(2,657)		(2,657)
Other comprehensive income, net of tax					370	370
Total comprehensive loss						(2,287)
Cash dividends of $.20 per share				(1,312)		(1,312)

Expense recognized in connection with stock options			50			50
Common stock issued pursuant to the exercise of stock options	130,881	131	519			650
Excess tax benefits from option exercise			157			157
Balance, December 31, 2008	6,633,169	$ 6,633	$ 33,090	$ 10,775	$ 784	$ 51,282

See accompanying notes to these consolidated financial statements.

B-53

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$ (2,657)	$ 5,020	$ 4,276
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	1,026	937	1,072
Provision for loan losses	4,999	1,033	2,612
Deferred income taxes	(2,798)	(342)	(938)
Gain on sale of investment securities		(20)	(60)
Other than temporary impairment of equity securities	2,881	76	
Loss on SERP investment	593		
Loss on sale of foreclosed real estate			144
(Gain) loss on disposal of fixed assets		(8)	7
Recognition of hedge ineffectiveness	(331)	(214)	(10)
Decrease in capital lease obligation	(9)	(9)	(9)
Equity compensation expense	50	52	375
Change in assets and liabilities:			
Decrease (increase) in accrued interest receivable	608	298	(506)
Decrease (increase) in other assets	(2,552)	454	(97)
Increase (decrease) in accrued expenses and other liabilities	(642)	905	(551)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,168	8,182	6,315
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of securities available for sale	(10,251)	(29,799)	(13,299)
Proceeds from sales of securities available for sale		6,460	3,909
Proceeds from maturities, calls and principal repayments of securities available for sale	11,858	12,823	8,763
Proceeds from maturities, calls and principal repayments of securities held to maturity		400	
Net increase in loans from originations and repayments	(36,460)	(23,503)	(39,375)
Purchases of bank premises and equipment	(184)	(379)	(326)
Proceeds from sale of bank premises and equipment	1,277	8	6
Proceeds from sale of foreclosed real estate	312	249	384
Investment in equity securities	(920)	(316)	(191)
Redemption of non-marketable equity securities			308
NET CASH USED IN INVESTING ACTIVITIES	(34,368)	(34,057)	(39,821)

See accompanying notes to these consolidated financial statements.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands)		
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase (decrease) in demand deposits	(11,379)	(28,662)	31,916
Net increase in time deposits	40,989	27,319	23,820
Proceeds from issuance of common stock	650	211	912
Repurchase of common stock		(6,080)	(263)
Advances from Federal Home Loan Bank	20,000		
Repayment of Federal Home Loan Bank advances			(5,111)
Redemption of long-term debt		(3,608)	
Excess tax benefits from stock options exercised	157	38	170
Cash dividends paid on common stock	(1,312)	(1,348)	(1,382)
Net increase (decrease) in securities sold under agreement to repurchase and federal funds purchased	(16,478)	16,036	3,740
NET CASH PROVIDED BY FINANCING ACTIVITIES	32,627	3,906	53,802
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(573)	(21,969)	20,296
CASH AND CASH EQUIVALENTS, BEGINNING	15,276	37,245	16,949
CASH AND CASH EQUIVALENTS, ENDING	$ 14,703	$ 15,276	$ 37,245
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 14,694	$ 15,957	$ 13,725
Income taxes	1,573	2,875	3,992
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Transfer of loans to foreclosed assets	$ 312	$ 54	337
Change in unrealized gain on available-for-sale securities and cash flow hedging activities, net of tax	370	1,063	94

See accompanying notes to these consolidated financial statements.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2008, 2007 and 2006

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.

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.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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 reversed out of 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 evident. 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 adjustments 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

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 the lower of cost or fair value less estimated cost to sell at the date of foreclosure. 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.

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 $351,479, net of amortization of $502,850, as of December 31, 2008. 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 for the years ended December 31, 2008, 2007, and 2006. 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 ending December 31, 2009, 2010, 2011 is $106,800 per year. Projected amortization expense for the year ending December 31, 2012 is $31,079.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2008 and December 31, 2008, which indicated that no impairment had occurred. Management does not believe that events and circumstances subsequent to those dates indicated that goodwill has been impaired.

Income Taxes

The Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) on January 1, 2007. FIN 48 applies to all "tax positions" within the scope of SFAS 109. This statement requires a "more-likely-than-not" threshold for initial recognition of a tax benefit in the financial statements, and requires measurement of the amount of benefit to be recognized based upon the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement with the taxing authority. The Company has analyzed its tax positions pursuant to the requirements of FIN 48 and determined that no liability for unrecognized tax benefits is needed.

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. It is the Company's policy to recognize interest and penalties associated with uncertain tax positions as components of income taxes. There were no interest or penalties accrued during the year. The Company's federal and state income tax returns are subject to examination for the years 2005, 2006, 2007 and 2008.

Stock Compensation Plans

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("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

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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 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, 2008, accumulated other comprehensive income consisted of net unrealized gains on securities available for sale of $784,000. At December 31, 2007, accumulated other comprehensive income consisted of net unrealized gains on securities available for sale of $356,000 and net unrealized gains on derivatives of $58,000.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Per Share Results

Basic and diluted net income per common share have been computed by dividing net income (loss) 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:

	2008	2007	2006
Weighted average number of common shares used in computing basic net income per share	6,555,255	6,779,635	6,913,534
Effect of dilutive stock options and warrants		158,624	257,879
Weighted average number of common shares and dilutive potential common shares used in computing diluted net income per share	6,555,255	6,938,259	7,171,413

For the years ended December 31, 2008, 2007, and 2006 there were 132,293, 90,329, and 90,000 options, respectively, that were anti-dilutive since the exercise price exceeded the average market price for the year. Due to the net loss for the year ended December 31, 2008, anti-dilutive options are not omitted from the calculation of diluted earnings per share. Anti-dilutive options are omitted from the calculation of diluted earnings per share for the years ended December 31, 2007 and 2006.

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.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

SFAS 141R

In December 2007, the FASB issued SFAS 141(R), "Business Combinations". SFAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this Statement include: the acquisition date will be date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition-related restructuring costs that do not meet the criteria in SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward.

The Company will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. Management is currently evaluating the effects that SFAS 141(R) will have on the financial condition, results of operations, liquidity, and the disclosures that will be presented in the consolidated financial statements and applied in the proposed merger with Yadkin Valley Financial Corporation.

SFAS 157

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, "Fair Value Measurements" ("FASB No. 157"), 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 adopted the provisions of SFAS 157, "Fair Value Measurements" effective January 1, 2008. The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SFAS 159

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This option is available to all entities. Most of the provisions in SFAS 159 are elective; however, the amendment to SFAS 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company did not elect the fair value option as of January 1, 2008 for any of its financial assets or financial liabilities and, accordingly, the adoption of the statement did not have a material impact on the Company's consolidated financial statements.

SFAS 161

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133". This statement applies to all derivatives and hedged items and is effective for periods beginning after November 15, 2008 prospectively, with comparative disclosures encouraged. This statement requires enhanced qualitative disclosures and tabular disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk contingent features in derivative agreements. The Company is currently evaluating the effects that SFAS 161 will have upon adoption as this standard will affect the presentation and disclosure in the consolidated financial statements.

NOTE 3 INVESTMENT SECURITIES

The following is a summary of the securities portfolio by major classification at December 31, 2008 and 2007:

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
U. S. Government agencies	$ 9,635	$ 211	$ 5	$ 9,841
Mortgage-backed securities	47,232	1,238	6	48,464
State and municipal bonds	12,143	42	202	11,983
	69,010	1,491	213	70,288
Marketable equity securities	974			974
Total securities available for sale	$69,984	$ 1,491	$ 213	$71,262

B-63

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 3 INVESTMENT SECURITIES (Continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
State and municipal bonds	$ 1,768	$	$ 8	$ 1,760
Total securities held to maturity	$ 1,768	$	$ 8	$ 1,760

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
U. S. Government agencies	$13,635	$ 341	$ 10	$13,966
Mortgage-backed securities	49,116	385	196	49,305
State and municipal bonds	10,762	109	44	10,827
	73,513	835	250	74,098
Marketable equity securities	907	7		914
Total securities available for sale	$74,420	$ 842	$ 250	$75,012

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
State and municipal bonds	$ 1,770	$ 34	$	$ 1,804
Total securities held to maturity	$ 1,770	$ 34	$	$ 1,804

The amortized cost and fair values of securities (excluding marketable equity securities) at December 31, 2008 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, 2008	
	Amortized Cost	Fair Value
	(Dollars in thousands)	

Due within one year	$	$
Due after one year through five years	7,625	7,749
Due after five years through ten years	17,249	17,540
Due after ten years	45,904	46,759
Total	$70,778	$72,048

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 3 INVESTMENT SECURITIES (Continued)

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.

There were no sales of investment securities for the year ended December 31, 2008. For the years ended December 31, 2007 and 2006, proceeds from sales of investment securities available for sale amounted to $6,459,570 and $3,908,955 respectively. Gross realized gains in 2007 and 2006 from these sales amounted to $19,445 and $60,072, respectively.

Available for sale securities, consisting of U. S. government agencies, mortgage-backed securities and state and municipal bonds, with carrying values of $11,651,000 and $13,173,000 at December 31, 2008 and 2007, 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 $17,123,000 and $18,762,000 were pledged to secure securities sold under agreements to repurchase at December 31, 2008 and 2007, respectively. Available for sale securities, consisting of mortgage-backed securities with carrying values of $8,391,000 and $997,000 were pledged to secure advances from the Federal Home Loan Bank at December 31, 2008 and 2007, 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, 2008 and 2007. 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 2008 unrealized losses on investment securities relate to one U.S. Government agency security, four mortgage-backed securities, and twenty-three municipal securities. The 2007 unrealized losses on investment securities relate to two U.S. Government agency securities, twenty-six mortgage-backed securities, and nine municipal securities. 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. The Company has the positive intent and ability to hold until recovery all investment securities with unrealized losses at December 31, 2008.

	2008					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(Dollars in thousands)					
Securities available for sale:						
U.S. government agencies	$	$	$1,568	$ 5	$ 1,568	$ 5
Mortgage-backed securities	2,213	6			2,213	6
State and municipal bonds	8,424	202			8,424	202
Total temporarily impaired securities	$10,637	$ 208	$1,568	$ 5	$12,205	$ 213

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 3 INVESTMENT SECURITIES (Continued)

	2007					
	Less Than 12 Months		12 Months or More		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
	(Dollars in thousands)					
Securities available for sale:						
U.S. government agencies	$	$	$ 2,731	$ 10	$ 2,731	$ 10
Mortgage-backed securities	2,891	12	21,674	184	24,565	196
State and municipal bonds	1,529	19	1,301	25	2,830	44
Total temporarily impaired securities	$ 4,420	$ 31	$ 25,706	$ 219	$ 30,126	$ 250

The Company periodically evaluates its investments for any impairment which would be deemed other than temporary. As part of its evaluation, the Company determined that the fair value of its investment in Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") preferred stock of $2,902,265 was other than temporarily impaired. As a result, the Company wrote down its investment in FNMA and FHLMC stock by $2,822,756, to an estimated fair value of $67,100 as of December 31, 2008.

NOTE 4 NON-MARKETABLE EQUITY SECURITIES CARRIED AT COST

The aggregate cost of the Company's cost method investments totaled $2,979,846 at December 31, 2008. The Company periodically evaluates these investments for any impairment which would be deemed other than temporary. As part of its evaluation, the Company determined that the fair value of an investment in a trust company, whose primary shareholders are ten community banks located throughout North Carolina, was less than the original cost of the investment and that the decline in fair value was not temporary in nature. As a result, in 2007 the Company wrote down its original investment in the trust company of $277,738 by $75,747, to an estimated fair value of $201,991. This write down was recorded as a charge to earnings during the year ended December 31, 2007. The Company wrote down this investment by an additional $59,082 to $142,909 by a charge to earnings during the year ended December 31, 2008. This trust company has two common directors with the Company.

Of the remaining $2,836,937 in equity investments, securities in the Federal Home Loan Bank and Silverton Bank, N.A. amounted to $2,077,700 and $84,237, respectively, at December 31, 2008. 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. The Company did not identify any events or changes in circumstances that may have had a significant adverse effect on the fair value of the remaining $675,000 cost method investments.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

NOTE 5 LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Following is a summary of loans at December 31, 2008 and 2007:

	2008		2007	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Real estate mortgage loans:				
1-4 family	$ 43,431	10.16%	$ 35,680	9.08%
Commercial mortgage	105,464	24.66%	104,209	26.51%
Construction/development	157,230	36.77%	136,531	34.73%
Home equity lines of credit	43,777	10.24%	34,784	8.85%
Commercial and industrial loans	60,017	14.03%	57,958	14.74%
Loans to individuals	15,844	3.70%	20,010	5.09%
Lease financing, net	1,901	0.44%	3,941	1.00%
Subtotal	427,664	100.00%	393,113	100.00%
Allowance for loan losses	(9,124)		(5,740)	
Net unamortized deferred fees	(172)		(154)	
Total	$418,368		$387,219	

Loans are primarily made in Union and Mecklenburg Counties, North Carolina and Cherokee and York Counties, 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. Significant declines in the housing markets and overall downturn in economic conditions over the past twelve months have resulted in write-downs and could further impact our loan portfolio.

At December 31, 2008 and 2007, respectively, there were $26,000 and $-0- of loans past due 90 days or more which were still accruing interest. Impaired loans, which consisted primarily of non-accrual loans and leases, were $8,062,000 and $2,477,000 at December 31, 2008 and 2007, respectively. Impaired loans of $5,508,000 and $2,477,000 had related allowances for loan losses aggregating $1,628,000 and $941,000 at December 31, 2008 and 2007, respectively. There were $2,554,000 and $-0- impaired loans without an allowance at December 31, 2008 or 2007, respectively. The average recorded investment in impaired loans during the years ended December 31, 2008 and 2007 was $2,858,000 and $1,565,000, respectively. Interest foregone on non-accrual loans was approximately $272,000 and $44,000 for the year ended December 31, 2008 and 2007, respectively.

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

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years Ended December 31, 2008, 2007 and 2006

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

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:

		(Dollars in thousands)
Loans to directors and officers as a group at January 1, 2008	$	3,525
New loans or advances on lines during the year ended December 31, 2008		4,794
Amounts collected during the year ended December 31, 2008		(3,169)
Loans to directors and officers as a group at December 31, 2008	$	5,150

At December 31, 2008, the Company had pre-approved but unused lines of credit totaling $1,987,000 to directors, executive officers and their related interests.

An analysis of the allowance for loan losses follows:

	2008	2007	2006
	(Dollars in thousands)		
Balance at beginning of year	$5,740	$5,628	$4,331
Provision charged to operations	4,999	1,033	2,612
Charge-offs	1,640	1,035	1,350
Recoveries	(25)	(114)	(35)
Net charge-offs	1,615	921	1,315
Balance at end of year	$9,124	$5,740	$5,628

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 6 BANK PREMISES AND EQUIPMENT

Following is a summary of bank premises and equipment at December 31, 2008 and 2007:

	2008	2007
	(Dollars in thousands)	
Land	$ 1,488	$ 1,668
Buildings and leasehold improvements	6,252	7,192
Furniture and equipment	4,225	4,095
	11,965	12,955
Accumulated depreciation and amortization	(4,840)	(4,261)
Total	$ 7,125	$ 8,694

Depreciation and amortization expense amounting to $741,000, $791,000 and $868,000 for the years ended December 31, 2008, 2007 and 2006, respectively, is included in occupancy and equipment expense.

NOTE 7 DEPOSITS

Time deposits in denominations of $100,000 or more were $178,900,000 and $143,732,000 at December 31, 2008 and 2007, respectively. Brokered deposits totaled $36,116,000 and $12,001,000 at December 31, 2008 and 2007, respectively.

At December 31, 2008, the scheduled maturities of certificates of deposit were as follows:

	Less than $100,000	$100,000 or more	Total
	(Dollars in thousands)		
2009	$ 92,286	$ 149,926	$ 242,212
2010	17,547	17,812	35,359
2011	1,434	2,903	4,337
2012	3,857	7,701	11,558
2013	242	558	800
Thereafter			
Total	$ 115,366	$ 178,900	$ 294,266

NOTE 8 BORROWINGS

Borrowings consist of advances from the Federal Home Loan Bank of Atlanta, securities sold under agreements to repurchase, federal funds purchased, junior subordinated debt and obligations under a capitalized lease for the Bank's main office facility.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 8 BORROWINGS (Continued)

The following table provides a summary of our borrowings:

	2008	2007
	(Dollars in thousands)	
Short-term borrowings		
Repurchase agreements	$ 14,623	$ 18,193
Federal funds purchased	408	13,316
	$ 15,031	$ 31,509
Long-term debt		
FHLB advances	$ 26,000	$ 6,000
Capitalized lease obligation	1,676	1,685
Junior subordinated debentures	10,310	10,310
	$ 37,986	$ 17,995

At December 31, 2008 and 2007, Federal Home Loan Bank advances were as follows:

Maturity date	Call Feature	2008 Amount	2008 Rate	2007 Amount	2007 Rate
		(Dollars in thousands)			
July 16, 2012	Callable quarterly	$ 1,000	3.900%	$ 1,000	3.900%
February 25, 2013	Callable quarterly	5,000	3.450%	5,000	3.450%
January 10, 2013	Callable quarterly	10,000	3.095%		
February 28, 2018	Callable quarterly	5,000	2.930%		
April 25, 2015	Callable quarterly	5,000	2.970%		
Total FHLB borrowings/weighted average rate		$ 26,000	3.138%	$ 6,000	3.525%

Pursuant to a collateral agreement with the FHLB, advances are collateralized by all the Company's FHLB stock of $2,077,700 and $1,158,000 at December 31, 2008 and 2007, respectively, 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, 2008 and 2007 was approximately $62,495,000 and $13,459,000, respectively. This agreement with the FHLB provides for a line of credit up to 15% of the Bank's assets.

The Company also had unused lines of credit totaling $35.1 million and $16.2 million from correspondent banks at December 31, 2008 and 2007, respectively.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 8 BORROWINGS (Continued)

Federal funds purchased and securities sold under agreements to repurchase, which generally mature 1 to 4 days from the transaction date, at December 31, 2008 and 2007 are summarized below:

	2008	2007
	(Dollars in thousands)	
Outstanding balance at December 31	$ 15,031	$ 31,509
Year-end weighted average rate	1.97%	3.61%
Average outstanding during the year	21,654	21,317
Average rate for the year	2.30%	3.71%
Maximum outstanding at any month-end during the year	30,194	31,509

Available for sale securities, consisting of US government agencies and mortgage-backed securities, with carrying values of $17,123,000 and $18,535,000 were pledged to secure securities sold under agreements to repurchase at December 31, 2008 and 2007, respectively and are held at an independent correspondent bank. Available for sale securities, consisting of mortgage-backed securities with carrying values of $8,391,000 and $997,000 were pledged to secure advances from the Federal Home Loan Bank at December 31, 2008 and 2007, respectively.

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. In 2008, the Company entered into another sale-leaseback arrangement. The Company sold its Blacksburg and Hwy 11 branch properties and leased them 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 $265,388 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 operating leases are as follows:

	(Dollars in thousands)
2009	$ 873
2010	600
2011	457
2012	384
2013	315
2014 - thereafter	2,394
Total	$ 5,023

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 9 LEASES (Continued)

Total rent expense under operating leases was approximately $841,000, $790,000 and $783,000 for the years ended December 31, 2008, 2007 and 2006, 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, 2008 and 2007 is $1.7 million as the capitalized cost of the Company's main office and accumulated amortization of $392,000 and $349,000 at December 31, 2008 and 2007, respectively.

At December 31, 2008, aggregate future minimum lease payments due under this capital lease obligation are as follows:

		(Dollars in thousands)
2009	$	148
2010		158
2011		158
2012		158
2013		158
2014 - 2029		2,883
Total minimum lease payments		3,665
Less amount representing interest		(1,989)
Present value of net minimum lease payments	$	1,676

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 $536,000, $476,000, and $495,000 were paid to these former directors under these leases during 2008, 2007 and 2006, respectively.

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 paid cumulative cash distributions quarterly at an annual rate of 9%. The dividends paid to holders of the capital trust preferred securities, which were recorded as interest expense, were deductible for income tax purposes. The quarterly distributions could, at the option of the Company, be deferred up to five years. The preferred securities issued in 2001 and 2002 were redeemable on

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 10 JUNIOR SUBORDINATED DEFERRABLE INTEREST DEBENTURES (Continued)

March 1, 2007 or afterwards at the par of $1,000 per share. These shares were redeemed on March 9, 2007.

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 1 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 2008	Principal Amount 2007
					(Dollars in thousands)	
American Community Capital Trust II, Ltd.	12/15/2003	10,000	6.56%	12/15/2033	$ 10,310	$ 10,310

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:

	(Dollars in thousands)
2009	$ 597
2010	635
Total	$ 1,232

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.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 12 INCOME TAXES

The significant components of the provision for income taxes for the periods ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
	(Dollars in thousands)		
Current tax provision:			
Federal	$ 1,267	$2,712	$2,899
State	178	499	479
	1,445	3,211	3,378
Deferred tax benefit:			
Federal	(2,357)	(314)	(848)
State	(441)	(28)	(90)
	(2,798)	(342)	(938)
Provision for income taxes	$(1,353)	$2,869	$2,440

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:

	2008	2007	2006
	(Dollars in thousands)		
Income tax expense (benefit) computed at statutory rate of 34%	$(1,364)	$2,682	$2,283
Effect of state income taxes	(173)	311	257
Tax exempt interest	(170)	(142)	(102)
Non-deductible merger expenses	160		
Other	194	18	2
Net provision for income taxes	$(1,353)	$2,869	$2,440

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 12 INCOME TAXES (Continued)

Significant components of deferred taxes at December 31, 2008 and 2007 are as follows:

	2008	2007
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for loan losses	$ 3,202	$ 1,921
Capital lease	139	129
Deferred gain on sale-leaseback	113	22
Income from deferred data processing payment	28	43
Nondeductible accrued expenses	43	18
Stock compensation expense	121	143
Other than temporary impairment of investment securities	1,346	
Other	93	44
Total deferred tax assets	5,085	2,320
Deferred tax liabilities:		
Premises and equipment	(131)	(144)
Leased property	(175)	(368)
Core deposit intangible	(133)	(177)
Prepaid expenses	(57)	(57)
Interest rate hedges	(207)	(36)
Net unrealized gains on available-for-sale securities	(493)	(236)
Other	(12)	(2)
Total deferred tax liabilities	(1,208)	(1,020)
Net deferred tax assets	$ 3,877	$ 1,300

NOTE 13 OTHER NON-INTEREST EXPENSE

The major components of other non-interest expense for the years ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
	(Dollars in thousands)		
Postage, printing and office supplies	$ 260	$ 280	$ 340
Advertising and promotion	179	195	189
Travel, meals, dues and subscriptions	281	265	225
Telephone	216	235	150
Data processing and technology	1,087	953	835
Professional fees and contracted services	1,242	1,280	1,027
Other	1,233	1,331	1,337
Total	$4,498	$4,539	$4,103

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 14 REGULATORY MATTERS

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The primary sources of funds for the payment of dividends by American Community Bancshares, Inc. are interest and dividends received from its subsidiary, American Community Bank, combined with the proceeds from stock sold by the Company. American Community, as a North Carolina banking corporation, may pay dividends only out of undivided profits as determined pursuant to North Carolina General Statutes Section 53-87. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such limitation is in the public interest and is necessary to ensure a bank's financial soundness.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its bank subsidiary to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2008 and 2007, that the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2008, the most recent notification from the Federal Deposit Insurance Corporation categorized American Community Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. Prompt corrective action provisions are not applicable to bank holding companies.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 14 REGULATORY MATTERS (Continued)

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2008 and 2007 are presented in the following table.

	Actual		Minimum For Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
December 31, 2008:						
Total Capital to Risk						
Weighted Assets:						
Consolidated	$56,221	12.64%	$35,572	8.00%	$ N/A	N/A
American Community Bank	48,308	10.95%	35,302	8.00%	44,128	10.00%
Tier 1 Capital to Risk						
Weighted Assets:						
Consolidated	50,618	11.38%	17,786	4.00%	N/A	N/A
American Community Bank	42,738	9.69%	17,651	4.00%	22,064	5.00%
Tier 1 Capital to						
Average Assets:						
Consolidated	50,618	9.45%	21,419	4.00%	N/A	N/A
American Community Bank	42,738	8.03%	21,277	4.00%	26,596	5.00%

	Actual		Minimum For Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
December 31, 2007:						
Total Capital to Risk						
Weighted Assets:						
Consolidated	$58,798	14.24%	$33,040	8.00%	$ N/A	N/A
American Community Bank	47,012	11.42%	32,940	8.00%	41,175	10.00%
Tier 1 Capital to Risk						
Weighted Assets:						
Consolidated	53,625	12.98%	16,520	4.00%	N/A	N/A
American Community Bank	41,862	10.17%	16,470	4.00%	20,587	5.00%
Tier 1 Capital to						
Average Assets:						
Consolidated	53,625	11.02%	19,461	4.00%	N/A	N/A
American Community Bank	41,862	8.58%	19,515	4.00%	24,394	5.00%

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 15 COMMITMENTS, CONTINGENCIES AND OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit is based on management's credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds, and certificates of deposit.

A summary of the contract amounts of the Company's exposure to off-balance sheet credit risk as of December 31, 2008 is as follows:

Financial instruments whose contract amounts represent credit risk:

		(Dollars in thousands)
Capital South II Partnership investment commitment	$	125
Capital South III Partnership investment commitment		700
Standby letters of credit		3,101
Commitments to extend credit		4,526
Undisbursed lines of credit		52,487
Undisbursed portion of construction loans		23,962

In the normal course of business, the Company is involved in various legal proceedings. The amount of any liability that may result from those proceedings in which the Company is currently involved is expected to be immaterial to the consolidated financial position.

NOTE 16 DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial instruments for which fair value disclosures are required include cash and due from banks, interest-earning deposits with banks, investment securities, loans, Federal Home Loan Bank and Bankers Bank stock, accrued interest, deposits, borrowings, securities sold under agreements to repurchase, and junior subordinated debentures. Fair value estimates are made at a specific moment in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no active market readily exists for a portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 16 DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Due from Banks and Interest-earning Deposits with Banks

The carrying amounts for cash and due from banks and interest-earning deposits with banks approximate fair value because of the short maturities of those instruments.

Investment Securities

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans

The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Non-marketable Equity Securities

The carrying value of non-marketable equity securities approximates fair value.

Accrued Interest Receivable and Payable

The carrying amount is a reasonable estimate of fair value.

Assets Held in Rabbi Trust

The carrying value of assets held in rabbi trust approximates fair value.

Deposits

The fair value of demand deposits, savings, money market, and NOW accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting expected cash flows using the rates currently offered for instruments of similar remaining maturities.

Borrowings, Securities Sold Under Agreements to Repurchase, Federal Funds Purchased and Junior Subordinated Debentures

The fair values of borrowings and fixed rate junior subordinated debentures are based on discounting expected cash flows at the interest rate for debt with the same or similar remaining maturities and collateral requirements. Short-term borrowings, including securities sold under

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 16 DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

agreements to repurchase and federal funds purchased, are carried at approximate fair value because of the short maturities of those instruments.

Financial Instruments with Off-Balance Sheet Risk

With regard to financial instruments with off-balance sheet risk discussed in Note 15, it is not practicable to estimate the fair value of future financing commitments. The large majority of commitments to extend credit and standby letters of credit are at variable rates and/or have relatively short terms to maturity. Therefore, the fair value for these financial instruments is considered to be immaterial.

The carrying amounts and estimated fair values of the Company's financial instruments, none of which are held for trading purposes, are as follows at December 31, 2008 and 2007:

	2008		2007	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(Dollars in thousands)			
Financial assets:				
Cash and due from banks	$ 13,809	$ 13,809	$ 14,346	$ 14,346
Interest-earning deposits with banks	894	894	930	930
Securities available for sale	71,262	71,262	75,012	75,012
Securities held to maturity	1,768	1,760	1,770	1,804
Loans, net	418,368	416,999	387,219	389,718
Accrued interest receivable	2,032	2,032	2,640	2,640
Non-marketable equity securities	2,980	2,980	2,119	2,119
Assets held in rabbi trust (SERP)	997	997		
Financial liabilities:				
Deposits	429,404	412,924	399,794	377,164
Short-term borrowings	15,031	15,031	31,509	31,509
Long-term debt	37,986	24,523	17,995	18,186
Accrued interest payable	698	698	898	898

The Company adopted the provisions of SFAS 157, "Fair Value Measurements" effective January 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 16 DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Hierarchy

Under SFAS 157, the Company groups assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1:	Valuation is based upon quoted prices for identical instruments traded in active markets.
Level 2:	Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
Level 3:	Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Investment Securities Available-for-Sale and Assets in Rabbi Trust

Securities classified as available for sale are reported at fair value utilizing Level 1,2, and 3 inputs. For Level 1 assets, the Company obtains quoted stock prices for identical stocks traded in active markets. For Level 2 assets, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U. S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the bond's terms and conditions, among other things. For Level 3 securities, which include equity securities, the Company measures fair value based on unobservable data that may include net book value of stock and profitability trends, among other things.

Interest Rate Floors

Interest rate floors are reported at fair value utilizing Level 3 inputs. For these floors, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider unobservable data that may include discounted cash flow models, among other things.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 16 DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The following table presents financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2008.

Description	December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)		
Assets:				
Investment securities available for sale	$ 71,262	$ 3	$ 70,356	$ 903
Interest rate floors	590			590
Assets in rabbi trust	997	985	12	

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 16 DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The following table reconciles the changes in Level 3 financial instruments measured at fair value on a recurring basis for the year ended December 31, 2008.

Description	Investment Securities Available for Sale	Interest Rate Floor
	(in thousands)	
Balance at December 31, 2007	$ 903	$ 532
Total gains:		
Included in earnings		237
Included in other comprehensive income		
Amortization		(179)
Balance at December 31, 2008	$ 903	$ 590

The following table reflects the changes in fair values of Level 3 financial instruments measured on a recurring basis for the year ended December 31, 2008 and where these changes are included in the financial statements.

Description	Net interest income	Non-interest income Other	Total changes in fair values included in earnings
		(in thousands)	
Interest rate floors:			
Change in fair value	$	$ 237	$ 237
Amortization	(179)		(179)
Total	$ (179)	$ 237	$ 58

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and specific allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, "Accounting by Creditors for Impairment of a Loan," (SFAS 114). The fair value of impaired loans is estimated using one of three methods, including collateral value, market value of similar debt, or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. As of December 31, 2008,

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 16 DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

impaired loans of $5,508,000 had a specific allowance of $1,628,000, resulting in a fair value of $3,880,000.

The following table presents financial assets measured at fair value on a non-recurring basis as of December 31, 2008.

Description	December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)		
Assets:				
Impaired loans and leases	$ 3,880	$	$	$ 3,880

NOTE 17 EMPLOYEE AND DIRECTOR BENEFIT PLANS

401(k) Retirement Plan

The Company has adopted a 401(k) retirement plan that covers all eligible employees. The Company matches contributions of up to 3.0% of each employee's salary. Expenses totaled $114,000, $105,000 and $99,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

Employment Agreement

The Company has entered into employment agreements with certain officers to ensure a stable and competent management base. These agreements provide for terms ranging from three to five years, with automatic extension for an additional year at the end of the initial term and annually thereafter. The agreements provide for benefits as provided in the contract and cannot be terminated by the Board of Directors, except for cause, without prejudicing the officer's right to receive certain vested rights, including compensation. In the event of a change in control of the Company and in certain other events, as defined in the agreements, the Company or any successor to the Company will be bound to the terms of the contracts and certain change in control compensation payments would result, subject to contractual limitations.

NOTE 18 STOCK COMPENSATION PLANS

The Company has five share-based compensation plans in effect at December 31, 2008. The compensation cost that has been charged against income for those plans was approximately $50,000, $52,000 and $375,000 for the years ended December 31, 2008, 2007 and 2006, respectively. The Company recorded a deferred tax benefit in the amount of $20,000 and $123,000 related to share-based compensation during the years ended 2007 and 2006, respectively. There were no deferred tax benefits related to share-based compensation during the year ended December 31, 2008.

In 1999, the Company implemented the 1999 Incentive Stock Option Plan which authorized the Board of Directors to grant up to 246,191 of stock options (as adjusted for stock dividends) to employees and officers of the Company and the 1999 Non-statutory Stock Option Plan which authorized the Board of Directors to grant up to 246,191 of non-qualified stock options to directors. Options granted under the 1999 Stock Option Plans have a term of up to ten years from the date of

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 18 STOCK COMPENSATION PLANS (Continued)

grant. Vesting of options is determined at the time of grant and ranges from immediate to five years. Options under these plans must be granted at a price not less than the fair market value at the date of grant.

In 2001, the Company implemented the 2001 Incentive Stock Option Plan which authorized the Board of Directors to grant up to 210,300 of stock options (as adjusted for stock dividends) to employees and officers of the company. Options granted under the 2001 Stock Option Plan have a term of up to ten years from the date of grant. These options have a five year vesting period. Options under this plan must be granted at a price not less than the fair market value at the date of grant.

In 2002, the Company implemented the 2002 Non-statutory Stock Option Plan which authorized the Board of Directors to grant up to 37,500 stock options (as adjusted for stock dividends) to directors of the Company. Options granted under the 2002 Non-Statutory Stock Option Plans have a term of up to ten years from the date of grant. Vesting of options is three years. Options under this plan must be granted at a price not less than the fair market value at the date of grant.

In 2004, the Company acquired FNB Bancshares, Inc. ("First National"). First National had two stock option plans, the 1997 Incentive Stock Option Plan and the 1997 Non-statutory Stock Option Plan. At the acquisition date the plans had 133,162 and 160,577 options outstanding, respectively, which vested immediately.

Stock Options

The fair market value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. The Company granted 21,000, 15,000, and 98,000 stock options for the years ended December 31, 2008, 2007 and 2006, respectively, with a weighted average fair value of $1.93, $3.98, and $4.52 per option, respectively.

Assumptions in estimating option values:

	2008	2007	2006
Risk-free interest rate	3.08%	4.08%	4.83%
Dividend yield	2.35%	1.77%	1.54%
Volatility	23.13%	21.04%	30.24%
Expected life	7 years	7 years	7 years

The risk-free interest rate is based upon a U.S. Treasury instrument with a life that is similar to the expected life of the option grant. Expected volatility is based upon the historical volatility of the Company based upon the previous seven years trading history. The expected term of the options is based upon the average life of previously issued stock options. The expected dividend yield is based upon current yield on date of grant. No post-vesting restrictions exist for these options.

At December 31, 2008, there were 350,895 exercisable options with a weighted average exercise price of $7.31. At December 31, 2007, there were 471,466 exercisable options with a weighted average exercise price of $6.62. Of the total options outstanding at December 31, 2008 and 2007, the remaining average contractual lives were 2.42 and 3.44 years, respectively.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 18 STOCK COMPENSATION PLANS (Continued)

A summary of option activity under the stock option plans as of December 31, 2008 and 2007, and changes during the year ended December 31, 2008 and 2007 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2006	561,084	$ 7.00	4.28 years	$2,268,658
Exercised	(34,998)	6.03		
Authorized				
Forfeited	(11,000)	10.77		
Granted	15,000	11.73		
Outstanding at December 31, 2007	530,086	$ 7.12	3.44 years	$1,636,043
Exercised	(130,881)	4.97		
Authorized				
Forfeited	(25,500)	12.13		
Granted	21,000	8.47		
Outstanding at December 31, 2008	394,705	$ 7.58	3.05 years	$1,257,694
Exercisable at December 31, 2008	350,895	$ 7.31	2.42 years	$1,207,934

For the years ended December 31, 2008, 2007 and 2006 the intrinsic value of options exercised was approximately $430,000, $191,000, and $1,163,000, respectively.

The fair value of stock options vested over the years ended December 31, 2008, 2007 and 2006 was $50,000, $52,000, and $375,000, respectively.

As of December 31, 2008, there was $86,000 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all of the Company's stock benefit plans. That cost is expected to be recognized over a weighted-average period of 1.70 years.

The Company funds the option shares from authorized but unissued shares. Company policy does allow option holders to exercise options with seasoned shares.

The actual tax benefit in stockholders equity realized for the tax deductions from option exercise of the share-based payment arrangements totaled $157,000, $38,000 and $170,000 for the years ended 2008, 2007 and 2006, respectively.

The adoption of SFAS 123R and its fair value compensation cost recognition provisions are different from the non-recognition provisions under SFAS 123 and the intrinsic value method for compensation cost allowed by APB 25. The effect (increase/(decrease)) of the adoption of SFAS 123R on cash flow activities for the years ended December 31, 2008, 2007 and 2006 is as follows:

	2008	2007	2006
		(In thousands)	
Cash flow from operating activities	$	$(38)	$(170)

Cash flow provided by financing activities	38	170

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 19 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

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

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

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

As of December 31, 2008, the Company had two derivative instruments with notional amounts of $30.0 million and $15.0 million, respectively. Both derivative instruments consist of an interest rate floor contract that is used to protect certain designated variable rate loans from the downward effects of their repricing in the event of a decreasing rate environment for a period of three years ending in February 2009 and June 2009, respectively. If the prime rate falls below 7.25% during the term of the first contract, the Company will receive payments based on the $30.0 million notional amount times the difference between 7.25% and the daily weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.25% or higher. The Company paid a premium of $228,000 on this contact, which is being amortized over the three-year term of the contract. Total payments received on the 7.25% floor were $482,917 and $-0- during 2008 and 2007, respectively and were recorded in other interest income. On the second floor, if the prime rate falls below 7.75% during the term of this contract, the Company will receive payments based on the $15.0 million notional amount times the difference between 7.75% and the weighted average prime rate for the quarter. No payments will be received by the Company if the weighted average prime rate is 7.75% or higher. The Company paid a premium of $95,250 on this contract. Total payments received on the 7.75% floor were $374,167 and $3,229 during 2008 and 2007, respectively and were recorded in other interest income. The interest rate floors are carried at a fair market value of $589,566 and $532,319 and are included in other assets as of December 31, 2008 and 2007, respectively.

As of March 31, 2007 the $15.0 million, 7.75% interest rate floor contract no longer qualified as a cash flow hedge and the hedge designation was removed. As a result, amounts accumulated in the other accumulated comprehensive income of approximately $6,000 at the beginning of the year were reclassified into earnings during the first quarter of 2007. Changes in fair value of the 7.75% interest rate floor are now accounted for in earnings for the period of the change. As of December 31, 2008, the $30.0 million, 7.25% interest rate floor contract no longer qualified as a cash flow hedge and the hedge designation was removed. Approximately $167,000 of other accumulated comprehensive income

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 19 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES (Continued)

was reclassified into earnings at that time. Changes in fair value of the remaining hedged instrument on the 7.25% floor are now recorded to other income. For the year ended December 31, 2008, the Company recorded a $224,000 gain in other income for the change in fair value of the 7.25% floor and a $107,000 gain in other income for the change in fair value of the 7.75% interest rate floor. For the year ended December 31, 2007, the Company recorded a $144,000 gain, net of tax in other comprehensive income for the effective portion of the 7.25% floor. The Company recorded a $205,000 gain in other income during the year ended December 31, 2007 for the change in fair value of the 7.75% interest rate floor, and a $9,250 gain in other income for the ineffective portion of the 7.25% hedged instrument. For the year ended December 31, 2006 the Company recorded a $10,000 gain in other income for the ineffective portions of the 7.25% and 7.75% hedged instruments and an $86,000 loss, net of tax in other comprehensive income for the effective portion of the floors.

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 20 PARENT COMPANY FINANCIAL DATA

Following are condensed financial statements of American Community Bancshares, Inc. as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007 and 2006.

Condensed Statements of Financial Condition
December 31, 2008 and 2007

	2008	2007
	(Dollars in thousands)	
Assets:		
Cash and due from banks	$ 77	$ 16
Interest earning deposits with banks	4,219	8,757
Investment in securities available for sale	904	904
Investment in American Community Bank	53,711	52,571
Investment in American Community Capital Trust II, Ltd.	310	310
Other assets	3,648	1,981
Total Assets	$ 62,869	$ 64,539
Liabilities and Stockholders' Equity:		
Liabilities:		
Due to American Community Capital Trust II, Ltd.	$ 10,310	$ 10,310
Due to American Community Bank	1,277	
Other liabilities		205
Total Liabilities	11,587	10,515
Stockholders' Equity:		
Common stock	6,633	6,502
Additional paid-in capital	33,090	32,364
Retained earnings	10,775	14,744
Accumulated other comprehensive income	784	414
Total stockholders' equity	51,282	54,024
Total Liabilities and Stockholders' Equity	$ 62,869	$ 64,539

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 20 PARENT COMPANY FINANCIAL DATA (Continued)

Condensed Statements of Operations
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Dollars in thousands)		
Interest income:			
Dividends from subsidiary	$	$4,999	$
Interest-earning deposits with banks	416	571	944
Total interest income	416	5,570	944
Interest expense:			
Junior subordinated debentures issued to American Community Capital Trust I and II	663	906	1,149
Non-interest income:			
Equity in undistributed earnings (loss) of American Community Bank	(2,437)	317	4,424
Non-interest expense:			
Professional fees	3	34	14
Other	84	80	22
Total non-interest expense	87	114	36
Income (loss) before taxes	(2,771)	4,867	4,183
Income tax benefit	(114)	(153)	(93)
Net income (loss)	$(2,657)	$5,020	$4,276

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 20 PARENT COMPANY FINANCIAL DATA (Continued)

Condensed Statements of Cash Flows
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Dollars in thousands)		
Cash flows from operating activities:			
Net income (loss)	$(2,657)	$ 5,020	$ 4,276
Equity in undistributed (earnings) loss of subsidiary	2,437	(317)	(4,424)
Decrease (increase) in other assets	(1,667)	884	(1,321)
Increase (decrease) in other liabilities	(205)	205	
Net cash provided (used) by operating activities	(2,092)	5,792	(1,469)
Cash flows from investing activities:			
Redemption of Capital Trust I stock		108	
Investment in securities available for sale		(501)	
Investment in American Community Bank	(3,000)		
Net cash used by investing activities	(3,000)	(393)	
Cash flows from financing activities:			
Advances from subsidiary	1,277		
Redemption of junior subordinated deferrable interest debentures		(3,608)	
Repurchase of common stock		(6,080)	(263)
Proceeds from issuance of common stock	650	211	912
Cash dividends paid on common stock	(1,312)	(1,348)	(1,382)
Net cash provided (used) by financing activities	615	(10,825)	(733)
Increase (decrease) in cash and cash equivalents	(4,477)	(5,426)	(2,202)
Cash and cash equivalents, beginning	8,773	14,199	16,401
Cash and cash equivalents, ending	$ 4,296	$ 8,773	$ 14,199

NOTE 21 STOCK SPLIT

On January 25, 2006, the Company declared a three-for-two stock split effected in the form of a 50% stock dividend to shareholders of record on February 7, 2006 and payable on February 21, 2006. All references to net income per share and weighted average shares outstanding have been adjusted for the effect of this stock split.

Table of Contents

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 22 QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table sets forth, for the periods indicated selected information from our consolidated quarterly financial information. This information is derived from our unaudited financial statements, which include, in the opinion of management, all normal recurring adjustments which management considers necessary for a fair presentation of the results for such periods.

	Year ended December 31, 2008			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(In thousands except per share data)			
Total interest income	$ 7,082	$ 7,572	$ 7,569	$ 8,188
Total interest expense	3,629	3,568	3,629	3,873
Net interest income	3,453	4,004	3,940	4,315
Provision for loan losses	2,837	1,441	296	425
Net interest income after provision for loan losses	616	2,563	3,644	3,890
Non-interest income				
Service charges on deposit accounts	525	593	597	602
Mortgage banking operations	35	43	95	86
Gain (loss) on derivatives	211	(4)	(148)	272
Loss on SERP investment	(105)	(397)	(72)	(19)
Other	(25)	51	68	78
Total non-interest income	641	286	540	1,019
Non-interest expense				
Salaries and employee benefits	1,823	1,873	1,639	1,743
Occupancy and equipment	516	566	614	584
Other than temporary impairment of investment securities	128	2,753		
Merger related expenses	73	399		
Other	1,155	1,109	1,190	1,044
Total non-interest expense	3,695	6,700	3,443	3,371
Income (loss) before income taxes	(2,438)	(3,851)	741	1,538
Provision (benefit) for income taxes	(1,504)	(653)	257	547
Net income (loss)	$ (934)	$ (3,198)	$ 484	$ 991
Net income (loss) per share				
Basic	$ (0.14)	$ (0.49)	$ 0.07	$ 0.15
Diluted	(0.14)	(0.49)	0.07	0.15
Common stock price				
High	$ 10.29	$ 11.25	$ 9.00	$ 10.00
Low	7.02	5.00	6.15	7.09

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 22 QUARTERLY FINANCIAL INFORMATION (UNAUDITED) (Continued)

	Year Ended December 31, 2007			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(In thousands except for per share data)			
Total interest income	$8,737	$ 9,070	$ 8,921	$ 8,698
Total interest expense	4,068	4,225	4,001	3,899
Net interest income	4,669	4,845	4,920	4,799
Provision for loan losses	471	156	231	183
Net interest income after provision for loan loss	4,198	4,689	4,689	4,616
Non-interest income				
Service charges on deposit accounts	613	617	608	581
Mortgage banking operations	83	70	93	80
Realized gains on sale of securities		3		17
Gain (loss) on economic hedge	132	138	(67)	11
Other	73	133	88	118
Total non-interest income	901	961	722	807
Non-interest expense				
Salaries and employee benefits	1,724	1,768	1,743	1,658
Occupancy and equipment	505	560	564	565
Other than temporary impairment				76
Other	1,132	1,121	1,175	1,103
Total non-interest expense	3,361	3,449	3,482	3,402
Income before income taxes	1,738	2,201	1,929	2,021
Provision for income taxes	626	801	707	735
Net income	$1,112	$ 1,400	$ 1,222	$ 1,286
Net income per share				
Basic	$ 0.17	$ 0.21	$ 0.18	$ 0.18
Diluted	0.17	0.20	0.17	0.18
Common stock price				
High	$12.84	$ 12.50	$ 12.30	$ 12.69
Low	9.19	10.15	10.87	10.60

NOTE 23 SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

In July 2007, the Bank established a Supplemental Executive Retirement Plan ("SERP"), which is a nonqualified plan that provides additional retirement benefits to the Bank's chief executive officer. Under the terms of the SERP, upon retirement or the occurrence of certain other events, the Company will pay benefits to the Bank's chief executive officer in the form of a single cash lump sum payment. Benefits under the SERP vest at a rate of 10% per year beginning at age 53 and are fully vested at age 62. Compensation expense related to the plan was $159,000 and $53,000 for the years ended

AMERICAN COMMUNITY BANCSHARES, INC. AND SUBSIDIARY

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Years ended December 31, 2008, 2007 and 2006

NOTE 23 SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (Continued)

December 31, 2008 and 2007, respectively. The plan was funded in February, 2008 in the amount of $1,590,000. The assets related to this plan are maintained in a rabbi trust and are included in other assets. The assets are accounted for at market value in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", with the resulting gains or losses in value recorded in income. During the year ended December 31, 2008, the impact on net income as a result of the decline in fair value of the assets held in the rabbi trust was a charge of $593,472. The assets had a market value of $996,528 at December 31, 2008. The accrued liability related to this plan was $132,870 at December 31, 2008.

NOTE 24 MERGER AGREEMENT

On September 9, 2008, the Company entered into a definitive agreement to be acquired by Yadkin Valley Financial Corporation ("Yadkin Valley"). The Bank will become a wholly-owned division of Yadkin Valley operating under its current name. Pursuant to the agreement, the Company will merge with and into Yadkin Valley and each of the Company's shareholders will be entitled to receive in exchange for each share of the Company's common stock one of the following: (i) .8517 shares of Yadkin Valley common stock, (ii) $12.35 in cash, or (iii) a combination of both stock and cash. In total, the merger consideration will be allocated as follows: 80.5% of the Company's outstanding shares of common stock will be exchanged for shares of Yadkin Valley common stock and 19.5% of the Company's outstanding shares of common stock will be exchanged for cash. The parties have received all regulatory approvals required for consummation of the merger, including approval of the Board of Governors of the Federal Reserve System, the North Carolina Commission of Banks and the Federal Deposit Insurance Corporation. The parties anticipate closing of the transaction during the second quarter of 2009.

NOTE 25 SUBSEQUENT EVENT

On February 27, 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund. The Board took action by imposing a special assessment on insured institutions of 20 basis points, implementing changes to the risk-based assessment system, and increased regular premium rates for 2009, which banks must pay on top of the special assessment. The 20 basis point special assessment on the industry will be as of June 30, 2009 payable on September 30, 2009. As a result of the special assessment and increased regular assessments, the Company projects it will experience an increase in FDIC assessment expense by approximately $1.8 million from 2008 to 2009. The 20 basis point special assessment represents $1.2 million of this increase.

On March 5, 2009, the FDIC Chairman announced that the FDIC intends to lower the special assessment from 20 basis points to 10 basis points. The approval of the cutback is contingent on whether Congress clears legislation that would expand the FDIC's line of credit with the Treasury to $100 billion. Legislation to increase the FDIC's borrowing authority on a permanent basis is also expected to advance to Congress, which should aid in reducing the burden on the industry. The assessment rates, including the special assessment, are subject to change at the discretion of the Board of Directors of the FDIC.

Table of Contents

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

At the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-14.

Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective (1) to provide reasonable assurance that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities Exchange Act was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) to provide reasonable assurance that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. Management has made a comprehensive review, evaluation and assessment of the Company's internal control over financial reporting as of December 31, 2008. In making its assessment of internal control over financial reporting, management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control Integrated Framework. In accordance with Section 404 of the Sarbanes-Oxley Act of 2002, management makes the following assertions:

- Management has implemented a process to monitor and assess both the design and operating effectiveness of internal control over financial reporting.

- All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

- The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework. Based on that assessment, we believe that, as of December 31, 2008, the company's internal control over financial reporting is effective based on those criteria.

- Due to the Company's status as a "Smaller reporting company" there is no auditor attestation as to the effectiveness of the Company's internal controls over financial reporting as of December 31, 2008.

Table of Contents

Changes in Internal Control over Financial Reporting

Management of the Company has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, changes in the Company's internal controls over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act) during the fourth quarter of 2008. In connection with such evaluation, the Company has determined that there have been no changes in internal control over financial reporting during the fourth quarter that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Randy P Helton	Dan R. Ellis, Jr.
President & Chief Executive Officer	*Chief Financial Officer*

Table of Contents

ITEM 9B OTHER INFORMATION

On March 24, 2009 the Company's Board of Directors voted to suspend payment of the Company's quarterly cash dividend. The Board concluded that it was more important to preserve capital than to pay a quarterly dividend. Suspending the dividend will save approximately $325,000 per quarter or $1.3 million annually in capital.

PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

Board of Directors

The Company's Bylaws provide that its board shall consist of between seven and twenty members. If there are more than nine members, the board shall be divided into three classes in as equal a number as possible. Such classes shall be elected to staggered three-year terms. The Board of Directors has set the number of directors of the Company at thirteen. The members of the Company's board of directors are set forth in the following table.

Name and Age	Position(s) Held	Director Since(1)	Term Expires	Principal Occupation and Business Experience During Past Five Years
Robert G. Dinsmore, Jr. (64)	Lead Independent Director	2001	2009	Consultant, International Tax, Mergers and Acquisitions; Retired partner KPMG, LLP
Frank L. Gentry (66)	Director	2002	2010	Independent Consultant; former Executive Vice President of Corporate Strategy and Development, Bank of America, Charlotte, NC, 1973-2000
Philip R. Gilboy (54)	Director	2003	2009	President, PR Gilboy & Associates, Inc., Weddington, NC (NASD registered broker dealer)
David J. Guilford (60)	Director	2003	2009	President, DLG Associates, Inc., Charlotte, NC (executive search firm)
Thomas J. Hall (61)	Director	1998	2011	President, Hall Group, Inc., Charlotte, NC (real estate holding company)
Larry S. Helms (63)	Director	1998	2011	Owner, Larry S. Helms and Associates, Monroe, NC (insurance)
Randy P. Helton (53)	President, Chief Executive Officer (CEO), Director and Chairperson of the Company	1998	2011	Chairman of the Board, President and Chief Executive Officer of the Company; President and Chief Executive Officer of American Community Bank

Table of Contents

Name and Age	Position(s) Held	Director Since(1)	Term Expires	Principal Occupation and Business Experience During Past Five Years
V. Stephen Moss (59)	Senior Vice President and South Carolina Regional Executive of the Bank, Director	1995	2011	Senior Vice President and South Carolina Regional Executive of American Community Bank
Peter A. Pappas (47)	Director	2003	2009	President and Managing Partner, Pappas Properties, LLC, Charlotte, NC (real estate development)
L. Steven Phillips (58)	Director	1998	2011	President Old South Landscape Services, LLC, Mt. Pleasant, SC (landscape contractor)
Alison J. Smith (54)	Director	2000	2010	President, Smith Capital, Inc., Charlotte, NC (financial advisory, investment banking)
David D. Whitley (62)	Director	1998	2010	President, Whitley Mortgage Associates, Inc., (mortgage broker) and Whitley Real Estate, Inc. (realty firm), Monroe, NC; Chairperson of the Board of Directors of American Community Bank
Gregory N. Wylie (54)	Director	1998	2010	Retired; former Chief Executive Officer, Metro Marketing, Inc., Charlotte, NC (specialty food brokerage)

(1) If applicable, includes prior service as director of American Community Bank or First National Bank of the Carolinas, which was acquired by the Company in 2004.

Table of Contents

Executive Officers

Set forth below is certain information regarding the executive officers of the Company.

Name	Age	Employed Since	Position With Company	Business Experience
Randy P. Helton	53	04/15/98	Chairman, President and CEO	Chairman of the Board, President and CEO of the Company; President and CEO of American Community Bank.
V. Stephen Moss	59	10/01/95(1)	Senior Vice President and South Carolina Regional Executive of American Community Bank	Former President and CEO of First National Bank of the Carolinas, Gaffney, South Carolina
Dan R. Ellis, Jr.	53	08/31/98	Senior Vice President, Chief Fnancial Officer and Corporate Secretary	Certified Public Accountant; Senior Vice President, Chief Financial Officer and Corporate Secretary
William M. DeMarcus	44	03/03/08	Senior Vice President and Chief Banking Officer of American Community Bank	Former Senior Vice President, Wachovia, Charlotte, NC
Stephanie D. Helms	39	11/12/99	Senior Vice President and Chief Administrative Officer	Lifelong resident of Monroe, NC with 15 years of banking experience in Monroe and Charlotte markets

(1) Includes prior service as an officer of First National Bank of the Carolinas

Table of Contents

Set forth below is certain information regarding American Community Bank's market area and other executive officers.

Name	Age	Employed Since	Position With American Community Bank	Business Experience
W. R. "Randy" Adcock	52	06/02/98	Senior Vice President and Monroe City Executive	Mr. Adcock, a lifelong resident of Monroe, NC, has 29 years of banking experience in the Bank's market.
Steven L. Barnes	53	11/4/99	Senior Vice President and Indian Trail City Executive	Mr. Barnes, a lifelong resident of Indian Trail, NC, has 24 years of banking experience in the Bank's market.
Richard M. Cochrane	56	02/19/99	Senior Vice President and Matthews/Mint Hill City Executive	Mr. Cochrane, a lifelong resident of Mint Hill, NC, has 27 years of banking experience in the Bank's market.
Jeff N. Coley	49	09/13/99	Senior Vice President and Marshville City Executive	Mr. Coley, a lifelong resident of Marshville, NC, has 26 years of banking experience in the Bank's market.

Section 16(a) Beneficial Ownership Reporting Compliance

Directors and executive officers of the Company are required by federal law to file reports with the Securities and Exchange Commission ("SEC") regarding the amount of and changes in their beneficial ownership of the Company's common stock. To the best knowledge of the Company, all such ownership reports have been timely filed and the ownership status of the Company's common stock by such individuals is current.

Meetings and Committees of the Board of Directors

The Company's Board of Directors held eleven meetings in 2008. Each director attended 75% or more of the aggregate board and committee meetings of which he or she was a member.

It is the policy of the Company that directors attend each annual meeting and any special meetings of the Company's shareholders. All of the Company's directors attended the 2008 annual meeting of shareholders except for Gregory N. Wylie who was out of town on business.

The Company's Board of Directors has several standing committees including an Audit Committee, Nominating Committee and Compensation Committee.

Audit Committee. The members of the Audit Committee are Chairperson Robert G. Dinsmore, Jr., Frank L. Gentry, Philip R. Gilboy, Alison J. Smith and Gregory N. Wylie. The members of the Audit Committee are "independent" as defined by NASDAQ listing standards and the regulations promulgated under the Securities Exchange Act of 1934. The Audit Committee met five times during 2008. The Board of Directors has adopted a written Audit Committee Charter which is available at *www.americancommunitybank.com*. The report of the Audit Committee is included in Item 14 of this annual report on Form 10-K and incorporated by reference herein.

Nominating Committee. The members of the Nominating Committee are Chairperson Alison J. Smith, Robert G. Dinsmore, Jr., Larry S. Helms, L. Steven Phillips, David D. Whitley, and Gregory N. Wylie. The Committee met once in 2008. The duties of the Nominating Committee include: (i) assisting the Board, on an annual basis, by identifying individuals qualified to become Board members, and recommending to the Board the director nominees for the next annual meeting of shareholders; (ii) assisting the Board in the event of any vacancy on the Board by identifying individuals qualified to become Board members, and recommending to the Board qualified individuals to fill any such vacancy; and (iii) recommending to the Board, on an annual basis, director nominees for each committee of the Board.

The Company's common stock is listed on the NASDAQ Capital Market and the members of the Nominating Committee are "independent" as defined by NASDAQ listing standards. The bylaws of the Company state that candidates may be nominated for election to the Board of Directors by the Nominating Committee or by any shareholder of the Company's common stock. It is the policy of the Nominating Committee to consider all shareholder nominations. Shareholder nominations must be submitted to the Nominating Committee in writing on or before September 30th of the year preceding the Annual Meeting at which the nominee would stand for election to the Board of Directors and must be accompanied by each nominee's written consent to serve as a director of the Company if elected. No shareholder nominations were received during the year. The bylaws of the Company require that all nominees for director, including shareholder nominees, have business, economic or residential ties to the Company's market area and have owned at least 1,000 shares of the Company's common stock for a period of twelve (12) months preceding the date of the nomination. In evaluating nominees for director, the Nominating Committee values community involvement and experience in finance or banking including prior service as an officer or director of an entity engaged in the financial services business, although such experience is not a prerequisite for nomination. The Board of Directors has adopted a written Nominating Committee Charter, which is available at *www.americancommunitybank.com*.

Compensation Committee. The members of the Compensation Committee are Chairperson Gregory N. Wylie, Robert G. Dinsmore, Jr., Thomas J. Hall, Alison Smith and David D. Whitley. The Compensation Committee meets on an as needed basis to review the salaries and compensation programs required to attract and retain the Company's executive officers. The Compensation Committee met two times in 2008. The committee approves the compensation of the President and Chief Executive Officer and "reporting officers" to the President including the Chief Financial Officer, Chief Banking Officer, and Chief Administrative Officer. The salary of each of such "reporting officers" is determined based upon the recommendation by the President and Chief Executive Officer and such officer's experience, managerial effectiveness, contribution to the Company's overall profitability, maintenance of regulatory compliance standards and professional leadership. The Committee also compares the compensation of the Company's executive officers with compensation paid to executives of similarly situated bank holding companies, other businesses in the Company's market area and appropriate state and national salary data. The Committee is not bound by recommendations made by the President and Chief Executive Officer. Furthermore, the President and Chief Executive Officer does not have any input into his own compensation. The compensation committee engages third party compensation consultants on occasion to assist in determining executive pay or additional benefits, but does not delegate its duties. The Board of Directors has adopted a written Compensation Committee Charter which is available at *www.americancommunitybank.com*.

The Company has adopted a code of ethics that applies, among others, to its principal executive officer and principal financial officer. The Company's code of ethics is available at *www.americancommunitybank.com*.

Table of Contents

ITEM 11 EXECUTIVE COMPENSATION

Director Compensation

Board Fees. During 2008, all non-employee directors received an annual retainer of $10,000. In addition, all non-employee directors received $500 for each board meeting attended and $500 for each Committee meeting attended, with the exception of the Chairman of the Board of the Bank who received $600 for each meeting chaired and Committee Chairpersons, who received $600 for each committee meeting chaired.

1999 Nonstatutory Stock Option Plan for Directors. At the 1999 Annual Meeting the shareholders of the Bank approved the 1999 Nonstatutory Stock Option Plan for Directors (the "1999 Nonstatutory Option Plan") pursuant to which options covering 246,191 shares of the Bank's common stock were available for issuance to members of the Board of Directors and the board of any subsidiary. In connection with the reorganization of the Bank into the holding company form which resulted in the creation of the Company, the Nonstatutory Option Plan was adopted by the Company and options under such plan are now options of the Company. On April 14, 1999, all options were granted under the 1999 Nonstatutory Option Plan at the exercise price of $11.00 per share which was the fair market value on the date of grant. The original exercise price is currently $5.55 per share as a result of a 20% stock dividend in 1999, 10% stock dividend in 2002 and a 50% stock dividend in 2006. Another 69,000 of the original options issued were forfeited and reissued on April 26, 2006 at the exercise price of $12.98 per share which was the fair market value on the date of grant. All but 5,080 of these options have been granted and there are currently 127,706 options outstanding with a weighted average exercise price of $8.98 per share which was the fair market value on the date of grant adjusted for stock dividends.

2002 Nonstatutory Stock Option Plan. At the 2002 Annual Meeting, the shareholders of the Company approved the 2002 Nonstatutory Stock Option Plan (the "2002 Nonstatutory Option Plan") pursuant to which options covering 37,500 shares of the Company's common stock were available for issuance to members of the Board of Directors and the board of any subsidiary. All but 1,500 of these options have been granted and there are currently 19,500 options outstanding with a weighted average exercise price of $6.64 per share which was the fair market value on the date of grant adjusted for stock dividends.

Table of Contents

The following table presents a summary of all compensation paid by the Company to its directors for their service as such during the year ended December 31, 2008.

DIRECTOR COMPENSATION TABLE

	Fees Earned or Paid in Cash	Stock Awards	Option Awards(1)	All Other Compensation	Total
Robert G. Dinsmore, Jr.	$ 30,700	$	$	$	$ 30,700
Frank L. Gentry	23,300				23,300
Philip Gilboy	22,900				22,900
David J. Guilford	27,300				27,300
Thomas J. Hall	23,500				23,500
Larry S. Helms	22,800				22,800
Randy P. Helton(2)					
V. Stephen Moss(2)					
Peter A. Pappas	20,200				20,200
L. Steven Phillips	15,800				15,800
Alison J. Smith	24,600				24,600
David D. Whitley	28,600				28,600
Gregory N. Wylie	25,000				25,000
Total	$ 264,700	$	$	$	$ 264,700

(1) Expense calculated in accordance with FAS 123R. The assumptions used in estimating the fair value of options are set forth in note 18 to the Company's audited consolidated financial statements at December 31, 2008.

(2) Compensation paid to Mr. Helton in connection with his service as President and Chief Executive Officer of the Company and Mr. Moss as Senior Vice President of the Company is presented in the Summary Compensation Table below.

EXECUTIVE COMPENSATION

Employment Agreements. American Community Bank has entered into an employment agreement with Randy P. Helton, President and Chief Executive Officer (dated April 15, 1998), to establish his duties and compensation and to provide for his continued employment with the Bank. The employment agreement provided for an initial term of employment of five years. The term automatically renews for an additional year at the end of each year unless notice of termination is received prior to renewal. The employment agreement provides for an annual base salary to be reviewed by the Board of Directors not less often than annually. In addition, the employment agreement provides for discretionary bonuses, participation in other pension and profit-sharing retirement plans maintained by the Bank on behalf of its employees, as well as fringe benefits normally associated with the officer's office or made available to all other employees. The employment agreement provides that the officer may be terminated for cause, as defined in the employment agreement, by the Bank, and otherwise be terminated by the Bank (subject to vested rights) or by the officer. The employment agreement provides that in the event of a "termination event" following a change in control of the Bank (i) the employee shall be able to terminate the agreement and receive 299% of his base amount of compensation and (ii) the term of the agreement shall be not less than 36 months from the employee's notice of termination of the agreement. A "termination event" will occur if (i) the employee is assigned any duties or responsibilities that are inconsistent with his position, duties, responsibilities or status at the time of the change in control or with his reporting responsibilities or title with the Bank in effect at the time of the change in control; (ii) the employee's annual base salary rate is reduced below the

Table of Contents

annual amount in effect as of the change in control; (iii) the employee's life insurance, medical or hospitalization insurance, disability insurance, stock option plans, stock purchase plans, deferred compensation plans, management retention plans, retirement plans or similar plans or benefits being provided by the Bank to the employee as of the date of the change in control are reduced in their level, scope or coverage, or any such insurance, plans or benefits are eliminated, unless such reduction or elimination applies proportionately to all salaried employees of the Bank who participated in such benefits prior to the change in control; or (iv) the employee is transferred to a location outside of Charlotte, North Carolina without the employee's express written consent. A change in control of the Bank will occur if (i) any individual or entity, directly or indirectly, acquires beneficial ownership of voting securities or acquires irrevocable proxies or any combination of voting securities and irrevocable proxies, representing 25% or more of any class of voting securities of the Bank, or acquires control in any manner of the election of a majority of the directors of the Bank; (ii) the Bank is consolidated or merged with or into another corporation, association or entity where the Bank is not the surviving corporation; or (iii) all or substantially all of the assets of the Bank are sold or otherwise transferred to or are acquired by any other corporation, association or other person, entity or group.

American Community Bank has also entered into an employment agreement with V. Stephen Moss, Senior Vice President and South Carolina Regional Executive of the Bank (dated April 15, 2004), to establish his duties and compensation and to provide for his continued employment with the Bank. The employment agreement provided for an initial term of employment of three years. The term automatically renews for an additional year at the end of each year of the term unless notice of termination is received prior to such renewal. The employment agreement provides for an annual base salary to be reviewed by the Board of Directors not less often than annually. In addition, the employment agreement provides for discretionary bonuses, participation in other pension and profit sharing retirement plans maintained by the Bank on behalf of its employees, as well as fringe benefits normally associated with Mr. Moss's office or made available to all other employees. The employment agreement provides that Mr. Moss may be terminated, by the Bank, for "cause" as defined in the employment agreement and further provides that the employment agreement may otherwise be voluntarily terminated by Mr. Moss or by the Bank (subject to vested rights). The employment agreement also provides that in the event of a "termination event" following a change of control of the Bank (i) Mr. Moss shall be able to terminate his employment agreement and receive 200% of his "base amount" of compensation. The definitions of the terms "change of control" and "termination event" under Mr. Moss' employment agreement are substantially identical to the definitions of those terms in Mr. Helton's employment agreement, which is summarized above.

American Community Bank has also entered into a change of control agreement with Stephanie D. Helms, Senior Vice President and Chief Administrative Officer of the Company and Dan R. Ellis, Jr, Senior Vice President and Chief Financial Officer. The change of control agreements provide that in the event of a "termination event" following a change of control of the Bank Ms. Helms and Mr. Ellis shall be able to receive 200% of their "base amount" of compensation. The definitions of the terms "change of control" and "termination event" under Ms. Helms' and Mr. Ellis' change of control agreements are substantially identical to the definitions of those terms in Mr. Helton's employment agreement, which is summarized above.

American Community Bank has also entered into a change of control agreement with William M. DeMarcus, Senior Vice President and Chief Banking Officer of the Company. The change of control agreement provides that in the event of a "termination event" following a change of control of the Bank Mr. DeMarcus shall be able to receive 100% of his "base amount" of compensation. The definitions of the terms "change of control" and "termination event" under Mr. DeMarcus' change of control agreement are substantially identical to the definitions of those terms in Mr. Helton's employment agreement, which is summarized above.

Table of Contents

The following table shows all compensation paid to or received by Randy P. Helton, Dan R. Ellis, Jr., V. Stephen Moss, William M. DeMarcus, and Stephanie D. Helms (the "Named Executive Officers") for services rendered in all capacities during the fiscal year ended December 31, 2008.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary	Option Awards(1)	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation(2)	Total
Randy P. Helton,	2008	$ 325,000	$	$	$	$ 9,965	$ 334,965
Chairman of the Board,	2007	280,000		80,000		8,807	368,807
President and CEO of the Company and President and CEO of the Bank	2006	265,200	3,419	67,000		8,025	343,644
Dan R. Ellis, Jr.	2008	160,000				5,945	165,945
Senior Vice President,	2007	140,000		32,000		5,202	177,202
Chief Financial Officer and Corporate Secretary of the Company	2006	115,500		23,000		4,529	143,029
V. Stephen Moss,	2008	149,000				4,513	153,513
Senior Vice President	2007	142,000				5,198	147,198
and South Carolina Regional Executive of the Bank	2006	135,200		10,000		4,530	149,730
William M. DeMarcus,	2008	175,000	3,095	47,062		270	225,427
Senior Vice President	2007						
and Chief Banking Officer of the Bank	2006						
Stephanie D. Helms,	2008	115,000				2,042	117,042
Senior Vice President and Chief	2007	98,050		19,000		2,243	119,293
Administrative Officer of the Bank	2006	92,500		19,000		2,148	113,648

(1) Expense calculated in accordance with FAS 123R. The assumptions used in estimating the fair value of options are set forth in note 18 to Company's audited consolidated financial statements at December 31, 2008.

(2) Includes life insurance premiums and contributions to 401(k) Plan.

Table of Contents

Stock Options

1999 Incentive Stock Option Plan. The shareholders previously approved the 1999 Incentive Stock Option Plan (the "1999 Incentive Option Plan") pursuant to which options are available for issuance to officers and key employees of the Company and any of its subsidiaries. In connection with the reorganization of the Bank into the holding company form of organization, which resulted in the organization of the Company, the 1999 Incentive Option Plan was adopted by the Company and options under such plan are now options of the Company.

2001 Incentive Stock Option Plan. The shareholders approved the 2001 Incentive Stock Option Plan (the "2001 Incentive Option Plan") at the 2001 annual meeting. The 2001 Incentive Option Plan also provides for the issuance of incentive stock options to officers and key employees of the Company and any of its subsidiaries. The plan originally provided for the grant of stock options covering up to 135,300 shares of the Company's common stock. At the 2005 Annual Meeting of Shareholders, the shareholders approved an amendment to the 2001 Incentive Stock Option Plan authorizing stock options covering an additional 75,000 shares of the Company's stock.

All stock options under the Company's incentive option plans are granted with a per share exercise price equal to 100% of the fair market value of the Company's common stock. The per share exercise price may then be adjusted in response to certain corporate actions, such as stock dividends and stock splits. For example, the option exercise prices in the table below have been adjusted for the effect of the 1999 20% stock dividend, the 2002 10% stock dividend, and the 2006 50% stock split where applicable.

Stock options were granted to William M. DeMarcus during the fiscal year ended December 31, 2008. Disclosed in the following table are the threshold, target and maximum incentive payments which each of the Named Executive Officers could realize under the Company's non-equity incentive plan upon attainment of stated corporate and individual goals under the plan.

GRANTS OF PLAN BASED AWARDS

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards					
Name	**Grant Date**	**Threshold**	**Target**	**Maximum**	**All other Stock Awards; Number of Shares of Stock or Units**	**All other Option Awards; Number of Securities Underlying Options**	**Exercise or Base Price of Option Awards**
Randy P. Helton		$20,000	$130,000	$168,000			
Dan R. Ellis, Jr.		10,000	40,000	56,000			
V. Stephen Moss		10,000	37,250	52,150			
William M. DeMarcus		10,000	43,750	61,250		10,000	$ 8.70
Stephanie D. Helms		10,000	28,750	40,250			

Table of Contents

The following table sets forth information regarding vested and unvested incentive stock options as of December 31, 2008. With the exception of Mr. Ellis and Mr. Helton, each of the Named Executive Officers had unexercisable stock options as of December 31, 2008. Incentive stock options granted by the Company are subject to a five-year vesting schedule, with 20% vesting on each anniversary of the option grant date. Option exercise prices reported below have been adjusted for the effect of all stock dividends occurring subsequent to the option grant date. The Company has not adopted any plan providing for the grant of restricted stock or long-term compensation units to employees and, accordingly, there is no information reported in the four columns on the right hand side of the table below.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

Name	No. of Securities Underlying Unexercised Options Exercisable	No. of Securities Underlying Unexercised Options Unexerciseable	Equity Incentive Plan Awards; No. of Securities Underlying Unexercised Unearned Options	Option Exercise Price(1)	Option Expiration Date	No. of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested	Equity Incentive Plan Awards; No. of Unearned Shares, Units or Other Rights That Have Not Vested	Equity Incentive Plan Awards; Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested
Randy P. Helton	89,178	0		$ 5.55	04/14/09				
	12,041	3,010		8.92	04/24/14				
	2,000	3,000		12.98	04/25/16				
Dan R. Ellis, Jr.									
	12,824	0		5.55	04/14/09				
V. Stephen Moss									
	12,000	3,000		8.83	04/16/14				
William M. DeMarcus									
	0	10,000		8.70	03/18/18				
Stephanie D. Helms									
	825	0		6.33	02/20/11				
	2,475	0		4.70	07/18/11				
	6,000	1,500		8.92	04/24/14				

(1) As adjusted for stock dividends and stock split.

Table of Contents

The following table sets forth information regarding stock options exercised by the Named Executive Officers during the fiscal year ended December 31, 2008. Mr. Helton and Mr. Ellis exercised stock options covering 9,201 and 4,500 shares, respectively, of the Company's common stock during the year at a per share exercise price of $5.55 per share.

OPTION EXERCISES AND STOCK VESTED

	Option Awards		Stock Awards	
Name	**Number of Shares Acquired on Exercise**	**Value Realized on Exercise**	**Number of Shares Acquired on Vesting**	**Value Realized on Vesting**
Randy P. Helton	9,201	$ 28,328		
Dan R. Ellis, Jr.	4,500	10,506		
V. Stephen Moss				
William M. DeMarcus				
Stephanie D. Helms				

Supplemental Retirement Plan

In October 2007, the Company implemented a non-qualified supplemental retirement benefit plan ("SERP") for selected executive officers. At December 31, 2008 the only executive officer designated to receive benefits under the SERP was Randy P. Helton. The Company may, however, designate other executive officers to receive benefits under the SERP in the future. The SERP is designed to provide a retirement benefit to plan participants at their normal retirement dates and upon the occurrence of certain other events. The plan was implemented because limits on qualified plan contributions and distributions, as well as Social Security, often limit bank executives' retirement benefits to 30% to 50% of final pay. In contrast, other bank staff are unaffected, or less severely affected, by such limits. An arrangement such as the SERP can remedy the shortfall in executive retirement compensation and deliver retirement benefits commensurate with bank executives' final pay.

Under the terms of the SERP, upon retirement or the occurrence of certain other events, the Company will pay benefits to plan participants in the form of a single cash lump sum payment. Benefits under the SERP vest at a rate of 10% per year beginning at age 53 and are fully vested at age 62. At retirement on or after age 53, the Company will pay the vested benefits to the participating officer. In the case of disability or death prior to retirement which results in termination of the officer's employment, the full benefit is payable within 90 days. The full benefit is also payable upon termination of employment for "good reason" following a change of control of the Company. As of December 31, 2008, Mr. Helton's participation in the SERP would have entitled him to a lump sum payment of $996,528, had he terminated his employment for "good reason" following a "change in control" of the Company or had his employment terminated due to death or disability. No benefits are payable at any time to a participant that has been terminated for "cause."

Table of Contents

Participants' benefits under the SERP are unfunded and are not intended to constitute a tax-qualified retirement plan under Section 401(a) of the Internal Revenue Code of 1986, as amended. As of December 31, 2008, Randy P Helton had $99,652 vested benefits under the plan.

Name	Plan Name	Number of Years Credited Service	Present Value of Accumulated Benefit	Payments During Last Fiscal Year
Randy P. Helton	SERP	1	$ 99,652	$ 0
Dan R. Ellis, Jr.				
V. Stephen Moss				
William M. DeMarcus				
Stephanie D. Helms				

Stock Splits

The Company has had three stock splits since opening as follows:

1999	five-for-four stock split in the form of a 20% stock dividend paid in December 1999
2002	eleven-for-ten stock split in the form of a 10% stock dividend paid in January 2002
2006	two-for-one stock split in the form of a 50% stock dividend paid in February 2006

401(k) Savings Plan

In 1999, the Bank adopted a tax-qualified plan (the "Savings Plan") which covers all current, full-time employees and any new full-time employees who have been employed for twelve months and who have attained the age of twenty-one. Under the Savings Plan, a participating employee may contribute up to 20% of his or her base salary (up to the maximum allowed by law) on a tax-deferred basis through salary reduction as permitted under Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). The Bank is permitted to make contributions equal to 50% of the employees' contributions up to a maximum equal to 3% of the employee's aggregate compensation. The employer contributions vest completely after six years of service. The Bank may make additional discretionary contributions that also vest completely after six years of service with the Bank. The value of a participant's accounts under the Savings Plan becomes payable to him or her according to the vesting schedule upon retirement, total or permanent disability or termination of employment for any other reason, or becomes payable to a designated beneficiary upon a participant's death. The Savings Plan also contains provisions for withdrawals in the event of certain hardships. A participant's contributions, matching contributions and discretionary contributions of the Bank, and any income accrued on such contributions, are not subject to federal or state taxes until such time as the participant withdraws them.

ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Voting Securities

The voting securities of the Company are the shares of its common stock, par value $1.00 per share, of which 25,000,000 shares are authorized and preferred stock, no par value, of which 1,000,000 shares are authorized. At March 24, 2009, there were 6,651,295 shares of common stock and no shares of preferred stock outstanding. There are approximately 2,500 holders of record of the Company's common stock.

Table of Contents

Ownership of Voting Securities

As of March 24, 2009, there were no shareholders known to management to own more than 5% of the Company's common stock, except those listed below.

NAME AND ADDRESS OF BENEFICIAL OWNER	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP	PERCENTAGE OF CLASS
Marla Braun Coral Gables, FL	474,807	7.14

As of March 24, 2009 the beneficial ownership of the Company's common stock, by directors and executive officers individually, and by directors and executive officers as a group, was as follows:

NAME AND ADDRESS OF BENEFICIAL OWNER		AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP(1)(2)	PERCENT OF CLASS(3)
William M. DeMarcus	Cornelius, NC	2,202	*
Robert G. Dinsmore, Jr.	Charlotte, NC	19,430	*
Dan R. Ellis, Jr.	Monroe, NC	32,017(4)	*
Frank L. Gentry	Charlotte, NC	15,500	*
Philip R. Gilboy	Waxhaw, NC	19,366	*
David J. Guilford	Charlotte, NC	16,250	*
Thomas J. Hall	Charlotte, NC	51,403	*
Larry S. Helms	Monroe, NC	25,140	*
Stephanie D. Helms	Monroe, NC	12,669	*
Randy P. Helton	Charlotte, NC	150,457(5)	2.23
V. Stephen Moss	Blacksburg, SC	39,242	*
Peter A. Pappas	Charlotte, NC	13,250	*
L. Steven Phillips	Isle of Palms, SC	75,030	1.13
Alison J. Smith	Charlotte, NC	63,521	*
David D. Whitley	Monroe, NC	30,281(6)	*
Gregory N. Wylie	Waxhaw, NC	78,041	1.17
All Directors and Executive Officers as a Group (16 persons)		644,949	9.37

(1) Except as otherwise noted, to the best knowledge of the Company's management, the above individuals and group exercise sole voting and investment power with respect to all shares shown as beneficially owned other than the following shares as to which such powers are shared: Mr. Dinsmore 8,100 shares, Mr. Ellis 13,599, Mr. Guilford 330 shares, Mr. Moss 20,000, and Mr. Whitley 3,460 shares.

(2) Included in the beneficial ownership tabulations are the following options to purchase shares of common stock of the Company: Mr. DeMarcus 2,000, Mr. Dinsmore 5,000, Mr. Ellis 12,824, Mr. Gentry 5,000, Mr. Gilboy 5,000, Mr. Guilford 9,500, Mr. Hall 5,000, Mr. Helms 5,000, Ms. Helms 9,300, Mr. Helton 101,419, Mr. Moss 12,000, Mr. Pappas 9,500, Mr. Phillips 10,694, Ms. Smith 5,000, Mr. Whitley 5,000, and Mr. Wylie 30,327, and an aggregate of 232,564 options for the group.

(3) The calculation of the percentage of class beneficially owned by each individual and the group is based on the sum of (i) 6,651,295 shares of common stock outstanding as of March 24, 2009, and (ii) options exercisable within 60 days of March 24, 2009 for the individual and the group.

(4) Includes 1,974 shares owned by Mr. Ellis' spouse

(5)

Includes 1,565 shares owned by Mr. Helton's spouse.

(6) Includes 7,263 shares owned by Mr. Whitley's spouse.

Table of Contents

Set forth below is certain information regarding the Registrant's various stock option plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights (a)	Weighted-average exercise price of outstanding options, warrants, and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	1999 Incentive: 169,600	$ 6.02	862
	1999 Non-statutory: 127,704	$ 8.98	5,080
	2001 Incentive: 77,901	$ 8.91	67,685
	2002 Non-statutory: 19,500	$ 6.64	1,500
Equity compensation plans not approved by security holders	None	None	None
Total	394,705	$ 7.58	75,127

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Director Independence

With the exception of Mr. Helton and Mr. Moss, each member of the Company's Board of Directors is "independent" as defined by NASDAQ listing standards and the regulations promulgated under the Securities Exchange Act of 1934 (the "Exchange Act"). In making this determination, the Board considered all insider transactions with directors for the provision of goods or services to the Company or the Bank. All such transactions were conducted at arm's length upon terms no less favorable than those that would be available from an independent third party.

Director Relationships

No director is a director of any company with a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 or subject to the requirements of Section 15(d) thereof, or any company registered as an investment company under the Investment Company Act of 1940.

Lead Independent Director

The board has long recognized the importance of independent leadership on the board, as evidenced by its designation of a lead independent director in 2004. The independent directors elect the lead independent director, and in January 2008, the independent directors elected Mr. Dinsmore to continue in his role as the board's lead independent director. The duties and responsibilities of the lead independent director include the following:

- assisting the Chairman of the Board with board-related matters, including approving board meeting agendas, board meeting schedules and various information sent to the board;
- serving as the principal liaison between the independent directors and the Chairman of the Board;

presiding at any meetings of the non-employee directors or independent directors or at any meetings of the board at which the Chairman of the Board is not present, and

Table of Contents

any other duties or responsibilities that may be requested by the independent directors or the Chairman of the Board, including, as the lead independent director deems appropriate, calling any meetings of the non-employee directors or independent directors or meeting with any of the Company's executive officers, stockholders or other constituents.

Indebtedness of and Transactions with Management

The Company has had, and expects to have in the future, banking transactions in the ordinary course of business with certain of its current directors, nominees for director, executive officers and their associates. All loans included in such transactions were made on substantially the same terms, including interest rates, repayment terms and collateral, as those prevailing at the time such loans were made for comparable transactions with other persons, and do not involve more than the normal risk of collectibility or present other unfavorable features.

Loans made by either American Community Bank to directors and executive officers are subject to the requirements of Regulation O of the Board of Governors of the Federal Reserve System. Regulation O requires, among other things, prior approval of the Board of Directors with any "interested director" not participating, dollar limitations on amounts of certain loans and prohibits any favorable treatment being extended to any director or executive officer in any of the bank's lending matters. To the best knowledge of the management of the Company and the bank, Regulation O has been complied with in its entirety.

ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES

The Audit Committee of the Board of Directors has appointed the firm of Dixon Hughes PLLC, Certified Public Accountants, as the Company's independent registered public accounting firm for 2009. A representative of Dixon Hughes PLLC is expected to be present at the Annual Meeting and available to respond to appropriate questions, and will have the opportunity to make a statement if he desires to do so.

The Company has paid Dixon Hughes PLLC fees in connection with its assistance in the Company's annual audit and review of the Company's financial statements. From time to time, the Company engages Dixon Hughes PLLC to assist in other areas.

The following table sets forth the fees paid to Dixon Hughes PLLC in various categories during 2008 and 2007.

Category	Actual 2008	Actual 2007
Audit Fees	183,800(1)	$200,750(1)
Audit-Related Fees	25,233(2)	22,250(2)
Tax Fees	22,725(3)	11,250(3)
Total Fees Paid	$231,758	$234,250

(1) Audit fees include fees billed and expected to be billed to the Company by Dixon Hughes in connection with the annual audit of the Company's financial statements, reviews of the Company's interim financial statements, and review of registration statements filed with the SEC incurred in 2008 and attest services provided pursuant to Section 404 of the Sarbanes-Oxley Act incurred in 2007.

(2) Audit related services include routine accounting consultations and employee benefit plan audit.

(3) Tax fees include corporate tax compliance, as well as counsel and advisory services.

All services rendered by Dixon Hughes PLLC during 2008 and 2007 were subject to pre-approval by the Audit Committee.

Table of Contents

Report of the Audit Committee

In the performance of its oversight functions, the Audit Committee is responsible for receiving and reviewing the annual audit report of the Company's independent auditors and reports of examinations by bank regulatory agencies, and helps formulate, implement, and review the Company's and its subsidiaries' internal audit programs. The Audit Committee assesses the performance and independence of the Company's independent accountants and recommends their appointment. The Audit Committee has in place pre-approval policies and procedures that involve an assessment of the performance and independence of the Company's independent auditors, an evaluation of any conflicts of interest that may impair the independence of the independent auditors and pre-approval of an engagement letter that outlines all services to be rendered by the independent auditors.

Management is responsible for the preparation and presentation of the Company's financial statements and its overall financial reporting process and, with the assistance of the Company's outsourced internal auditors, for maintaining appropriate internal controls and procedures that provide for compliance with accounting standards and applicable laws. The independent auditors are responsible for planning and carrying out a proper audit of the Company's financial statements, expressing an opinion as to their conformity with generally accepted accounting principles and annually auditing management's assessment of the effectiveness of internal control over financial reporting. Members of the Audit Committee are not professionally engaged in the practice of auditing or accounting and are not full-time employees of the Company.

During the course of its examination of the Company's audit process in 2008, the Audit Committee reviewed and discussed the audited financial statements with management. The Audit Committee also discussed with the independent auditors, Dixon Hughes PLLC, all matters required to be discussed by the Statement of Auditing Standards No. 61, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T. Furthermore, the Audit Committee received from Dixon Hughes disclosures regarding their independence required by the PCAOB Rule 3526 "Communication with Audit Committees Concerning Independence". Based on the review and discussions above, the Audit Committee (i) recommended to the board that the audited financial statements be included in the Company's annual report on Form 10-K for the year ended December 31, 2008 for filing with the SEC and (ii) recommended that shareholders ratify the appointment of Dixon Hughes PLLC as auditors for 2009.

The Audit Committee has a written charter which is reviewed by the Committee for adequacy on an annual basis. The members of the Audit Committee are "independent" and "financially literate" as defined by the NASDAQ listing standards. The Board of Directors has determined that Robert G. Dinsmore, Jr., a member of the Audit Committee, meets the requirements adopted by the SEC for qualification as an "audit committee financial expert." An audit committee financial expert is defined as a person who has the following attributes: (i) an understanding of generally accepted accounting principles and financial statements; (ii) the ability to assess the general application of GAAP in connection with the accounting for estimates, accruals and reserves; (iii) experience preparing, auditing, analyzing or evaluating financial statements that are of the same level of complexity that can be expected in the registrant's financial statements, or experience supervising people engaged in such activities; (iv) an understanding of internal controls and procedures for financial reporting; and (v) an understanding of audit committee functions.

This report is submitted by the Audit Committee,

Robert G. Dinsmore, Jr.	Chairman
Frank L. Gentry	
Philip R. Gilboy	
Alison J. Smith	
Gregory N. Wylie	

Table of Contents

PART IV

ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this report:

1. Financial statements required to be filed by Item 8 of this Form:

   a) Report of independent registered public accounting firm

   b) Consolidated Balance Sheets as of December 31, 2008 and 2007

   c) Consolidated Statements of Operations for the years ended December 31, 2008, 2007 and 2006

   d) Consolidated Statements of Comprehensive Income for the years ended December 31, 2008, 2007 and 2006

   e) Consolidated Statements of Stockholders' Equity for the years ended December 31, 2008, 2007 and 2006

   f) Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006

   g) Notes to Consolidated Financial Statements

2. Financial statement schedules required to be filed by Item 8 of this Form:

None

3. Exhibits

   (a) Index to Exhibits

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
3.1	Registrant's Articles of Incorporation(1)
3.2	Registrant's Bylaws(1)
4.1	Specimen Stock Certificate(1)
10.1	Employment Agreement of Randy P. Helton(1), a management contract
10.2	1999 Incentive Stock Option Plan, a compensatory plan(1)
10.3	1999 Nonstatutory Stock Option Plan, a compensatory plan(1)
10.4	401(k) Plan, a compensatory plan(1)

10.5(i)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Amended and Restated Declaration of Trust, dated December 15, 2003(2)
10.5(ii)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Indenture, dated December 15, 2003(2)
10.5(iii)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Guarantee Agreement, dated December 31, 2003(2)
10.5(iv)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Form of Floating Rate Junior Subordinated Debenture of American Community Bancshares, Inc. (incorporated by reference to Exhibit A of Exhibit 10.5(ix))(2)
10.6	2001 Incentive Stock Option Plan, a compensatory plan(3)

Table of Contents

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
10.7	2002 Nonstatutory Stock Option Plan, a compensatory plan(4)
10.8	Dividend Reinvestment and Common Stock Purchase Plan(6)
10.9	Agreement and Plan of Merger by and between Yadkin Valley Financial Corporation and American Community Bancshares, Inc.(7)
21	Subsidiaries of Registrant (Filed herewith)
23	Consent of Dixon Hughes, PLLC
31(i)	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act (Filed herewith)
31(ii)	Certification of Principal Accounting Officer Pursuant to Section 302 of the Sarbanes Oxley Act (Filed herewith)
32(i)	Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes Oxley Act (Filed herewith)
32(ii)	Certification of Principal Accounting Officer Pursuant to Section 906 of the Sarbanes Oxley Act (Filed herewith)
99	Registrant's Definitive Proxy Statement(5)

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

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

(3) Incorporated by reference from Exhibit 10.5 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.

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

(5) Filed with the Commission pursuant to Rule 14a-6.

(6) Incorporated by reference from Exhibit 99.1 to Registrant's Statement on Form S-3D (File No. 333-129991)

(7) Incorporated by reference from Registrant's current report on Form 8-K dated September 10, 2008 (File No. 000-30517)

Table of Contents

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 30, 2009

/s/ RANDY P. HELTON

Randy P. Helton
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ RANDY P. HELTON Randy P. Helton *President, Chief Executive Officer and Director*	March 30, 2009
/s/ DAN R. ELLIS, JR. Dan R. Ellis, Jr. *Chief Financial Officer*	March 30, 2009
/s/ ROBERT D. DINSMORE Robert D. Dinsmore *Director*	March 30, 2009
/s/ FRANK L. GENTRY Frank L. Gentry *Director*	March 30, 2009
/s/ THOMAS J. HALL Thomas J. Hall *Director*	March 30, 2009
/s/ LARRY S. HELMS Larry S. Helms *Director*	March 30, 2009
/s/ V. STEPHEN MOSS V. Stephen Moss *Director*	March 30, 2009

Table of Contents

/s/ PETER A. PAPPAS Peter A. Pappas *Director*	March 30, 2009
/s/ L. STEVEN PHILLIPS L. Steven Phillips *Director*	March 30, 2009
/s/ ALISON J. SMITH Alison J. Smith *Director*	March 30, 2009
/s/ DAVID D. WHITLEY David D. Whitley *Director*	March 30, 2009
/s/ GREGORY N. WYLIE Gregory N. Wylie *Director*	March 30, 2009
/s/ PHILIP R. GILBOY Philip R. Gilboy *Director*	March 30, 2009

Table of Contents

Index to Exhibits

EXHIBIT NUMBER	DESCRIPTION OF EXHIBIT
3.1	Registrant's Articles of Incorporation(1)
3.2	Registrant's Bylaws(1)
4.1	Specimen Stock Certificate(1)
10.1	Employment Agreement of Randy P. Helton(1), a management contract
10.2	1999 Incentive Stock Option Plan, a compensatory plan(1)
10.3	1999 Nonstatutory Stock Option Plan, a compensatory plan(1)
10.4	401(k) Plan, a compensatory plan(1)
10.5(i)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Amended and Restated Declaration of Trust, dated December 15, 2003(2)
10.5(ii)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Indenture, dated December 15, 2003(2)
10.5(iii)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Guarantee Agreement, dated December 31, 2003(2)
10.5(iv)	Issuance of Trust Preferred Securities by American Community Capital Trust II, Ltd.: Form of Floating Rate Junior Subordinated Debenture of American Community Bancshares, Inc. (incorporated by reference to Exhibit A of Exhibit 10.5(ix))(2)
10.6	2001 Incentive Stock Option Plan, a compensatory plan(3)
10.7	2002 Nonstatutory Stock Option Plan, a compensatory plan(4)
10.8	Dividend Reinvestment and Common Stock Purchase Plan(6)
10.9	Agreement and Plan of Merger by and between Yadkin Valley Financial Corporation and American Community Bancshares, Inc.(7)
21	Subsidiaries of Registrant (Filed herewith)
23	Consent of Dixon Hughes, PLLC
31(i)	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act (Filed herewith)
31(ii)	Certification of Principal Accounting Officer Pursuant to Section 302 of the Sarbanes Oxley Act (Filed herewith)
32(i)	Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes Oxley Act (Filed herewith)

32(ii)	Certification of Principal Accounting Officer Pursuant to Section 906 of the Sarbanes Oxley Act (Filed herewith)
99	Registrant's Definitive Proxy Statement(5)

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

Table of Contents

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

(3) Incorporated by reference from Exhibit 10.5 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.

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

(5) Filed with the Commission pursuant to Rule 14a-6.

(6) Incorporated by reference from Exhibit 99.1 to Registrant's Statement on Form S-3D (File No. 333-129991)

(7) Incorporated by reference from Registrant's current report on Form 8-K dated September 10, 2008 (File No. 000-30517)

Exhibit 21

Subsidiaries

American Community Bank
(a North Carolina chartered banking corporation)

American Community Capital Trust II
(a Connecticut statutory trust)

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
American Community Bancshares, Inc. and subsidiary

We consent to the incorporation by reference in the Form S-8 Registration Statements No. 333-128833, 333-127746, 333-117778, 333-101208, 333-58278, and 333-129991 of American Community Bancshares, Inc. of our report dated February 19, 2009, except for Note 25, as to which the date is March 26, 2009 with respect to the consolidated financial statements of American Community Bancshares, Inc. and subsidiary, which report appears in this Annual Report on Form 10-K of American Community Bancshares, Inc. for the year ended December 31, 2008.

Charlotte, North Carolina
March 26, 2009

Exhibit 31(i)

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Randy P. Helton, certify that:

1. I have reviewed this annual report on Form 10-K of American Community Bancshares, Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period which this report is being prepared.

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based upon our most recent evaluation of internal control over financial reporting, to the registrant's auditor and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2009	By:	/s/ RANDY P. HELTON
		Randy P. Helton *President and Chief Executive Officer*

Table of Contents

Exhibit 31(ii)

CERTIFICATION OF PRINCIPAL ACCOUNTING OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Dan R. Ellis, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of American Community Bancshares, Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period which this report is being prepared.

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based upon our most recent evaluation of internal control over financial reporting, to the registrant's auditor and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2009	By:	/s/ DAN R. ELLIS, JR.
		Dan R. Ellis, Jr. *Chief Financial and Principal Accounting Officer*

Exhibit 32(i)

Certification of the Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The undersigned hereby certifies that, to his knowledge, **(i)** the Form 10-K filed by American Community Bancshares, Inc. (the "Issuer") for the year ended December 31, 2008, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and **(ii)** the information contained in that report fairly presents, in all material respects, the financial condition and results of operations of the Issuer on the dates and for the periods presented therein.

Date: March 30, 2009

/s/ RANDY P. HELTON

Randy P. Helton
President and Chief Executive Officer

Table of Contents

Exhibit 32(ii)

Certification of the Principal Accounting Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The undersigned hereby certifies that, to his knowledge, **(i)** the Form 10-K filed by American Community Bancshares, Inc. (the "Issuer") for the year ended December 31, 2008, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and **(ii)** the information contained in that report fairly presents, in all material respects, the financial condition and results of operations of the Issuer on the dates and for the periods presented therein.

Date: March 30, 2009	/s/ DAN R. ELLIS, JR.
	Dan R. Ellis, Jr. *Chief Financial and Principal Accounting Officer*