COMMUNITY BANKSHARES INC /SC/
Form 10-K
March 31, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2004 Commission File No. 000-22054

COMMUNITY BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

South Carolina	57-0966962
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

791 Broughton Street, Orangeburg, SC 29115
(Address of principal executive offices, zip code)

Registrant's telephone number, including area code (803) 535-1060

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

Title of each class	Name of each exchange on which registered
Common Stock, No Par Value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act): Yes [ ] No [X]

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter, June 30, 2004 was approximately $59,459,000.

As of March 09, 2005, there were 4,390,784 shares of the registrant's common stock, no par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the Registrant's Proxy Statement for the 2004 Annual Meeting of

Shareholders - Part III

10-K TABLE OF CONTENTS

Part I

Item 1 Description of Business ....
Item 2 Description of Property ....
Item 3 Legal Proceedings ....
Item 4 Submission of Matters to a Vote of Security Holders ....

Part II

Item 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities ....
Item 6 Selected Financial Data ....
Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations ....
Item 7A Quantitative and Qualitative Disclosures about Market Risk ....
Item 8 Financial Statements and Supplementary Data ....
Report of Independent Registered Public Accounting Firm ....
Consolidated Balance Sheets, December 31, 2004 and 2003 ....
Consolidated Statements of Income, Years Ended December 31, 2004, 2003 and 2002 ....
Consolidated Statements of Changes in Shareholders' Equity, Years Ended December 31, 2004, 2003 and 2002 ....
Consolidated Statements of Cash Flows, Years Ended December 31, 2004, 2003 and 2002 ....
Notes to Consolidated Financial Statements ....
Quarterly Data for 2004 and 2003 ....
Item 9 Changes In and Disagreements with Accountants on Accounting and Financial Disclosure ....
Item 9A Controls and Procedures ....
Item 9B Other Information ....

Part III

Item 10 Directors and Executive Officers of the Registrant ....
Item 11 Executive Compensation ....
Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters ....
Item 13 Certain Relationships and Related Transactions ....
Item 14 Principal Accountant Fees and Services ....

Part IV

Item 15 Exhibits and Financial Statement Schedules ....

* Incorporated by reference to Registrant's Proxy Statement for the 2005 Annual Meeting of Shareholders

FORWARD-LOOKING STATEMENTS

Statements included in this report which are not historical in nature are intended to be, and are hereby identified as `forward-looking statements' for purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical facts. Such forward-looking statements may be identified, without limitation, by the use the of the words "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "projects," and similar expressions. The Corporation's expectations, beliefs, estimates and projections are expressed in good faith and are believed by the Corporation to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in the Corporation's records and other data available from third parties, but there can be no assurance that management's expectations, beliefs, estimates or projections will result or be achieved or accomplished. The Corporation cautions readers that forward-looking statements, including without limitation, those relating to the Corporation's recent and continuing expansion, its future business prospects, revenues, working capital, liquidity, capital needs, interest costs, income, and adequacy of the allowance for loan losses, are subject to risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements, due to several important factors herein identified, among others, and other risks and factors identified from time to time in the Corporation's reports filed with the Securities and Exchange Commission. The Corporation undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

References to our Website Address

References to our website address throughout this Annual Report on Form 10-K and in any documents incorporated into this Form 10-K by reference are for informational purposes only, or to fulfill specific disclosure requirements of the Securities and Exchange Commission's rules or the American Stock Exchange listing standards. These references are not intended to, and do not, incorporate the contents of our website by reference into this Form 10-K or the accompanying materials.

PART I

Item 1. Description of Business

Form of organization

Community Bankshares, Inc. (CBI or the Corporation) is a South Carolina corporation and a bank holding company. CBI commenced operations on July 1, 1993, upon effectiveness of the acquisition of the Orangeburg National Bank as a wholly-owned subsidiary. In June 1996 CBI acquired all the stock of Sumter National Bank, which is also a wholly-owned subsidiary. In July 1998 CBI acquired all the stock of Florence National Bank, which is also a wholly-owned subsidiary. In July 2002 CBI acquired by merger Ridgeway Bancshares, Inc., the parent company of the Bank of Ridgeway.

Orangeburg National Bank (the Orangeburg bank) is a national bank, chartered in 1987, operating from two offices located in Orangeburg, South Carolina.

Sumter National Bank (the Sumter bank) is a national bank, chartered in 1996, operating from two offices located in Sumter, South Carolina.

Florence National Bank (the Florence bank) is a national bank, chartered in 1998, operating from two offices located in Florence, South

Carolina. A second office was opened in early 2005.

Bank of Ridgeway (the Ridgeway bank) is a South Carolina state-chartered bank, organized in 1898, operating from one office in Ridgeway, one office in Winnsboro, and one office in Blythewood, South Carolina.

In November 2001, CBI acquired all the common stock of Resource Mortgage Inc., a Columbia, South Carolina based mortgage company. The mortgage company operates as a wholly-owned subsidiary of the holding company and is now named Community Resource Mortgage, Inc. (CRM).

Business of banking

The Orangeburg, Sumter, Florence and Ridgeway banks (hereafter referred to as the Banks) offer a full array of commercial bank services. Deposit services include business and personal checking accounts, NOW accounts, savings accounts, money market accounts, various term certificates of deposit, IRA accounts, and other deposit services. The Federal Deposit Insurance Corporation insures deposits up to applicable limits. Most of the Banks' deposits are attracted from individuals and small businesses.

The Banks offer secured and unsecured, short-to-intermediate term loans, with floating and fixed interest rates for commercial and consumer purposes. Consumer loans include car loans, home equity improvement loans secured by first and second mortgages, personal expenditure loans, education loans, and the like. Commercial loans include short-term unsecured loans, short and intermediate term real estate mortgage loans, loans secured by listed stocks, loans secured by equipment, inventory, accounts receivable, and the like. The Banks do not and will not discriminate against any applicant for credit on the basis of race, color, creed, sex, age, marital status, familial status, handicap, or derivation of income from public assistance programs.

Other services offered by the Banks include safe deposit boxes, night depository service, VISA and Master Card brand charge cards (through a correspondent), tax deposits, sale of U.S. Treasury bonds, notes and bills and other U. S. government securities (through a correspondent), twenty-four hour automated teller service, and Internet banking services. Each of the Banks has ATMs and they are all part of the Star and Cirrus networks.

The mortgage company provides a wide variety of one to four family residential mortgage products in the Columbia, Sumter and Anderson, South Carolina markets.

Competition

The market for financial institutions in our various markets is generally highly competitive. Banks generally compete with other financial institutions through the banking services and products offered, the pricing of services, the level of service provided, the convenience and availability of services, and the degree of expertise and personal concern with which services are offered. The Banks encounter strong competition from most of the financial institutions in their market areas.

The market area for the Orangeburg bank generally encompasses an area extending nine miles around the city of Orangeburg. The market area for the Sumter bank generally encompasses the county of Sumter. The market area for the Florence bank generally encompasses the city of Florence. The market area for the Ridgeway bank generally encompasses Fairfield County (for the Ridgeway and

Winnsboro offices) and the town of Blythewood in Richland County. In the conduct of certain banking business, the Banks also compete with credit unions, consumer finance companies, insurance companies, money market mutual funds, and other financial institutions, some of which are not subject to the same degree of regulation and restrictions imposed upon the Banks. Many of these competitors have substantially greater resources and lending limits than the Banks and offer certain services, such as international banking and trust services, which the Banks do not provide. The Banks believe, however, that their relatively small size permits them to offer more personalized services than many of their competitors. The Banks attempt to compensate for their lower lending limits by participating larger loans with other institutions, often with each other.

Most of the other financial institutions in the Orangeburg, Sumter, Florence and most of the Ridgeway service areas are branch offices of large, regional banks with offices located throughout South Carolina. At June 30, 2004, there were five FDIC insured financial institutions competing with the Corporation in the city of Orangeburg, eight financial institutions competing with the Corporation in Sumter County, and 15 financial institutions competing with the Corporation in the city of Florence. At June 30, 2004, the Orangeburg bank had the second largest deposit base in the city of Orangeburg; the Sumter bank had the third largest deposit base in Sumter County; the Florence bank had the sixth largest deposit base in the city of Florence; and the Ridgeway bank had the largest deposit base in Fairfield County and approximately half the deposits in the town of Blythewood.

The mortgage company has offices in Anderson, Richland and Sumter Counties of South Carolina, where it competes with hundreds of financial institutions and mortgage originators.

Dependence on Major Customers

The Banks do not consider themselves dependent on any single customer or small group of customers, either in the deposit or lending areas.

SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under federal and state law. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to such statutes and regulations. Any change in applicable law or regulation may have a material effect on the business of CBI and the Banks.

As discussed below under the caption "Gramm-Leach-Bliley Act", Congress has adopted extensive changes in the laws governing the financial services industry. Among the changes adopted are creation of the financial holding company, a new type of bank holding company with powers that greatly exceed those of standard holding companies, and creation of the financial subsidiary, a subsidiary that can be used by national banks to engage in many, though not all, of the same activities in which a financial holding company may engage. The legislation also establishes the concept of functional regulation whereby the various financial activities in which financial institutions engage are overseen by the regulator with the relevant regulatory experience. Accordingly, the following discussion relates to the supervisory and regulatory provisions that apply to CBI and the Banks as they currently operate.

Regulation of Bank Holding Companies

General

As a bank holding company registered under the Bank Holding Company Act ("BHCA"), CBI is subject to the regulations of the Board of Governors of the Federal Reserve System (the "Federal Reserve"). Under the BHCA, CBI's activities and those of its subsidiaries are limited to banking, managing or controlling banks, furnishing services to or performing services for its subsidiaries or engaging in any other activity which the Federal Reserve determines to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. The BHCA prohibits CBI from acquiring direct or indirect control of more than 5% of the outstanding voting stock or substantially all of the assets of any bank or from merging or consolidating with another bank holding company without prior approval of the Federal Reserve. The BHCA also prohibits CBI from acquiring control of any bank operating outside the State of South Carolina unless such action is specifically authorized by the statutes of the state where the bank to be acquired is located.

Additionally, the BHCA prohibits CBI from engaging in or from acquiring ownership or control of more than 5% of the outstanding voting stock of any company engaged in a non-banking business unless such business is determined by the Federal Reserve to be so closely related to banking as to be properly incident thereto. The BHCA generally does not place territorial restrictions on the activities of such non-banking-related activities.

As discussed below under "Gramm-Leach-Bliley Act", a bank holding company that meets certain requirements may now qualify as a financial holding company and thereby significantly increase the variety of services it may provide and the investments it may make.

CBI is also subject to limited regulation and supervision by the South Carolina State Board of Financial Institutions (the "State Board"). A South Carolina bank holding company may be required to provide the State Board with information with respect to the financial condition, operations, management and inter-company relationships of the holding company and its subsidiaries. The State Board also may require such other information as is necessary to keep itself informed about whether the provisions of South Carolina law and the regulations and orders issued thereunder by the State Board have been complied with, and the State Board may examine any bank holding company and its subsidiaries. Furthermore, pursuant to applicable law and regulations, the Company must receive approval of, or give notice to (as applicable) the State Board prior to engaging in the acquisition of banking or non-banking institutions or assets.

Obligations of Holding Company to its Subsidiary Banks

A number of obligations and restrictions are imposed on bank holding companies and their depository institution subsidiaries by Federal law and regulatory policies that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event the depository institution is in danger of becoming insolvent or is insolvent. For example, under the policy of the Federal Reserve, a bank holding

company is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so absent such policy. In addition, the "cross-guarantee" provisions of the Federal Deposit Insurance Act, as amended ("FDIA"), require insured depository institutions under common control to reimburse the FDIC for any loss suffered or reasonably anticipated by either the Savings Association Insurance Fund ("SAIF") or the Bank Insurance Fund ("BIF") of the FDIC as a result of the default of a commonly controlled insured

depository institution or for any assistance provided by the FDIC to a commonly controlled insured depository institution in danger of default. The FDIC may decline to enforce the cross-guarantee provisions if it determines that a waiver is in the best interest of the SAIF or the BIF or both. The FDIC's claim for damages is superior to claims of stockholders of the insured depository institution or its holding company but is subordinate to claims of depositors, secured creditors and holders of subordinated debt (other than affiliates) of the commonly controlled insured depository institutions.

The FDIA also provides that amounts received from the liquidation or other resolution of any insured depository institution by any receiver must be distributed (after payment of secured claims) to pay the deposit liabilities of the institution prior to payment of any other general or unsecured senior liability, subordinated liability, general creditor or stockholder. This provision gives depositors a preference over general and subordinated creditors and stockholders in the event a receiver is appointed to distribute the assets of the bank.

Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such 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 will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Under the National Bank Act, if the capital stock of a national bank is impaired by losses or otherwise, the OCC is authorized to require payment of the deficiency by assessment upon the bank's shareholders', pro rata, and to the extent necessary, if any such assessment is not paid by any shareholder after three months notice, to sell the stock of such shareholder to make good the deficiency.

Capital Adequacy Guidelines for Bank Holding Companies and Banks

The various federal bank regulators, including the Federal Reserve and the FDIC, have adopted risk-based and leverage capital adequacy guidelines assessing bank holding company and bank capital adequacy. These standards define what qualifies as capital and establish minimum capital standards in relation to assets and off-balance-sheet exposures, as adjusted for credit risks. The capital guidelines and CBI's capital position are summarized in Note 19 to the Financial Statements, contained elsewhere in this report. All four of the Banks are considered well capitalized.

Failure to meet capital guidelines could subject the Banks to a variety of enforcement remedies, including the termination of deposit insurance by the FDIC and a prohibition on the taking of brokered deposits.

The risk-based capital standards of both the Federal Reserve Board and the FDIC explicitly identify concentrations of credit risk and the risk arising from non-traditional activities, as well as an institution's ability to manage these risks, as important factors to be taken into account by the agencies in assessing an institution's overall capital adequacy. The capital guidelines also provide that an institution's exposure to a decline in the economic value of its capital due to changes in interest rates be considered by the agencies as a factor in evaluating a bank's capital adequacy. The Federal Reserve Board also has recently issued additional capital guidelines for bank holding companies that engage in certain trading activities.

Payment of Dividends

CBI is a legal entity separate and distinct from the Banks. Most of the revenues of CBI result from dividends paid to CBI by the Banks. There are

statutory and regulatory requirements applicable to the payment of dividends by subsidiary banks as well as by CBI to its shareholders.

Each national banking association is required by federal law to obtain the prior approval of the OCC for the payment of dividends if the total of all dividends declared by the board of directors of such bank in any year will exceed the total of (i) such bank's net profits (as defined and interpreted by regulation) for that year plus (ii) the retained net profits (as defined and interpreted by regulation) for the preceding two years, less any required transfers to surplus. In addition, national banks can only pay dividends to the extent that retained net profits (including the portion transferred to surplus) exceed bad debts (as defined by regulation). South Carolina banking regulations also restrict the amount of dividends that South Carolina state banks can pay shareholders. Any dividends by a South Carolina state bank that exceed the

6

bank's total year-to-date earnings are subject to prior approval of the South Carolina Commissioner of Banking and are generally payable only from undivided profits. Payment of dividends by a state bank would also be prohibited if the effect would be to cause the Bank's capital to fall below applicable minimum capital requirements.

The payment of dividends by CBI and the Banks may also be affected or limited by other factors, such as the requirements to maintain adequate capital above regulatory guidelines. In addition, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the Banks, could include the payment of dividends), such authority may require, after notice and hearing, that such bank cease and desist from such practice. The OCC has indicated that paying dividends that deplete a national bank's capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve, the OCC and the FDIC have issued policy statements, which provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

Certain Transactions by CBI with its Affiliates

Federal law regulates transactions among CBI and its affiliates, including the amount of the Banks' loans to or investments in nonbank affiliates and the amount of advances to third parties collateralized by securities of an affiliate. Further, a bank holding company and its affiliates are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

FDIC Insurance Assessments

Because Orangeburg National Bank's, Sumter National Bank's, Florence National Bank's and the Bank of Ridgeway's deposits are insured by the Bank Insurance Fund of the FDIC ("BIF"), the Banks are subject to semiannual insurance assessments imposed by the FDIC. Since January 1, 1997, the assessments imposed on all FDIC deposits for deposit insurance have an effective rate ranging from 0 to 27 basis points per $100 of insured deposits, depending on the institution's capital position and other supervisory factors. However, legislation enacted in 1996 requires that both Savings Association Insurance Fund ("SAIF") insured and BIF insured deposits pay a pro rata portion of the interest due on the obligations issued by the Financing Corporation ("FICO"). The FICO assessment is adjusted quarterly to reflect changes in the assessment bases of the respective funds based on quarterly Call Report and Thrift Financial Report submissions.

Regulation of the Banks

Orangeburg National Bank, Sumter National Bank, and Florence National Bank are also subject to regulation and examination by the OCC bank examiners. The Bank of Ridgeway is subject to regulation and examination by the FDIC and the State Board. In addition, the Banks are subject to various other state and federal laws and regulations, including state usury laws, laws relating to fiduciaries, consumer credit laws and laws relating to branch banking. The Banks' loan operations are subject to certain federal consumer credit laws and regulations promulgated thereunder, including, but not limited to: the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers; the Home Mortgage Disclosure Act, requiring financial institutions to provide certain information concerning their mortgage lending; the Equal Credit Opportunity Act and the Fair Housing Act, prohibiting discrimination on the basis of certain prohibited factors in extending credit; the Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies; the Bank Secrecy Act, dealing with, among other things, the reporting of certain currency transactions; and the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies. The deposit operations of the Banks are subject to the Truth in Savings Act, requiring certain disclosures about rates paid on savings accounts; the Expedited Funds Availability Act, which deals with disclosure of the availability of funds deposited in accounts and the collection and return of checks by banks; the Right to Financial Privacy Act, which imposes a duty to maintain certain confidentiality of consumer financial records and the Electronic Funds Transfer Act and regulations promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

The Banks are subject to the requirements of the Community Reinvestment Act (the "CRA"). The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. Each financial institution's actual performance in meeting community credit needs is evaluated as part of the examination process, and also is considered in evaluating mergers, acquisitions and applications to open a branch or facility.

Other Safety and Soundness Regulations

Prompt Corrective Action. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institutions in question are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized."

A bank that is "undercapitalized" becomes subject to provisions of the Federal Deposit Insurance Act ("FDIA") restricting payment of capital distributions and management fees; requiring the OCC to monitor the condition of the bank; requiring submission by the bank of a capital restoration plan; restricting the growth of the bank's assets and requiring prior approval of certain expansion proposals. A bank that is "significantly undercapitalized" is also subject to restrictions on compensation paid to senior management of the bank, and a bank that is "critically undercapitalized" is further subject to restrictions on the activities of the bank and restrictions on payments of subordinated debt of the bank. The purpose of these provisions is to require

banks with less than adequate capital to act quickly to restore their capital and to have the OCC move promptly to take over banks that are unwilling or unable to take such steps.

Brokered Deposits. Under current FDIC regulations, "well capitalized" banks may accept brokered deposits without restriction, "adequately capitalized" banks may accept brokered deposits with a waiver from the FDIC (subject to certain restrictions on payments of rates), while "undercapitalized" banks may not accept brokered deposits. The regulations provide that the definitions of "well capitalized", "adequately capitalized" and "undercapitalized" are the same as the definitions adopted by the agencies to implement the prompt corrective action provisions described in the previous paragraph.

Interstate Banking

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal"), CBI and any other adequately capitalized bank holding company located in South Carolina can acquire a bank located in any other state, and a bank holding company located outside South Carolina can acquire any South Carolina-based bank, in either case subject to certain deposit percentage and other restrictions. Riegle-Neal also provides that, in any state that has not previously elected to prohibit out-of-state banks from operating interstate branches within its territory, adequately capitalized and managed bank holding companies can consolidate their multistate bank operations into a single bank subsidiary and branch interstate through acquisitions. De novo branching by an out-of-state bank is permitted only if it is expressly permitted by the laws of the host state. The authority of a bank to establish and operate branches within a state will continue to be subject to applicable state branching laws. South Carolina law was amended, effective July 1, 1996, to permit such interstate branching but not de novo branching by an out-of-state bank.

The Riegle-Neal Act, together with legislation adopted in South Carolina, resulted in a number of South Carolina banks being acquired by large out-of-state bank holding companies. Size gives the larger banks certain advantages in competing for business from larger customers. These advantages include higher lending limits and the ability to offer services in other areas of South Carolina and the region. As a result, the Banks do not generally attempt to compete for the banking relationships of large corporations, but concentrate their efforts on small to medium-sized businesses and on individuals. CBI believes its Banks have competed effectively in this market segment by offering quality, personal service.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act, which makes it easier for affiliations between banks, securities firms and insurance companies to take place, became effective in March 2000. The Act removes Depression-era barriers that had separated banks and securities firms, and seeks to protect the privacy of consumers' financial information.

Under provisions of the legislation and regulations adopted by the appropriate regulators, banks, securities firms and insurance companies are able to structure new affiliations through a holding company structure or through a financial subsidiary. The legislation creates a new type of bank holding company called a "financial holding company" which has powers much more extensive than those of standard holding companies. These expanded powers include authority to engage in "financial activities," which are activities that are (1) financial in nature; (2) incidental to activities that are financial in nature; or (3) complementary to a financial activity and that do not impose a safety and soundness risk. Significantly, the permitted financial activities for financial holding companies include authority to engage in merchant banking and insurance activities, including insurance portfolio investing. A bank holding company can

qualify as a financial holding company and expand the services it offers only if all of its subsidiary depository institutions are well-managed, well-capitalized and have received a rating of "satisfactory" on their last Community Reinvestment Act examination.

The legislation also creates another new type of entity called a "financial subsidiary." A financial subsidiary may be used by a national bank or a group of national banks to engage in many of the same activities permitted for a financial holding company, though several of these activities, including real estate development or investment, insurance or annuity underwriting, insurance portfolio investing and merchant banking, are reserved for financial holding companies. A bank's investment in a financial subsidiary affects the way in which the bank calculates its regulatory capital, and the assets and liabilities of financial subsidiaries may not be consolidated with those of the bank. The bank must also be certain that its risk management procedures are adequate to protect it from financial and operational risks created both by itself and by any financial subsidiary. Further, the bank must establish policies to maintain the separate corporate identities of the bank and its financial subsidiary and to prevent each from becoming liable for the obligations of the other. The Florence bank and the Orangeburg bank each have a financial subsidiary for the sale of securities and insurance products.

The Act also establishes the concept of "functional supervision," meaning that similar activities should be regulated by the same regulator. Accordingly, the Act spells out the regulatory authority of the bank regulatory agencies, the Securities and Exchange Commission and state insurance regulators so that each type of activity is supervised by a regulator with corresponding expertise. The Federal Reserve Board is intended to be an umbrella supervisor with the authority to require a bank holding company or financial holding company or any subsidiary of either to file reports as to its financial condition, risk management systems, transactions with depository institution subsidiaries and affiliates, and compliance with any federal law that it has authority to enforce.

Although the Act reaffirms that states are the regulators for insurance activities of all persons, including federally-chartered banks, the Act prohibits states from preventing depository institutions and their affiliates from conducting insurance activities.

The Act also establishes a minimum federal standard of privacy to protect the confidentiality of a consumer's personal financial information and gives the consumer the power to choose how personal financial information may be used by financial institutions.

The Act and the regulations adopted pursuant to the Act create new opportunities for CBI to offer expanded services to customers in the future, though, except as noted above, CBI has not yet determined what the nature of the expanded services might be or when CBI might find it feasible to offer them. The Act has increased competition from larger financial institutions that are currently more capable than CBI of taking advantage of the opportunity to provide a broader range of services. However, CBI continues to believe that its commitment to providing high quality, personalized service to customers will permit it to remain competitive in its market area.

Fiscal and Monetary Policy

Banking is a business which depends to a large extent on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and its other borrowings, and the interest received by a bank on

its loans and securities holdings, constitutes the major portion of a bank's earnings. Thus, the earnings and growth of CBI are subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The Federal Reserve regulates the supply of money through various means, including open-market dealings in United States government securities, the discount rate at which banks may borrow from the Federal Reserve, and the reserve requirements on deposits. The nature and timing of any changes in such policies and their impact on CBI cannot be predicted.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act, which was enacted in 2002, mandated extensive reforms and requirements for public companies. The SEC has adopted extensive new regulations pursuant to the requirements of the Sarbanes-Oxley Act. The Sarbanes-Oxley Act and the SEC's new regulations have increased the Corporation's cost of doing business, particularly its fees for internal and external audit services and legal services, and the law and regulations are expected to continue to do so. However, the Corporation does not believe that it will be affected by Sarbanes-Oxley and the new SEC regulations in ways that are materially different or more onerous than those of other public companies of similar size and in similar businesses.

Legislative Proposals

Legislation which could significantly affect the business of banking is introduced in Congress from time to time. CBI cannot predict the future course of such legislative proposals or their impact on CBI should they be adopted.

Employees

At December 31, 2004 the Corporation employed 182 full time equivalent employees. Management believes that its employee relations are excellent.

Further Information

Further information about the business of the Corporation and the Banks is set forth in this Form 10-K under Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 2. Description of Property

The Orangeburg bank owns land located at 1820 Columbia Road NE, in Orangeburg, South Carolina, where the Orangeburg bank maintains its main office. The Bank operates from a one-story building of approximately 7,000 square feet. The Orangeburg bank also owns a building, which was previously a branch of the bank, at the corner of Broughton and Glover Streets in Orangeburg. The Orangeburg bank currently rents this facility to the Corporation for office space. In June 1999, the Bank moved into a branch facility located adjacent to the old building. This branch office is approximately 6,500 square feet.

The Corporation's Sumter bank has fee simple title to land and a one-story 6,500 square foot building located at 683 Bultman Drive, in Sumter, South Carolina, where the Sumter bank maintains its main office. The Sumter bank opened a branch bank on West Liberty Street in Sumter in February 2002. The branch is a one-story building of approximately 3,600 square feet. The land, approximately one acre, is leased under a non-cancellable operating lease for an initial term of twenty years. The lease terms provide for four five-year renewal options after the initial term. The Sumter bank is responsible for property

taxes and improvements.

The Florence bank leases approximately 1.7 acres of land located at 2009 Hoffmeyer Road in Florence, South Carolina for its main office. The lease is for an initial term of ten years and provides for two ten year renewals and a final two year renewal. The Florence bank is responsible for property taxes and improvements. The Corporation built a 7,500 square foot, one-story building for the Florence bank on the leased site. The Florence bank also leases approximately one quarter acre of land and a 2,000 square foot building at 812 Second Loop Road, Florence, SC for its branch office. The lease is for an initial term of five years and contains both early termination and renewal options. The Florence bank has also purchased a 1.1 acre lot on the 600 block of the Pamplico Highway in Florence for approximately $600,000. This property is intended for future development.

The Ridgeway bank's main office is located in a two story building on a quarter acre site owned by the Bank at 100 S. Palmer St. in Ridgeway. The bank also owns a 1,590 square foot one story branch office on a .9 acre site at 115 McNulty St. in Blythewood, SC, and a 1,900 square foot one story branch office on a one acre site at 610 West Moultrie St. in Winnsboro, SC. The bank also owns approximately 1.5 acres of land on Longtown Road in Northeast Richland County, SC, where it intends to build a new full-service banking office. Construction is tentatively scheduled to begin in 2006. The Ridgeway Bank has signed a letter of intent to move its Blythewood, SC office from its present location to the Village, located off Blythewood Road near Interstate 77. The Bank will occupy approximately 6,600 square feet of a two story building which is expected to be built by early 2006.

The mortgage company operates from leased offices located at 508 Hampton Street, Suite 201, Columbia, SC, 10253 Two Notch Road, Columbia, SC, 304 West Westmark, Sumter, SC, and 1704 E. Greenville Street, Anderson, SC. The Hampton Street, Columbia office is leased under the terms of a five year lease. At the end of that period, the lease will automatically renew on a month-to-month basis. The other offices are rented under month-to-month rental agreements. The mortgage company expects to move its Sumter operations into the Sumter National Bank branch located on West Liberty Street in early 2005.

Information about future lease payments is included in Note 7 to the consolidated financial statements contained elsewhere in this report.

The Corporation has acquired approximately three acres of land in the northeast area of the City of Orangeburg and expects to soon begin the construction of a two story, 16,000 square foot corporate headquarters and operations center building on that property. It is anticipated that the new building will be completed in early 2006. The Corporation expects this project to cost approximately $2,000,000.

Item 3. Legal Proceedings

The Company, the Banks and the Mortgage Company are from time to time subject to legal proceedings in the ordinary course of their business. No proceedings were pending at December 31, 2004, that management believes are likely to have a material adverse effect on the Company or its subsidiaries.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted for a vote of the security holders during the fourth quarter of 2004.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Corporation's shares of Common Stock are traded on the American Stock Exchange (the AMEX) under the ticker symbol SCB.

The following table summarizes the range of high and low prices for the Corporation's Common Stock as reported on the American Stock Exchange for each quarterly period over the last two years.

Quarter Ended	High	Low
March 31, 2003	$ 17.09	$ 14.50
June 30, 2003	$ 16.45	$ 15.00
September 30, 2003	$ 18.85	$ 15.91
December 31, 2003	$ 19.40	$ 18.10
March 31, 2004	$ 20.92	$ 17.70
June 30, 2004	$ 19.00	$ 16.80
September 30, 2004	$ 18.90	$ 17.30
December 31, 2004	$ 19.50	$ 17.37

During 2004, the Corporation had stock sales volume of 385,500 shares compared with 416,600 shares the prior year.

There were 2,183 holders of record of the Corporation's Common Stock (no par value) as of December 31, 2004 compared with 2,104 the prior year.

During 2004, the Corporation authorized and paid quarterly cash dividends totaling 40 cents per share. The total cost of these dividends was $1,744,000 or 54.3% of after tax profits. During 2003, the Corporation authorized and paid quarterly cash dividends totaling 36 cents per share. The total cost of these dividends was $1,554,000 or 27.6% of after tax profits. The dividend policy of the Corporation is subject to the discretion of the Board of Directors and depends upon a number of factors, including earnings, financial condition, cash needs and general business conditions, as well as applicable regulatory considerations. Subject to ongoing review of these circumstances, the Board expects to maintain a reasonable, safe and sound dividend payment policy.

The current source of dividends to be paid by the Corporation is the dividends received from its banking subsidiaries. Accordingly, the laws and regulations that govern the payment of dividends by national banking associations and state chartered banks may restrict the Corporation's ability to pay dividends. National banks may pay dividends only out of present and past earnings and state banks may only pay out of current earnings without prior regulatory approval. Both are subject to numerous limitations designed to ensure that the Banks have adequate capital to operate safely and soundly (See Item 1. Description of Business - Supervision and Regulation - Payment of Dividends). At December 31, 2004 the Banks could pay up to approximately $7,961,000 in dividends without prior approval of their regulators.

The information required by Item 201(d) of Regulation S-K is set forth in Item 12 of this Form 10-K.

The Corporation did not purchase any shares of its common stock during the fourth quarter of 2004. The Corporation did not sell any of its securities in transactions that were not registered under the Securities Act of 1933 during the year ended December 31, 2004.

Item 6. Selected Financial Data

The following is a summary of the consolidated financial position and results of operations of the Corporation for the years ended December 31, 1999 through 2004.

Community Bankshares, Inc. and Subsidiaries
(Dollars in thousands, except per share data)

			Years Ended December		
	2004	2003	2002 (1)	2001 (2)	
INCOME STATEMENT DATA					
Net interest income	$ 17,843	$ 16,708	$ 14,625	$ 10,940	$
Provision for loan losses	5,102	1,119	1,033	650	
Noninterest income	7,278	9,125	7,194	3,584	
Noninterest expense	15,039	15,932	12,465	7,810	
Net income	3,209	5,635	5,401	3,908	
PER COMMON SHARE (3)					
Net income - basic	$0.74	$1.31	$1.42	$1.21	
Net income - diluted	0.72	1.27	1.38	1.20	
Cash dividends	0.40	0.36	0.32	0.28	
Book value	11.39	11.10	10.16	8.35	
BALANCE SHEET DATA (YEAR END)					
Total assets	$512,377	$466,580	$437,320	$318,617	$
Loans held for sale	15,090	8,411	24,664	10,265	
Loans, net	389,302	327,900	302,911	237,340	
Deposits	423,458	378,704	337,062	255,433	
Shareholders' equity	50,027	48,070	43,717	27,547	
FINANCIAL RATIOS					
Return on average assets	0.67%	1.25%	1.43%	1.36%	
Return on average equity	6.41%	12.17%	15.10%	15.58%	
Net interest margin	4.00%	3.95%	4.14%	4.00%	
OPERATIONS DATA					
Banks' branch offices	9	8	8	4	
Mortgage loan offices	4	3	3	3	
Employees (full-time equivalent)	182	190	175	126	

(1) July, 2002 - Ridgeway Bancshares, Inc. acquired.
(2) November, 2001 - Community Resource Mortgage, Inc. acquired.
(3) Per share amounts have been retroactively adjusted to reflect a five percent stock dividend issued in 2000.
(4) Includes growth from proceeds of issuances of stock.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

INTRODUCTION

The discussion and data presented below analyze major factors and trends regarding the financial condition and results of operations of Community Bankshares Inc. and its subsidiaries for the three year period ended December 31, 2004. This information should be reviewed in conjunction with the consolidated financial statements and related notes contained elsewhere in this report.

Business of the Corporation

Community Bankshares Inc. is a bank holding company. CBI owns four banking subsidiaries: Orangeburg National Bank, Sumter National Bank, Florence National Bank, and the Bank of Ridgeway (acquired in July 2002), and a mortgage company subsidiary, Community Resource Mortgage, Inc. (acquired in November 2001). CBI provides item and data processing and other technical services for its subsidiaries. The consolidated financial report for 2004 represents the operations of the holding company, its banks and the mortgage company on a consolidated basis. Condensed parent-only financial statements are presented in the notes to the consolidated financial statements.

Orangeburg National Bank is a national banking association and commenced operations in November 1987. It operates two offices in Orangeburg, South Carolina. Sumter National Bank is a national banking association and commenced operations in June 1996. It operates two offices in Sumter, South Carolina. Florence National Bank is a national banking association and commenced operations in July 1998. It operates two offices in Florence, South Carolina. The Bank of Ridgeway is a state chartered bank and operates from three offices, located in Ridgeway, Winnsboro and Blythewood, SC. The banks provide a variety of commercial banking services in their respective communities. Their primary customer markets are consumers and small to medium sized businesses.

Community Resource Mortgage, Inc. is a South Carolina corporation that commenced business in 1996, and was acquired by the Corporation in 2001. It is a mortgage brokerage company that provides a variety of one to four family residential mortgage products, primarily for resale in the secondary market, from offices in Columbia, Sumter and Anderson, South Carolina.

EARNINGS PERFORMANCE

2004 compared with 2003

For the year ended December 31, 2004, the Corporation recorded net income of $3,209,000, a decrease of $2,426,000, or 43.1%, from net income of $5,635,000 for 2003. Net income per share for 2004 was $.74 compared with $1.31 for 2003. Diluted net income per share was $.72 for 2004 compared with $1.27 for 2003. Return on average assets was .67% for 2004 compared with 1.25% for 2003.

Return on average shareholders' equity was 6.41% for 2004 compared with 12.17% for 2003.

Net income for 2004 was affected primarily by the following factors:

- o the 2004 loan loss provision expense increased by $3,983,000 over 2003 due to problems associated with several large commercial loans,
- o mortgage loan brokerage income decreased $2,070,000 because of a significant reduction in residential mortgage loan production,
- o noninterest expenses decreased by $893,000, primarily due to lower commission based salaries and benefits paid for mortgage brokerage staffing;
- o increased average holdings of loans and investments resulted in a $606,000 increase in interest and dividend income;
- o interest expense was decreased by $529,000 primarily due to lower interest rates paid on time deposits and lower funding costs for mortgage brokerage activities;
- o income tax expense was reduced by $1,376,000 due to the net effect of the factors enumerated above.

Net interest income for 2004 increased by $1,135,000 over the 2003 amount due to increases of $587,000 and $90,000 in interest income on loans and investment securities, respectively, and decreases of $465,000 and $545,000 in interest expenses related to time deposits and short-term borrowings,

respectively. Interest expense for long-term debt increased by $401,000 in 2004, primarily due to the issuance of $10,000,000 of trust preferred securities by the Corporation. The proceeds of this debt were used primarily to increase the capitalization of some of the subsidiary Banks, to fund mortgage loan brokerage production and for other general corporate purposes.

2003 compared with 2002

For the year ended December 31, 2003, the Corporation recorded net income of $5,635,000, an increase of $234,000, or 4.3%, over net income of $5,401,000 for 2002. Net income per share for 2003 was $1.31 compared with $1.42 for 2002. Diluted net income per share was $1.27 for 2003 and $1.38 for 2002. Return on average assets was 1.25% for 2003 compared with 1.43% for 2002. Return on average shareholders' equity was 12.17% for 2003 compared with 15.10% for 2002. Per share income amounts were affected negatively in 2003 by the anticipated dilutive effect of the inclusion for the entire year of the one million shares issued to acquire the Ridgeway bank. Such shares impacted the 2002 calculation of average shares outstanding for only one-half of the year. Similarly, the 2003 return statistics include the Ridgeway bank's average assets and average equity amounts for the full year in 2003, but only one-half year of such amounts were included in 2002.

Net income for 2003 was substantially influenced by four major factors:

- o interest rates were stable at historically low levels which put pressure on net interest margin but also resulted in extremely heavy volumes of initial financing and refinancing of residential real estate loans (refinancing activity diminished significantly in the fourth quarter) and continuing "call" activity by issuers of investment securities;
- o the Corporation recorded twelve months of operations for Bank of Ridgeway, which was acquired in July of 2002;
- o the Sumter bank opened an additional branch office; and

o there were significant increases in noninterest income and expenses, primarily due to increased fee income in CRM and the recognition of the results of operations of the Ridgeway bank for a full year in 2003 compared with only half of a year in 2002.

Net interest income increased significantly for 2003 despite a 19 basis point (one basis point equals one one-hundredth of one percent) decrease in the net interest margin. Increased volumes of loans and significantly reduced rates paid for interest bearing deposit liabilities offset, to a large extent, the effects of a 70 basis point reduction in the earning assets yield. CBI's short-term borrowings costs increased, however, due to the funding needs of CRM. Average short-term borrowings for 2003 were $10,314,000 more than the average amount for 2002 and the rate paid in 2003 was slightly higher than in 2002. Interest expense related to this funding source increased by $272,000 in 2003. The average rate paid for interest bearing deposits in 2003 decreased by 62 basis points from the 2002 rate and 2003 deposit interest expenses decreased by $831,000 to $5,687,000.

Comprehensive Income

Comprehensive income for 2004, 2003, and 2002 was $3,061,000, $5,595,000, and $5,506,000, respectively. Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Other elements of comprehensive income for the Corporation are correlated directly to the effects that changing market rates of interest have on the fair values of the Corporation's holdings of available-for-sale securities. The resulting changes in unrealized holding gains and losses on such securities are reported as a separate component of shareholders' equity. Those changes in fair value, net of income tax effects, are the only elements of comprehensive income.

Net Interest Income

Net interest income, the difference between interest income earned and interest expense incurred, is the principal source of the Corporation's earnings. Net interest income is affected by changes in the levels of interest rates and by changes in the volume and mix of interest earning assets and interest bearing liabilities. During the first six months of 2004 and throughout 2003 and 2002, market interest rates were generally stable. Beginning in 2000 and continuing until late in the second quarter of 2004, the Federal Reserve Board's policy was to provide stimulus to the U.S. economy by first setting, and then maintaining, interest rates at low levels. The effects of these actions on the Corporation were varied. The Corporation's overall funding costs decreased during the period, but there were similar decreases in the yields realized on loans and investments. The mortgage subsidiary experienced extremely large volumes of originations and refinancing activity, which strained its ability both to fund and to process those transactions until the volume diminished in the fourth quarter of 2003. Refinancing activity during the first six months of 2004 was driven primarily by uncertainty and concern about whether the Federal Reserve Board would begin to cause interest rates to rise, and, if so, the magnitude and timing of those increases. Finally, late in the second quarter of 2004, the Federal Reserve Board implemented a series of "measured increases."

Net interest income was $17,843,000, $16,708,000, and $14,625,000 for 2004, 2003, and 2002, respectively. The amounts of interest income increased in both 2004 and 2003, and interest expense amounts decreased. Average earning assets and average interest bearing liabilities amounts increased steadily over those two years, also. A large percentage of the increase in 2003 is attributable to the Ridgeway bank acquisition in July 2002.

The following table presents the average balance sheets, the average yield and the interest earned on earning assets, and the average rate and the interest expense on interest bearing liabilities for the years ended December 31, 2004, 2003, and 2002.

Average Balances, Yields and Rates

	Years Ended December					
	2004			2003		
	Average Balances	Interest Income/ Expense	Yields/ Rates	Average Balances	Interest Income/ Expense	Yie Ra
				(Dollars in thousan		
Assets						
Interest-bearing deposits with other banks	$ 1,086	$ 20	1.84%	$ 990	$ 19	1.9
Investment securities - taxable	49,546	1,518	3.06%	45,488	1,414	3.1
Investment securities - tax exempt (1)	9,201	312	3.39%	9,174	322	3.5
Federal funds sold	16,950	203	1.20%	26,582	279	1.0
Loans, including held for sale (1) (2)	371,061	22,821	6.15%	340,518	22,234	6.5
Total interest earning assets	447,844	24,874	5.55%	422,752	24,268	5.7
Cash and due from banks	15,587			14,452		
Allowance for loan losses	(4,615)			(3,861)		
Premises and equipment	7,327			6,996		
Intangible assets	7,526			7,772		
Other assets	4,041			3,400		
Total assets	$477,710			$451,511		
Liabilities and shareholders' equity						
Interest bearing deposits						
Interest bearing transaction accounts	$ 54,918	$ 225	0.41%	$ 44,481	$ 193	0.4
Savings	80,534	814	1.01%	70,552	766	1.0
Time deposits	190,290	4,263	2.24%	186,502	4,728	2.5
Total interest bearing deposits	325,742	5,302	1.63%	301,535	5,687	1.8
Short-term borrowings	10,309	205	1.99%	29,026	750	2.5
Long-term debt	28,601	1,524	5.33%	20,395	1,123	5.5
Total interest bearing liabilities	364,652	7,031	1.93%	350,956	7,560	2.1
Noninterest-bearing demand deposits	61,220			52,047		
Other liabilities	1,782			2,217		
Shareholders' equity	50,056			46,291		
Total liabilities and shareholders' equity	$477,710			$451,511		

	========		========	
Interest rate spread (3)		3.62%		3.5
Net interest income and net yield on earning assets (4)	$17,843	3.98%	$16,708	3.9

(1) Interest income on tax-exempt loans and investment securities has not been calculated on a tax-equivalent basis.
(2) Nonaccruing loans are included in the average balances and income from such loans is recognized on a cash basis.
(3) Total interest earning assets yield less total interest bearing liabilities rate.
(4) Net yield equals net interest income divided by total interest earning assets.

By year end 2004 compared with 2003, gross loans grew $61,543,000, while deposits grew $44,754,000. Because the growth in deposit liabilities in 2004 has not been sufficient to fund the Corporation's growth in loans, management took several actions. Early in the second quarter of 2004, the Corporation issued approximately $10,000,000 in long-term debt trust preferred securities to enhance the capital positions of some of the banking subsidiaries and to provide a more stable funding source for its mortgage banking operations. As a result, the Corporation reduced its reliance on short-term, relatively high cost borrowings in 2004. The Corporation continues to maintain a short-term line of credit with another financial institution which can be used to fund construction mortgage loan demand. The Corporation also changed its asset allocation such that its investments in federal funds sold and securities available-for-sale decreased significantly by the end of 2004 compared 2003. This also allowed the Corporation to invest significantly more dollars in the higher yielding loan earning asset category.

Time deposits are the largest category of the Corporation's deposit liabilities. Interest rates paid for such liabilities continued to decrease during 2004. Accordingly, total interest expense decreased from $8,119,000 in 2002, to $7,560,000 in 2003 and to $7,031,000 in 2004. The average rates paid for time deposits declined from 3.28% in 2002 to 2.24% in 2004. Recent increases in short-term market rates of interest are expected to cause the Corporation to begin increasing the rates it offers for deposit liabilities. The trust preferred securities were issued with a variable rate, as well. As a result, it is expected that the costs of deposits and other funding sources will increase in 2005.

The table "Volume and Rate Variance Analysis" provides a summary of changes in net interest income resulting from changes in volume and changes in rate. The changes in volume are the difference between the current and prior year's balances multiplied by the prior year's rate. The changes in rate are the difference between the current and prior year's rate multiplied by the prior year's balance.

As reflected in the table, the increases in net interest income during each of the past two years primarily are due to higher volumes of earning assets coupled with reductions in the rates paid on deposit liabilities. Loan growth has been especially prominent in contributing to increases in interest income.

Volume and Rate Variance Analysis

	2004 compared with 2003		
	Volume*	Rate*	Total
			(Dollars
Interest earning assets			
Interest-bearing deposits with other banks	$ 2	$ (1)	$ 1
Investment securities - taxable	124	(20)	104
Investment securities - tax exempt	1	(11)	(10)
Federal funds sold	(111)	35	(76)
Loans, including held for sale	1,924	(1,337)	587
Interest income	1,940	(1,334)	606
Interest bearing liabilities			
Interest bearing deposits			
Interest bearing transaction accounts	43	(11)	32
Savings	103	(55)	48
Time deposits	94	(559)	(465)
Total interest bearing deposits	240	(625)	(385)
Short-term borrowings	(402)	(143)	(545)
Long-term debt	438	(37)	401
Total interest expense	276	(805)	(529)
Net interest income	$ 1,664	$ (529)	$ 1,135

* The rate/volume variance for each category has been allocated on a consistent basis between rate and volume variances based on the percentage of rate or volume variance to the sum of the two absolute variances except in categories having balances in only one period. In such cases, the entire variance is attributed to volume variance.

Although management currently expects that interest rates will increase in 2005, management has not presently identified any factors that it believes might cause interest rates to increase sharply in a short period of time. However, changes in interest rates that can significantly affect the Corporation, positively or negatively, are possible. In the absence of significant changes in market interest rate levels, any significant changes in net interest income during 2005 are expected to result from changes in the volumes of interest earning assets and liabilities. Management expects to continue using its marketing strategies to increase the Corporation's market share of both deposits and quality loans within its market areas. These strategies involve offering attractive interest rates and outstanding customer service.

Provision for Loan Losses

The provision for loan losses is charged to earnings based on management's continuing review and evaluation of the loan portfolio and its estimate of the related allowance for loan losses. Provisions for loan losses totaled $5,102,000, $1,119,000, and $1,033,000 for the years ended December 31, 2004, 2003 and 2002, respectively. The significant increase in the 2004

provision was associated with several large problem commercial loan relationships, most of which were handled by a former lending officer. The other major component of the increase was a writedown on a large commercial loan which financed the purchase of a business. Following the sale the business did not perform at the level expected by the buyer who has charged the seller with fraud. Net charge-offs for 2004 were $4,961,000, compared with $486,000 and $734,000 for 2003 and 2002, respectively. The underlying causes of these problems are believed by management to be isolated and not indicative of a general trend in the loan portfolio. Management continues to monitor these loans and is pursuing all available legal options. See "Impaired Loans," "Potential Problem Loans," "Allowance for Loan Losses," and "The Application of Critical Accounting Policies" for further information and a discussion of the methodology used and the factors considered by management in its estimate of the allowance for loan losses.

Noninterest Income

Noninterest income for 2004 decreased by $1,847,000 or 20.2% from 2003, primarily due to a $2,070,000 or 39.8% decrease in mortgage brokerage income. This decrease resulted from a mortgage-industry-wide slowdown in refinancing activity in 2004. The Corporation inititated measures in 2004 that are intended to decrease the costs and complexity of funding its mortgage brokerage operation. Service charges on deposit accounts were $112,000 lower in 2004 than in 2003, as well. This resulted from a slight decrease in the volume of returned check charges and a slowing in demand for the automated overdraft service. During 2004, gains on the sale of investment securities totaled $76,000 compared with losses of $252,000 in 2003.

Noninterest income for 2003 increased by $1,931,000 or 26.8% over 2002. Service charges on deposit accounts increased by $589,000 or 21.3% due primarily to increased service charges assessed on pre-arranged overdraft protection services. Also, mortgage brokerage income, primarily fees and gains associated with the origination and sale of mortgage loans for home purchases and refinancing of existing loans, was $5,198,000 in 2003, an increase of $1,543,000 or 42.2% over the 2002 amount. The mortgage brokerage subsidiary and Banks generally obtain take-out commitments for mortgage loans originated for resale at the same time that they issue commitments to make loans.

Noninterest Expenses

Noninterest expenses for 2004 decreased by $893,000 or 5.6% from the 2003 amount, primarily due to lower expenses for salaries and employee benefits. Such expenses were reduced because of the decline in mortgage loan originations resulting in less commission expense.

Noninterest expenses for 2003 increased by $3,467,000 or 27.8% over the 2002 amount. Salaries and employee benefits expenses increased by $1,845,000 due primarily to the opening, in February 2003, of a new branch office of the Sumter bank and the commission-driven compensation system employed by the mortgage brokerage subsidiary. Expenses for premises and equipment increased by $360,000 or 24.9% due primarily to the opening of the branch office, higher expenses associated with the rental of office space for the mortgage brokerage subsidiary's operations, and the acquisition and implementation of imaging equipment and software for customer statement rendering and other purposes. Also, other expenses increased by $981,000. Approximately 40% of this increase was directly attributable to twelve months of operation of the Ridgeway bank compared with only six months during 2002. The remaining increases were normal increases associated with the operation of the other banks, the mortgage brokerage subsidiary and the holding company.

Income Taxes

Income tax expense for for 2004 was $1,771,000, a decrease of $1,376,000 or 43.7% from the 2003 amount. Income tax expense for 2003 was $3,147,000, an increase of $227,000 or 7.8% over the 2002 amount. The effective income tax rate (income tax expense divided by income before income taxes) was 35.6%, 35.8%, and 35.1% for 2004, 2003 and 2002, respectively.

INVESTMENT PORTFOLIO

The Corporation's investment portfolio consists primarily of short- and intermediate-term U.S. Treasury and U.S. Government agency debt issues. The acquisition of the Ridgeway bank in 2002 significantly increased the Corporation's tax exempt portfolio. Investment securities averaged $58,747,000 in 2004, $54,662,000 in 2003 and $48,868,000 in 2002.

The table below summarizes the amortized cost and estimated fair value of the Corporation's investment portfolio for the past three years.

Securities Portfolio Composition

	Decemb			
	2004			
	Amortized cost	Estimated fair value	Amortized cost	Es fa
	(Dollars			
Securities available-for sale				
U.S. Treasury and U.S. Government agencies	$50,619	$50,361	$56,633	$
States and political subdivisions	4,985	5,110	8,140	
Total available for sale	$55,604	$55,471	$64,773	$
Securities held-to-maturity				
States and political subdivisions	$ 1,925	$ 1,907	$ 2,000	$

The following is a summary of maturities and weighted average yields of securities as of December 31, 2004:

Securities Portfolio Maturities and Yields

	December 31, 2004					
	Within One Year		After One Year Through Five Years		After Five Years Through Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield

(Dollars in thousands)

U.S Treasury and U.S. Government agencies	$3,742	2.40%	$35,877	2.96%	$ 9,214	3.79%
States and political subdivisions (1) ..	1,100	3.85%	3,014	3.60%	2,921	3.69%
Mortgage-backed securities (2)	-	0.00%	1,514	2.33%	-	0.00%
Total	$4,842	2.73%	$40,405	2.98%	$12,135	3.77%

(1) Yields on tax-exempt securities of states and political subdivisions have not been calculated on a tax-equivalent basis.
(2) Maturity category based on final stated maturity dates. Average maturity is expected to be substantially shorter because of the monthly return of principal on certain securities.

On an ongoing basis, management assigns securities upon purchase into one of two categories (available-for-sale or held-to-maturity) based on intent, taking into consideration other factors including expectations for changes in market rates of interest, liquidity needs, asset/liability management strategies, and capital requirements. The Corporation has never held securities for trading purposes. No transfers of available-for-sale or held-to-maturity securities to other categories were made in any of the years 2002 through 2004.

During 2004, management changed the composition of the securities portfolio, primarily by decreasing the amounts invested in securities throughout the year. Despite investment securities being larger in average amount in 2004, the Corporation's investment in such instruments at December 31, 2004 was $9,468,000 less than at December 31, 2003. Proceeds from sales and calls of investment securities and reductions in federal funds sold have been used, in part, to fund loan growth in excess of the growth in deposits, short-term borrowings and long-term debt.

During the years ended December 31, 2004, 2003 and 2002, the Corporation sold investment securities for gross proceeds of $13,676,000, $2,068,000, and $20,543,000, respectively. Realized gains and (losses) on those transactions were $76,000, ($252,000), and $119,000, for the years ended December 31, 2004, 2003 and 2002, respectively. Securities may be sold to provide liquidity, to reduce interest rate risk, or for other reasons. There were no sales of held-to-maturity securities in any of the periods presented.

All mortgage-backed securities held by the Corporation were issued by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Government National Mortgage Association.

LOAN PORTFOLIO

Management believes the loan portfolio is adequately diversified. There are no significant concentrations of loans in any particular individual, industry or groups of related individuals or industries, and there are no foreign loans.

The following table shows the composition of the loan portfolio by category:

Loan Portfolio Composition

	December		
	2004	2003	200
			(Dollars
Commercial, financial and agricultural	$ 96,275	$ 84,844	$ 78,
Real estate - construction	29,968	23,590	23,
Real estate - mortgage	230,986	188,530	168,
Consumer installment	36,420	35,142	36,
Total loans - gross	$393,649	$332,106	$306,

Risk taking is inherent in the granting of credit. To control the amounts and types of risks incurred, and to minimize losses, management has established loan policies and practices. Such policies and practices include limitations on loan-to-collateral values for various types of collateral, requirements for appraisals of real estate collateral, problem loan management practices, collection procedures, and nonaccrual and charge-off guidelines. On an ongoing basis, management is always seeking ways to better manage risk and improve internal control systems. As part of this continuous process, late in 2004 management began seeking a Chief Credit Officer for the Corporation. This position will have specific loan approval authority over major commercial loan relationships and will assist the subsidiary banks in other areas of loan operation and administration. Management is also expanding the nature and scope of its internal loan review system effective in early 2005.

Commercial, financial, and agricultural loans, primarily representing loans made to small and medium size businesses, may be made on either a secured or an unsecured basis. When taken, security usually consists of liens on inventories, receivables, equipment, and furniture and fixtures. Unsecured business loans are generally short-term with emphasis on repayment strengths and

21

low debt-to-worth ratios. Commercial lending involves significant risk because repayment usually depends on the cash flows generated by a borrower's business, and debt service capacity can deteriorate because of downturns in national and local economic conditions. Management generally controls risks by conducting more in-depth and ongoing financial analysis of a borrower's cash flows and other financial information. Each of the banking subsidiaries has a Loan Committee which is responsible for overseeing the credit granting and monitoring processes.

Real estate loans consist of construction loans and other loans secured by mortgages. Because the Corporation's subsidiaries are community banks, real estate loans comprise the bulk of the loan portfolio. Loan-to-value ratios for real estate loans generally are limited to 80%.

The Banks generally do not compete with 15 and 30 year fixed rate secondary market mortgage interest rates, so they have elected to pursue the origination of mortgage loans that could easily be sold into the secondary

mortgage market. CRM also originates such loans for sale in the secondary market. These loans are generally pre-qualified with various underwriters to facilitate the sales process. In 2004, 2003 and 2002, the Corporation sold $174,074,000, $309,914,000, and $176,011,000 respectively, of such loans. The Corporation's subsidiaries may originate mortgage loans for their own loan portfolios. Such loans are usually for a shorter term than loans originated to sell and usually have a variable rate or reprice within a three to five year term.

Consumer installment loans to individuals are generally for personal, automobile, or household purposes and may be secured or unsecured.

The Corporation has a geographic concentration of loans within the Banks' market areas because of the nature of its business. As of December 31, 2004, the Corporation had no other significant concentrations of credit to customers engaged in similar business activities.

Unsecured Loans

The Corporation does not aggressively seek to make unsecured loans, since these loans may be somewhat more risky than collateralized loans. There are, however, occasions when it is in the business interests of the Corporation to provide short-term, unsecured loans to certain customers. At December 31, 2004, the Corporation had approximately $25,000,000, or 6.4% of its loan portfolio, in unsecured loans. As of December 31, 2003, the Corporation had approximately $25,400,000 in unsecured loans, or 7.6% of its loan portfolio. Such loans are made on the basis of management's evaluation of the customer's ability to repay and net worth.

Maturity and Interest Sensitivity Distribution of Loans

The following table sets forth the maturity distribution of the Corporation's loans, by type, as of December 31, 2004 as well as the type of interest requirement on loans due after one year.

		D
	Within one year	After year but five
		(Dol
Commercial, financial and agricultural	$ 52,449	$ 35,
Real estate	63,317	143,
Consumer installment	8,824	23,
Total	$124,590	$202,
Predetermined rate, maturity greater than one year	$ -	$140,
Variable rate or maturity within one year	$124,590	$ 62,

Impaired Loans

Impaired loans are those loans on which, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans which management has identified as impaired generally are nonaccrual loans. The Corporation had no restructured loans in the past five years. Following is a summary of the Corporation's nonaccrual and other nonperforming loans:

Nonaccrual and Past Due Loans

		Decemb	
	2004	2003	20
		(Dollars in	
Nonaccrual loans	$4,941	$2,595	$
Accruing loans 90 days or more past due	137	146	1
Total	$5,078	$2,741	$2
Total as a % of outstanding loans	1.29%	0.83%	
Impaired loans (included in non accrual)	$4,941	$2,595	$

As of December 31, 2004, approximately $2,434,000, or 49%, of the Corporation's nonaccrual loans consisted of the balances of one loan relationship, net of a partial charge-off of $1,001,000. Problems with information supplied by a third party supporting an appraisal underlying this credit were discovered in the fourth quarter of 2004. Approximately $1,093,000, or 22% of nonaccrual loans, represents the remaining loan balances included in a former lending officer's portfolio, net of partial charge-offs of $1,200,000. Management became aware of possible problems in the former officer's portfolio during the third quarter of 2004. As of December 31, 2003, approximately $1,350,000, or 52%, of the Corporation's nonaccrual loans consisted of one loan relationship. During the first quarter of 2004, the Corporation collected all amounts due under this credit.

Gross income that would have been recorded for the years ended December 31, 2004, 2003 and 2002, if nonaccrual loans had been performing in accordance with their original terms was approximately $63,000, $117,000 and $39,000, respectively. No cash basis interest income was recognized in 2004, 2003 and 2002 on non-accrual loans.

The Corporation's accounting policies on nonaccrual and impaired loans are discussed in Note 2 to the consolidated financial statements.

Nonaccrual loans and impaired loans were not material in relation to the portfolio as a whole in 2004. Management is aware of no trends, events or uncertainties that would cause a material adverse change in nonaccrual loans in 2005.

Potential Problem Loans

At December 31, 2004 the Corporation's internal loan review process had identified $4,628,000 (1.2% of the portfolio) in various loans, not including loans identified as nonaccrual or 90 days past due and still accruing loans

shown above, where information about credit problems of borrowers had caused management to have doubts about the ability of the borrowers to comply with original repayment terms. The amount identified does not represent management's estimate of the potential losses since a large portion of these loans are secured by real estate and other collateral.

Other Real Estate

Other real estate, consisting of foreclosed properties, was $252,000, $327,000, and $219,000 as of December 31, 2004, 2003 and 2002, respectively. Other real estate is initially recorded at the lower of net loan balance or the property's estimated fair value, net of estimated disposal costs. The estimate of fair value for other real estate is determined by appraisal at the time of acquisition.

ALLOWANCE FOR LOAN LOSSES

The table, "Analysis of the Allowance for Loan Losses," summarizes loan balances as of the end of each period indicated, averages for each period, changes in the allowance arising from mergers, charge-offs and recoveries by loan category, and additions to the allowance which have been charged to expense.

The allowance for loan losses is increased by the provision for loan losses, which is a direct charge to expense. Losses on specific loans are charged against the allowance in the period in which management determines that such loans become uncollectible. Recoveries of previously charged-off loans are credited to the allowance. See "The Application of Critical Accounting Policies - Provision and Allowance for Loan Losses."

Analysis of the Allowance for Loan Losses

	Years Ended D		
	2004	2003	200
	(Dollars in		
Total amount of loans outstanding at end of year	$393,649	$332,106	$306
Average amount of loans outstanding	$371,061	$340,518	$281
Allowance for loan losses - January 1	$ 4,206	$ 3,573	$ 2
Changes incident to merger activities	-	-	
Loans charged-off			
Real estate	1,293	250	
Installment	387	247	
Credit cards and related plans	-	-	
Commercial and other	3,400	163	
Total charge-offs	5,080	660	

Recoveries			
Real Estate	21	105	
Installment	67	58	
Credit cards and related plans	-	-	
Commercial and other	31	11	
Total recoveries	119	174	
Net charge-offs	4,961	486	
Provision for loan losses charged to expense	5,102	1,119	1
Allowance for loan losses - December 31	$ 4,347	$ 4,206	$ 3
Ratios			
Net charge-offs to average loans outstanding	1.34%	0.14%	
Net charge-offs to loans outstanding at end of year	1.26%	0.15%	
Allowance for loan losses to average loans	1.17%	1.24%	
Allowance for loan losses to total loans at end of year	1.10%	1.27%	
Net charge-offs to allowance for losses	114.12%	11.55%	2
Net charge-offs to provision for loan losses	97.24%	43.43%	7

The Corporation operates four independent community banks in South Carolina. Under the provisions of law and regulations governing banks, each bank's board of directors is responsible for determining the adequacy of its bank's loan loss allowance. In addition, each bank is supervised and regularly

examined by the Office of the Comptroller of the Currency (the "OCC") (or the South Carolina State Board of Financial Institutions (the "State Board") in the case of the Ridgeway bank) or the Federal Deposit Insurance Corporation (the "FDIC"). As a normal part of a safety and soundness examination, bank examiners assess and comment on the adequacy of a bank's allowance for loan losses and may require that changes be made in the allowance. The allowance presented in the consolidated financial statements is on an aggregated basis and as such might differ from the allowance that would be presented if the Corporation had only one banking subsidiary.

The nature of community banking is such that the individual loan portfolios are predominantly composed of small and medium size business and individual loans. As community banks, there exists, by definition, a geographic concentration of loans within each Bank's respective city or county. Management at each bank monitors the loan concentrations and loan portfolio quality on an ongoing basis including, but not limited to: quarterly analysis of loan concentrations, monthly reporting of past dues, nonaccruals, and watch loans, and quarterly reporting of loan charge-offs and recoveries. These efforts focus on historical experience and are bolstered by quarterly analysis of local and state economic conditions, which are part of the Banks' assessment of the adequacy of their allowances for loan losses.

DEPOSITS

The average deposits for the Corporation for the years ended December 31, 2004, 2003 and 2002 are summarized below:

Average Deposits

	Years Ended Decemb			
	2004		2003	
	Average balance	Average cost	Average balance	Av c
			(Dollars in thous	
Noninterest-bearing demand	$ 61,220	-	$ 52,047	
Interest bearing transaction accounts	54,918	0.41%	44,481	0
Savings - regular	20,106	0.54%	20,998	0
Savings - money market	60,428	1.17%	49,554	1
Time deposits less than $100	122,125	2.26%	122,488	2
Time deposits greater than $100	68,165	2.20%	64,014	2
Total average deposits	$ 386,962		$ 353,582	

Deposits are the primary source of funds for the Banks' lending and investing activities. Deposits are attracted principally from customers within the Banks' local market areas through the offering of a variety of products with varying features and by offering competitive interest rates.

At December 31, 2004 the Corporation had $86,344,000 in certificates of deposit of $100,000 or more. Approximately $26,040,000 mature within three months, $16,542,000 mature over three through six months, $25,944,000 mature over six months through twelve months and $17,818,000 mature after one year. This level of large time deposits, as well as the growth in other deposits, can be attributed to planned growth by management. The majority of time deposits $100,000 and over is acquired within the Company's market areas in the ordinary course of business from customers with standing banking relationships. It is a common industry practice not to consider time deposits of $100,000 or more as core deposits since their retention can be influenced heavily by rates offered. Therefore, such deposits have the characteristics of shorter-term purchased funds. Certificates of deposit $100,000 and over require that the Corporation achieve and maintain an appropriate matching of maturity distributions and a diversification of sources to achieve an appropriate level of liquidity.

SHORT-TERM BORROWINGS

The Corporation's short-term borrowings may consist of federal funds purchased and securities sold under agreements to repurchase, which generally have maturities ranging from daily to no more than ninety days, and mortgage loan warehouse and general purpose lines of credit payable. As of December 31, 2004, securities sold under agreements to repurchase totaled $4,979,000. These

amounts are secured by pledges of investment securities and the interest rate is subject to change daily. Federal funds purchased totaled $1,683,000 as of December 31, 2004 and are unsecured and mature on a daily basis. No amounts were outstanding under warehouse lines of credit as of December 31, 2004.

Summary information about total short-term borrowings is provided in the following table.

	2004
Balance outstanding at end of year	$ 6,662
Weighted average interest rate at end of the period	1.54%
Interest expense	$ 205
Maximum outstanding at any month-end during the period	$17,940
Average outstanding during the period	$10,309
Weighted average interest rate during the period	1.99%

(

LONG-TERM DEBT

The Corporation's banking subsidiaries are members of the Federal Home Loan Bank of Atlanta ("FHLB"). As such, they have access to long-term borrowing from the FHLB. As of December 31, 2004, the Banks had borrowed a total of $20,263,000 from the FHLB. The borrowings are secured by blanket liens on all qualifying first lien residential mortgage loans held by the Banks, specifically excluding such loans originated for resale on the secondary market.

Early in the second quarter of 2004, the Corporation sponsored the creation of SCB Capital Trust 1 (the "Trust"). The Trust issued trust preferred debt securities totaling $10,310,000. The Trust invested the proceeds of its debt issuance by purchasing a like amount of subordinated debentures issued by the Corporation. The amount of the Corporation's debt is includible in Tier 1 capital for purposes of computing regulatory required capital ratios.

RETURN ON EQUITY AND ASSETS

The following table shows the return on assets (net income divided by average total assets), return on equity (net income divided by average equity), dividend payout ratio (dividends declared per share divided by net income per share), and equity to assets ratio (average equity divided by average total assets) for the years ended December 31, 2004, 2003 and 2002.

	Years Ended December 31,		
	2004	2003	2002
Return on assets (ROA)	0.67%	1.25%	1.43%
Return on equity (ROE)	6.41%	12.17%	15.10%
Dividend payout ratio	54.05%	27.48%	22.54%
Equity as a percent of assets	10.48%	10.25%	9.46%

LIQUIDITY

Liquidity is the ability to meet current and future obligations through liquidation or maturity of existing assets or the acquisition of additional

liabilities. Adequate liquidity is necessary to meet the requirements of customers for loans and deposit withdrawals in a timely and economical manner. The most manageable sources of liquidity are composed of liabilities, with the primary focus of liquidity management being on the ability to attract deposits within the Banks' market areas. Core deposits (total deposits less certificates of deposit of $100,000 or more) provide a relatively stable funding base. Certificates of deposit of $100,000 or more are generally more sensitive to changes in rates, so they must be monitored carefully. Asset liquidity is provided by several sources, including amounts due from banks, federal funds sold, and investments available-for-sale.

The Corporation maintains an available-for-sale investment securities portfolio. While investment securities purchased for this portfolio are generally purchased with the intent to be held to maturity, such securities are marketable and occasional sales may occur prior to maturity as part of the process of asset/liability and liquidity management. The Corporation also occasionally designates securities as held-to-maturity. Securities in this portfolio are generally not considered a primary source of liquidity. Management deliberately maintains a relatively short-term maturity schedule for its investments so that there is a continuing stream of maturing investments. The Corporation intends to maintain a relatively short-term investment portfolio in order to continue to be able to supply liquidity to its loan portfolio and for customer withdrawals.

The Corporation has substantially more liabilities maturing in the next 12 months than it has assets maturing in the same period. The Corporation also has legal obligations to extend credit pursuant to loan commitments, lines of credit and standby letters of credit which totaled $11,644,000, $43,312,000, and $2,919,000, respectively, at December 31, 2004 (see Note 15 to the consolidated financial statements). However, based on its historical experience, and that of similar companies, the Corporation believes that it is unlikely that so many deposits would be withdrawn, without being replaced by other deposits, and extensions of credit would be required, that the Corporation would be unable to meet its liquidity needs with the proceeds of maturing assets, in the ordinary course of business.

The Corporation also maintains various federal funds lines of credit with correspondent banks and is able to borrow from the Federal Home Loan Bank of Atlanta and the Federal Reserve's discount window.

The Corporation, through its Banks, has a demonstrated ability to attract deposits from its market area. Deposits grew from $218,811,000 as of December 31, 2000 to $423,458,000 as of December 31, 2004. This consistently growing base of deposits is the major source of operating liquidity.

In the opinion of management, the current and projected liquidity position is adequate.

CAPITAL

Dividends

The Corporation exists as a legal entity distinct from its subsidiaries. Its main sources of revenues consist of service fees and dividends paid to it by the Banks. The Banks are subject to various laws and regulations that limit the amounts of dividends that they may pay. In addition, the Corporation and the Banks are each subject to regulatory minimum capital

adequacy guidelines. These regulatory restrictions have not historically hindered the Corporation's or the Banks' ability to pay reasonable dividends and no such future restrictions are anticipated. During the year ended December 31, 2004, the Corporation received dividends from the Banks totaling $2,679,000. Subject to restrictions imposed by state laws and federal regulations, the Boards of Directors of the Banks could have declared additional dividends from their retained earnings of up to approximately $7,961,000 as of December 31, 2004.

Capital Adequacy

The Federal Reserve and federal bank regulatory agencies have adopted risk-based capital standards for assessing the capital adequacy of bank holding companies and financial institutions. Under the risk-based capital requirements, the Corporation and each of the Banks are required to maintain a minimum ratio of capital to risk-weighted assets (including certain off-balance-sheet activities, such as letters of credit) of 8%. At least half of total capital must be composed of common equity, retained earnings and qua