COMMUNITY BANKSHARES INC /SC/
Form 10-Q
August 11, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2005 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, South Carolina 29115

(Address of principal executive offices, zip code)

(803) 535-1060

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, no par or stated value, 4,404,303 shares outstanding on August 2, 2005.

COMMUNITY BANKSHARES, INC.

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

COMMUNITY BANKSHARES, INC.
Consolidated Balance Sheets

Assets

Cash and due from banks ....
Federal funds sold ....

Total cash and cash equivalents ....
Interest bearing deposits with other banks ....
Securities available-for-sale ....

Securities held-to-maturity (estimated fair value $1,912 for 2005 and $1,907 for 2004) ....
Other investments ....
Loans held for sale ....
Loans receivable ....
Less, allowance for loan losses ....

Net loans ....
Premises and equipment - net ....
Accrued interest receivable ....
Net deferred income tax assets ....
Goodwill ....
Core deposit intangible assets ....
Prepaid expenses and other assets ....

Total assets ....

Liabilities
Deposits
Noninterest bearing ....
Interest bearing ....

Total deposits ....
Short-term borrowings ....
Long-term debt ....
Accrued interest payable ....
Accrued expenses and other liabilities ....

Total liabilities ....

Shareholders' equity
Common stock - no par value;12,000,000 shares authorized; issued and outstanding - 4,404,303 for 2005 and 4,390,784 for 2004 ....
Retained earnings ....
Accumulated other comprehensive income (loss) ....

Total shareholders' equity ....

Total liabilities and shareholders' equity ....

See accompanying notes to unaudited consolidated financial statements.

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COMMUNITY BANKSHARES, INC.
Consolidated Statements of Income

Period

Three Months

	2005	2004
	(Dollars in tho	
Interest and dividend income		
Loans, including fees	$ 7,124	$ 5,449
Interest bearing deposits with other banks	11	4
Debt securities	432	409
Dividends	34	19
Federal funds sold	95	47
Total interest and dividend income	7,696	5,928
Interest expense		
Deposits		
Time deposits $100M and over	630	323
Other deposits	1,361	895
Total interest expense on deposits	1,991	1,218
Short-term borrowings	44	64
Long-term debt	468	380
Total interest expense	2,503	1,662
Net interest income	5,193	4,266
Provision for loan losses	585	258
Net interest income after provision	4,608	4,008
Noninterest income		
Service charges on deposit accounts	853	822
Mortgage loan brokerage income	937	903
Net securities gains or (losses)	-	(1
Other	254	207
Total noninterest income	2,044	1,931
Noninterest expenses		
Salaries and employee benefits	2,334	2,225
Premises and equipment	550	473
Other	1,341	1,077
Total noninterest expenses	4,225	3,775
Income before income taxes	2,427	2,164
Income tax expense	876	769
Net income	$ 1,551	$ 1,395
Per share		
Net income	$ 0.35	$ 0.32
Net income - diluted	0.35	0.31
Cash dividends declared	0.10	0.10

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.
Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

	Common Stock		
	Number of Shares	Amount	Reta Earn
	(Dollars in tho		
Balance, January 1, 2004	4,331,460	$ 29,402	$ 18
Comprehensive income:			
Net income	-	-	2
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $330	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $2	-	-	
Total other comprehensive income	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	27,777	323	
Cash dividends declared, $.20 per share	-	-	
Balance, June 30, 2004	4,359,237	$ 29,725	$ 20
Balance, January 1, 2005	4,390,784	$ 30,042	$ 20
Comprehensive income:			
Net income	-	-	2
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $118	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $3	-	-	
Total other comprehensive income (loss)	-	-	
Total comprehensive income	-	-	

Exercise of employee stock options	12,744	146	
Sale of common stock	775	14	
Cash dividends declared, $.20 per share	-	-	
Balance, June 30, 2005	4,404,303	$ 30,202	$ 22

See accompanying notes to unaudited consolidated financial statements.

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COMMUNITY BANKSHARES, INC.
Consolidated Statements of Cash Flows

Operating activities

Net income
Adjustments to reconcile net income to net cash provided by operating activities
Provision for loan losses
Depreciation and amortization
Net amortization of securities
Net losses on sales of securities
Proceeds of sales of loans held for sale
Originations of loans held for sale
(Increase) decrease in accrued interest receivable
Decrease (increase) in other assets
Gains on sales of other real estate
Increase in accrued interest payable
Increase in other liabilities

Net cash provided by operating activities

Investing activities
Net decrease in interest bearing deposits with other banks
Purchases of available-for-sale securities
Maturities, calls and paydowns of available-for-sale securities
Proceeds of sales of available-for-sale securities
Net purchases of other investments
Net increase in loans made to customers
Purchases of premises and equipment
Proceeds from sales of other real estate

Net cash used by investing activities ....

Financing activities

Net increase in deposits ....

Net increase (decrease) in short-term borrowings ....

Proceeds from issuing long-term debt ....

Repayment of long-term debt ....

Exercise of employee stock options ....

Sale of common stock ....

Cash dividends paid ....

Net cash provided by financing activities ....

Increase (decrease) in cash and cash equivalents ....

Cash and cash equivalents, beginning of period ....

Cash and cash equivalents, end of period ....

Supplemental Disclosures of Cash Flow Information

Cash payments for interest ....

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Transfers of loans receivable to other real estate ....

Transfer to net deferred income tax assets from prepaid current income taxes ....

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.

Notes to Unaudited Consolidated Financial Statements

Accounting Principles - A summary of significant accounting policies and the audited financial statements for 2004 are included in Community Bankshares, Inc.'s (the "Company" or "CBI") Annual Report on Form 10-K for the year ended December 31, 2004.

Management Opinion - The interim financial statements in this report are unaudited. In the opinion of management, all the adjustments necessary to present a fair statement of the results for the interim period have been made. Such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of the results to be expected for an entire year. These interim financial statements should be read in conjunction with the annual financial statements and notes thereto contained in the 2004 Annual Report on Form 10-K.

Nonperforming Loans - As of June 30, 2005, there were $5,259,000 in nonaccrual loans and $343,000 of loans 90 or more days past due and still accruing interest.

Earnings Per Share - Basic earnings per share is computed by dividing net income

applicable to common shares by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing applicable net income by the weighted average number of shares outstanding and any dilutive potential common shares and dilutive stock options. It is assumed that all dilutive stock options are exercised at the beginning of each period and that the proceeds are used to purchase shares of the Company's common stock at the average market price during the period. Net income per share and net income per share, assuming dilution, were computed as follows:

	(Una	
	Period E	
	Three Months	
	2005	2004
	(Dollars in thousands, e	
Net income per share, basic		
Numerator - net income	$ 1,551	$ 1,395
Denominator		
Weighted average common shares issued and outstanding	4,404,045	4,348,905
Net income per share, basic	$ .35	$ .32
Net income per share, assuming dilution		
Numerator - net income	$ 1,551	$ 1,395
Denominator		
Weighted average common shares issued and outstanding	4,404,045	4,348,905
Effect of dilutive stock options	100,142	112,304
Total shares	4,504,187	4,461,209
Net income per share, assuming dilution	$ .35	$ .31

Stock Based Compensation - On April 14, 2005, the Securities and Exchange Commission adopted a rule amending the compliance date for the adoption of Statement of Accounting Standards No. 123(R) until the first interim or annual reporting period of the registrant's first fiscal year beginning on or after June 15, 2005. The Company has elected to continue using the methodology of Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees," to account for compensation expenses related to stock-based compensation. Options issued under the Company's plans have no intrinsic value at the grant date and no compensation cost is recognized in accordance with APB No. 25. Statement of Financial Accounting Standards No. 123

("SFAS No. 123"), "Accounting for Stock-Based Compensation," requires entities to provide pro forma disclosures of net income, and earnings per share, as if the fair value based method of accounting promulgated by that standard had been applied. The Company has adopted and intends to continue using the disclosure provisions of SFAS No. 123, as amended, until the required adoption of the provisions of SFAS 123(R) on January 1, 2006. Had compensation cost for the Company's stock option plan been determined based on the fair value as of the grant dates for awards under the plans consistent with the method prescribed by SFAS No. 123, the Company's net income and earnings per share would have been adjusted to the pro forma amounts indicated below:

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	(Period	
	Three Months	
	2005	2004
	(Dollars in thousands	
Net income, as reported	$ 1,551	$ 1,395
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of any related tax effects	49	214
Pro forma net income	$ 1,502	$ 1,181
Net income per share, basic		
As reported	$ 0.35	$ 0.32
Pro forma	0.34	0.27
Net income per share, assuming dilution		
As reported	$ 0.35	$ 0.31
Pro forma	0.33	0.26

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (R), which requires that the costs resulting from all share based payment transactions be recognized in the financial statements. SFAS 123 (R) replaces SFAS 123 and supersedes APB No. 25, as well as several other related pronouncements. As originally issued, SFAS 123 (R) is effective as of the beginning of the first interim or annual period beginning after June 30, 2005. The Company originally stated in its Form 10-K filed for the period as of and ending December 31, 2004 that it would adopt the provisions of SFAS 123 (R) as required. The Securities and Exchange Commission ("SEC") issued, effective April 21, 2005, an "Amendment to Rule 4-01(a) of Regulation S-X Regarding the Effective Date for Statement of Financial Accounting Standards No. 123 (Revised 2004), Share Based Payment." This amendment changes the required SFAS 123 (R) compliance date for registrants that are not small business issuers to the beginning of the first interim or annual reporting period of the registrant's first fiscal year beginning on or after June 15, 2005. Early adoption is permitted. For CBI, this amendment has the effect of delaying the required implementation of the provisions of SFAS 123 (R) until the first quarter of 2006. CBI now intends to adopt the provisions of SFAS 123 (R) as of January 1, 2006.

Variable Interest Entity - On March 8, 2004, CBI sponsored the creation of a Variable Interest Entity ("VIE"), SCB Capital Trust I (the "Trust"), and is the sole owner of the common securities issued by the Trust. On March 10, 2004, the Trust issued $10,000,000 in floating rate capital securities. The proceeds of this issuance, and the amount of CBI's capital investment, were used to acquire $10,310,000 principal amount of CBI's floating rate junior subordinated deferrable interest debt securities ("Debentures") due April 7, 2034, which securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, was established initially at 3.91% and is adjustable quarterly at 3 month LIBOR plus 280 basis points. The index rate (LIBOR) may not be lower than 1.11%. CBI may defer interest payments on the Debentures for up to twenty consecutive quarters, but not beyond the stated maturity date of the Debentures. In the event that such interest payments are deferred by CBI, the Trust may defer distributions on the common securities. In such an event, CBI would be restricted in its ability to pay dividends on its common stock and to perform under other obligations that are not senior to the junior subordinated Debentures.

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The Debentures are redeemable at par at the option of CBI, in whole or in part, on any interest payment date on or after April 7, 2009. Prior to that date, the Debentures are redeemable at 105% of par upon the occurrence of certain events that would have a negative effect on the Trust or that would cause it to be required to be registered as an investment company under the Investment Company Act of 1940 or that would cause trust preferred securities not to be eligible to be treated as Tier 1 capital by the Federal Reserve Board. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of trust preferred securities and trust common securities. The Trust's obligations under the trust preferred securities are unconditionally guaranteed by CBI.

The Company's investment in the Trust is carried at cost in other assets and the debentures are included in long-term debt in the consolidated balance sheet.

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

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 of the words "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "projects," and similar expressions. The Company's expectations, beliefs, estimates and projections are expressed in good faith and are believed by the Company to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in the Company'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 Company cautions readers that forward-looking statements, including without limitation, those relating to the Company'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 Company's reports filed with the Securities and Exchange Commission. The Company 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 Quartertly Report on Form 10-Q and in any documents incorporated into this Form 10-Q 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-Q or the accompanying materials.

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Critical Accounting Policies

CBI has adopted various accounting policies, which govern the application of accounting principles generally accepted in the United States of America in the preparation of CBI's financial statements. The significant accounting policies of CBI are described in detail in the notes to CBI's audited consolidated financial statements included in CBI's Annual Report on Form 10-K.

Certain accounting policies involve significant judgments and estimates by management, which have a material impact on the carrying value of certain assets and liabilities. Management considers such accounting policies to be critical accounting policies. The judgments and estimates used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of operations of CBI.

CBI is a holding company for four community banks and a mortgage company and, as a financial institution, believes the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of its consolidated financial statements. Refer to the sections "The Application of Critical Accounting Policies," "Allowance for Loan Losses" and "Provision for Loan Losses" in the Annual Report on Form 10-K for 2004 for a detailed description of CBI's estimation process and methodology related to the allowance for loan losses.

CHANGES IN FINANCIAL CONDITION

During the six months ended June 30, 2005, loans increased by $20,226,000, or 5.1%, over the amount as of December 31, 2004. This increase was funded primarily by increases in interest bearing deposits totaling $12,912,000 and additional short-term and long-term borrowings totaling $4,202,000.

RESULTS OF OPERATIONS

Earnings Performance

Three Months Ended June 30, 2005 and 2004

For the quarter ended June 30, 2005, CBI earned consolidated net income of $1,551,000, compared with $1,395,000 for the comparable period of 2004. This represents an increase of $156,000 or 11.2%. Basic earnings per share were $.35 in the 2005 period, compared with $.32 for the 2004 quarter. Diluted earnings per share were $.35 for the 2005 period and $.31 for the 2004 period.

Operating results for the second quarter of 2005 were positively affected primarily by an increase in net interest income caused by strong loan growth and increasing yields. Deposit growth was significantly less than loan growth during the 2005 second quarter. The Company uses a combination of short-term and long-term debt to fund the difference between loan growth and deposit growth. The Company's normal liquidity, comprised of deposit

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liabilities, short-term and long-term debt issuances and proceeds from sales of loans originated for sale, continues to be sufficient to fund demand for new loans.

Increases in the provision for loan losses and noninterest expenses partially offset the gains made in net interest income and noninterest income. The provision for loan losses continues to be affected by several loans which have not performed as agreed and by the significant growth in the Company's loan portfolio. During the second quarter of 2005, net charge-offs were $495,000 compared with net charge-offs of $178,000 during the same period of 2004. Growth in the amount of potential problem loans was also a factor contributing to the increased provision for loan losses.

Noninterest expenses increased in part because of changes in the corporate management structure designed to enhance controls and risk management activities particularly in the lending function, and to meet the increased corporate governance responsibilities placed on public companies by the Sarbanes-Oxley Act of 2002. In addition, in January of 2005, the Florence National Bank subsidiary opened a branch office, contributing further to increased noninterest expenses in the 2005 periods.

Summary Inc

(Dollars i

For the Three Months Ended June 30,	2005	2004
Interest income	$7,696	$5,928
Interest expense	2,503	1,662
Net interest income	5,193	4,266
Provision for loan losses	585	258
Noninterest income	2,044	1,931
Noninterest expenses	4,225	3,775
Income tax expense	876	769
Net income	$1,551	$1,395

Six Months Ended June 30, 2005 and 2004

CBI's consolidated net income for the six months ended June 30, 2005 was positively affected by increased levels of net interest income, primarily related to increased loan volumes and yields. A significant proportion of the banking subsidiaries' loan portfolios are made up of variable rate loans, which have repriced favorably several times during 2005. The prime rate, which is the index to which most of those variable rate loans are related, has increased four times and 100 basis points during 2005, and nine times and 225 basis points since June 30, 2004. The provision for loan losses and noninterest expenses negatively affected results for the 2005 year-to-date period for the same reasons discussed above for the second quarter.

Summary Inc

(Dollars i

For the Six Months Ended June 30,	2005	2004
Interest income	$14,847	$11,836
Interest expense	4,719	3,302
Net interest income	10,128	8,534
Provision for loan losses	1,035	491
Noninterest income	3,811	3,777
Noninterest expenses	8,344	7,507
Income tax expense	1,649	1,533
Net income	$ 2,911	$ 2,780

Net Interest Income

Net interest income is the amount of interest income earned on interest earning assets (primarily loans, securities, interest bearing deposits with other banks, and federal funds sold), less the interest expense incurred on interest bearing liabilities (interest bearing deposits and other borrowings), and is the principal source of the Company's earnings. Net interest income is affected by the level of interest rates, volume and mix of interest earning assets and interest bearing liabilities and the relative funding of those assets.

Interest income increased by $1,768,000, or 29.8%, in the 2005 second quarter compared with the same 2004 period. Interest and fees on loans increased to $7,124,000 for the 2005 quarter from $5,449,000 for the same period of 2004, primarily due to higher levels of commercial, consumer and mortgage lending activity and the higher interest rate environment in the 2005 period. Amounts of interest earned on other categories of interest earning assets also increased due to increases in the average yields earned on those assets resulting from increasing market rates of interest during the 2005 period.

Interest expense for the second quarter of 2005 increased to $2,503,000 from $1,662,000 for the 2004 period as a result of larger average amounts of time deposits and higher interest rates paid in the 2005 period. Interest expense associated with long-term debt increased in the 2005 three month period to $468,000 from $380,000 for the same period of 2004 primarily due to

contractual changes in the variable interest rates paid for such borrowings.

Interest income for the six months ended June 30, 2005 increased by $3,011,000, or 25.4% from the same period of 2004, due to increases in interest rates and a 19.7% increase in the average amount of loans outstanding. Interest and fee income on loans for the 2005 six month period was $13,738,000, an increase of $2,958,000 or 27.4% over the same period of 2004. Interest income from other earning assets categories during the 2005 six-month period were slightly higher than in the same period of 2004 primarily due to a 170 basis point increase in the rate earned on federal funds sold.

Interest expense for the 2005 six month period was $1,417,000 higher than in the same 2004 period due to higher rates paid for deposits and significantly higher average amounts of interest bearing time deposits in the 2005 period. Higher deposit rates primarily are attributable to the higher interest rate environment in 2005. Average short-term borrowings decreased, and long-term debt increased, for the 2005 period, primarily as a result of the Company's issuance of $10,000,000 of long-term subordinated debentures in March 2004.

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During the first quarter of 2004, CBI sponsored the creation of a Trust that issued $10,000,000 in trust preferred securities. The Trust invested the proceeds of this issuance and $310,000 of capital provided by CBI into $10,310,000 of junior subordinated debentures due in 2034 ("Debentures") issued by CBI. Interest payments on the Debentures are due quarterly at a variable interest rate. CBI used the proceeds of the Debentures to repay certain pre-existing debt obligations, to enhance the capital position of two of the subsidiary banks, to provide an additional funding mechanism for its mortgage loan brokerage activities, and for other general corporate purposes. Under current regulatory guidelines, the trust preferred securities issued by the Trust are includible in the Company's Tier 1 capital for risk-based capital purposes.

Average Balances,
Six Months End

	2005		
	Average Balances	Interest Income / Expense	Yields / Rates *
	(Dollars in tho		
Assets			
Interest earning deposits	$ 665	$ 19	5.71%
Investment securities - taxable	51,264	817	3.19%
Investment securities - tax exempt	6,535	110	3.37%
Federal funds sold	12,336	163	2.64%
Loans, including loans held for sale	420,422	13,738	6.54%
Total interest earning assets	491,222	14,847	6.04%
Cash and due from banks	15,897		
Allowance for loan losses	(4,890)		
Premises and equipment, net	7,820		
Intangible assets	7,341		

Other assets	4,185		
Total assets	$ 521,575		
Liabilities and shareholders' equity			
Interest bearing deposits			
Savings	$ 88,899	$ 627	1.41%
Interest bearing transaction accounts	61,724	192	0.62%
Time deposits	213,048	2,907	2.73%
Total interest bearing deposits	363,671	3,726	2.05%
Short-term borrowings	8,390	87	2.07%
Long-term debt	32,329	906	5.60%
Total interest bearing liabilities	404,390	4,719	2.33%
Noninterest bearing demand deposits	64,266		
Other liabilities	1,955		
Shareholders' equity	50,964		
Total liabilities and shareholders' equity	$ 521,575		
Interest rate spread			3.71%
Net interest income and net yield on earning assets		$10,128	4.12%

* Yields and rates are annualized.

Provision and Allowance for Loan Losses

The provision for loan losses for the 2005 three month period was $585,000, an increase of $327,000, or 126.7%, from $258,000 for the same period of 2004. The provision for loan losses increased to $1,035,000 for the 2005 six month period from $491,000 for the 2004 six month period, an increase of $544,000 or 110.8%. Ongoing developments associated with a few large problem loans continue to affect the Company's allowance and provision for loan losses negatively. Management continues to use new information about these loans to refine its estimates of the loans' ultimate collectibility and the adequacy of its loan loss allowance.

Net charge-offs during the six months ended June 30, 2005 were $570,000, compared with $412,000 for the same period of 2004. The allowance for loan losses as of June 30, 2005 was 1.16% of loans outstanding, compared with 1.10% as of December 31, 2004 and 1.21% as of June 30, 2004. Non-performing loans totaled $5,602,000 as of June 30, 2005, compared with $5,078,000 as of December 31, 2004, an increase of $524,000 or 10.3%. The coverage ratio (allowance for loan losses divided by non-performing loans) was .86x as of both June 30, 2005 and December 31, 2004.

The activity in the allowance for loan losses is summarized in the following table:

	Six Months Ended June 30, 2005
	(Do
Allowance at beginning of period	$ 4,347
Provision for loan losses	1,035
Net charge-offs	(570)
Allowance at end of period	$ 4,812
Allowance as a percentage of loans outstanding	1.16%
Loans at end of period	$ 413,875

Following is a summary of non-performing loans as of June 30, 2005 and December 31, 2004:

	June 30, 2005	December 31, 2004
	(Dollars in thousands)	
Non-performing loans		
Nonaccrual loans	$5,259	$4,941
Past due 90 days or more and still accruing	343	137
Total	$5,602	$5,078
Nonperforming loans as a percentage of loans outstanding	1.35%	1.29%

Included in nonaccrual loans as of June 30, 2005, is one loan relationship totaling $2,444,000, or 46.5% of nonaccrual loans. This relationship originated in 2004 to finance the borrower's purchase of a

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business. The business did not perform as expected and the borrower subsequently discovered problems with information supporting an appraisal of the business. Because of deterioration of the borrower's financial condition, proceeds from the sale of the business are expected to be the primary source of repayment. During the fourth quarter of 2004, a partial charge-off of $1,001,000 was recorded. The borrower is cooperating with management to maximize ultimate collection by actively pursuing sale of the business as an operating concern. If the business cannot be sold for a sufficient price within a reasonable period of time, further write-downs might be necessary which could decrease net income. Approximately $367,000 of the allowance for loan losses is allocated to this credit as of June 30, 2005.

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. On an ongoing basis, management seeks to better manage risk and improve internal control systems. As part of this continuous process, management hired a Chief Credit Officer for the Corporation

in the second quarter of 2005. This officer has specific loan approval authority over major loan relationships and also assists the subsidiary banks and mortgage company in other areas of loan operations and administration. Also, during the second quarter of 2005, management changed its outside independent loan review provider.

The new loan review firm is in the process of conducting a comprehensive review of the major credits in the Corporation's loan portfolio. Based on that review, which was substantially completed in early August, the Corporation had identified $17 to $18 million in loans, approximately 4%, of the loan portfolio, as potential problem loans where information about credit attributes of borrowers had caused management to have more than normal concern 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 or could be repaid under different terms. This is an increase of approximately $12 to $13 million over the amount identified as of December 31, 2004 by the previous loan review process.

Management will continue to monitor the levels of non-performing loans and address the weaknesses in these credits to enhance the ultimate collection or recovery of these assets. Management considers the levels and trends in non-performing assets and potential problem loans in determining how the provision and allowance for loan losses is estimated and adjusted. In the opinion of management, the Corporation's allowance for loan losses at June 30, 2005 is adequate to provide for losses that may be inherent in the loan portfolio.

Noninterest Income

Noninterest income for the 2005 second quarter increased $113,000, or 5.9%, over the $1,931,000 reported for the same 2004 period. Mortgage loan brokerage income for the 2005 quarter increased by $34,000, or 3.8%, over the

$903,000 in the 2004 period. Service charge income totaled $853,000 in the 2005 quarter, an increase of $31,000, or 3.8%.

For the six months ended June 30, 2005, noninterest income was $34,000, or .9% more than for the first six months of 2004. Mortgage loan brokerage income increased $79,000, but this was offset partially by a $52,000 decrease in service charge income.

Noninterest Expenses

Noninterest expenses for the second quarter of 2005 were $450,000, or 11.9%, higher than the amounts reported for the same period of 2004. Salaries and employee benefits expenses were $109,000, or 4.9%, higher in the 2005 period, due to increased activity in mortgage lending and additions made to the Company's executive managment. Expenses related to premises and equipment increased by $77,000 in the 2005 period, primarily due to the opening of a new branch office of Florence National Bank during the first quarter of 2005.

Noninterest expense for the first six months of 2005 was $837,000, or 11.1%, more than for the same period of 2004. Salaries and employee benefits for the 2005 six month period were $276,000, or 6.4%, more than for the same period of 2004. This expense increased due to higher levels of mortgage loan brokerage

activity in the 2005 period, additions made to the Company's executive management, and normal periodic wage and salary adjustments. Expenses associated with premises and equipment were $122,000, or 12.7%, higher in the 2005 period, primarily due to the opening of a new branch office of Florence National Bank during the first quarter of 2005. Other expenses were $439,000, or 19.9%, higher in the 2005 period due in part to expenses related to complying with the provisions of Sarbanes-Oxley Act Section 404 and the new Florence office.

Income Taxes

Income tax expense was $107,000 more in the 2005 second quarter than for the 2004 period, as a result of higher net income before taxes. Income tax expense for the 2005 six month period was $116,000 more than for the same period of 2004.

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 the ability to attract deposits within CBI's service areas. Individual and commercial deposits are the primary source of funds for credit activities, along with long-term borrowings from the Federal Home Loan Bank of Atlanta and the proceeds of issuing $10,000,000 of subordinated debentures. Cash and amounts due from banks and federal funds sold are CBI's primary sources of asset liquidity. These funds provide a cushion against short-term fluctuation in cash flow from both loans and deposits. Securities available-for-sale are CBI's principal source of secondary asset liquidity. However, the availability of this source is limited by pledging commitments for public deposits and securities sold under agreements to repurchase, and is influenced by market conditions. CBI and its subsidiaries also maintain various federal funds lines of credit with correspondent banks and are able to borrow from the Federal Home Loan Bank of Atlanta and the Federal Reserve Bank's discount window.

Total deposits as of June 30, 2005 were $433,418,000, an increase of $9,960,000, or 2.4%, over the amount as of December 31, 2004. During the six months ended June 30, 2005, there was a notable movement of funds from interest bearing transaction accounts into savings and certificate of deposit accounts. As of June 30, 2005 the loan to deposit ratio was 95.5%, compared with 93.0% at December 31, 2004 and 93.2% at June 30, 2004.

Management believes CBI and its subsidiaries' liquidity sources are adequate to meet their current and projected operating needs.

CAPITAL RESOURCES

CBI and its banking subsidiaries are subject to regulatory risk-based capital adequacy standards. Under these standards, bank holding companies and banks are required to maintain certain minimum ratios of capital to risk-weighted assets and average total assets. Under the provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991, federal bank regulatory authorities are required to implement prescribed "prompt corrective actions" upon the deterioration of the capital position of a bank. If the capital position of an affected institution were to fall below a certain level,

increasingly stringent regulatory corrective actions would be mandated.

The June 30, 2005 risk-based capital ratios for CBI and its banking subsidiaries are presented in the following table, compared with the "well capitalized" and minimum ratios under the regulatory definitions and guidelines:

	June 30, 2005		
	Tier 1	Total Capital	Leverage
Community Bankshares, Inc.	13.65%	14.84%	10.83%
Orangeburg National Bank	12.12%	13.29%	9.10%
Sumter National Bank	9.86%	10.93%	8.39%
Florence National Bank	9.94%	11.01%	8.79%
Bank of Ridgeway	12.92%	13.97%	8.79%
Minimum "well capitalized" requirement	6.00%	10.00%	6.00%
Minimum requirement	4.00%	8.00%	4.00%

As shown in the table above, each of the capital ratios exceeds the regulatory requirement to be considered "well capitalized." In the opinion of management, the current and projected capital positions of CBI and its banking subsidiaries are adequate. The Company's issuance of $10,000,000 of subordinated debentures during the first quarter of 2004 is includible in Tier 1 and Total Capital for regulatory risk-based capital purposes.

OFF-BALANCE-SHEET ARRANGEMENTS

In the normal course of business, CBI engages in transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements (generally commitments to extend credit) or are recorded in amounts that differ from their notional amounts (generally derivatives). These transactions involve elements of credit, interest rate and liquidity risk of varying degrees. Such transactions are used by CBI for general corporate purposes.

Variable Interest Entity

As discussed under "Results of Operations - Net Interest Income" and in the notes to unaudited consolidated financial statements under "Variable Interest Entity," as of June 30, 2005, CBI held an equity interest in, and guarantees the liabilities of, a non-consolidated variable interest entity.

Commitments

CBI's banking and mortgage brokerage subsidiaries are parties to credit related financial instruments with off-balance-sheet risk in the normal course

of business to meet the financing needs of their customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve varying degrees of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Exposure to credit loss is represented by the contractual, or notional, amounts of these commitments. The same credit policies are used in making commitments as for on-balance-sheet instruments.

The following table sets forth the contractual amounts of commitments which

represent credit risk:

	June 30, 2005 (Dollars in thousands)
Loan commitments	$53,748
Standby letters of credit	3,011

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by management upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include personal residences, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support private borrowing arrangements. All letters of credit are short-term guarantees. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Generally, collateral supporting those commitments is held if deemed necessary. Since many of the standby letters of credit are expected to expire without being drawn upon, the total letter of credit amounts do not necessarily represent future cash requirements.

On March 22, 2005, CBI entered into a contract for the construction of an approximately 16,000 square foot two-story brick office building to house its corporate headquarters and operations center. The contract price for this project is $1,476,000. Through August 2, 2005, $341,000 has been expended for this project. Management expects completion of the building in the fourth quarter of 2005 and the Company will relocate at that time.

On June 30, 2005, CBI reached an agreement with Jack Henry & Associates, Inc. to obtain licensing rights for a new core management information software system, known as Silverlake, to be used by each of its subsidiaries. The cost of this core system conversion will be approximately $1,000,000. The agreement also requires CBI to pay various support and maintenance costs throughout the license period. CBI estimates that during the next five years these costs will range from approximately $200,000 to $300,000 per year. However, the exact amounts will be determined by future events, such as asset growth, and cannot be exactly determined at this time. Management expects to begin implementing the new software during the second quarter of 2006, with all subsidiaries converted shortly thereafter.

Derivative Financial Instruments

In April, 2003, the Financial Accounting Standards Board issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." Among other requirements, this Statement provides that loan commitment contracts entered into or modified after June 30, 2003 that relate to the origination of mortgage loans that will be held for sale shall be accounted

for as derivative instruments by the issuer of the loan commitment. In March, 2004, the SEC issued its Staff Accounting Bulletin No 105 "Application of Accounting Principles to Loan Commitments," which resulted in no changes in CBI's accounting for such commitments. CBI issues mortgage loan rate lock commitments to potential borrowers to facilitate its origination of home mortgage loans that are intended to be sold. Between the time that CBI issues its commitments and the time that the loans close and are sold, CBI is subject to variability in the selling prices related to those commitments due to changes in market rates of interest. However, CBI offsets this variability through the use of so-called "forward sales contracts" to investors in the secondary market. Under these arrangements, an investor agrees to purchase the closed loans at a predetermined price. CBI generally enters into such forward sales contracts at the same time that rate lock commitments are issued. These arrangements effectively insulate CBI from the effects of changes in interest rates during the time the commitments are outstanding, but the arrangements do not qualify as fair value hedges. These derivative financial instruments are carried in the balance sheet at estimated fair value and changes in the estimated fair values of these derivatives are recorded in the statement of income in net gains or losses on loans held for sale.

Derivative financial instruments are written in amounts referred to as notional amounts. Notional amounts only provide the basis for calculating payments between counterparties and do not represent amounts to be exchanged between parties or a measure of financial risk. The following table includes the notional principal amounts of rate lock commitments and forward sales contracts as of June 30, 2005, and the estimated fair values of those financial instruments included in other assets and liabilities in the balance sheet as of that date.

	June 30, 2005	
	Nominal Amount	Estimated Fair Value Asset (Liability)
	(Dollars in thousands)	
Rate lock commitments to potential borrowers to originate mortgage loans to be held for sale	$27,722	$ 48
Forward sales contracts with investors of mortgage loans to be held for sale	27,722	(48)

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. CBI's market risk arises principally from interest rate risk inherent in its lending, deposit and borrowing activities. Management actively monitors and manages its interest rate risk exposure. Although CBI manages other risks, such as credit quality and liquidity risk in the normal course of business, management considers interest rate risk to be its most significant market risk and this risk could potentially have the largest material effect on CBI's financial condition and results of operations. Other types of market risks such as foreign currency exchange risk and commodity price risk do not arise in the normal course of community banking activities.

CBI's Asset/Liability Committee uses a simulation model to assist in achieving consistent growth in net interest income while managing interest rate risk. According to the model, as of June 30, 2005, CBI is positioned so that net interest income would increase $214,000 and net income would increase $129,000

in the next twelve months if interest rates rose 100 basis points. Conversely, net interest income would decline $214,000 and net income would decline $129,000 in the next twelve months if interest rates declined 100 basis points. Computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates and loan prepayment, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions CBI and its customers could undertake in response to changes in interest rates.

As of June 30, 2005 there was no significant change from the interest rate sensitivity analysis for the various changes in interest rates calculated as of December 31, 2004. The foregoing disclosures related to the market risk of CBI should be read in connection with Management's Discussion and Analysis of Financial Position and Results of Operations included in the 2004 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Based on the evaluation required by 17 C.F.R. Section 240.13a-15(b) or 240.15d-15(b) of the Company's disclosure controls and procedures (as defined in 17 C.F.R. Sections 240.13a-15(e) or 240.15d-15(e)), the Company's chief executive officer and chief financial officer concluded that such controls and procedures, as of the end of the period covered by this quarterly report, were effective.

There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II--OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On April 21, 2005, the Company sold 775 shares of its common stock to Samuel L. Erwin, Chief Executive Officer of the Company, at a price of $18.02 per share, an aggregate of $13,965.50. Sale of these shares to Mr. Erwin was not registered under the Securities Act of 1933 in reliance on the exemption provided under Section 4(2) of the Act because no public offering was involved.

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

On Monday, May 16, 2005, the shareholders of Community Bankshares, Inc. held their regular annual meeting. At the meeting, one matter was submitted to a vote with results as follows:

1. Election of five directors to hold office for three-year terms, and one director to hold office for a two-year term:

SHARES VOTED

DIRECTORS	FOR	AGAINST OR AUTHORITY WITHHELD	BROKER NON-VOTES
Three-Year Terms			
Thomas B. Edmunds	3,042,804	12,062	0
Martha Rose C. Carson	3,017,483	37,383	0
J. M. Guthrie	3,009,219	45,647	0
Wm. Reynolds Williams	3,019,590	35,276	0
Charles E. Fienning	3,043,230	11,636	0
Two-Year Term			
Samuel L. Erwin	3,045,600	9,266	0

The following directors continue to serve until the expiration of their terms at the annual meetings to be held in the years indicated and were not voted on at the 2005 annual meeting: E. J. Ayers, Jr., - 2006; Alvis J. Bynum - 2006; J. Otto Warren, Jr. - 2006 and J. V. Nicholson, Jr. - 2006; Anna O. Dantzler - 2007; Richard L Havekost - 2007 and Samuel F. Reid, Jr. - 2007.

Item 6. Exhibits

Exhibits 31-1 Rule 13a-14(a)/15d-14(a) Certification of principal executive officer

31-2 Rule 13a-14(a)/15d-14(a) Certification of principal financial officer

32 Certifications Pursuant to 18 U.S.C. Section 1350

SIGNATURES

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

DATED: August 11, 2005

COMMUNITY BANKSHARES, INC.

By: s/ Samuel L. Erwin

Samuel L. Erwin
Chief Executive Officer

By: s/ William W. Traynham

William W. Traynham
President and Chief Financial Officer
(Principal Accounting Officer)

EXHIBIT INDEX

31-1	Rule 13a-14(a)/15d-14(a) Certification of principal executive officer
31-2	Rule 13a-14(a)/15d-14(a) Certification of principal financial officer
32	Certifications Pursuant to 18 U.S.C. Section 1350