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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
(State or other jurisdiction of
incorporation or organization)

57-0966962
(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 Common Stock, No Par Value | Name of each exchange on which registered 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 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

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

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Shareholders - Part III

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

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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 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

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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).

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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

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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.

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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

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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

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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

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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

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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.

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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.

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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

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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

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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.

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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

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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.

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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

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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.

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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.

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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.

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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 |

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- (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.

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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.

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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,

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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

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- 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.

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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.

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Average Balances, Yields and Rates

| | Years Ended December | | | | | |
|---|------------------------|--------------------|---------|-----------|--------------------|---------|
| | 2004 | | | 2003 | | |
| | Average | Interest | Yields/ | Average | Interest | Yields/ |
| | Balances | Income/ Expense | Rates | Balances | Income/ Expense | Rates |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| | (Dollars in thousands) | | | | | |
| 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 | | |

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| | | | |
|--|----------|-------|--------------|
| | ===== | ===== | |
| 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.

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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

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| | 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

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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 initiated 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.

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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

| | 2004 | | December 31, 2003 | |
|--|----------------|----------------------|-------------------|----------------------|
| | Amortized cost | Estimated fair value | Amortized cost | Estimated fair value |
| | ----- | ----- | ----- | ----- |
| | (Dollars) | | | |
| Securities available-for sale | | | | |
| U.S. Treasury and U.S. Government agencies | \$50,619 | \$50,361 | \$56,633 | \$56,633 |
| States and political subdivisions | 4,985 | 5,110 | 8,140 | 8,140 |
| | ----- | ----- | ----- | ----- |
| Total available for sale | \$55,604 | \$55,471 | \$64,773 | \$64,773 |
| | ===== | ===== | ===== | ===== |
| Securities held-to-maturity | | | | |
| States and political subdivisions | \$ 1,925 | \$ 1,907 | \$ 2,000 | \$ 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 | | |
| ----- | ----- | ----- | ----- | ----- | ----- | | |

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(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.

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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:

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Loan Portfolio Composition

| | 2004 ---- | 2003 ---- | December ----- 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

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

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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.

| | 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, |

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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

| | 2004 ---- | 2003 ---- | Decemb ----- 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

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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 | 2002 |
| | ---- | ---- | ---- |
| | (Dollars in | | |
| Total amount of loans outstanding at end of year | \$393,649 | \$332,106 | \$306,000 |
| | ===== | ===== | ===== |
| Average amount of loans outstanding | \$371,061 | \$340,518 | \$281,000 |
| | ===== | ===== | ===== |
| Allowance for loan losses - January 1 | \$ 4,206 | \$ 3,573 | \$ 2,800 |
| | ----- | ----- | ----- |
| 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 | - |
| | ----- | ----- | ----- |

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| | | | |
|---|----------|----------|-------|
| 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 | 1.26% | 0.15% | |
| year | | | |
| Allowance for loan losses to average loans | 1.17% | 1.24% | |
| Allowance for loan losses to total loans at end | 1.10% | 1.27% | |
| of year | | | |
| 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

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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:

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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

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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.

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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

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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 qualifying perpetual preferred stock and certain hybrid instruments, less certain intangibles ("Tier 1 Capital"). The remainder may consist of certain subordinated debt or hybrid capital instruments, qualified preferred stock and a limited amount of the allowance for loan losses ("Tier 2 Capital," which, along with Tier 1 Capital, composes "Total Capital"). Unrealized gains and losses on available-for-sale securities generally are excluded from the calculation of the risk-based capital ratios. To be considered well-capitalized under the risk-based capital guidelines, an institution must maintain a total risk-weighted capital ratio of at least 10% and a Tier 1 risk-weighted ratio of at least 6%.

Each of the Federal bank regulatory agencies also has established minimum leverage capital requirements for banking organizations. Pursuant to these requirements, banking organizations generally must maintain a minimum ratio of Tier 1 Capital to adjusted average quarterly assets equal to from 4% to 5%, subject to federal bank regulatory evaluation of the institution's overall safety and soundness.

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Federal regulators may categorize an institution as less than well-capitalized based on subjective criteria. Management believes that there are no conditions or events that would cause the Corporation's or the Banks' capital category to be other than resulting from meeting the minimum ratio requirements.

Under the risk-based capital standards and pursuant to the provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991, federal bank regulatory agencies are required to implement prescribed "prompt corrective actions" if an institution's capital position deteriorates to specified levels. The corrective actions become increasingly stringent as the capital position continues to deteriorate.

The Banks are each considered to be 'well capitalized' for regulatory purposes. Detailed information on the Corporation's and the Banks' capital positions can be found in Note 19 to the consolidated financial statements.

The mortgage subsidiary is also subject to minimum capital requirements to maintain its certification as a HUD-approved Title II Loan Correspondent. Certain investor and warehouse credit line agreements require that the mortgage subsidiary maintain its HUD certification. Failure of CRM to meet its capital requirements could result in a significant limitation of the mortgage subsidiary's ability to originate, fund or sell loans, and therefore could have

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a direct, material adverse effect on its business and the consolidated financial statements. As of December 31, 2004, CRM exceeded its minimum regulatory capital requirement by approximately \$1,098,000.

During the first quarter of 2004, the Corporation acquired \$10,310,000 in proceeds from the issuance of trust preferred securities. Of this amount, \$3,000,000 was used to provide additional capital to two of the Banks, approximately \$1,400,000 was used to repay a short-term line of credit of the mortgage subsidiary and approximately \$635,000 was used to repay the Corporation's short-term borrowings. The remainder is being used for the Corporation's general corporate purposes. Under current Federal Reserve policy, the Corporation is allowed to treat the trust preferred securities, subject to certain limitations, as capital for capital adequacy purposes.

INFLATION

The assets and liabilities of the Corporation are mostly monetary in nature. Accordingly, the financial results and operations of the Corporation are much more affected by changes in interest rates than changes in inflation. There is, however, a strong correlation between increasing inflation and increasing interest rates. The rate of inflation, as measured by the average change in the Consumer Price Index, has been moderate, but increasing, over the past several years, about 3.3% in 2004 and 1.9% in 2003. Prospects appear reasonable for continued moderate inflation, despite some risk related to energy prices and the political and military situation in the Middle East. Although inflation does not normally affect a financial institution as dramatically as it does businesses with large investments in plants and inventories, it does have an effect. During periods of high inflation there are usually corresponding increases in the money supply and banks experience above-average growth in assets, loans, and deposits. General increases in the prices of goods and services also result in increased operating expenses.

OFF-BALANCE-SHEET ARRANGEMENTS, CONTRACTUAL OBLIGATIONS AND CONTINGENT LIABILITIES AND COMMITMENTS

The Company presently engages in only limited off-balance sheet arrangements. Such arrangements are defined as potentially material transactions, agreements, or other contractual arrangements which the Company has entered into to which an entity unconsolidated with the registrant is a party and, under which the Company, whether or not it is a party to the arrangement, has, or in the future may have:

- o any obligation under a direct or indirect guarantee or similar arrangement;
- o a retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to such entity for such assets;
- o derivatives, to the extent that the fair value thereof is not fully reflected as a liability or asset in the financial statements; or
- o any obligation, including a contingent obligation, arising out of a variable interest (as referenced in FASB Interpretation No. 46, Consolidation of Variable Interest Entities (January 2003), as may be modified or supplemented), in an unconsolidated entity that is held by, and material to, the registrant, where such entity provides financing, liquidity, market risk or credit support to, or engages in leasing, hedging or research and development services with, the registrant.

The Company's off-balance sheet arrangements presently include only

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commitments to extend credit and standby letters of credit. Such instruments have elements of credit risk in excess of the amount recognized in the balance sheet. The exposure to credit loss in the event of nonperformance by the other parties to these instruments is represented by the contractual, or notional, amount of those instruments. Generally, the same credit policies used for on-balance sheet instruments, such as loans, are used in extending loan commitments and letters of credit. The following table sets out the contractual or notional amounts of those arrangements:

| | December 31, ----- | |
|--|------------------------|--------------|
| | 2004 ---- | 2003 ---- |
| | (Dollars in thousands) | |
| Loan commitments | \$11,644 | \$15,501 |
| Unfunded commitments under lines of credit | 43,312 | 36,735 |
| Standby letters of credit | 2,919 | 4,489 |

Loan commitments involve 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 some involve payment of a fee. Many of the commitments are expected to expire without being fully drawn; therefore, the total amount of loan commitments does not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if any, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include commercial and residential real properties, accounts receivable, inventory and equipment.

Standby letters of credit are conditional commitments to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is the same as that involved in making loan commitments to customers.

As described under "Liquidity," management believes that its various sources of liquidity provide the resources necessary for the Banks to fund the loan commitments and to perform under standby letters of credit, if the need arises. Neither the Company nor the Banks are involved in other off-balance sheet contractual relationships or transactions that could result in liquidity needs or other commitments or significantly impact earnings.

The Corporation's contractual cash obligations are summarized in the following table.

| | December 31, ----- | | |
|-----------------------------------|-----------------------|------------------------------|-------------------|
| | Total ----- | Less than 1 Year ----- | 1 to 3 Y ----- |
| | (Dollars in th | | |
| Contractual Cash Obligations | | | |
| Time deposits | \$205,863 | \$160,652 | \$ 42,00 |
| Long-term debt | 30,573 | 1,370 | 1,50 |
| Operating lease obligations | 2,785 | 226 | 44 |

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| | | | |
|-------------|-----------|-----------|----------|
| Total | \$239,221 | \$162,248 | \$ 43,95 |
| | ===== | ===== | ===== |

THE APPLICATION OF CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are based on the selection and application of accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to the financial statements. Management believes that the following policy may involve a higher degree of judgment and complexity in its application and represents the critical accounting policy used in the preparation of the Corporation's financial statements. If different assumptions or conditions were to prevail, the results could be materially different from the reported results.

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Provision and Allowance for Loan Losses

The Corporation is required to estimate the collectibility of its loan portfolio as of each accounting period end and, as a result, provide an allowance for possible loan losses. The allowance for loan losses is increased by the provision for loan losses charged to expense and any recoveries received on loans previously charged off. The allowance is decreased by deducting the amount of uncollectible loans charged off.

A considerable degree of judgment is exercised in computing an estimate of the allowance for loan losses. Management's judgment must be applied in assessing the current creditworthiness of the Corporation's borrowers and in estimating uncertain future events and their effects based on currently known facts and circumstances. Changes in the estimated allowance for loan losses arising as new events occur or more information is obtained are accounted for as changes in accounting estimates in the accounting period in which such changes occur.

Management reviews its allowance for loan losses utilizing three broad loan categories: commercial, real estate and consumer installment loans to individuals. Within these categories, the allowance for loan losses is composed of specific and general amounts. Specific allowance amounts are provided for individual loans based on management's evaluation of the Corporation's loss exposure taking into account the current payment status, underlying collateral and other known information about the borrower's circumstances. Typically, these loans are identified as impaired or nonperforming, or have been assigned internal risk grades of management attention, special mention, substandard or doubtful. General allowance amounts are provided for all other loans, excluding those for which specific amounts were determined, by applying estimated loss percentages to the portfolio categorized using risk grades. These percentages are based on management's current evaluation with consideration given to historical loss experience, general national and local economic and business conditions affecting key lending market areas, credit quality trends, collateral values, loan volumes, portfolio seasoning, and any identified credit concentrations. The findings of internal and external credit reviews and results from external audits and regulatory examinations are also considered.

The following table presents the allocation of the allowance for loan

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losses, as of December 31, 2000 through 2004, compared with the percentage of loans in the applicable categories to total loans.

| | 2004 ---- | 2003 ---- | Dec --- |
|--|--------------|--------------|------------|
| | | | (Dollars |
| Amount allocated to loan category ----- | | | |
| Commercial, financial and agricultural | \$1,960 | \$1,796 | \$ |
| Real estate | 1,907 | 1,800 | |
| Consumer installment | 480 | 610 | |
| | ----- | ----- | |
| Total | \$4,347 | \$4,206 | \$ |
| | ===== | ===== | = |

| | 2004 ---- | 2003 ---- | Dec --- |
|--|--------------|--------------|------------|
| Percentage of loans in category ----- | | | |
| Commercial, financial and agricultural | 24.5% | 25.5% | |
| Real estate | 66.3% | 63.9% | |
| Consumer installment | 9.2% | 10.6% | |
| | ----- | ----- | |
| Total | 100.0% | 100.0% | |
| | ===== | ===== | |

The Corporation utilizes its risk grading system for all loans held in the portfolio. This system involves the Corporation's lending officers' assigning a risk grade, on a loan-by-loan basis, considering information about the borrower's capacity to repay, collateral, payment history, and other known factors. Assigned risk grades are updated monthly for any known changes in circumstances affecting the borrower or the loan. The risk grading system is monitored on a continuing basis by management and the Corporation's external credit review consultant who is independent of the lending function.

The provision for loan losses charged to expense was \$5,102,000 in 2004, an increase of \$3,983,000 or 356% over the amount for 2003. The allowance

for loan losses at the end of 2004 was \$4,347,000, an increase of \$141,000 or 3.4% over the allowance of \$4,206,000 as of the end of 2003. As a percentage of total loans outstanding at year end, the allowance for loan losses stood at 1.10%, 1.27% and 1.17% for 2004, 2003 and 2002, respectively. Net loan charge-offs were \$4,961,000 for 2004, an increase of 921% over the 2003 amount. As of the end of 2004, non-performing loans (nonaccrual and accruing loans 90 days or more past due) grew to \$5,078,000, up from \$2,741,000 and \$2,536,000 at the end of 2003 and 2002, respectively. Potential problem loans, exclusive of non-performing loans, grew to \$4,628,000 at the end of 2004, compared with

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\$3,237,000 and \$2,737,000 at the end of 2003 and 2002, respectively.

As discussed under the caption, "Impaired Loans," approximately \$3,527,000, or 71% of nonperforming loans as of December 31, 2004, consisted of the remaining balances, net of partial charge-offs, of several loans included in a former loan officer's portfolio and one other problem relationship. As of the end of 2004, approximately \$669,000, or 15.4% of the year end allowance had been specifically allocated to these loans. As of December 31, 2003 and 2002, approximately \$1,350,000, or 49% and 53%, respectively, of the Corporation's nonperforming loans consisted of one commercial loan relationship. The borrower's principals had been involved in a legal dispute among themselves. The Corporation collected all amounts due under this contract during the first quarter of 2004.

Management has established loan and credit policies and practices that are designed to control credit risks as a part of the loan underwriting process. These policies and practices include, for example, requirements for minimum loan to collateral value ratios, real estate appraisal requirements and obtaining credit and financial information on borrowers. However, if the capacity for borrowers to repay or collateral values should deteriorate subsequent to the underwriting process, or both, the estimate of the provision and allowance for loan losses might have to increase, thereby decreasing net income and shareholders' equity. During the two year period ending December 31, 2004, commercial loans increased \$18,065,000 to \$96,275,000. The total of loans secured by real estate mortgages increased by \$69,110,000 from \$191,844,000 at the end of 2002 to \$260,954,000 by the end of 2004. Any significant, prolonged downturn in national and local economic and business conditions could negatively affect the borrowers' capacity to repay these loans as well as the value of the underlying collateral. This scenario would be likely to substantially increase the level of impaired or non-performing loans and non-earning foreclosed real estate, and increase overall credit risk by shrinking the margin of collateral values as compared with loans outstanding. Another factor that could adversely affect borrowers' ability to make payments in accordance with loan terms is the potential for increases in rates charged for loans. The Corporation has a significant amount of variable rate loans outstanding. In addition, some loans are refinanced at maturity rather than being paid out in a lump sum. If interest rates were to increase sharply in a short time period, some loan customers might not be able to afford payments on loans made or repriced at the higher resulting interest rates, nor would they necessarily be able to obtain more favorable terms elsewhere. This could also cause an increase in the amounts of impaired or non-performing assets and other credit risks.

Management believes that its estimate of the allowance for loan losses, as of December 31, 2004, is sufficient to absorb any losses inherent in the loan portfolio. Management will continue to monitor closely the levels of non-performing and potential problem loans and will address the weaknesses in those credits to enhance the amount of ultimate collection or recovery of these assets.

IMPACT OF RECENT ACCOUNTING CHANGES

Consolidation of Variable Interest Entities - FASB Interpretation 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51," provides a new framework for identifying variable interest entities ("VIEs") and determining when a company should include the assets, liabilities, noncontrolling interests and results of activities of a VIE in its consolidated financial statements. FIN 46 requires that if a business enterprise has a controlling financial interest in a VIE, the assets, liabilities and results of the activities of the VIE must be included in the consolidated financial statements of a business enterprise. This interpretation also requires existing unconsolidated VIEs to be consolidated by their primary beneficiaries if the

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entities do not effectively disperse risks among parties involved. VIEs that effectively disperse risks will not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed. FIN 46 was effective immediately for VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. It applied in the first fiscal year or interim period beginning after June 15, 2003, to VIEs in which an enterprise holds a variable interest that it acquired before February 1, 2003. This Interpretation does not apply to securitization structures that are qualified special purpose entities as defined within FASB Statement No. 140. Management does not believe that adoption of this Interpretation has had, or will have, any material adverse or beneficial effect on the Corporation's consolidated financial position or results of operations.

Share-Based Payment - SFAS No. 123 (revised 2004), "SFAS 123(R)," was issued in December 2004 and requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. The statement replaces

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SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." Several other pronouncements are amended or superseded as well. SFAS 123(R) generally requires use of a fair-value measurement objective for such transactions and amends SFAS No. 95 to require that excess tax benefits resulting from such transactions be reported as financing cash flows rather than as a reduction of taxes paid. SFAS No. 123(R) is effective for public companies, other than "small business filers," as of the beginning of the first interim or annual reporting period that begins after June 30, 2005. Various transition methods are available for the restatement of prior period information. Management has not yet decided which of the available transition methods the Corporation will employ, and accordingly is unable to estimate the effect of the implementation of this statement on the Corporation's financial position or results of operations for any period.

Exchanges of Nonmonetary Assets - SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29," eliminates an exception to the measurement of such exchanges at fair value for similar productive assets and replaces it with an exception for such exchanges that do not have commercial substance. The provisions of this Statement are required to be applied prospectively to exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for such exchanges occurring in fiscal periods beginning after December 16, 2004. It is not expected that adoption and application of the provisions of this Statement will have any material adverse or beneficial effect on the Corporation's consolidated financial position or results of operations.

EITF Issue No. 03-1 - Emerging Issues Task Force ("EITF") Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," requires that companies report information about certain debt and equity securities when the estimated fair values of those securities are less than their cost. Implementation of the guidance contained in paragraphs 10-20 of EITF Issue No. 03-1 was delayed by the FASB and the effective date for those paragraphs will be superseded concurrent with the final issuance of proposed FASB Staff Position EITF Issue No. 03-1-a. Substantially all of the Corporation's investment securities are issued by the U.S. Government, or by U.S. Government agencies and corporations, and generally do not contain provisions that would allow the securities to be settled in such a way that the Corporation would not recover substantially all of its cost. Management intends, and believes that it has the ability, to hold such securities until a forecasted recovery of the fair market value, including until maturity. Management does not

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believe that implementation of this guidance will have any material adverse or beneficial effect on the Company's consolidated financial position or results of operations.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Corporation'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 the Corporation 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 the Corporation'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.

Achieving consistent growth in net interest income is the primary goal of the Corporation's asset/liability function. The Corporation attempts to control the mix and maturities of assets and liabilities to achieve consistent growth in net interest income despite changes in market interest rates. The Corporation seeks to accomplish this goal while maintaining adequate liquidity and capital. The Corporation's asset/liability mix is sufficiently balanced so that the effect of interest rates moving in either direction is not expected to be material over time.

The Corporation's Asset/Liability Committee uses a simulation model to assist in achieving consistent growth in net interest income while managing interest rate risk. The model takes into account interest rate changes as well as changes in the mix and volume of assets and liabilities. The model simulates the Corporation's balance sheet and income statement under several different rate scenarios. The model's inputs (such as interest rates and levels of loans and deposits) are updated on a quarterly basis in order to obtain the most accurate forecast possible. The forecast presents information over a twelve-month period. It reports a base case in which interest rates remain flat and variations that occur when rates increase and decrease 100, 200 and 300 basis points. According to the model, as of December 31, 2004 the Corporation is positioned so that net interest income would increase \$332,000 and net income would increase \$208,000 if interest rates were to rise 100 basis points in the next twelve months. Conversely, net interest income would decline \$432,000 and net income would decline \$272,000 if interest rates were to decline 100 basis

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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 the Corporation could undertake in response to changes in interest rates or the effects of responses by others, including borrowers and depositors.

The following table summarizes the Corporation's interest sensitivity position as of December 31, 2004.

Interest Sensitivity Analysis

| | Within 3 months | Within 4-12 months | Wit 1-5 |
|--|--------------------|-----------------------|------------|
|--|--------------------|-----------------------|------------|

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| | ----- | ----- | ----- |
|---|-----------|-------------|-------------|
| | | | (Dollars in |
| Interest earning assets | | | |
| Interest-bearing deposits | \$ 852 | \$ - | \$ |
| Taxable investment securities | 12,670 | 24,298 | 1 |
| Tax exempt investment securities | 577 | 777 | |
| Other investments | 2,642 | - | |
| Federal funds sold | 12,571 | - | |
| Loans held for sale (1) | 15,090 | - | |
| Loans | 191,274 | 20,110 | 14 |
| | ----- | ----- | ----- |
| Total interest earning assets | 235,676 | 45,185 | 15 |
| | ----- | ----- | ----- |
| Interest bearing liabilities | | | |
| Savings | \$ 85,679 | \$ - | \$ |
| Interest bearing transaction accounts | 64,870 | - | |
| Time deposits <\$100 | 26,823 | 65,303 | 27 |
| Time deposits > \$100 | 26,040 | 42,486 | 1 |
| Short-term borrowings | 6,662 | - | |
| Long-term debt | 10,310 | 1,370 | |
| | ----- | ----- | ----- |
| Total interest bearing liabilities | 220,384 | 109,159 | 5 |
| | ----- | ----- | ----- |
| Interest sensitivity gap | \$ 15,292 | \$ (63,974) | \$ 10 |
| Cumulative gap | \$ 15,292 | \$ (48,682) | \$ 5 |
| RSA/RSL (2) | 107% | 41% | |
| Cumulative RSA/RSL (2) | 107% | 85% | |

(1) Loans held for sale are reflected in the period of expected sale.

(2) RSA- rate sensitive assets; RSL- rate sensitive liabilities

The above table reflects the balances of interest earning assets and interest bearing liabilities at the earlier of their repricing or maturity dates. Amortizing fixed rate loans are reflected at the scheduled maturity date. Variable rate amortizing loans are reflected at the earliest date at which they may be repriced contractually. Deposits in other banks and debt securities are reflected at each instrument's ultimate maturity date. Overnight federal funds sold are reflected as instantly repriceable. Interest bearing liabilities with no contractual maturity, such as savings deposits and interest bearing transaction accounts, are reflected in the earliest repricing period possible. Fixed rate time deposits are reflected at their maturity dates.

The static interest rate sensitivity gap position, while not a complete measure of interest sensitivity, is also reviewed periodically to provide insights related to the static repricing structure of the Banks' assets and liabilities. At December 31, 2004 on a cumulative basis through twelve months, rate sensitive liabilities exceeded rate sensitive assets by \$48,682,000. The liability sensitive position is largely due to the assumption that the Banks' \$150,549,000 in interest bearing transaction accounts, savings accounts, and money market accounts will reprice within a year. This assumption may or may not be valid, since these accounts vary greatly in their sensitivity to interest rate changes in the market. Rising interest rates would be likely to diminish net interest income of banks in a liability sensitive position if the assumption is valid and in the absence of factors which would be likely to occur.

The Market Risk table, which follows this discussion, shows the Corporation's financial instruments that are sensitive to changes in interest rates. The Corporation uses certain assumptions to estimate fair values and expected maturities. For assets, expected maturities are based upon contractual

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maturity, projected repayments, and prepayment of principal and potential calls. For core deposits without contractual maturity (i.e., interest checking, savings

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and money market accounts), the table presents principal cash flows based on management's judgment concerning their most likely runoff. The actual maturities and runoff could vary substantially if future prepayments, runoff and calls differ from the Corporation's historical experience.

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| | | December 31, | | | | |
|-------------------------------------|--------------------------------------|--------------|--------|--------|--------|--------|
| | 2004 Year- End Average Rate | 2005 | 2006 | 2007 | 2008 | 2009 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| (Dollars in thousands) | | | | | | |
| Interest earning assets | | | | | | |
| Interest-bearing deposits | | | | | | |
| with other banks | 2.10% | \$ 852 | \$ - | \$ - | \$ - | \$ - |
| Investment securities | 3.13% | 38,321 | 8,805 | 2,815 | 3,129 | 1,111 |
| Federal funds sold | 1.97% | 12,571 | - | - | - | - |
| Loans held for sale | 5.66% | 15,090 | - | - | - | - |
| Loans | 6.36% | 124,578 | 41,119 | 49,996 | 40,755 | 70,600 |
| Interest bearing liabilities | | | | | | |
| Savings | 0.53% | \$ 67,046 | \$ - | \$ - | \$ - | \$ - |
| Interest bearing | | | | | | |
| transaction accounts | 1.04% | 64,870 | - | - | - | - |
| Time deposits | 2.50% | 160,652 | 31,950 | 10,057 | 2,909 | 2,909 |
| | | ----- | ----- | ----- | ----- | ----- |
| Total interest bearing deposits.... | 1.83% | 292,568 | 31,950 | 10,057 | 2,909 | 2,909 |
| Short-term borrowings | 1.54% | 6,662 | - | - | - | - |
| Long-term debt | 5.28% | 1,370 | 500 | 1,000 | 2,500 | 5,000 |

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Item 8. Financial Statements and Supplementary Data

COMMUNITY BANKSHARES, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and
Board of Directors of
Community Bankshares, Inc.

We have audited the accompanying consolidated balance sheets of Community Bankshares, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and

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disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Community Bankshares, Inc. and subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

Columbia, South Carolina
February 7, 2005

s/ J. W. Hunt and Company LLP

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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 \$1,907 for 2004 and \$2,155 for 2003) | |
| Other investments | |
| Loans held for sale | |
| Loans, net of allowance for loan losses of \$4,347 for 2004 and \$4,206 for 2003 | |
| Premises and equipment - net | |
| Accrued interest receivable | |
| Net deferred income tax assets | |
| Goodwill | |
| Core deposit intangible assets | |
| Prepaid expenses and other assets | |
| Total assets | |

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Liabilities

Deposits

| | |
|---|--|
| Demand, noninterest-bearing | |
| Interest-bearing transaction accounts | |
| Savings | |
| Certificates of deposit of \$100 and over | |
| Other time deposits | |
| Total deposits | |
| Short-term borrowings | |
| Long-term debt | |
| Accrued interest payable | |
| Accrued expenses and other liabilities | |
| Total liabilities | |

Commitments and contingent liabilities

Shareholders' equity

| | |
|---|--|
| Common stock - no par value, 12,000,000 authorized shares; issued and outstanding - 4,390,784 shares for 2004 and 4,331,460 shares for 2003 | |
| Retained earnings | |
| Accumulated other comprehensive income (loss) | |
| Total shareholders' equity | |
| Total liabilities and shareholders' equity | |

See accompanying notes to consolidated financial statements.

COMMUNITY BANKSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME

| | |
|--|--------------------------|
| | 2004 |
| | ---- |
| | (Dollars) |
| Interest and dividend income | |
| Loans, including fees | \$ 22,821 |
| Interest-bearing deposits with other banks | 20 |
| Debt securities | |
| Taxable | 1,441 |
| Tax exempt | 312 |
| Dividends | 77 |
| Federal funds sold | 203 |
| Total interest and dividend income | ----- 24,874 ----- |
| Interest expense | |

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| | |
|---|----------|
| Deposits | |
| Interest-bearing transaction accounts | 225 |
| Savings | 814 |
| Certificates of deposit of \$100 and over | 1,498 |
| Other time deposits | 2,765 |
| | ----- |
| Total interest on deposits | 5,302 |
| Short-term borrowings | 205 |
| Long-term debt | 1,524 |
| | ----- |
| Total interest expense | 7,031 |
| | ----- |
| Net interest income | 17,843 |
| Provision for loan losses | 5,102 |
| | ----- |
| Net interest income after provision | 12,741 |
| | ----- |
| Noninterest income | |
| Service charges on deposit accounts | 3,237 |
| Mortgage brokerage income | 3,128 |
| Gains (losses) on sales of securities | 76 |
| Deposit box rent | 51 |
| Bank card fees | 30 |
| Loan related insurance commissions | 83 |
| Other | 673 |
| | ----- |
| Total noninterest income | 7,278 |
| | ----- |
| Noninterest expenses | |
| Salaries and employee benefits | 8,228 |
| Premises and equipment | 2,021 |
| Marketing | 445 |
| Regulatory fees | 247 |
| Supplies | 288 |
| Director fees | 298 |
| FDIC insurance | 54 |
| Other | 3,458 |
| | ----- |
| Total noninterest expenses | 15,039 |
| | ----- |
| Income before income taxes | 4,980 |
| Income tax expense | 1,771 |
| | ----- |
| Net income | \$ 3,209 |
| | ===== |
| Earnings per share | |
| Basic | \$ 0.74 |
| Diluted | 0.72 |

See accompanying notes to consolidated financial statements

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| | Number of Shares ----- | Amount ----- (Dollars in thousands, | Retain Earnin ----- |
|--|------------------------------|---|---------------------------|
| Balance, January 1, 2002 | 3,299,674 | \$ 17,208 | \$ 10,3 |
| Comprehensive income | | | |
| Net income | - | - | 5,4 |
| Unrealized holding gains arising during the period, net of income tax effects of \$102 | - | - | |
| Reclassification adjustment, net of income tax effects of \$43 | - | - | |
| Total other comprehensive income | - | - | |
| Total comprehensive income | - | - | |
| Common stock issued in purchase of Ridgeway Bancshares, Inc., net of issuance costs of \$178 | 1,000,000 | 11,842 | |
| Exercise of stock options | 4,710 | 40 | |
| Cash dividends (\$.32 per share) | - | - | (1,2 |
| Balance, December 31, 2002 | 4,304,384 | 29,090 | 14,5 |
| Comprehensive income | | | |
| Net income | - | - | 5,6 |
| Unrealized holding losses arising during the period, net of income tax effects of \$113 | - | - | |
| Reclassification adjustment, net of income tax effects of \$91 | - | - | |
| Total other comprehensive income (loss) | - | - | |
| Total comprehensive income | - | - | |
| Exercise of stock options | 27,076 | 312 | |
| Cash dividends (\$.36 per share) | - | - | (1,5 |
| Balance, December 31, 2003 | 4,331,460 | 29,402 | 18,6 |
| Comprehensive income | | | |
| Net income | - | - | 3,2 |
| Unrealized holding losses arising during the period, net of income tax effects of \$56 | - | - | |
| Reclassification adjustment, net of income tax effects of \$26 | - | - | |
| Total other comprehensive income (loss) | - | - | |
| Total comprehensive income | - | - | |
| Exercise of stock options | 59,324 | 640 | |

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| | | | |
|--|-----------|-----------|---------|
| Cash dividends (\$.40 per share) | - | - | (1,7 |
| | ----- | ----- | ----- |
| Balance, December 31, 2004 | 4,390,784 | \$ 30,042 | \$ 20,0 |
| | ===== | ===== | ===== |

See accompanying notes to consolidated financial statements.

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COMMUNITY BANKSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | | | |
|---|--|----|--------|
| | | | 200 |
| | | | ---- |
| Operating activities | | | |
| Net income | | \$ | 3,2 |
| Adjustments to reconcile net income to net cash provided | | | |
| (used) by operating activities | | | |
| Provision for loan losses | | | 5,1 |
| Depreciation | | | 9 |
| Writedowns of other real estate | | | |
| Amortization of definite-lived purchased intangibles | | | 2 |
| Deferred income taxes | | | 2 |
| Securities accretion and premium amortization | | | 1 |
| (Gain) loss on sale of available-for-sale securities | | | (|
| (Increase) decrease in accrued interest receivable | | | (2 |
| Increase (decrease) in accrued interest payable | | | 1 |
| Gain on sale of other real estate | | | |
| (Increase) decrease in prepaid expenses and other assets | | | (1,2 |
| (Decrease) increase in accrued expenses and other liabilities | | | (1 |
| Originations of loans held for sale | | | (180,7 |
| Proceeds of sales of loans held for sale | | | 174,0 |
| | | | ----- |
| Net cash provided (used) by operating activities | | | 1,6 |
| | | | ----- |
| Investing activities | | | |
| Net decrease (increase) in interest-bearing deposits with other banks | | | 2 |
| Purchases of held-to-maturity securities | | | |
| Purchases of available-for-sale securities | | | (35,7 |
| Maturities of held-to-maturity securities | | | |
| Maturities of available-for-sale securities | | | 31,1 |
| Proceeds from sale of available-for-sale securities | | | 13,6 |
| Purchases of other investments | | | (6 |
| Proceeds from sales of other investments | | | |
| Acquisitions accounted for using the purchase method | | | |
| Cash paid in connection with purchase acquisition | | | |
| Net increase in loans made to customers | | | (66,5 |
| Purchases of premises and equipment | | | (1,7 |
| Proceeds from sales of other real estate | | | 1 |
| | | | ----- |
| Net cash used by investing activities | | | (59,3 |
| | | | ----- |
| Financing activities | | | |
| Net increase in deposits | | | 44,7 |
| Net (decrease) increase in short-term borrowings | | | (11,2 |

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| | |
|--|---------|
| Proceeds from issuance of long-term debt | 10,5 |
| Repayments of long-term debt | (|
| Exercise of stock options | 6 |
| Issuance costs of common stock in business combinations | |
| Cash dividends paid | (1,7 |
| | ----- |
| Net cash provided by financing activities | 42,7 |
| | ----- |
| (Decrease) increase in cash and cash equivalents | (14,9 |
| Cash and cash equivalents, beginning | 41,8 |
| | ----- |
| Cash and cash equivalents, ending | \$ 26,9 |
| | ===== |
| Supplemental disclosures of cash flow information | |
| Cash payments for interest expense | \$ 6,9 |
| Cash payments for income taxes | 2,4 |
| Supplemental disclosures of non-cash investing activities | |
| Transfers of loans receivable to other real estate | \$ |
| Fair value of common stock issued in business combinations | |
| Other comprehensive income (loss) | (1 |

See accompanying notes to consolidated financial statements.

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COMMUNITY BANKSHARES, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION

Community Bankshares, Inc. (the "Corporation"), was organized under the laws of the State of South Carolina and was chartered as a business corporation on November 30, 1992. Pursuant to the provisions of the Federal Bank Holding Company Act, an application was filed with and approved by the Board of Governors of the Federal Reserve System for the Corporation to become a bank holding company by the acquisition of Orangeburg National Bank (ONB).

In June 1996, Sumter National Bank (SNB), and in July 1998, Florence National Bank (FNB), commenced operations in Sumter and Florence, South Carolina, respectively, following approval by the Comptroller of the Currency and other regulators. Upon completion of their organization, the common stock of SNB and FNB was acquired by the Corporation.

In November 2001, the Corporation acquired all the common stock of Resource Mortgage, Inc., a Columbia, South Carolina based mortgage brokerage company. The Corporation issued 95,454 shares of its common stock in exchange for 100% of the common stock of Resource Mortgage, Inc. The subsidiary was renamed Community Resource Mortgage, Inc. (CRM).

In July 2002, Ridgeway Bancshares, Inc., the holding company for the Bank of Ridgeway (BOR), merged into the Corporation. The Corporation issued 1,000,000 shares of its common stock and paid \$4,000,000 cash in exchange for 100% of the common stock of Ridgeway Bancshares, Inc. The transaction was consummated on July 1, 2002.

ONB, SNB, FNB and BOR (the "Banks") and CRM operate as wholly-owned subsidiaries

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of the Corporation with separate Boards of Directors and operating policies and they provide a variety of financial services to individuals and businesses throughout South Carolina. The primary deposit products are checking, savings and term certificate accounts. The primary lending products are consumer, commercial and mortgage loans.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

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

SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK - Most of the Corporation's activities are with customers located within South Carolina. Note 4 discusses the types of securities the Corporation purchases. Note 6 discusses the types of lending in which the Corporation engages. The Banks grant commercial, consumer and mortgage loans to customers throughout South Carolina. Although the Banks have diversified loan portfolios, a substantial portion of their debtors' ability to honor their contracts is dependent upon the economies of various South Carolina communities. The mortgage brokerage company generally originates and sells loans into the secondary market; but it sometimes maintains loans for its own portfolio on a limited basis.

CASH AND CASH EQUIVALENTS - For purposes of the consolidated statements of cash flows, the Corporation has defined cash and cash equivalents as those amounts included in the balance sheets under the caption, "Cash and due from banks" and "Federal funds sold," all of which mature within ninety days.

INTEREST-BEARING DEPOSITS WITH OTHER BANKS - Interest-bearing deposits with other banks generally mature within one year and are carried at cost.

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SECURITIES - Securities that management has both the ability and positive intent to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for amortization of premium and accretion of discounts using methods approximating the interest method. The Corporation has made a management decision generally to avoid acquiring further held-to-maturity securities. Securities that may be sold prior to maturity for asset/liability management purposes, or that may be sold in response to changes in interest rates, changes in prepayment risk, increase in regulatory capital, or other similar factors, are classified as available-for-sale and are carried at estimated fair value. Unrealized gains and losses on securities available-for-sale are excluded from earnings and reported in other comprehensive income. Gains and losses on the sale of securities available-for-sale are recorded on the trade date and are determined using the specific identification method. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses.

Interest and dividends on securities, including the amortization of premiums and

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the accretion of discounts, are reported in interest and dividends on securities.

No securities are being held for short-term resale; therefore, the Corporation does not currently use a trading account classification.

LOANS HELD FOR SALE - The Corporation originates loans held for sale to other financial institutions under commitments or other arrangements in place prior to loan origination. Loans originated and intended for sale are residential mortgage loans and are carried at the lower of cost or estimated fair value in the aggregate. Gains and losses, if any, on the sale of such loans are determined using the specific identification method. All fees and other income from these activities are recognized in income when loan sales are completed.

LOANS - The Corporation grants mortgage, commercial and consumer loans to customers. The ability of the Corporation's debtors to honor their contracts is dependent upon the general economic conditions in its market areas. Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are carried at principal amounts outstanding, increased or reduced by deferred net loan costs or fees and any unamortized purchase premiums or discounts. Interest income on loans is recognized using the interest method based upon the principal amounts outstanding. Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized as an adjustment of the related loan's yield. Generally, these amounts are amortized over the contractual life of the related loans or commitments.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well collateralized and in process of collection. Residential real estate loans are typically placed on nonaccrual at the time the loan is 120 days delinquent. Unsecured personal credit lines and certain consumer finance loans are typically charged off no later than the time the loan is 180 days delinquent.

Other consumer loans are typically charged off at the time the loan is 120 days delinquent. Generally, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost recovery method, until the loans qualify for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

ALLOWANCE FOR LOAN LOSSES - The allowance for loan losses is established through a provision for loan losses charged against earnings as losses are estimated to have occurred. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrowers' ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Management of each Bank reviews its allowance for loan losses in three broad categories: commercial and industrial, loans secured by real estate and loans to individuals, and assigns an estimated percentage factor to each in the determination of the estimate of the allowance for loan losses. Where the Banks'

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internal and external loan review programs identify loans that are subject to specific weaknesses such loans are reviewed for a specific loan loss allowance.

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A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the known circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures.

DERIVATIVE FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, requires that all derivatives be recognized as assets or liabilities in the balance sheet and measured at fair value.

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. The Corporation 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 the Corporation issues its commitments and the time that the loans close and are sold, the Corporation is subject to variability in the selling prices related to those commitments due to changes in market rates of interest. However, the Corporation 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. The Corporation generally enters into such forward sales contracts at the same time that rate lock commitments are issued. These arrangements effectively insulate the Corporation from the effects of changes in interest rates during the time that the commitments are outstanding, but the arrangements do not qualify, and are not designated, 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. Because the Corporation has effectively matched its forward sales contracts to investors and rate lock commitments to potential borrowers, no net gains or losses due to changes in market interest rates have been recorded in the statement of income for 2004.

Derivative financial instruments are written in amounts referred to as notional

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amounts. Notional amounts provide only the basis for calculating payments between counterparties and do not represent amounts to be exchanged between parties or a measure of financial risk. The table below presents the notional principal amounts of rate lock commitments and forward sales contracts as of December 31, 2004 and 2003, and the estimated fair values of those financial instruments included in other assets and liabilities in the balance sheets as of those dates.

| | 2004 ----- | 2003 ----- |
|--|-----------------------------|--|
| | Notional Amount ----- | Estimated Fair Value ----- (Dollar) |
| Commitments to originate loans to be held for sale | \$(2,612) | \$ |
| Forward sales commitments | 2,612 | ----- |
| | ----- | ----- |
| Total | \$ - | \$ |
| | ===== | ===== |

STOCK-BASED COMPENSATION - Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock-Based Compensation, as amended, encourages all

entities to adopt a fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," whereby compensation cost is the excess, if any, of the quoted market price of the stock at the grant date (or other measurement date) over the amount an employee must pay to acquire the stock. Stock options issued under the Corporation's stock option plans have no intrinsic value at the grant date, and under APB Opinion No. 25 no compensation cost is recognized for them. The Corporation has elected to continue with the accounting methodology in APB Opinion No. 25 and, as a result, has provided pro forma disclosures of net income and earnings per share and other disclosures, as if the fair value based method of accounting had been applied.

Had compensation cost for the Corporation's stock option plans been determined based on the fair value at the grant dates for awards under the plans consistent with the method prescribed by SFAS No. 123, the Corporation's net income and earnings per share would have been adjusted to the pro forma amounts indicated below:

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(Dollars in th

| | | |
|--|-------|-------|
| Net income, as reported | \$ | 3,209 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of any related tax effects | | (626) |
| | ----- | |
| Pro forma net income | \$ | 2,583 |
| | ===== | |
| | | |
| Net income per share, basic | | |
| As reported | \$ | 0.74 |
| Pro forma | | 0.59 |
| Net income per share, assuming dilution | | |
| As reported | \$ | 0.72 |
| Pro forma | | 0.58 |

OTHER REAL ESTATE - Other real estate, which is included in other assets, consists of properties acquired through foreclosure or in full or partial satisfaction of the related loan and is held for sale.

Other real estate is initially recorded at the lower of cost or the estimated fair market value, less estimated selling costs. Loan losses arising from the acquisition of such property are charged to the allowance for loan losses. An allowance for losses on foreclosed properties is maintained for subsequent downward valuation adjustments. Revenues and expenses from operation of other real estate and changes in the valuation allowance are included in other expenses.

PREMISES AND EQUIPMENT - Premises and equipment are stated at cost, less accumulated depreciation computed principally on the straight-line method over the estimated useful lives of the assets. Useful lives of assets are outlined below:

| | |
|---|---------------|
| Buildings | 32 - 40 years |
| Building components | 5 - 30 years |
| Vault doors, safe deposit boxes, night depository, etc. | 32 - 40 years |
| Furniture, fixtures and equipment | 5 - 25 years |

INCOME TAXES - Deferred income tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

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OFF-BALANCE-SHEET CREDIT RELATED FINANCIAL INSTRUMENTS - In the ordinary course of business the Banks enter into commitments to extend credit and grant standby letters of credit. Such off-balance-sheet financial instruments are recorded in the consolidated financial statements when they are funded.

SEGMENTS - Community Bankshares, Inc. through its banking subsidiaries, ONB, SNB, FNB, BOR and its mortgage subsidiary, CRM, provides a broad range of financial services to individuals and businesses in South Carolina. These

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services include demand, time, and savings deposits; lending services; ATM processing; and similar financial services. While the Corporation's decision makers monitor the revenue streams of the various financial products and services, operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, the subsidiary operations are not considered by management to comprise more than one reportable operating segment.

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

TRANSFERS OF FINANCIAL ASSETS - Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

ACCOUNTING CHANGES

Consolidation of Variable Interest Entities - FASB Interpretation 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51," provides a new framework for identifying variable interest entities ("VIEs") and determining when a company should include the assets, liabilities, noncontrolling interests and results of activities of a VIE in its consolidated financial statements. FIN 46 requires that if a business enterprise has a controlling financial interest in a VIE, the assets, liabilities and results of the activities of the VIE must be included in the consolidated financial statements of a business enterprise. This interpretation also requires existing unconsolidated VIEs to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. VIEs that effectively disperse risks will not be consolidated unless a single party holds an interest or combination of interests that effectively recombines risks that were previously dispersed. FIN 46 was effective immediately for VIEs created after January 31, 2003, and to VIEs in which an enterprise obtains an interest after that date. It applied in the first fiscal year or interim period beginning after June 15, 2003, to VIEs in which an enterprise holds a variable interest that it acquired before February 1, 2003. This Interpretation does not apply to securitization structures that are qualified special purpose entities as defined within FASB Statement No. 140. Management does not believe that adoption of this Interpretation has had, or will have, any material adverse or beneficial effect on the Corporation's consolidated financial position or results of operations.

Share-Based Payment - SFAS No. 123 (revised 2004), "SFAS 123(R)," was issued in December 2004 and requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. The statement replaces SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." Several other pronouncements are amended or superseded as well. SFAS 123(R) generally requires use of a fair-value measurement objective for such transactions and amends SFAS No. 95 to require that excess tax benefits resulting from such transactions be reported as financing cash flows rather than as a reduction of taxes paid. SFAS No. 123(R) is effective for public companies, other than "small business filers," as of the beginning of the first interim or annual reporting period that begins after June 30, 2005. Various transition methods are available for

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the restatement of prior period information. Management has not yet decided which of the available transition methods the Corporation will employ, and accordingly is unable to estimate the effect of the implementation of this statement on the Corporation's financial position or results of operations for any period.

Exchanges of Nonmonetary Assets - SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29," eliminates an exception to the measurement of such exchanges at fair value for similar productive assets and replaces it with an exception for such exchanges that do not have commercial substance. The provisions of this Statement are required to be applied prospectively to exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for such exchanges occurring in fiscal periods beginning after December 16, 2004. It is not expected that adoption and

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application of the provisions of this Statement will have any material adverse or beneficial effect on the Corporation's consolidated financial position or results of operations.

EITF Issue No. 03-1 - Emerging Issues Task Force ("EITF") Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investment," requires that companies report information about certain debt and equity securities when the estimated fair values of those securities are less than their cost. Implementation of the guidance contained in paragraphs 10-20 of EITF Issue No. 03-1 was delayed by the FASB and the effective date for those paragraphs will be superseded concurrent with the final issuance of proposed FASB Staff Position EITF Issue No. 03-1-a. Substantially all of the Corporation's investment securities are issued by the U.S. Government, or by U.S. Government agencies and corporations, and generally do not contain provisions that would allow the securities to be settled in such a way that the Corporation would not recover substantially all of its cost. Management intends, and believes that it has the ability, to hold such securities until a forecasted recovery of the fair market value, including until maturity. Management does not believe that implementation of this guidance will have any material adverse or beneficial effect on the Company's consolidated financial position or results of operations.

ADVERTISING COSTS - The cost of advertising is expensed as incurred.

OTHER - Certain amounts previously reported in the statements have been reclassified to conform to the current year's presentation and disclosure requirements. These reclassifications had no effect on reported net income or retained earnings.

NOTE 3 - CASH AND DUE FROM BANKS

The Banks are required to maintain average reserve balances with the Federal Reserve or in available cash. The average daily reserve balance requirements at December 31, 2004 and 2003 were approximately \$3,893,000 and \$2,140,000, respectively. At December 31, 2004 the Corporation had cash balances with unrelated correspondent banks totaling approximately \$9,016,000, of which \$1,159,000 was fully insured by the FDIC.

NOTE 4 - SECURITIES

Securities consist of the following:

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| | 2004 | | | December 31, | |
|--|-----------|---|--|----------------------------|-------------------|
| | Amortized | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Estimated Fair Value | Amortized Cost |
| | ----- | ----- | ----- | ----- | ----- |
| | | | | (Dollars in | |
| Securities available-for-sale | | | | | |
| U.S. Treasury and U.S. | | | | | |
| Government agencies | \$50,619 | \$ 9 | \$ 267 | \$50,361 | \$56,6 |
| States and political | | | | | |
| subdivisions | 4,985 | 126 | 1 | 5,110 | 8,1 |
| | ----- | ----- | ----- | ----- | ----- |
| Total securities available-for-sale .. | \$55,604 | \$ 135 | \$ 268 | \$55,471 | \$64,7 |
| | ===== | ===== | ===== | ===== | ===== |
| Securities held-to-maturity | | | | | |
| States and political | | | | | |
| subdivisions | \$ 1,925 | \$ - | \$ 18 | \$ 1,907 | \$ 2,0 |
| | ===== | ===== | ===== | ===== | ===== |

The amortized cost and fair value of debt securities at December 31, 2004 by contractual maturity are detailed below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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| | December | |
|---|--------------------|------------|
| | Available-for-sale | |
| | Amortized | Estimated |
| | Cost | Fair Value |
| | ----- | ----- |
| Securities available-for-sale | | |
| Due within one year | \$ 4,850 | \$ 4,842 |
| Due after one through five years | 40,534 | 40,405 |
| Due after five through ten years | 10,203 | 10,210 |
| Due after ten years | 17 | 14 |
| | ----- | ----- |
| Total securities available-for-sale | \$55,604 | \$55,471 |
| | ===== | ===== |

The following tables provide information about the Corporation's securities

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holdings which were maintained in an unrealized loss position as of December 31, 2004 and 2003:

| Description of Securities | December 31, 2004 | | |
|---|---------------------------------|--------------------|-------------------------|
| | Continuously in Unrealized Loss | | |
| | Less than 12 Months | 12 Months or more | |
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value |
| | | | |
| | | | (Dollars in thousands) |
| U.S. Treasury and | \$20,806 | \$ 102 | \$18,875 |
| U.S. Government agencies | | | |
| States and political subdivisions | 1,907 | 18 | 101 |
| | ----- | ----- | ----- |
| Total securities | \$22,713 | \$ 120 | \$18,976 |
| | ===== | ===== | ===== |

| Description of Securities | December 31, 2003 | | |
|---|---------------------------------|--------------------|-------------------------|
| | Continuously in Unrealized Loss | | |
| | Less than 12 Months | 12 Months or more | |
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value |
| | | | |
| | | | (Dollars in thousands) |
| U.S. Treasury and | \$17,132 | \$ 293 | \$ 528 |
| U.S. Government agencies | | | |
| States and political subdivisions | - | - | 204 |
| | ----- | ----- | ----- |
| Total securities | \$17,132 | \$ 293 | \$ 732 |
| | ===== | ===== | ===== |

At December 31, 2004, the Corporation held 28 securities that had been in an unrealized loss position for less than 12 months and 16 securities that had been in an unrealized loss position for 12 months or more. Unrealized losses reflected in this table generally are the result of interest rate changes that have occurred since the securities were purchased. No loss is expected on any of these securities if they are held until their maturities.

At December 31, 2004 and 2003, investment securities with a carrying value of \$25,255,000 and \$31,418,000, respectively, were pledged to secure public deposits, repurchase agreements and for other purposes required and permitted by law.

For the years ended December 31, 2004, 2003 and 2002, proceeds from sales of

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securities available-for-sale amounted to \$13,676,000, \$2,068,000, and \$20,543,000, respectively. Gross realized gains totaled \$107,000, \$73,000 and \$122,000, respectively. Gross realized losses were \$31,000, \$325,000 and \$3,000, respectively. The tax benefit (provision) applicable to the net realized gains and losses amounted to \$(27,000), \$90,000 and \$(43,000), respectively.

NOTE 5 - OTHER INVESTMENTS

Other investments consist of restricted stocks of the Federal Reserve Bank of Richmond, the Federal Home Loan Bank of Atlanta, and correspondent Bankers' Banks which are carried at cost. Management periodically evaluates these investments for impairment, with any appropriate downward adjustments being made when necessary.

NOTE 6 - LOANS

The following is a summary of loans by category:

| | December 31, | |
|--|------------------------|------------|
| | 2004 | 2003 |
| | ---- | ---- |
| | (Dollars in thousands) | |
| Commercial, financial and agricultural | \$ 96,275 | \$ 84,844 |
| Real estate- construction | 29,968 | 23,590 |
| Real estate - mortgage | 230,986 | 188,530 |
| Consumer installment | 36,420 | 35,142 |
| | ----- | ----- |
| Total | 393,649 | 332,106 |
| Allowance for loan losses | (4,347) | (4,206) |
| | ----- | ----- |
| Loans - net | \$ 389,302 | \$ 327,900 |
| | ===== | ===== |

Overdrawn demand deposits totaling \$379,000 and \$564,000 have been reclassified as loan balances at December 31, 2004 and 2003, respectively.

Gross proceeds from sales of mortgage loans originated for resale were approximately \$174,074,000, \$309,914,000, and \$176,011,000 for the years ended December 31, 2004, 2003, and 2002, respectively. Income from this activity is recognized as mortgage brokerage income.

Loans outstanding to directors, executive officers, principal holders of equity securities, or to any of their associates totaled \$6,795,000 at December 31, 2004 and \$7,416,000 at December 31, 2003. A total of \$5,720,000 in loans were made or added, while a total of \$6,341,000 were repaid or deducted during 2004. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectibility. Changes in the composition of the board of directors or the group comprising executive officers also result in additions to or deductions from loans outstanding to directors, executive officers or principal holders of equity securities.

As of December 31, 2004 and 2003, there were no significant concentrations of credit risk in any single borrower or groups of borrowers. The Corporation's loan portfolio consists primarily of extensions of credit to businesses and individuals in its local market areas in Orangeburg, Sumter, Florence, Richland,

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Fairfield and Anderson counties of South Carolina. The Banks and CRM regularly monitor various segments of their credit portfolios to assess potential concentration risks and to obtain collateral when considered necessary.

Changes in the allowance for loan losses were as follows:

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| | Years Ended December 31, | | |
|---|--------------------------|----------|----------|
| | 2004 | 2003 | 2002 |
| | ----- | ----- | ----- |
| | (Dollars in thousands) | | |
| Balance at January 1 | \$ 4,206 | \$ 3,573 | \$ 2,830 |
| Changes incident to merger activities | - | - | 444 |
| Provision charged to expense | 5,102 | 1,119 | 1,033 |
| Recoveries | 119 | 174 | 38 |
| Charge-offs | (5,080) | (660) | (772) |
| | ----- | ----- | ----- |
| Balance at December 31 | \$ 4,347 | \$ 4,206 | \$ 3,573 |
| | ===== | ===== | ===== |

The following is summary information pertaining to impaired loans:

| | December 31, | |
|---|------------------------|---------|
| | 2004 | 2003 |
| | ----- | ----- |
| | (Dollars in thousands) | |
| Impaired loans without a valuation allowance | \$ - | \$ - |
| Impaired loans with a valuation allowance | 4,941 | 2,595 |
| | ----- | ----- |
| Total impaired loans | \$4,941 | \$2,595 |
| | ===== | ===== |
| Allowance for loan losses on impaired loans at year end | \$ 881 | \$ 389 |
| | ===== | ===== |
| Average total investment in impaired loans during the year | \$2,818 | \$1,983 |

No additional funds are committed to be advanced in connection with impaired loans.

Nonaccrual and past due loans at December 31, 2004 and 2003, were as follows:

| | December 31, | |
|---|------------------------|---------|
| | 2004 | 2003 |
| | ----- | ----- |
| | (Dollars in thousands) | |
| Nonaccrual loans | \$4,941 | \$2,595 |
| Accruing 90 days or more past due | 137 | 146 |
| | ----- | ----- |
| Total | \$5,078 | \$2,741 |
| | ===== | ===== |

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Gross interest 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 income was recognized on such loans during 2004, 2003 and 2002.

NOTE 7 - PREMISES AND EQUIPMENT; OPERATING LEASES

Premises and equipment at December 31, 2004 and 2003 consist of the following:

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| | December 31, | |
|---|------------------------|----------|
| | 2004 | 2003 |
| | ----- | ----- |
| | (Dollars in thousands) | |
| Land | \$ 2,258 | \$ 1,260 |
| Buildings and components | 3,884 | 3,884 |
| Furniture, fixtures and equipment | 6,341 | 5,713 |
| Construction in process | 67 | - |
| | ----- | ----- |
| Total | 12,550 | 10,857 |
| Less, accumulated depreciation | 4,811 | 3,942 |
| | ----- | ----- |
| Premises and equipment - net | \$ 7,739 | \$ 6,915 |
| | ===== | ===== |

Depreciation expense was approximately \$926,000, \$793,000, and \$643,000, for the years ended December 31, 2004, 2003, and 2002, respectively.

As of December 31, 2003 future minimum rent commitments under various non-cancelable operating leases are as follows:

| Year | Amount |
|------------------------|----------|
| ---- | ----- |
| (Dollars in thousands) | |
| 2005 | \$ 227 |
| 2006 | 230 |
| 2007 | 216 |
| 2008 | 135 |
| 2009 | 135 |
| Thereafter | 1,884 |
| | ----- |
| Total | \$ 2,827 |
| | ===== |

Total rent expense for the years ended December 31, 2004, 2003, and 2002 was \$308,000, \$205,000, and \$149,000, respectively. Some leases provide for the payment of executory costs and contain options to renew.

NOTE 8 - INTANGIBLE ASSETS

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Changes in the carrying amounts of goodwill for the years ended December 31, 2004 and 2003 are as follows:

| | Years Ended December 31, | |
|---|--------------------------|---------|
| | 2004 | 2003 |
| | ----- | ----- |
| | (Dollars in thousands) | |
| Balance, beginning of year | \$4,321 | \$4,321 |
| Goodwill acquired during the year | - | - |
| Impairment losses | - | - |
| | ----- | ----- |
| Balance, end of year | \$4,321 | \$4,321 |
| | ===== | ===== |

Goodwill is tested for impairment annually by an independent consulting firm. As of December 31, 2004 no impairment has been determined.

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As part of the valuation of Ridgeway Bancshares, Inc., conducted by a third party firm, a core deposit intangible was computed. All amortizable intangible assets are evaluated annually to determine whether any revisions of their estimated useful lives are warranted. For the years ended December 31, 2004 and 2003, and for 2002, no such revisions have resulted.

The following tables present the gross carrying amounts and accumulated amortization for the Corporation's amortizable intangible assets as of December 31, 2004 and 2003, and the estimated amounts of amortization expense to be recognized for each of the five succeeding fiscal years, as of December 31, 2004 and 2003. Such assets are being amortized on a straight-line basis over fifteen years.

| | | December 31, 2004 |
|------------------------------------|-----------------------|--------------------------|
| | Gross Carrying Amount | Accumulated Amortization |
| | ----- | ----- |
| | | (Dollars in thousands) |
| Amortizable intangible asset class | | |
| Core deposit intangible | \$3,698 | \$ 615 |
| | ===== | ===== |

Estimated amounts of amortization expense to be recognized in each of the next five succeeding years:

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| Year ---- | December 31, ----- | |
|--------------|------------------------|--------------|
| | 2004 ---- | 2003 ---- |
| | (Dollars in thousands) | |
| 2004 | \$ - | \$ 246 |
| 2005 | 246 | 246 |
| 2006 | 246 | 246 |
| 2007 | 246 | 246 |
| 2008 | 246 | 246 |
| 2009 | 246 | NA |

NOTE 9 - DEPOSITS

At December 31, 2004, the scheduled maturities of certificates of deposit and other time deposits are as follows:

| Year ---- | Amount ----- |
|------------------------|-----------------|
| (Dollars in thousands) | |
| 2005 | \$ 160,652 |
| 2006 | 31,950 |
| 2007 | 10,057 |
| 2008 | 2,909 |
| 2009 | 288 |
| Thereafter | 7 |
| | ----- |
| Total | \$ 205,863 |
| | ===== |

Deposits of directors and officers and their related business interests totaled approximately \$4,739,000 and \$6,982,000 at December 31, 2004 and 2003, respectively.

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NOTE 10 - SHORT-TERM BORROWINGS

The Corporation's short-term borrowings generally consist of federal funds purchased and securities sold under agreements to repurchase. Federal funds purchased and securities sold under agreements with customers to repurchase generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Corporation monitors the fair value of the underlying securities on a daily basis and it is the Banks' policy to maintain a collateral value greater than the principal and accrued interest of the transaction. All securities underlying these agreements are institution-owned securities.

Short-term borrowings are summarized as follows:

December 31,

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| | 2004 ---- | 2003 ---- |
|--|------------------------|--------------|
| | (Dollars in thousands) | |
| Securities sold under agreements to repurchase | \$ 4,979 | \$ 8,090 |
| Federal funds purchased | 1,683 | - |
| Warehouse lines of credit | - | 7,743 |
| Other short-term debt | - | 2,127 |
| | ----- | ----- |
| Total | \$ 6,662 | \$17,960 |
| | ===== | ===== |

The following summarizes information about short-term borrowings during each of the periods presented:

| | December 31, ----- | |
|--|------------------------|--------------|
| | 2004 ---- | 2003 ---- |
| | (Dollars in thousands) | |
| Balance outstanding at end of year | \$ 6,662 | \$17,960 |
| Weighted average interest rate at end of the period | 1.54% | 2.38% |
| Interest expense | \$ 205 | \$ 750 |
| Maximum outstanding at any month end during the period ... | \$17,940 | \$39,379 |
| Average outstanding during the period | \$10,309 | \$29,026 |
| Weighted average interest rate during the period | 1.99% | 2.58% |

As of December 31, 2004, the Banks had unused credit availabilities under federal funds lines established with unrelated correspondent banks totaling \$34,017,000.

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NOTE 11 - LONG-TERM DEBT

Long-term debt is summarized as follows:

| | December 31, ----- | |
|---|------------------------|--------------|
| | 2004 ---- | 2003 ---- |
| | (Dollars in thousands) | |
| Advances from Federal Home Loan Bank of Atlanta to0 subsidiary banks, varying maturities to 2023 with interest rates from 2.00% to 6.94% | \$20,263 | \$20,140 |
| Junior Subordinated Debt to Unconsolidated Trusts (1), dated April 7, 2004, maturing April 7, 2034, with variable interest rate based on 3-month LIBOR..... | 10,310 | - |

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| | | |
|----------------------------|----------|----------|
| Total long-term debt | \$30,573 | \$20,140 |
| | ===== | ===== |

(1) Securities qualify as Tier 1 capital under the regulatory risk-based capital guidelines, subject to certain limitations.

Collateral for the Advances from Federal Home Loan Bank of Atlanta consists of blanket liens on the Banks' one-to-four family first lien residential mortgage loans and all of the Banks' stock in the FHLB. Such collateral was carried in the consolidated balance sheet at approximately \$71,462,000 and \$54,623,000 at December 31, 2004 and 2003, respectively.

Under the blanket lien agreements, the Banks collectively have the ability to borrow an additional \$33,674,000 from the FHLB as of December 31, 2004. Any such borrowings would be subject to the FHLB's normal approval process and would be subject to interest rates established by the FHLB at the time of each such transaction. The FHLB may terminate the availability at any time.

On March 8, 2004, the Corporation sponsored the creation of a Delaware trust, SCB Capital Trust I (the "Trust"), and is the sole owner of the common securities issued by the Trust. The Trust is a variable interest entity under FIN 46R, but is not subject to consolidation by the Corporation since substantially all risk of loss has been transferred to other entities through the Trust's March 10, 2004 issuance of \$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%. As of December 31, 2004, the interest rate associated with the debt was 4.87%. 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 perform under other obligations that are not senior to the junior subordinated Debentures.

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.

Required future principal reductions of the Corporation's long-term debts are

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summarized as follows:

| Year ---- | Amount ----- |
|------------------------|-----------------|
| (Dollars in thousands) | |
| 2005 | \$ 1,370 |
| 2006 | 500 |
| 2007 | 1,000 |
| 2008 | 2,500 |
| 2009 | 5,000 |
| Thereafter | 20,203 |
| | ----- |
| Total | \$ 30,573 |
| | ===== |

NOTE 12 - STOCK OPTIONS AND DIVIDEND REINVESTMENT SHARES

Under the Corporation's Dividend Reinvestment Plan, shareholders may reinvest all or part of their cash dividends in shares of common stock and also purchase additional shares of common stock. During the three-year period ended December 31, 2004 all shares purchased under this plan were purchased in the market, not issued by the Corporation.

At December 31, 2004, 302,783 of the Corporation's authorized common shares were reserved for future grant pursuant to an employee stock option plan and 624,655 common shares were reserved for issuance pursuant to the dividend reinvestment and additional stock purchase plan.

During 2001, the Corporation amended its 1997 Stock Option Plan (the "Plan") to increase by 200,000 shares the number of shares reserved for issuance upon exercise of options and to permit participation in the plan by non-employee directors. During 2003, the Corporation amended the Plan to increase by 300,000 shares the number of shares reserved for issuance upon exercise of employee incentive stock options. Under the Plan, as amended, up to 785,600 shares of common stock were authorized to be granted to selected officers, other employees, and non-employee directors of the Corporation and/or its subsidiaries pursuant to exercise of incentive and nonqualified stock options. Of such shares, 590,050 were reserved for issuance pursuant to exercise of incentive stock options and 195,550 were reserved for issuance pursuant to exercise of nonqualified stock options.

The exercise price of any incentive option granted is equal to the fair value of the common stock on the date the option is granted. Nonqualified options can be issued for less than fair value; however, the Corporation has not elected to issue these options for less than fair value at the date of the grant. The options become vested and may be exercised one year after issuance.

A summary of the status of options issued pursuant to the Corporation's stock option plan is presented below:

| | Years Ended December ----- |
|--------------|-------------------------------|
| 2004 ---- | 2003 ---- |

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| | Number of Shares ----- | Weighted Average Exercise Price ----- | Number of Shares ----- | Weight Averag Exerci Price ----- |
|--|------------------------------|---|------------------------------|--|
| Outstanding at beginning of year | 543,991 | \$ 13.85 | 384,667 | \$ 11.2 |
| Granted | 27,000 | \$ 17.74 | 195,750 | \$ 18.8 |
| Exercised | (59,324) | \$ 10.80 | (27,076) | \$ 11.5 |
| Forfeited or expired | (28,850) | \$ 18.85 | (9,350) | \$ 18.8 |
| | ----- | | ----- | |
| Outstanding at end of year | 482,817 | \$ 14.14 | 543,991 | \$ 13.8 |
| | ===== | | ===== | |
| Options exercisable at year end | 455,817 | \$ 13.93 | 543,991 | \$ 11.2 |

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The weighted average fair values of options granted each year are computed using the Black-Scholes option pricing model using the assumptions detailed below:

| | Years Ended December 31, ----- | | |
|--|-----------------------------------|--------------|--------------|
| | 2004 ---- | 2003 ---- | 2002 ---- |
| Weighted average fair value of options granted during the year | \$ 4.74 | \$ 4.33 | \$ - |
| Risk-free interest rate | 3.74% | 3.72% | 0.00% |
| Expected life (years) | 7.00 | 6.01 | - |
| Expected volatility | 26.15% | 24.01% | 0.00% |
| Yield | 2.18% | 2.00% | 0.00% |

The following table summarizes information about the options outstanding:

| | | December 31, 2004 ----- | | |
|-----------------------------------|--------------------------------|--|---|-----------------------|
| | | Options Outstanding ----- | | Op --- |
| Range of Exercise Prices ----- | Number Outstanding ----- | Weighted Average Remaining Contractual Life (Years) ----- | Weighted Average Exercise Price ----- | Num Outst ----- |
| \$ 7.62 to \$ 11.00 | 182,410 | 5.5 | \$ 10.37 | 182 |
| \$12.83 to \$ 18.85 | 300,407 | 7.1 | \$ 16.43 | 273 |
| | ----- | | | --- |
| | 482,817 | 6.5 | \$ 14.14 | 455 |
| | ===== | | | ===== |

The Corporation applies APB Opinion No. 25 and related interpretations in accounting for its stock-based compensation plans. Accordingly, no compensation cost has been recognized.

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NOTE 13 - INCOME TAXES

The Corporation files consolidated federal income tax returns on a calendar-year basis.

The provision for income taxes consists of the following:

| | Years Ended December 31, | | |
|--------------------------------|--------------------------|---------|----------|
| | 2004 | 2003 | 2002 |
| | ----- | ----- | ----- |
| | (Dollars in thousands) | | |
| Current | | | |
| Federal | \$1,367 | \$2,820 | \$2,687 |
| State | 117 | 280 | 248 |
| | ----- | ----- | ----- |
| Total current | 1,484 | 3,100 | 2,935 |
| | ----- | ----- | ----- |
| Deferred | 287 | 47 | (15) |
| | ----- | ----- | ----- |
| Total income tax expense | \$1,771 | \$3,147 | \$ 2,920 |
| | ===== | ===== | ===== |

The provision for income taxes differs from that computed by applying federal statutory rates at 34% to income before income tax expense as indicated in the following summary:

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| | Years Ended December 31, | | |
|--|--------------------------|---------|---------|
| | 2004 | 2003 | 2002 |
| | ----- | ----- | ----- |
| | (Dollars in thousands) | | |
| Tax expense at statutory rate | \$1,693 | \$2,986 | \$2,829 |
| State income tax, net of federal | | | |
| income tax benefit | 184 | 174 | 156 |
| Tax-exempt interest income | (133) | (136) | (78) |
| Amortization of organization costs and | | | |
| core deposit intangibles | 84 | 63 | 25 |
| Other, net | (57) | 60 | (12) |
| | ----- | ----- | ----- |
| Total | \$1,771 | \$3,147 | \$2,920 |
| | ===== | ===== | ===== |

Temporary differences, which give rise to deferred tax assets and liabilities, are as follows:

| | December 31, | |
|---------------------|------------------------|-------|
| | 2004 | 2003 |
| | ----- | ----- |
| | (Dollars in thousands) | |
| Deferred tax assets | | |

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| | | |
|---|---------|---------|
| Allowance for loan losses | \$1,073 | \$1,378 |
| Unrealized net holding losses on available-for-sale securities | 50 | - |
| Other | 67 | 82 |
| | ----- | ----- |
| Gross deferred tax assets | 1,190 | 1,460 |
| Valuation allowance | - | - |
| | ----- | ----- |
| Total | 1,190 | 1,460 |
| | ----- | ----- |
| Deferred tax liabilities | | |
| Accelerated depreciation | 486 | 462 |
| Accretion | 8 | 10 |
| Unrealized net holding gains on available-for-sale securities | - | 30 |
| Purchase adjustments - securities | 44 | 92 |
| Purchase adjustments - loans | 44 | 61 |
| Other | 9 | - |
| | ----- | ----- |
| Gross deferred tax liabilities | 591 | 655 |
| | ----- | ----- |
| Net deferred income tax assets | \$ 599 | \$ 805 |
| | ===== | ===== |

NOTE 14 - EMPLOYEE BENEFIT PLANS

The Corporation provides a defined contribution plan with an Internal Revenue Code Section 401(k) provision. All employees who have completed 500 hours of service during a six-month period and have attained age 21 may participate in the plan.

A participant may elect to make tax deferred contributions up to a maximum of 12% of eligible compensation. The Corporation will make matching contributions on behalf of each participant for 100% of the elective deferral, not exceeding 3% of the participant's compensation. The Corporation may also make additional contributions determined at the discretion of the Board of Directors.

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The Corporation's contributions for 401(k) related profit sharing for the years ended December 31, 2004, 2003, and 2002 totaled approximately \$285,000, \$170,000, and \$132,000, respectively. Since 2001, the senior officers of the Corporation are no longer included in this profit sharing program.

The Bank of Ridgeway maintains a defined benefit pension plan covering the majority of its employees. This plan was in place prior to the Corporation's acquisition of Ridgeway Bancshares, Inc. in 2002. Because there are no such plans for the Corporation's other subsidiaries, and there are no plans to establish any other such plans, the Corporation froze benefit accruals and discontinued additional participation and voluntary contributions in the plan during 2003. Management has no immediate plans to formally terminate the plan and distribute its assets. The changes in the pension plan have been accounted for as curtailments in accordance with the provisions of SFAS No. 88. The following table shows the activity and status of that plan:

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2004

Change in Benefit Obligation

| | |
|--|--------|
| Benefit obligation as of January 1 | \$ 710 |
| Service cost | - |
| Interest cost | 46 |
| Curtailments | - |
| Actuarial (gain) loss | 106 |
| Acquisition | - |
| Benefits paid | (110) |
| | ----- |
| Benefit obligation as of December 31 | 752 |
| | ----- |

Change in Plan Assets

| | |
|---|-------|
| Fair value of plan assets as of January 1 | 656 |
| Actual return (loss) on plan assets | 88 |
| Acquisition | - |
| Employer contributions | 60 |
| Benefits paid | (110) |
| | ----- |
| Fair value of plan assets as of December 31 | 694 |
| | ----- |

| | |
|--|-------|
| Funded Status of the Plan | (58) |
| Unrecognized transition obligation | - |
| Unrecognized net loss | 101 |
| | ----- |

| | |
|---|-------|
| Prepaid (accrued) benefit liability | \$ 43 |
| | ===== |

Amount Recognized in the Consolidated
Balance Sheets consists of:

| | |
|--------------------------------------|-------|
| Prepaid (accrued) benefit cost | \$ 43 |
| | ===== |

The actuarial assumptions used to determine the benefit obligation as of December 31, 2004 and 2003 were as follows:

| | December 31, | | |
|---|--------------|-------|-------|
| | 2004 | 2003 | 2002 |
| | ---- | ---- | ---- |
| Pension Benefits Weighted Average Assumptions | | | |
| Discount rate | 6.25% | 7.25% | 7.25% |
| Rate of compensation increase | 3.00% | 5.00% | 5.00% |

The components of net periodic pension cost were as follows:

| Years Ended December 31, | | |
|--------------------------|------|------|
| 2004 | 2003 | 2002 |
| ---- | ---- | ---- |
| (Dollars in thousands) | | |

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Components of Net Periodic Benefit Cost

| | | | |
|---|-------|-------|-------|
| Service cost | \$ - | \$ 11 | \$ 59 |
| Interest cost | 46 | 50 | 50 |
| Expected return on plan assets | (47) | (41) | (39) |
| Recognized net actuarial loss (gain) | - | 169 | - |
| Amortization of transition obligation | - | - | 3 |
| Amortization of unrecognized net loss | 2 | 1 | 3 |
| Curtailement (gain) loss | - | (169) | - |
| | ----- | ----- | ----- |
| Net periodic benefit cost | \$ 1 | \$ 21 | \$ 76 |
| | ===== | ===== | ===== |

For the years ended December 31, 2004, 2003 and 2002, the assumptions used to determine net periodic pension cost were as follows:

| | | | |
|---|--------------------------|-------|-------|
| | Years Ended December 31, | | |
| | ----- | | |
| | 2004 | 2003 | 2002 |
| | ---- | ---- | ---- |
| Pension Cost Weighted Average Assumptions | | | |
| Discount rate | 6.25% | 7.25% | 7.25% |
| Expected long-term rate of return on plan assets | 7.25% | 7.25% | 7.25% |
| Rate of compensation increase | 3.00% | 5.00% | 5.00% |

As of December 31, 2004 and 2003, pension plan assets consisted primarily of the following:

| | | |
|--------------------------------|--|------|
| | Percentage of Plan Assets at December 31, | |
| | ----- | |
| Asset Category | 2004 | 2003 |
| | ---- | ---- |
| Equities | 53% | 69% |
| Bonds | 24% | 10% |
| Cash | 0% | 3% |
| Stable value instruments | 23% | 18% |
| | --- | --- |
| Total | 100% | 100% |
| | === | === |

As of December 31, 2003, plan assets included a \$22,000 Bank of Ridgeway money market account bearing interest at the rate of 1.00%. The plan did not hold any direct investment in the Corporation's common stock.

The Bank of Ridgeway expects to contribute \$60,000 to the pension plan in 2005.

Estimated future benefit payments are as follows:

| | |
|------|------------------------|
| Year | Amount |
| ---- | ----- |
| | (Dollars in thousands) |
| 2005 | \$ 1 |
| 2006 | 18 |
| 2007 | 33 |
| 2008 | 34 |

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2009
Years 2010 through 2014

47
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The Corporation maintains no postretirement or post employment benefit plans.

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NOTE 15 - OFF-BALANCE-SHEET COMMITMENTS

The Banks 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, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Banks' exposure to credit loss is represented by the contractual notional amount of these commitments. The Banks generally use the same credit policies in making these commitments as they do for on-balance-sheet instruments.

At December 31, 2004 and 2003, the following financial instruments were outstanding whose contract amounts represent credit risk:

| | December 31, | |
|--|------------------------|----------|
| | 2004 | 2003 |
| | ---- | ---- |
| | (Dollars in thousands) | |
| Loan commitments | \$11,644 | \$15,501 |
| Unfunded commitments under lines of credit | 43,312 | 36,735 |
| Standby letters of credit | 2,919 | 4,489 |

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 drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Banks upon extension of credit, is based on management's credit evaluation of the borrower. 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 by the Banks 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. The Banks generally hold collateral supporting those commitments 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. To reduce credit risk related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Banks' credit evaluation of the customer. Collateral

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held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment and real estate.

NOTE 16 - EARNINGS PER SHARE

Basic earnings per share represent income available to common shareholders divided by the weighted-average number of shares outstanding during the year. Diluted earnings per share reflect additional common shares that would have been outstanding if all dilutive potential stock options were exercised at the beginning of each year and the proceeds used to purchase shares of the Corporation's common stock at the average market price during the year. Dilutive potential common shares that may be issued by the Corporation relate solely to outstanding stock options.

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Earnings per common share were computed based on the following:

| | 2004 |
|---|-----------|
| | ----- |
| | (Dollar) |
| Net income per share, basic | |
| Numerator - net income | \$ 3,209 |
| | ===== |
| Denominator | |
| Weighted average common shares issued and outstanding | 4,357,919 |
| | ===== |
| Net income per share, basic | \$.74 |
| | ===== |
| Net income per share, assuming dilution | |
| Numerator - net income | \$ 3,209 |
| | ===== |
| Denominator | |
| Weighted average common shares issued and outstanding | 4,357,919 |
| Effect of dilutive stock options | 114,500 |
| | ----- |
| Total shares | 4,472,419 |
| | ===== |
| Net income per share, assuming dilution | \$.72 |
| | ===== |

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation

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techniques. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS No. 107, "Disclosures about Fair Value of Financial Instruments," as amended, excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation.

The following methods and assumptions were used by the Corporation in estimating fair values of financial instruments as disclosed herein:

Cash and cash equivalents. The carrying amounts of cash and cash equivalents approximate fair values.

Interest-bearing deposits with other banks. The carrying amounts of interest-bearing deposits with banks approximate their fair values.

Securities available-for-sale and held-to-maturity. Fair values for securities are based on quoted market prices. The market values of state and local government securities are established with the assistance of an independent pricing service. The values are based on data which often reflect transactions of relatively small size and are not necessarily indicative of the value of the securities when traded in large volumes.

Other investments. Fair values of other investments, consisting of restricted securities, approximate the carrying amounts and are based on the redemption provisions of the issuers.

Loans held for sale. The carrying amounts approximate their fair values.

Loans. Fair values for certain mortgage loans (for example, one-to-four family residential) and other consumer loans are based on quoted market prices of similar loans sold, adjusted for differences in loan

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characteristics. Fair values for all other performing loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Accrued interest. The carrying amounts of accrued interest receivable and payable approximate fair value.

Deposits. The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for certificates of deposit and other time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term borrowings. The carrying amounts of federal funds purchased and borrowings under repurchase agreements approximate their fair values because of the associated variable interest rates.

Long-term debt. The fair value of fixed-rate long-term debt is estimated using discounted cash flow analyses based on the Corporation's current

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incremental borrowing rates for similar types of borrowing arrangements. The fair value of variable-rate long-term debt is estimated at the carrying amount of the debt.

Off-balance-sheet commitments. Fair values for off-balance-sheet commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings. The vast majority of loan commitments do not involve the charging of a fee, and costs associated with outstanding letters of credit are not material. For loan commitments and standby letters of credit, the committed interest rates are either variable or approximate current interest rates offered for similar commitments. Therefore, the estimated fair values of these off-balance-sheet commitments are nominal.

The estimated fair values and related carrying or notional amounts of the Corporation's financial instruments at December 31, 2004 and 2003, are as follows:

| | 2004 ----- | 2003 ----- |
|--|---|--|
| | Carrying Amount of Assets (Liabilities) ----- | Estimated Fair Value of Assets (Liabilities) ----- |
| | | (Dollars) |
| Cash and cash equivalents | \$ 26,968 | \$ 26,968 |
| Interest bearing deposits with other banks | 852 | 852 |
| Securities available-for-sale | 55,471 | 55,471 |
| Securities held-to-maturity | 1,925 | 1,907 |
| Other investments | 2,642 | 2,642 |
| Loans held for sale | 15,090 | 15,090 |
| Loans, net | 389,302 | 383,625 |
| Accrued interest receivable | 2,419 | 2,419 |
| Deposits | (423,458) | (424,623) |
| Short-term borrowings | (6,662) | (6,662) |
| Long-term debt | (30,573) | (31,486) |
| Accrued interest payable | (691) | (691) |
| Off-balance-sheet commitments | | |
| Loan commitments | \$ (11,644) | \$ - |
| Unfunded commitments under lines of credit | (43,312) | - |
| Standby letters of credit | (2,919) | - |

NOTE 18 - CONTINGENCIES

The Corporation is subject at times to claims and lawsuits arising out of the normal course of business. As of December 31, 2004, no claims or lawsuits were pending or threatened which, in the opinion of management, are likely to have a

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material effect on the Corporation's consolidated financial statements.

NOTE 19 - REGULATORY MATTERS

The Banks are subject to the dividend restrictions set forth by various banking regulators. Under such restrictions, the national banks may not, without prior approval, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained earnings (as defined) from the prior two years and the state bank may not declare dividends in excess of the current year's earnings. At December 31, 2004, the dividends that the Banks could declare without the approval of their primary bank regulator amounted to approximately \$7,961,000. In addition, dividends paid by the Banks to the Corporation would be prohibited if the effect thereof would cause the Banks' capital to be reduced below applicable minimum capital requirements. The Banks are also restricted by law as to the amount they may lend to any non-depository affiliate, including the Corporation and CRM. Such loans are subject to the requirements of Section 23A of the Federal Reserve Act including a general limitation to not more than 10% of capital and specified ratios of the fair market value of allowable collateral to loan amounts.

The Corporation (on a consolidated basis) and the Banks are each subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on the Corporation's and the Banks' financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Banks to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital to average assets (as defined). Management believes, as of December 31, 2004 and 2003, that the Corporation and the Banks met all capital adequacy requirements to which they are subject.

As of December 31, 2004, for ONB, for SNB, for FNB, and for BOR, the most recent notifications from the FDIC categorized the Banks as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Banks must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since the notifications that management believes have changed the Banks' categories. The Corporation's and the Banks' actual capital amounts and ratios are also presented in the following table.

| | | | |
|--------|--------|--|--------|
| | Actual | | Mi |
| | ----- | | Capi |
| Amount | Ratio | | Amount |

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| | ----- | ----- | ----- |
|--|----------|-------|----------|
| December 31, 2004 | | | (Dollar |
| Tier I Capital (to Average Assets) | | | |
| Consolidated | \$52,713 | 10.7% | \$19,720 |
| ONB | 18,037 | 8.9% | 8,118 |
| SNB | 10,540 | 7.8% | 5,379 |
| FNB | 6,202 | 8.6% | 2,872 |
| BOR | 7,426 | 8.7% | 3,413 |
| Tier I Capital (to Risk Weighted Assets) | | | |
| Consolidated | \$52,713 | 13.7% | \$15,408 |
| ONB | 18,037 | 12.0% | 6,037 |
| SNB | 10,540 | 9.5% | 4,459 |
| FNB | 6,202 | 9.6% | 2,573 |
| BOR | 7,426 | 13.0% | 2,292 |
| Total Capital (to Risk Weighted Assets) | | | |
| Consolidated | \$57,060 | 14.8% | \$20,816 |
| ONB | 19,763 | 13.1% | 12,074 |
| SNB | 11,714 | 10.5% | 8,917 |
| FNB | 6,781 | 10.5% | 5,146 |
| BOR | 7,914 | 13.8% | 4,583 |
| December 31, 2003 | | | |
| Tier I Capital (to Average Assets) | | | |
| Consolidated | \$40,380 | 9.1% | \$17,709 |
| ONB | 16,285 | 9.1% | 7,125 |
| SNB | 9,058 | 7.6% | 4,741 |
| FNB | 5,047 | 8.9% | 2,266 |
| BOR | 6,906 | 8.2% | 3,377 |
| Tier I Capital (to Risk Weighted Assets) | | | |
| Consolidated | \$40,380 | 12.0% | \$13,473 |
| ONB | 16,285 | 12.5% | 5,213 |
| SNB | 9,058 | 9.0% | 4,015 |
| FNB | 5,047 | 9.9% | 2,042 |
| BOR | 6,906 | 14.4% | 1,921 |
| Total Capital (to Risk Weighted Assets) | | | |
| Consolidated | \$44,385 | 13.2% | \$26,947 |
| ONB | 17,916 | 13.8% | 10,427 |
| SNB | 10,313 | 10.3% | 8,030 |
| FNB | 5,591 | 11.0% | 4,083 |
| BOR | 7,338 | 15.3% | 3,841 |

The mortgage brokerage subsidiary is subject to a minimum regulatory adjusted net worth requirement to maintain its certification as a HUD-approved Title II Loan Correspondent. Certain investor and warehouse credit line agreements require that the mortgage subsidiary maintain its HUD certification. Accordingly, failure to maintain the minimum regulatory adjusted net worth could result in a significant limitation of the mortgage subsidiary's ability to originate, fund or sell loans, and therefore could have a direct, material adverse effect on its business and the Corporation's consolidated financial statements.

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CRM's actual regulatory adjusted net worth and the minimum amount required by HUD were as follows:

| | December 31, ----- | |
|---------------------------------|------------------------|--------------|
| | 2004 ---- | 2003 ---- |
| | (Dollars in thousands) | |
| Actual adjusted net worth | \$ 1,161 | \$ 1,502 |
| Minimum required | 63 | 63 |

HUD regulations require that 20%, up to a maximum of \$100,000, of the adjusted net worth amount be held in liquid assets. CRM's liquid assets for regulatory purposes totaled \$1,331,000 and \$1,310,000, respectively, as of December, 31, 2004 and 2003.

NOTE 20 - CONDENSED FINANCIAL STATEMENTS

Presented below are the condensed financial statements for Community Bankshares, Inc. (Parent Company only):

COMMUNITY BANKSHARES, INC. (PARENT COMPANY ONLY)

| | December 31, ----- | |
|--|------------------------|--------------|
| | 2004 ---- | 2003 ---- |
| | (Dollars in thousands) | |
| Condensed Balance Sheets | | |
| Assets | | |
| Cash | \$ 3,991 | \$ 1,340 |
| Investment in banking subsidiaries | 48,598 | 44,082 |
| Investment in nonbanking subsidiary | 1,471 | 1,502 |
| Securities available-for-sale, at fair value | 96 | 96 |
| Loans to nonbanking subsidiary | 4,883 | - |
| Premises and equipment - net | 1,037 | 1,009 |
| Goodwill | 921 | 921 |
| Other assets | 96 | 179 |
| | ----- | ----- |
| Total assets | \$61,093 | \$49,129 |
| | ===== | ===== |
| Liabilities | | |
| Short-term borrowings | \$ - | \$ 635 |
| Long-term debt | 10,310 | - |
| Other liabilities | 756 | 424 |
| Shareholders' equity | 50,027 | 48,070 |
| | ----- | ----- |
| Total liabilities and shareholders' equity | \$61,093 | \$49,129 |
| | ===== | ===== |

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Condensed Statements of Income

Income

| | |
|--|--------|
| Management fees from subsidiaries | \$ 2,2 |
| Dividends received from banking subsidiaries | 2,6 |
| Interest income | 1 |
| Other income | |

Total income 5,1

Expenses

| | |
|--------------------------------------|-----|
| Salaries and employee benefits | 1,3 |
| Premises and equipment | 6 |
| Supplies | 1 |
| Directors' fees | |
| Interest expense | 4 |
| Other expenses | 9 |

Total expenses 3,5

Income before income taxes and equity in

| | |
|--|-----|
| undistributed earnings of subsidiaries | 1,6 |
| Income tax (benefit) | (3) |
| Equity in undistributed earnings of banking subsidiaries | 1,6 |
| Equity in undistributed earnings (loss) of nonbanking subsidiary | (4) |

Net income \$ 3,2

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2004

Condensed Statements of Cash Flows

Operating activities

| | |
|--|----------|
| Net income | \$ 3,209 |
| Adjustments to reconcile net income to net cash provided by operating activities | |
| Equity in undistributed earnings of subsidiaries | (1,197) |
| Depreciation and amortization | 332 |
| Loss on disposal of premises and equipment | - |
| Decrease (increase) in other assets | 83 |
| Increase in other liabilities | 332 |

Net cash provided by operating activities 2,759

Investing activities

| | |
|--|---------|
| Purchase of securities available-for-sale | - |
| Net increase in loans to nonbanking subsidiaries | (4,883) |

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| | |
|---|----------|
| Investment in Bank of Ridgeway | - |
| Investment in SCB Capital Trust | (310) |
| Investments in banking subsidiaries | (3,000) |
| Investment in nonbanking subsidiary | (126) |
| Purchases of premises and equipment | (360) |
| | ----- |
| Net cash used by investing activities | (8,679) |
| | ----- |
| Financing activities | |
| (Decrease) increase in short-term borrowings, net | (635) |
| Proceeds of issuing long-term debt | 10,310 |
| Issuance costs of common stock in business combinations | - |
| Exercise of stock options | 640 |
| Cash dividends paid | (1,744) |
| | ----- |
| Net cash provided (used) by financing activities | 8,571 |
| | ----- |
| Increase (decrease) in cash and cash equivalents | 2,651 |
| Cash and cash equivalents, beginning | 1,340 |
| | ----- |
| Cash and cash equivalents, ending | \$ 3,991 |
| | ===== |

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NOTE 21 - QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

| | Years Ended Dec | | | | |
|---|----------------------------|----------|----------|----------|-------|
| | ----- | | | | |
| | 2004 | | | | |
| | Fourth | Third | Second | First | Fou |
| | Quarter | Quarter | Quarter | Quarter | Qua |
| | ----- | ----- | ----- | ----- | ----- |
| | (Dollars in thousands, exc | | | | |
| Interest and dividend income | \$ 6,785 | \$ 6,253 | \$ 5,928 | \$ 5,908 | \$ 5 |
| Interest expense | 1,972 | 1,757 | 1,662 | 1,640 | 1 |
| | ----- | ----- | ----- | ----- | ----- |
| Net interest income | 4,813 | 4,496 | 4,266 | 4,268 | 4 |
| Provision for loan losses | 2,963 | 1,648 | 258 | 233 | 2 |
| | ----- | ----- | ----- | ----- | ----- |
| Net interest income after provision | 1,850 | 2,848 | 4,008 | 4,035 | 3 |
| Noninterest income | 1,581 | 1,839 | 1,932 | 1,850 | 1 |
| Gains (losses) on sales of securities | 71 | 10 | (1) | (4) | 1 |
| Noninterest expense | 3,705 | 3,826 | 3,775 | 3,733 | 3 |
| | ----- | ----- | ----- | ----- | ----- |
| Income (loss) before income taxes | (203) | 871 | 2,164 | 2,148 | 2 |
| Provision for income taxes | (67) | 306 | 769 | 763 | 7 |
| | ----- | ----- | ----- | ----- | ----- |
| Net income (loss) | \$ (136) | \$ 565 | \$ 1,395 | \$ 1,385 | \$ 1 |
| | ===== | ===== | ===== | ===== | ===== |

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Earnings (loss) per share

| | | | | | |
|---------------|-----------|---------|---------|---------|----|
| Basic | \$ (0.03) | \$ 0.13 | \$ 0.32 | \$ 0.32 | \$ |
| Diluted | (0.03) | 0.12 | 0.31 | 0.31 | |

In the third quarter of 2004, management became aware of possible problems regarding several large commercial loans. In most cases, the loans were single payment term loans and management decided to seek collection as the loans became due contractually. Using the information available at the end of third quarter, management increased the provision for loan losses to raise the allowance for loan losses to cover its estimate of possible future losses on these loans as well as the overall portfolio. During the fourth quarter, most of these loans became delinquent and management pursued legal options which resulted in some loan payoffs. As of December 31, 2004, management charged off most of the balances of the remaining problem loans. This action resulted in a further significant increase in the provision for loan losses in the fourth quarter to replenish the allowance for loan losses to an amount estimated by management to be adequate for the portfolio as a whole as of year end.

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Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

There were no disagreements with or changes in accountants.

Item 9A. 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 Corporation's disclosure controls and procedures (as defined in 17 C.F.R. Sections 240.13a-15(e) or 240.15d-15(e)), the Corporation's chief executive officer and chief financial officer concluded that such controls and procedures, as of the end of the period covered by this annual report, were effective.

No disclosure is required under 17 C.F.R. Section 229.308 (a) or (b). 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.

Item 9B. Other Information

No information required to be disclosed in a report on Form 8-K during the fourth quarter of 2004 was not so disclosed.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information set forth under the captions "Management - Directors," "Management - Executive Officers," "Management - Committees of the Board of Directors - Audit Committee" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement to be used in conjunction with the 2005 Annual Meeting of Shareholders (the "Proxy Statement"), which will be filed within 120 days of the Corporation's fiscal year end, is incorporated herein by reference.

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Phil P. Leventis (age 59) has served as a director of the Corporation since 1996. His term as a director will expire at the 2005 annual meeting of shareholders and he has chosen not to be nominated for another term. Mr. Leventis is President and Chief Executive Officer of Dixie Central Distributing Co., Inc., a wholesale beverage distributor. He is also a member of the South Carolina State Senate. Mr. Leventis has also served as Chairman of the Board of Directors of Sumter National Bank since June 1996.

Audit Committee Financial Expert

The Corporation's board of directors has determined that the Corporation does not have an "audit committee financial expert," as that term is defined by Item 401(h) of Regulation S-K promulgated by the Securities and Exchange Commission, serving on its audit committee. The Corporation's audit committee is a committee of directors who are elected by the shareholders and who are independent of the Corporation and its management. After reviewing the experience and training of all of the Corporation's independent directors, the board of directors has concluded that no independent director meets the SEC's very demanding definition. Therefore, it would be necessary to find a qualified individual willing to serve as both a director and member of the audit committee and have that person elected by the shareholders in order to have an "audit committee financial expert" serving on the Corporation's audit committee. The Corporation's audit committee is, however, authorized to use consultants to provide financial accounting expertise in any instance where members of the committee believe such assistance would be useful. Accordingly, the Corporation does not believe that it needs to have an "audit committee financial expert" on its audit committee.

Code of Ethics

The Corporation has adopted a code of ethics (as defined by C.F.R. 229.406) that applies to its principal executive officer and principal financial officer. The code of ethics is posted on the Corporation's website at www.communitybanksharesinc.com.

Item 11. Executive Compensation

With the exception of the information set forth under the captions "Board Report on Executive Officer Compensation" and "Shareholder Return Performance Graph", which information is not incorporated herein by reference, the information set forth under the caption "Management Compensation" in the Proxy Statement is incorporated herein by reference.

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

The information set forth under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement is incorporated herein by reference.

Equity Compensation Plan Information. The following table sets forth aggregated information as of December 31, 2004 about all of the Corporation's compensation plans (including individual compensation arrangements) under which equity securities of the Corporation are authorized for issuance.

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| Stock option plan | Number of securities to be issued upon exercise of outstanding options warrants and rights (a) ----- | Weighted average exercise price of outstanding options warrants and rights (b) ----- |
|---|---|---|
| Equity compensation plans approved by security holders | 482,817 | \$14.14 |
| Equity compensation plans not approved by security holders | NA ----- | NA ----- |
| Total | 482,817 ===== | \$14.14 ===== |

The Corporation's 1997 Stock Option Plan, and issuance of up to 785,600 shares under that plan, have previously been approved by shareholders.

Item 13. Certain Relationships and Related Transactions

The information set forth under the caption "Certain Relationships and Related Transactions" in the Proxy Statement is incorporated herein by reference.

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Item 14. Principal Accountant Fees and Services

The information set forth under the caption "Independent Public Accountants - Fees Billed by Independent Auditors" and "- Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors" in the Proxy Statement is incorporated herein by reference.

Item 15. Exhibits and Financial Statement Schedules

(a) (1) All financial statements:

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

(2) Financial statement schedules:

Quarterly Data for 2004 and 2003

(3)

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| Exhibit No. (from item 601 of S-K) | Description |
|--|---|
| 3.1 | Articles of Incorporation, as amended (incorporated by reference to exhibits filed in the Registrant's Form 10-QSB for the quarter ended September 30, 1997). |
| 3.2 | Bylaws, as amended (incorporated by reference to Registrant's Form 8-K filed February 4, 2005). |
| 4 | Stock certificate (incorporated by reference to exhibits filed in the Registrant's Registration Statement on Form S-2, filed September 11, 1995, Commission File No. 33-96746). |
| 10.1 | 1997 Stock Option Plan, as amended (incorporated by reference to exhibit to Registrant's Form S-8 (File No. 333-118119)). |
| 10.2 | Lease for site of Florence National Bank (incorporated by reference to Registrant's Form 10-K for the year ended December 31, 1999). |
| 10.3 | Change of Control Agreements between the Registrant and each of William Traynham and Michael A. Wolfe (incorporated by reference to exhibits Registrant's Form 10-QSB for the quarter ended June 30, 1999). |
| 10.4 | Warehouse Credit and Security Agreement, dated October 5, 2004, between Community Resource Mortgage, Inc. and Branch Bank and Trust Company. |
| 10.5 | Guaranty, dated October 5, 2004, by Registrant of obligations of Community Resource Mortgage, Inc. to Branch Bank and Trust Company. |
| 10.6 | Indenture, dated as of March 1, 2004, between Registrant and Wells Fargo Bank, National Association (incorporated by reference to exhibit filed with Registrant's Form 10-Q for the quarter ended March 31, 2004 ("First Quarter 2004 Form 10-Q")). |
| 71 | |
| 10.7 | Amended and Restated Declaration of Trust, dated March 10, 2004, among the Trustees and Administrators named therein and SCB Capital Trust (incorporated by reference to the First Quarter 2004 Form 10-Q). |
| 10.8 | Guaranty Agreement, dated as of March 10, 2004, between Registrant and Wells Fargo Bank, National Association (incorporated by reference to the First Quarter 2004 Form 10-Q). |
| 10.9 | Employment Agreement between Community Resource Mortgage Inc. and A. Wade Douroux (incorporated by reference to exhibits filed in the Registrant's Form S-4, Commission File No. 333-819000). |
| 10.10 | Form of Employment Agreement between the Corporation and William A. Harwell (incorporated by reference to exhibits filed in the Registrant's Form S-4, Commission File No. 333-819000). |
| 10.11 | Form of Employment Agreement between the Corporation and Samuel L. Erwin. |
| 10.12 | Form of Employment Agreement between the Corporation and each of William W. Traynham, Michael A. Wolfe, Robert B. Smith, and Keith W. Buckhouse |
| 21 | Subsidiaries of the registrant |
| 23 | Consent of J. W. Hunt and Company, LLP |
| 31.1 | Rule 13a-14(a) / 15d-14(a) Certifications of Chief Executive Officer |
| 31.2 | Rule 13a-14(a) / 15d-14(a) Certifications of Chief Financial Officer |
| 32 | 18 U.S.C. Section 1350 Certifications |

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s/Richard L. Havekost Date: March 28, 2005

 Richard L. Havekost, Director

s/ Phil P. Leventis Date: March 28, 2005

 Phil P. Leventis, Director

s/John V. Nicholson Date: March 28, 2005

 John V. Nicholson, Director

s/ Samuel F. Reid, Jr. Date: March 28, 2005

 Samuel F. Reid, Jr., Director

s/ J. Otto Warren, Jr. Date: March 28, 2005

 J. Otto Warren, Jr., Director

s/Wm. Reynolds Williams Date: March 28, 2005

 Wm. Reynolds Williams, II, Director

EXHIBIT INDEX

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|--|--|
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- 31.2 Rule 13a-14(a) / 15d-14(a) Certifications of Chief Financial Officer
- 32 18 U.S.C. Section 1350 Certifications