COMMUNITY BANKSHARES INC /SC/
Form 10-Q
November 12, 2004

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

FORM 10-Q

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

For the quarterly period ended September 30, 2004	Commission File No. 000-22054

COMMUNITY BANKSHARES, INC.

(Exact name of registrant as specified in its charter)

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

791 Broughton Street
Orangeburg, South Carolina 29115

(Address of principal executive offices, zip code)

(803) 535-1060

(Registrant's telephone number, including area code)

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

Yes [X] No [ ]

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

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: common stock, no par or stated value, 4,385,744 shares outstanding on November 3, 2004.

COMMUNITY BANKSHARES, INC.

FORM 10-Q

Index

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

COMMUNITY BANKSHARES, INC.
Consolidated Balance Sheet

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 $1,959 for 2004 and $2,155 for 2003) ....
Other investments ....
Loans held for sale ....
Loans receivable ....

Less, allowance for loan losses	
Net loans	
Premises and equipment - net	
Accrued interest receivable	
Net deferred income tax assets	
Intangible assets	
Prepaid expenses and other assets	
Total assets	
Liabilities	
Deposits	
Noninterest bearing	
Interest bearing	
Total deposits	
Short-term borrowings	
Long-term debt	
Accrued interest payable	
Accrued expenses and other liabilities	
Total liabilities	
Shareholders' equity	
Common stock - no par value; 12,000,000 shares authorized; issued and outstanding - 4,364,362 for 2004 and 4,331,460 for 2003	
Retained earnings	
Accumulated other comprehensive income (loss)	
Total shareholders' equity	
Total liabilities and shareholders' equity	

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.
Consolidated Statement of Income

	(U	
	Period	
	Three Months	
	2004	2003
	(Dollars in th	
Interest and dividend income		
Loans, including fees	$ 5,756	$ 5,698

Interest bearing deposits with other banks	4	5
Debt securities	434	365
Dividends	19	18
Federal funds sold	40	69
Total interest and dividend income	6,253	6,155
Interest expense		
Time deposits $100M and over	360	382
Other deposits	958	993
Total deposits	1,318	1,375
Short-term borrowings	76	28
Long-term debt	363	491
Total interest expense	1,757	1,894
Net interest income	4,496	4,261
Provision for loan losses	1,648	232
Net interest income after provision	2,848	4,029
Noninterest income		
Service charges on deposit accounts	841	893
Securities gains (losses)	10	-
Mortgage brokerage income	835	1,428
Other	163	202
Total noninterest income	1,849	2,523
Noninterest expenses		
Salaries and employee benefits	2,123	2,461
Premises and equipment	508	464
Other	1,195	1,184
Total noninterest expenses	3,826	4,109
Income before income taxes	871	2,443
Income tax expense	306	871
Net income	$ 565	$ 1,572
Per share		
Net income	$ 0.13	$ 0.36
Net income, assuming dilution	0.12	0.35
Cash dividends declared	0.10	0.09

See accompanying notes to unaudited consolidated financial statements.

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

(Unaudited)

	Common Stock		
	Number of Shares	Amount	Ret Ear
		(Dollars in thousa	
Balance, January 1, 2003	4,304,384	$ 29,090	$ 14
Comprehensive income:			
Net income	-	-	4
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $136	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $90	-	-	
Total other comprehensive income	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	14,009	160	
Cash dividends declared, $.27 per share	-	-	(1
Balance, September 30, 2003	4,318,393	$ 29,250	$ 17
Balance, January 1, 2004	4,331,460	$ 29,402	$ 18
Comprehensive income:			
Net income	-	-	3
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $14	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $2	-	-	
Total other comprehensive income (loss)	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	32,902	384	
Cash dividends declared, $.30 per share	-	-	(1
Balance, September 30, 2004	4,364,362	$ 29,786	$ 20

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.
Consolidated Statement of Cash Flows

Operating activities

Net income ....

Adjustments to reconcile net income to net
cash provided by operating activities

Depreciation and amortization ....
Amortization of intangibles ....
Net amortization of securities ....
Provision for loan losses ....
Net realized losses or (gains) on sales of securities ....
Net realized losses on other dispositions of securities available-for-sale ....
Net loss realized on disposition of equipment ....
Net gain realized on sale of other real estate ....
Proceeds of sales of loans held for sale ....
Originations of loans held for sale ....
(Increase) decrease in accrued interest receivable ....
(Increase) in other assets ....
Increase in accrued interest payable ....
(Decrease) increase in other liabilities ....

Net cash provided by operating activities ....

Investing activities

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

Net cash used by investing activities ....

Financing activities

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

Proceeds from issuing long-term debt	
Repayments of long-term debt	
Exercise of employee stock options	
Cash dividends paid	
Net cash provided by financing activities	
(Decrease) increase in cash and cash equivalents	
Cash and cash equivalents, beginning of period	
Cash and cash equivalents, end of period	
Supplemental Disclosures of Cash Flow Information	
Cash payments for interest	
Cash payments for income taxes	
Supplemental Disclosures of Non-cash Investing Activities	
Transfers of loans receivable to other real estate	

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.

Notes to Unaudited Consolidated Financial Statements

Accounting Principles - A summary of significant accounting policies is included in Community Bankshares, Inc.'s (the "Company" or "CBI") Annual Report for the year ended December 31, 2003 on Form 10-K filed with the Securities and Exchange Commission. Certain amounts in the 2003 financial statements have been reclassified to conform to the current period presentation. Such reclassifications had no effect on previously reported shareholders' equity or net income.

Management Opinion - The interim financial statements in this report are unaudited. In the opinion of management, all the adjustments necessary to present a fair statement of the results for the interim period have been made. Such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of the results to be expected for an entire year. These interim financial statements should be read in conjunction with the annual financial statements and notes thereto contained in the 2003 Annual Report on Form 10-K.

Nonperforming Loans - As of September 30, 2004, there were $2,826,000 in nonaccrual loans and $557,000 in loans 90 or more days past due and still accruing interest.

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

	(Unaudi Period Ended S Three Months 2004	2003
	(Dollars in thousands, exc	
Net income per share, basic		
Numerator - net income	$ 565	$ 1,572
Denominator		
Weighted average common shares issued and outstanding	4,363,582	4,315,482
Net income per share, basic	$ .13	$ .36
Net income per share, assuming dilution		
Numerator - net income	$ 565	$ 1,572
Denominator		
Weighted average common shares issued and outstanding	4,363,582	4,315,482
Effect of dilutive stock options	298,929	113,966
Total shares	4,662,511	4,429,448
Net income per share, assuming dilution	$ .12	$ .35

Stock-Based Compensation - The Company has elected to continue using the methodology of Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees," to account for compensation expenses related to stock-based compensation. Options issued under the Company's plans have no intrinsic value at the grant date and no compensation cost is recognized for them in accordance with APB No. 25. Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation," as amended by SFAS 148, requires entities to provide proforma disclosures of net

income, and earnings per share, as if the fair value based method of accounting promulgated by that standard had been applied. While the Company has adopted the disclosure provisions of SFAS No. 123, as amended, there are no current intentions to adopt the fair value recognition provisions of that Statement. Had compensation cost of the Company's stock options been determined based on the fair value as of the grant date for awards under the plans consistent with the method prescribed by SFAS No. 123, the Company's net income and earnings per share would have been adjusted to the pro forma amounts indicated below:

	Period	
	Three Months	
	2004	2003
	(Dollars in thousan	
Net income, as reported	$ 565	$ 1,572
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of any related tax effects	214	-
Pro forma net income	$ 351	$ 1,572
Net income per share, basic		
As reported	$ 0.13	$ 0.36
Pro forma	0.08	0.36
Net income per share, assuming dilution		
As reported	$ 0.12	$ 0.35
Pro forma	0.08	0.35

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

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.

FASB Interpretation 46 (FIN 46), "Consolidation of Variable Interest Entities," was issued by the Financial Accounting Standards Board (FASB) in January 2003. FIN 46 requires the primary beneficiary of a variable interest entity's activities to consolidate the VIE. FIN 46 defines a VIE as an entity in which the equity investors do not have substantive voting rights and there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The primary beneficiary is the party that absorbs a majority of the expected losses and/or receives a majority of the expected residual returns of the VIE's activities. In December 2003, the FASB issued FIN 46(R), which supersedes and amends certain provisions of FIN 46. FIN 46(R) retains many of the concepts and provisions of FIN 46, provides additional guidance related to the application of FIN 46, provides for certain additional scope exceptions, and incorporates several FASB Staff Positions issued related

to the application of FIN 46. The provisions of FIN 46 are immediately applicable to VIEs created, or interests in VIEs obtained, after January 31, 2003 and the provisions of FIN 46(R) are required to be applied to such entities, except for special purpose entities, by the end of the first reporting period ending after March 15, 2004 (March 31, 2004 for CBI).

Since CBI is not the primary beneficiary of the VIE as defined by FIN 46 and FIN 46(R), the activities of this VIE have not been consolidated into the consolidated financial statements of CBI. CBI's investment in the VIE is carried in the consolidated balance sheet in other assets and the Debentures are included in long-term debt.

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

FORWARD LOOKING STATEMENTS

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

CRITICAL ACCOUNTING POLICIES

CBI has adopted various accounting policies, which govern the application of accounting principles generally accepted in the United States of America in the preparation of CBI's financial statements. The significant accounting policies of CBI are described in detail in the notes to CBI's audited consolidated financial statements included in CBI's 2003 Annual Report on Form 10-K.

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

CBI is a holding company for four community banks and a mortgage company and, as a financial institution, believes the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of its consolidated financial statements. Refer to the sections "Allowance for Loan Losses" and "Provision for Loan Losses" in the Annual Report on Form 10-K for 2003 for a detailed description of CBI's estimation process and methodology related to the allowance for loan losses.

9

RESULTS OF OPERATIONS

Earnings Performance

Operating results for both the third quarter and the first nine-months of 2004 were adversely affected by additional provision for loan losses resulting from the identification of certain problem loans at one of the banking subsidiaries and by a marked decrease in mortgage loan origination activity.

The problem loans were originated by a former lending officer and totaled $5,121,000 as of September 30, 2004. Based on currently available information, management determined at the end of the 2004 third quarter that the amount of the allowance for loan losses should include an allocation of $1,300,000 for those loans. That allocation was effected by charging the provision for loan losses. Of these loans, $1,024,000 to one borrower is currently in workout status, with management and the borrower cooperating to achieve the orderly repayment of the debt. Management has engaged legal counsel and is vigorously pursuing collection of the remaining loans. As collection efforts progress and additional information becomes available, further provisions for loan losses may be required. Management anticipates any further required provision expense will be recognized in the near future. For additional information, refer to the section "Provision and Allowance for Loan Losses, Non-performing and Potential Problem Loans" contained elsewhere in this discussion.

Because of recent increases in residential mortgage interest rates, mortgage origination and refinancing activity decreased significantly from the unprecedented industry-wide levels experienced in the previous year. As a result, income from mortgage brokerage activities decreased by $593,000, or

41.5%, for the third quarter of 2004 and by $1,766,000, or 41.5%, for the first nine months of 2004, each compared with the same period of 2003. These effects were partially offset by decreases in interest expense on borrowings, commission based salaries and employee benefits, and other expenses related to the origination of residential mortgage loans.

Three Months Ended September 30, 2004 and 2003

For the quarter ended September 30, 2004, CBI earned consolidated net income of $565,000, compared with $1,572,000 for the comparable period of 2003, a decrease of $1,007,000, or 64.1%. Basic earnings per share was $.13 in the 2004 quarter compared with $.36 for the 2003 quarter. Diluted earnings per share was $.12 for the 2004 quarter compared with $.35 for the 2003 quarter. The changes in the items comprising net income resulted from essentially the same factors discussed below regarding the results of operations for the nine months ended September 30, 2004.

Summary Income

(Dollars in th

For the Three Months Ended September 30,	2004	2003
Interest income	$ 6,253	$ 6,155
Interest expense	1,757	1,894
Net interest income	4,496	4,261
Provision for loan losses	1,648	232
Noninterest income	1,849	2,523
Noninterest expenses	3,826	4,109
Income tax expense	306	871
Net income	$ 565	$ 1,572

Nine Months Ended September 30, 2004 and 2003

CBI's consolidated net income for the nine months ended September 30, 2004 was $3,345,000, down 22.9% from $4,338,000 for the comparable 2003 period. Basic earnings per share for the 2004 period was $.77, down from $1.01 per share in 2003. Diluted earnings per share was $.74 for the 2004 period, down from $.98 for 2003.

Summary Income St

(Dollars in tho

For the Nine Months Ended September 30,	2004	2003
Interest income	$18,089	$18,289
Interest expense	5,059	5,855

Net interest income	13,030	12,434
Provision for loan losses	2,139	775
Noninterest income	5,626	7,154
Noninterest expenses	11,333	12,062
Income tax expense	1,839	2,413
Net income	$ 3,345	$ 4,338

CBI increased net interest income by reallocating resources into loans and investments and decreasing average amounts of short-term borrowings related to mortgage brokerage activities. Also, rates paid on deposits and other funding sources were lower in 2004 as compared with 2003.

Net Interest Income

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

Net interest income increased by $235,000, or 5.5%, in the 2004 third quarter compared with the same 2003 quarter. This occurred primarily as a result of lower interest expenses. CBI had a reduced need for short-term funding during the 2004 period resulting from lower demand for refinancing of residential mortgage loans and the increased use of long-term debt that CBI obtained through the issuance of trust-preferred securities during the first quarter of 2004. Interest income for the 2004 three month period was slightly higher than in the same prior year period primarily because loans, other than residential mortgage loans held for sale, increased $28,186,000 during the 2004 third quarter.

During the 2004 nine month period, net interest income increased by $596,000, or 4.8%, over the same period of 2003. This resulted primarily from a decrease in interest expense of $796,000 in the 2004 period. Interest income decreased by $200,000 during the 2004 period, as well.

Total average interest bearing liabilities for the 2004 nine months increased $6,870,000 or 2.0% over 2003. Average short-term borrowings for the 2004 nine-month period fell $21,451,000, or 65.6%, below the average for the same period of 2003, while long-term debt for the 2004 period increased by $7,594,000, or 37.3%, due to the issuance of trust preferred securities during the 2004 first quarter. Average savings and interest bearing transaction account balances grew significantly in the 2004 nine month period, also, increasing $21,710,000, or 19.4%. Average time deposits were slightly lower in the 2004 period. Management believes that the 45 basis point decrease in the average rate paid for time deposits in the 2004 nine month period may have contributed to depositors moving funds to shorter-term, more liquid deposit products, probably in anticipation of increases in rates that depositors expect to be offered for time deposits in the future.

Total average interest earning assets for the 2004 nine month period increased $18,287,000 or 4.3% over the same 2003 period. Average loans outstanding for the 2004 period, including loans held for sale, were $18,962,000, or 5.5%, greater than in the 2003 period. As of September 30, 2004, loans, other than loans held for sale, were $50,852,000, or 15.3%, more than the amount of such loans as of December 31, 2003. Investment securities grew also, averaging $8,108,000, or 15.5%, more than in the first nine months of 2003. The average rates earned on these assets were 30 basis points lower in the 2004 period than in the 2003 period, however.

The following table provides details of the changes in the composition of CBI's average balance sheet, its interest income and expense, and the relationships between those items.

11

Average Balances, Yi
Nine Months Ended

	2004 Average Balances	2004 Interest Income / Expense	2004 Yields / Rates *
			(Dollars in
Assets			
Interest earning deposits	$ 1,008	$ 12	1.59%
Investment securities - taxable	50,662	1,152	3.03%
Investment securities - tax exempt	9,619	244	3.38%
Federal funds sold	17,866	145	1.08%
Loans, including loans held for sale	360,723	16,536	6.11%
Total interest earning assets	439,878	18,089	5.48%
Cash and due from banks	15,536		
Allowance for loan losses	(4,283)		
Premises and equipment, net	7,166		
Intangible assets	7,557		
Other assets	4,014		
Total assets	$ 469,868		
Liabilities and shareholders' equity			
Interest bearing deposits			
Savings	$ 78,882	$ 571	0.97%
Interest bearing transaction accounts	54,813	165	0.40%
Time deposits	185,557	3,033	2.18%
Total interest bearing deposits	319,252	3,769	1.57%
Short-term borrowings	11,251	186	2.20%
Long-term debt	27,943	1,105	5.27%
Total interest bearing liabilities	358,446	5,060	1.88%
Noninterest bearing demand deposits	59,704		
Other liabilities	1,772		
Shareholders' equity	49,946		
Total liabilities and shareholders' equity .	$ 469,868		
Interest rate spread			3.60%
Net interest income and net yield on earning assets		$13,029	3.95%

* Yields and rates are annualized.

12

Provision and Allowance for Loan Losses, Non-performing and Potential Problem Loans

The provision for loan losses for the third quarter of 2004 was $1,648,000, an increase of $1,416,000, or 610.3%, over the same period of 2003. During the 2004 third quarter, net loan charge-offs were $164,000 and the allowance for loan losses as a percentage of loans outstanding (excluding loans held for sale) increased to 1.51% as compared with 1.21% at the end of the second quarter of 2004. Total non-performing loans (non-accrual and accruing loans past due 90 days and more) increased $1,976,000 during the third quarter of 2004.

The provision for loan losses for the nine month 2004 period was $2,139,000, an increase of $1,364,000 or 176.0% over the comparable period of 2003. Net charge-offs in the 2004 period were $576,000, compared with $318,000 in the 2003 period. The allowance for loan losses stood at 1.51% of loans outstanding (excluding loans held for sale), compared with 1.27% at the end of 2003. The activity in the allowance for loan losses is summarized in the following table:

	Nine Months Ended September 30, 2004	Year End December 31
	(Dollars in th	
Allowance at beginning of period	$ 4,206	$ 3,57
Provision for loan losses	2,139	1,11
Net charge-offs	(576)	(48
Allowance at end of period	$ 5,769	$ 4,20
Allowance as a percentage of loans outstanding	1.51%	1.2
Loans at end of period	$ 382,958	$ 332,10

Non-performing loans totaled $3,383,000 as of the end of the 2004 period compared with $2,741,000 as of December 31, 2003, an increase of $642,000 or 23.4%. Of the amount of nonaccrual loans, $1,776,000 or 62.8% was collateralized by commercial furniture and fixtures, inventories and accounts receivable, $712,000 or 25.2% was secured by mortgages on real estate, and the remainder is primarily secured by consumer automobiles and other personal property. The coverage ratio (allowance for loan losses divided by non-performing loans) was 1.71 as of the end of the 2004 third quarter and 1.53 at the end of 2003. Following is a summary of non-performing loans as of September 30, 2004 and December 31, 2003. There were no restructured loans during any of the periods listed below.

	September 3
Non-performing loans	
Nonaccrual loans	$2,82
Past due 90 days or more and still accruing	55
Total	$3,38
Non-performing loans as a percentage of loans outstanding	0.8

Potential problem loans are defined as loans, not including nonaccrual loans or loans that are 90 days past due and still accruing, where information about the borrowers' credit problems causes management to have doubts about the borrowers' ability to comply with the original repayment terms. At September 30, 2004, the Corporation had identified $6,800,000, or 1.8%, of the loan portfolio, as potential problem loans. This is an increase of $3,563,000 over the amount as of December 31, 2003. The amount of potential problem loans does not represent management's estimate of potential losses since a significant portion of these loans are secured by real estate and other forms of collateral.

Based on current levels of non-performing and other potential problem loans, including an evaluation of any available collateral, management believes that loan charge-offs in 2004 will substantially exceed the amount experienced in 2003 as such loans progress through the collection, foreclosure, and repossession process. Management will continue to closely monitor the levels of non-performing and potential problem loans and address the weaknesses in those credits to enhance the amount of ultimate collection or recovery of these assets. Management considers the levels and trends in non-performing and past due loans in determining how the provision and allowance for loan losses is estimated and adjusted.

During the third quarter of 2004, management identified $5,121,000 of problem loans in the portfolio of one of the banking subsidiaries. Of this amount, $1,750,000 is included in nonaccrual loans and $3,371,000 is included in potential problem loans as of September 30, 2004.

The loans classified as nonaccrual are collateralized by equipment, inventory and accounts receivable of business entities involved in bankruptcy proceedings. It is doubtful that the net realizable value of the collateral will be sufficient to repay the loans.

Of the amount included in potential problem loans, $200,000 is unsecured and $824,000 is collateralized by inventory, accounts receivables and the proceeds of contracts. The remaining $2,347,000 is collateralized by restricted securities of indeterminate value.

Noninterest Income

Non-interest income for the 2004 quarter decreased $674,000, or 26.7% from the 2003 quarter. The majority of the decrease was attributable to mortgage brokerage income which decreased $593,000, or 41.5%. Service charges on deposit accounts were down by $52,000. CBI realized gains of $10,000 from sales of available-for-sale securities in the 2004 three-month period. There were no sales of securities in the 2003 quarter.

Non-interest income for the 2004 nine month period decreased $1,528,000, or 21.4%, from the 2003 amount. Most of the decrease was attributable to a $1,766,000 or 41.5% decrease in mortgage brokerage income. The Company's mortgage brokerage activities in 2004 have been affected adversely by increasing interest rates and decreasing demand for mortgage loans. CBI also recorded securities gains of $5,000 in the 2004 nine month period compared with losses of $252,000 in 2003.

Noninterest Expenses

Noninterest expenses decreased $283,000, or 6.9%, for the third quarter of 2004 compared with the 2003 quarter. Salaries and employee benefits decreased $338,000, or 13.7%, due to the reduced mortgage brokerage activity. Premises and equipment expenses increased $44,000, or 9.5%, primarily due to the deployment of new technologies, as described below.

During the first nine months of 2004, noninterest expenses decreased $729,000, or 6.0%, as compared with the same 2003 period. Salaries and employee benefits decreased $1,033,000, or 13.8%, primarily due to the mortgage brokerage subsidiary's largely commission-based compensation system and the lower volume of home mortgage originations and sales in 2004. For the first nine months of 2004, premises and equipment expenses were up $201,000, or 15.8%, as compared with the 2003 period, due to depreciation and amortization expenses resulting from the acquisition and implementation of hardware and software associated with imaging technologies. Over time, the use of such technology is expected to reduce certain operating expenses, including postage and research, improve internal processes and access to information, enable the Company to take advantage of opportunities presented by the effectiveness of Check 21 legislation, and enhance the Company's ability to provide customer service. Management believes that noninterest expenses will continue to increase for the remainder of 2004 and in 2005 as a result of legislative mandates, such as Sarbanes-Oxley Section 404 which will be effective for the Company's 2005 audited financial statements, and the implementation of certain improvements in internal processes that are presently contemplated.

Income Tax Expense

Income tax expense decreased $565,000 and $574,000 for the third quarter and nine months ended September 30, 2004, respectively, due to lower taxable income. The average income tax rates applied to year-to-date income before income taxes during 2004 and 2003 were approximately 35.5% and 35.7%, respectively.

14

LIQUIDITY

Liquidity is the ability to meet current and future obligations through liquidation or maturity of existing assets or the acquisition of additional liabilities. Adequate liquidity is necessary to meet the requirements of customers for loans and deposit withdrawals in a timely and economical manner. The most manageable sources of liquidity are composed of liabilities, with the primary focus of liquidity management being the ability to attract deposits within CBI's market areas. Individual and commercial deposits are the primary source of funds for credit activities, along with long-term borrowings from the Federal Home Loan Bank of Atlanta and the proceeds of issuing $10,000,000 of subordinated debentures. Cash and amounts due from banks and federal funds sold are CBI's primary sources of asset liquidity. These funds provide a cushion against short-term fluctuations in cash flow from both loans and deposits. Securities available-for-sale are CBI's principal source of secondary asset liquidity. However, the availability of this source is limited by pledging commitments for public deposits and securities sold under agreements to repurchase, and is influenced by market conditions.

Total deposits at September 30, 2004 were $393,567,000, an increase of $14,863,000 or 3.9% over the amount at December 31, 2003. As of September 30, 2004, the loan to deposit ratio was 97.3%, compared with 87.7% at December 31, 2003 and 91.1% as of September 30, 2003.

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

CAPITAL RESOURCES

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

The September 30, 2004 risk based capital ratios for CBI and its banking subsidiaries are presented in the following table, compared with the "well capitalized" and minimum ratios under the regulatory definitions and guidelines:

	Septe	
	Tier 1	To
Community Bankshares, Inc.	14.46%	
Orangeburg National Bank	12.11%	
Sumter National Bank	9.62%	
Florence National Bank	10.66%	
Bank of Ridgeway	14.04%	
Minimum "well capitalized" requirement	6.00%	
Minimum requirement	4.00%	

As shown in the table above, each of the capital ratios exceed the regulatory requirement for being considered "well capitalized." In the opinion of management, the CBI and the banking subsidiaries' current and projected capital positions are adequate.

OFF-BALANCE-SHEET ACTIVITIES

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

Variable Interest Entity

As discussed under "Results of Operations - Net Interest Income," and in the notes to unaudited consolidated financial statements under "Variable Interest Entities," as of September 30, 2004, CBI held an interest in, and guarantees the liabilities of, a non-consolidated variable interest entity.

Commitments

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

The following table sets forth the contractual amounts of commitments which represent credit risk:

	September 30, 2004 (Dollars in thousands)
Loan commitments	$ 51,936
Standby letters of credit	2,609

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 management upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include personal residences, accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

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

Derivative Financial Instruments

In April, 2003, the Financial Accounting Standards Board issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." Among other requirements, this Statement provides that loan commitment contracts entered into or modified after June 30, 2003 that relate to the origination of mortgage loans that will be held for sale shall be accounted for as derivative instruments by the issuer of the loan commitment. CBI issues mortgage loan rate lock commitments to potential borrowers to facilitate its origination of home mortgage loans that are intended to be sold. Between the time that CBI issues its commitments and the time that the loans close and are sold, CBI is subject to variability in the selling prices related to those commitments due to changes in market rates of interest. However, CBI offsets this variability through the use of so-called "forward sales contracts" to investors in the secondary market. Under these arrangements, an investor agrees to purchase the closed loans at a predetermined price. CBI generally enters into such forward sales contracts at the same time that rate lock commitments are issued. These derivative financial instruments are carried in the balance sheet at estimated fair value and changes in the estimated fair values of these derivatives are recorded in the statement of income in net gains or losses on loans held for sale.

Derivative financial instruments are written in amounts referred to as notional amounts. Notional amounts only provide the basis for calculating payments between counterparties and do not represent amounts to be exchanged between parties or a measure of financial risk. The following table includes the notional principal amounts of rate lock commitments and forward sales contracts as of September 30, 2004, and the estimated fair values of those financial instruments included in other assets and liabilities in the balance sheet as of that date.

	September 30, 2004	
	Notional Amount	Estimated Fair Value Asset (Liability)
	(Dollars in thousands)	
Rate lock commitments to potential borrowers to originate mortgage loans to be held for sale	$ 7,101	$ 36
Forward sales contracts with investors of mortgage loans to be held for sale	7,101	(36)

ACCOUNTING AND REPORTING CHANGES

Statement of Financial Accounting Standards No. 150 ("SFAS No. 150"), "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," requires financial instruments within its scope to be classified as liabilities (or assets in some circumstances). SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise effective at the beginning of the first interim period beginning after June 15, 2003, except for certain mandatorily redeemable financial instruments. For those mandatorily redeemable financial instruments, the effective date of certain provisions of SFAS No. 150 has been deferred by FASB Staff Position FAS 150-3. When fully implemented, the adoption of SFAS No. 150 is not expected to have a material on the Company's financial statements.

Effectiveness of the guidance issued in paragraphs 10-20 of Emerging Issues Task Force ("EITF") Issue No 03-1, "The Meaning of Other-Than-Temporarily Impairment and Its Application to Certain Investments" has been delayed by FASB Staff Position EITF Issue 03-1-1 until the final issuance of proposed EITF Issue 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF Issue No 03-1..." All disclosures required by EITF Issue No 03-1 for annual financial statements continue to be effective for fiscal years ending after December 15, 2003 for investments accounted for under FASB Statements No 115 and 124. For all other investments within the scope of this Issue, the disclosures continue to be effective in annual financial statements for fiscal years ending after June 15, 2004. Additional disclosures for cost method investments continue to be effective for fiscal years ending after June 15, 2004. The adoption of this EITF is not expected to materially affect the Company's financial statements.

The American Institute of Certified Public Accountants' Accounting Standards Executive Committee issued its Statement of Position ("SOP") 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer," which is effective generally for loans acquired in fiscal years beginning after December 15, 2004. Early application is encouraged. The SOP addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes loans acquired in business combinations and applies to all nongovernmental organizations, including not-for-profit organizations. The SOP does not apply to loans originated by the entity. For loans acquired in fiscal years prior to this SOP's effective date and within the scope of Practice Bulletin 6, the SOP also amends the application of Practice Bulletin 6 with regard to accounting for decreases in cash flows expected to be collected. The adoption of this SOP as of January 1, 2005 is not expected to have any material impact on the Company's financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

CBI's Asset/Liability Committee uses a simulation model to assist in achieving consistent growth in net interest income while managing interest rate risk. According to the model, as of September 30, 2004, CBI is positioned so that net interest income would increase $271,000 and net income would increase $163,000 in the next twelve months if interest rates rose 100 basis points. Conversely, net interest income would decline $371,000 and net income would decline $227,000 in the next twelve months if interest rates declined 100 basis points. In the current interest rate environment, it is unlikely that there will be any large rate decreases in the immediate future. Computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates and loan prepayment, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions CBI, its customers and the issuers of its investment securities could undertake in response to changes in interest rates.

As of September 30, 2004, there was no significant change from the interest rate sensitivity analysis for the various changes in interest rates calculated as of December 31, 2003. The foregoing disclosures related to the market risk of CBI should be read in connection with Management's Discussion and Analysis of Financial Position and Results of Operations included in the 2003 Annual Report on Form 10-K.

Item 4. Controls and Procedures

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

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

PART II--OTHER INFORMATION

Item 6. Exhibits

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

Signatures

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

DATED: November 10, 2004

COMMUNITY BANKSHARES, INC.
s/E. J. Ayers, Jr.
By: ------------------------------------
E. J. Ayers, Jr.

Chief Executive Officer

s/William W. Traynham

By: -------------------------------------

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