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

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 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, 4,364,362 shares outstanding on August 2, 2004.

COMMUNITY BANKSHARES, INC.

FORM 10-Q

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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 $1,833 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	
Non-interest 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 - 4,359,237 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.

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COMMUNITY BANKSHARES, INC.
Consolidated Statement of Income

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Perio

Three Months

	2004	2003
		(Dollars in
Interest and dividend income		
Loans, including fees	$ 5,449	$ 5,816
Interest bearing deposits with other banks	4	5
Debt securities	409	352
Dividends	19	20
Federal funds sold	47	92
Total interest and dividend income	5,928	6,285
Interest expense		
Time deposits $100M and over	323	412
Other deposits	895	1,079
Total deposits	1,218	1,491
Short-term borrowings	64	190
Long-term debt	380	279
Total interest expense	1,662	1,960
Net interest income	4,266	4,325
Provision for loan losses	258	279
Net interest income after provision	4,008	4,046
Noninterest income		
Service charges on deposit accounts	822	838
Securities gains (losses)	(1)	(298
Mortgage brokerage income	903	1,314
Other	207	222
Total noninterest income	1,931	2,076
Noninterest expenses		
Salaries and employee benefits	2,225	2,680
Premises and equipment	473	403
Other	1,077	1,135
Total noninterest expenses	3,775	4,218
Income before income taxes	2,164	1,904
Income tax expense	769	719
Net income	$ 1,395	$ 1,185
Per share		
Net income	$ 0.32	$ 0.28
Net income, assuming dilution	0.31	0.27
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	Common Stock Amount	Retai Earni
		(Dollars in thousands	
Balance, January 1, 2003	4,304,384	$ 29,090	$ 14
Comprehensive income:			
Net income	-	-	2
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $247	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $85	-	-	
Total other comprehensive income	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	6,262	69	
Cash dividends declared, $.18 per share	-	-	
Balance, June 30, 2003	4,310,646	$ 29,159	$ 16
Balance, January 1, 2004	4,331,460	$ 29,402	$ 18
Comprehensive income:			
Net income	-	-	2
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $330	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $2	-	-	
Total other comprehensive income (loss)	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	27,777	323	
Cash dividends declared, $.20 per share	-	-	

Balance, June 30, 2004	4,359,237	$ 29,725	$ 20
	=========	=========	=====

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 (used) provided by operating activities	
Depreciation and amortization	
Net amortization of securities	
Provision for loan losses	
Net losses or (gains) on sales of securities	
Proceeds of sales of loans held for sale	
Originations of loans held for sale	
Decrease (increase) in accrued interest receivable	
(Decrease) increase in other assets	
Gains on sales of other real estate	
Increase in accrued interest payable	
Increase (decrease) 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	
Net purchases of other investments	
Net increase in loans made to customers	
Purchases of premises and equipment	
Proceeds from sales of other real estate	
Net cash used by investing activities	
Financing activities	
Net increase in deposits	
Net (decrease) increase in short-term borrowings	
Proceeds from issuing 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.

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COMMUNITY BANKSHARES, INC.

Notes to Unaudited Consolidated Financial Statements

Accounting Principles - A summary of significant accounting policies and the audited financial statements for 2003 are included in Community Bankshares, Inc.'s (the "Company" or "CBI") Annual Report on Form 10-K for the year ended December 31, 2003. Certain amounts in the 2003 consolidated financial statements have been reclassified to conform to the current period classification. Such reclassification 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 June 30, 2004, there were $1,181,000 in nonaccrual loans and $226,000 of loans 90 or more days past due and still accruing interest.

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

	(Una Period E	
	Three Months	
	2004	2003
	(Dollars in thousands,	
Net income per share, basic		
Numerator - net income	$ 1,395	$ 1,185
Denominator		
Weighted average common shares issued and outstanding	4,348,905	4,308,263
Net income per share, basic	$ .32	$ .28
Net income per share, assuming dilution		
Numerator - net income	$ 1,395	$ 1,185
Denominator		
Weighted average common shares issued and outstanding	4,348,905	4,308,263
Effect of dilutive stock options	112,304	113,573
Total shares	4,461,209	4,421,836
Net income per share, assuming dilution	$ .31	$ .27

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 in accordance with APB No. 25. Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), as amended, "Accounting for Stock-Based Compensation,"

requires entities to provide pro forma disclosures of net income, and earnings per share, as if the fair value based method of accounting promulgated by that standard had been applied. 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 for the Company's stock option plan been determined based on the fair value as of the grant dates for awards under the plans consistent with the method prescribed by SFAS No. 123, the Company's net income and earnings per share would have been adjusted to the pro forma amounts indicated below:

	(U	
	Period	
	Three Months	
	2004	2003
	(Dollars in thousa	
Net income, as reported	$ 1,395	$ 1,185
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	$ 1,181	$ 1,185
Net income per share, basic		
As reported	$ 0.32	$ 0.28
Pro forma	0.27	0.28
Net income per share, assuming dilution		
As reported	$ 0.31	$ 0.27
Pro forma	0.26	0.27

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

RESULTS OF OPERATIONS

Earnings Performance

Three Months Ended June 30, 2004 and 2003

For the quarter ended June 30, 2004, CBI earned consolidated net income of $1,395,000, compared with $1,185,000 for the comparable period of 2003. This

represents an increase of $210,000 or 17.7%. Basic earnings per share were $.32 in the 2004 period, compared with $.28 for the 2003 quarter. Diluted earnings per share were $.31 for the 2004 period and $.27 for the 2003 period.

Operating results for the second quarter of 2004 continued to be affected by lower demand for mortgage loan refinancing and the effects of the continued low interest rate environment. Because interest rates have remained low for a relatively long period of time, the constant strong demand for mortgage refinancings declined from the level of 2003. Management believes this occurred because most people who were inclined to refinance had already done so. However, in response to the Federal Reserve Board's recent actions to raise some benchmark interest rates, the Company has experienced some upward fluctuations in activity in this area. Still, except for these occasional spikes, the current level of mortgage loan activity is believed to reflect more nearly the underlying base amount of such activity that would be expected to result from normal, ongoing factors and, accordingly, is believed to be more indicative of a sustainable level of such activity.

Interest expense was lower in the 2004 quarter, also. This is a result of the low interest rate environment and a decreased rate of growth for deposits and other interest bearing liabilities. Total interest bearing liabilities at June 30, 2004 were $360,129,000 compared with $357,467,000 at December 31, 2003 and $357,225,000 at June 30, 2003. Short-term borrowings have decreased due to the Company's issuance in March, 2004 of $10,000,000 of subordinated debentures due in 2034, because of reduced demand for mortgage refinancing for the mortgage subsidiary, and the Company's decision to finance much of the existing mortgage loan demand internally.

Also affecting the Company favorably during the three month period were lower amounts of losses recognized on investment securities transactions in the 2004 period and decreased salaries and employee benefits costs resulting from the decreased mortgage lending activity. Most of the mortgage subsidiary's loan officers are compensated using a combination of salary and performance-based incentives. The incentive component results in lower total expenses for those employees during periods of decreased mortgage lending activity.

		Summary Income St	
		(Dollars in th	
For the Three Months Ended June 30,	2004	2003	D
Interest income	$5,928	$6,285	
Interest expense	1,662	1,960	
Net interest income	4,266	4,325	
Provision for loan losses	258	279	
Noninterest income	1,931	2,076	
Noninterest expenses	3,775	4,218	
Income tax expense	769	719	
Net income	$1,395	$1,185	

Six Months Ended June 30, 2004 and 2003

CBI's consolidated net income for the six months ended June 30, 2004 was $2,780,000, an increase of $14,000 or 0.5% over the comparable period of 2003. Basic earnings per share were $.64 for the 2004 period and $.65 for the 2003 period. Diluted earnings per share were $.62 and $.63 for the 2004 and 2003 periods, respectively. Net interest income in the 2004 period was $361,000 more than in the 2003 period, but mortgage brokerage income decreased by $1,173,000. Salaries and employee benefits were $695,000 less in the 2004 period than in the 2003 period. As discussed above, demand for, and the Company's resources dedicated to, mortgage lending activities were lower in 2004 than they were in 2003.

		Summary Income St	
		(Dollars in thou	
For the Six Months Ended June 30,	2004	2003	Do
Interest income	$11,836	$12,134	
Interest expense	3,302	3,961	
Net interest income	8,534	8,173	

Provision for loan losses	491	543
Noninterest income	3,777	4,631
Noninterest expenses	7,507	7,953
Income tax expense	1,533	1,542
Net income	$ 2,780	$ 2,766

Net Interest Income

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

Interest income decreased by $357,000, or 5.7%, in the 2004 second quarter compared with the same 2003 period. Interest and fees on loans decreased to $5,449,000 for the 2004 quarter from $5,816,000 for the same period of 2003, primarily due to lower levels of mortgage lending activity and the lower interest rate environment in the 2004 period. Amounts of interest earned on other categories of interest earning assets were substantially unchanged, in the aggregate, as reductions in the average yields earned on those assets were offset by increased average balances held.

Interest expense for the second quarter of 2004 decreased to $1,662,000 from $1,960,000 for the 2003 period primarily as a result of lower interest rates paid in the 2004 period. Also, because of the lower demand for mortgage loan-related products, the Company's average amounts of short-term borrowings were lower in the 2004 period. As a result, the quarterly interest expense for such borrowings declined from $190,000 in 2003 to $64,000 for 2004. Interest expense associated with long-term debt increased in the 2004 three month period to $380,000 from $279,000 for the same period of 2003 due to the issuance of $10,000,000 of subordinated debentures in March 2004, discussed below.

Interest income for the six months ended June 30, 2004 decreased by $298,000, or 2.5% from the same period of 2003, due to the lower levels of mortgage activity and lower interest rates. Interest and fee income on loans for the 2004 six month period was $10,780,000, a decrease of $311,000 or 2.8% from the same period of 2003. The decrease was the result of an approximately $491,000 decrease in interest and fee income on loans associated with mortgage lending activities.

Interest expense for the 2004 six month period was $659,000 lower than in the same 2003 period due to lower rates paid for deposits and reduced amounts of short-term borrowings. Lower deposit rates primarily are attributable to the lower interest rate environment in 2004. Reduced short-term borrowings resulted directly from lower levels of mortgage lending activity and the Company's issuance of $10,000,000 of long-term subordinated debentures in March 2004, discussed below.

During the first quarter of 2004, CBI sponsored the creation of a Trust that issued $10,000,000 in trust preferred securities. The Trust invested the proceeds of this issuance and $310,000 of capital provided by CBI into $10,310,000 of junior subordinated debentures due in 2034 ("Debentures") issued by CBI. Interest payments on the Debentures are due quarterly at a variable interest rate. CBI used the proceeds of the Debentures to repay certain pre-existing debt obligations, to enhance the capital position of two of the subsidiary banks, to provide an additional funding mechanism for its mortgage brokerage activities, and for other general corporate purposes. Although the interest rate associated with the debt is variable, management believes that the indenture provisions governing that variability will result in less volatility in interest expense than achievable under certain short-term debt agreements. In addition, because of the long-term nature of the new arrangement, transaction costs, such as those incurred to renew lines of credit, are expected to be reduced. Under current regulatory guidelines, the trust preferred securities issued by the Trust are includible in the Company's Tier 1 capital for risk-based capital purposes.

Average Balances,
Six Months En

	2004		
	Average Balances	Interest Income/ Expense	Yields/ Rates*
			(Dollars i
Assets			
Interest earning deposits	$ 1,057	$ 8	1.51%
Investment securities - taxable	52,270	779	2.98%
Investment securities - tax exempt	9,811	164	3.34%
Federal funds sold	22,353	105	0.94%
Loans, including loans held for sale	351,261	10,780	6.14%
Total interest earning assets	436,752	11,836	5.42%
Cash and due from banks	16,277		
Allowance for loan losses	(4,237)		
Premises and equipment, net	7,080		
Intangible assets	7,588		
Other assets	3,936		
Total assets	$467,396		
Liabilities and shareholders' equity			
Interest bearing deposits			
Savings	$ 78,473	$ 371	0.95%
Interest bearing transaction accounts	55,822	114	0.41%
Time deposits	182,816	1,965	2.15%
Total interest bearing deposits	317,111	2,450	1.55%
Short-term borrowings	13,262	169	2.55%
Long-term debt	26,608	683	5.13%
Total interest bearing liabilities	356,981	3,302	1.85%
Noninterest bearing demand deposits	59,542		
Other liabilities	1,710		
Shareholders' equity	49,163		
Total liabilities and shareholders' equity	$467,396		

Interest rate spread			3.57%
Net interest income and net yield on earning assets		$8,534	3.91%
Interest free funds supporting earning assets	$ 79,771		

* Yields and rates are annualized.

Provision and Allowance for Loan Losses

The provision for loan losses for the 2004 three month period was $258,000, a decrease of $21,000, or 7.5%, from $279,000 for the same period of 2003. The provision for loan losses decreased to $491,000 for the 2004 six month period from $543,000 for the 2003 six month period. During the first quarter of

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2004, a nonaccrual loan of $1,350,000, or approximately 52% of CBI's December 31, 2003 nonaccrual loans, was satisfactorily resolved with CBI collecting all principal and interest owed. Because of this favorable outcome, the amount previously included in the allowance for loan losses for this loan was no longer required. Therefore, the 2004 provision for loan losses was beneficially affected.

Net charge-offs during the six months ended June 30, 2004 were $412,000, compared with $194,000 for the same period of 2003. The allowance for loan losses as of June 30, 2004 was 1.21% of loans outstanding, compared with 1.27% as of December 31, 2003 and 1.23% as of June 30, 2003. Non-performing loans totaled $1,407,000 as of June 30, 2004, compared with $2,741,000 as of December 31, 2003, a decrease of $1,334,000 or 48.7%. The coverage ratio (allowance for loan losses divided by non-performing loans) was 3.05x as of June 30, 2004 and 1.53x as of December 31, 2003. The majority of non-performing loans at June 30, 2004 were secured by commercial real estate and other collateral.

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

	Six Months Ended June 30, 2004
	(Do
Allowance at beginning of period	$ 4,206
Provision for loan losses	491
Net charge-offs	(412)
Allowance at end of period	$ 4,285
Allowance as a percentage of loans outstanding	1.21%
Loans at end of period	$ 354,772

Following is a summary of non-performing loans as of June 30, 2004 and December 31, 2003:

	June 30, 2
	(Do
Non-performing loans	
Nonaccrual loans	$1,181
Past due 90 days or more and still accruing	226
Total	$1,407
Nonperforming loans as a percentage of loans outstanding	0.40%

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 June 30, 2004, the Corporation had identified $3,762,000, or 1.1% of the loan portfolio, as potential problem loans. This is an increase of $525,000 over the amount as of December 31, 2003. At the end of the the second quarter of 2004, an $824,000 commercial loan was added to potential problem loans. Management is currently working with this borrower who has presented alternatives for the repayment of this loan in the near term. 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.

Management will continue to monitor the levels of non-performing and potential problem loans and address the weaknesses in these credits to enhance the ultimate collection or recovery of these assets. Management considers the levels and trends in non-performing assets and potential problem loans in determining how the provision and allowance for loan losses is estimated and adjusted.

Noninterest Income

Non-interest income for the 2004 second quarter decreased $145,000, or 7.0%, from the $2,076,000 reported for the same 2003 period. Mortgage brokerage income for the 2004 quarter decreased by $411,000, or 31.3%, from $1,314,000 in the 2003 period, due to the market factors discussed previously. Service charge income totaled $822,000 in the 2004 quarter, a decrease of $16,000, or 1.9%. Losses on securities transactions in the 2004 period were $297,000 less than in the same period of 2003.

For the six months ended June 30, 2004, noninterest income was $854,000, or 18.4% less than for the first six months of 2003. Again, lower amounts of mortgage brokerage income were the primary factor in this decrease, but this was partially offset by a $247,000 decrease in losses on securities transactions.

Noninterest Expenses

Noninterest expenses for the second quarter of 2004 were $443,000, or 10.5%, lower than the amounts reported for the same period of 2003. Salaries and employee benefits expenses were $455,000, or 17.0%, lower in the 2004 period, due to the reduced activity in mortgage lending. Expenses related to premises and equipment increased by $70,000 in the 2004 period, however, due to the deployment of new technologies, as described below.

Noninterest expense for the first six months of 2004 was $446,000, or 5.6% less than for the same period of 2003. Salaries and employee benefits for the 2004 six month period were $695,000, or 13.8%, less than for the same period of 2003. These decreases resulted primarily from the decreased level of activity in the mortgage brokerage subsidiary. Because demand for refinancing and other mortgage loan products has declined recently, the number of employees needed to conduct the operations of that company has decreased. Also, that entity's compensation system is predominantly commission-based. Expenses associated with premises and equipment were $157,000, or 19.5%, higher in the 2004 period, primarily due to the acquisition and implementation of hardware and software associated with imaging technologies. Over time, the use of such technology is expected to reduce postage expense, reduce time required for research, improve internal processes and access to information, enable the Company to take advantage of the opportunities presented by the recent Check 21 legislation, and enhance the Company's ability to provide service to its customers. Other expenses were $92,000, or 4.3%, higher in the 2004 period. The major area of increase was advertising, which was increased primarily as a result of the mortgage company's efforts to increase the volume of loan originations.

Income Taxes

Income tax expense was $50,000 more in the 2004 second quarter than for the 2003 period, as a result of higher net income before taxes. Income tax expense for the 2004 six month period was $9,000 less than for the same period of 2003.

LIQUIDITY

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

Total deposits as of June 30, 2004 were $380,767,000, an increase of $2,063,000, or .5%, from the amount as of December 31, 2003. During the six months ended June 30, 2004, there was a notable movement of funds from interest bearing transaction accounts into savings and certificate of deposit accounts. As of June 30, 2004 the loan to deposit ratio was 93.2%, compared with 87.7% at December 31, 2003 and 89.4% at June 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, federal bank regulatory authorities are required to implement prescribed "prompt corrective actions" upon the deterioration of the capital position of a bank. If the capital position of an affected institution were to fall below a certain level, increasingly stringent regulatory corrective actions would be mandated.

The June 30, 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:

	Tier 1
Community Bankshares, Inc.	14.90%
Orangeburg National Bank	12.67%
Sumter National Bank	10.72%
Florence National Bank	11.23%
Bank of Ridgeway	14.31%
Minimum "well capitalized" requirement	6.00%
Minimum requirement	4.00%

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

OFF-BALANCE-SHEET ARRANGEMENTS

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

Variable Interest Entity

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

Commitments

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

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

	June 30, 2004 (Dollars in thousands)
Loan commitments	$ 44,703
Standby letters of credit	2,835

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. In March, 2004, the SEC issued its Staff Accounting Bulletin No 105 "Application of Accounting Principles to Loan Commitments," which resulted in no changes in CBI's accounting for such commitments. CBI issues mortgage loan rate lock commitments to potential borrowers to facilitate its origination of home mortgage loans that are intended to be sold. Between the time that CBI issues its commitments and the time that the loans close and are sold, CBI is subject to variability in the selling prices related to those commitments due to changes in market rates of interest. However, CBI offsets this variability through the use of so-called "forward sales contracts" to investors in the secondary market. Under these arrangements, an investor agrees to purchase the closed loans at a predetermined price. CBI generally enters into such forward sales contracts at the same time that rate lock commitments are issued. These arrangements are 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 CBI 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.

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

Rate lock commitments to potential borrowers to originate mortgage loans to be held for sale	
Forward sales contracts with investors of mortgage loans to be held for sale	

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

CBI's Asset/Liability Committee uses a simulation model to assist in achieving consistent growth in net interest income while managing interest rate risk. According to the model, as of June 30, 2004, CBI is positioned so that net interest income would increase $300,000 and net income would increase $167,000 in the next twelve months if interest rates rose 100 basis points. Conversely, net interest income would decline $400,000 and net income would decline $231,000 in the next twelve months if interest rates declined 100 basis points. CBI issued $10 million in trust preferred securities (also referred to herein as "subordinated debentures") that float with LIBOR, which are at or near their contractual floor rate. In the current interest rate environment, it is not expected that there will be any large decreases in market interest rates 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 and its customers could undertake in response to changes in interest rates.

As of June 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 the effectiveness of such controls and procedures, as of the end of the period covered by this quarterly report, was adequate.

No disclosure is required under 17 C.F.R. Section 229.308(c).

PART II--OTHER INFORMATION

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

On Monday, May 17, 2004, the shareholders of Community Bankshares, Inc. held their regular annual meeting. At the meeting, two matters were submitted to a vote with results as follows:

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

	SHARES VOTE	
DIRECTORS	FOR	AGAINST
Three-Year Terms		
Anna O. Dantzler	3,073,506	0
William A. Harwell	3,098,084	0

Richard L. Havekost	3,103,389	0
William H. Nock *	3,098,189	0
Samuel F. Reid, Jr.	3,098,084	0
William W. Traynham	3,097,684	0
Two-Year Term		
Keith W. Buckhouse	3,095,189	0

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* Mr. Nock resigned effective June 25, 2004 and Robert B. Smith was appointed to serve in his place until the next election of directors at the 2005 annual meeting of shareholders.

The following directors continue to serve until the expiration of their terms at the annual meetings to be held in the years indicated and were not voted on at the 2004 annual meeting: Thomas B. Edmunds - 2005, Martha Rose C. Carson - 2005, A. Wade Douroux - 2005, J. M. Guthrie - 2005, Phil P. Leventis - 2005, Wm. Reynolds Williams - 2005, Michael A. Wolfe - 2005, E. J. Ayers, Jr., - 2006; Alvis J. Bynum - 2006; J. Otto Warren, Jr. - 2006 and J. V. Nicholson, Jr. - 2006.

2. Amendment to the 1997 Stock Option Plan to increase by 300,000 shares the number of shares of common stock reserved for issuance upon exercise of options under that plan.

	SHARES VOTED	
	FOR	AGAINST OR AUTHORITY WITHHELD
	2,041,957	305,069

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

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

b) Reports on Form 8-K. Form 8-K filed April 21, 2004 pursuant to Items 7 and 12 of that Form.

SIGNATURES

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

DATED: August 11, 2004

COMMUNITY BANKSHARES, INC.

By: s/ E. J. Ayers, Jr.,

E. J. Ayers, Jr.,
Chief Executive Officer

By: s/ William W. Traynham

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

EXHIBIT INDEX

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

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

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