SLADES FERRY BANCORP
Form 10-Q
August 15, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISION
Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended June 30, 2005

Commission file number 000-23904

SLADE'S FERRY BANCORP.
(Exact name of registrant as specified in its character)

Massachusetts	04-3061936
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
100 Slade's Ferry Avenue Somerset, Massachusetts	02726
(Address of principal executive offices)	(Zip code)

(508)-675-2121
(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 practical date:

Common stock ($0.01 par value) 4,123,781 shares as of July 31, 2005.

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PART I

ITEM 1

FINANCIAL STATEMENTS

SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)	(Unaudited) June 30, 2005	December 31

Assets		
Cash and due from banks	$ 20,073	$ 15,9
Interest-bearing deposits with other banks	512	4
Federal Home Loan Bank overnight deposit	-	5,0
Federal funds sold	5,100	13,8
Cash and cash equivalents	25,685	35,1
Interest-bearing time deposits with other bank	100	1
Investments in available-for-sale securities (at fair value)	95,334	83,8
Investments in held-to-maturity securities (fair value of $33,545 as of June 30, 2005 and $38,112 as of December 31, 2004)	33,404	37,7
Federal Home Loan Bank stock	5,905	4,6
Loans, net of allowance for loan losses of $4,223 at June 30, 2005 and $4,101 at December 31, 2004	391,303	362,2
Premises and equipment	6,164	5,5
Goodwill	2,173	2,1
Accrued interest receivable	2,183	1,9
Cash surrender value of life insurance	11,674	11,5
Deferred taxes	1,493	1,1
Other assets	2,378	3,1
Total assets	$577,796	$549,3
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 77,593	$ 80,2
Interest-bearing	329,045	319,6
Total deposits	406,638	399,9
Federal Home Loan Bank advances	110,078	90,2
Subordinated debentures	10,310	10,3
Other liabilities	2,808	2,2
Total liabilities	529,834	502,7
Stockholders' equity:		
Common stock, par value $0.01 per share; authorized 10,000,000 shares; issued and outstanding 4,115,200 shares on June 30, 2005 and 4,068,423 shares on December 31, 2004	41	
Paid-in capital	30,703	29,9
Retained earnings	17,669	16,4
Accumulated other comprehensive income (loss)	(451)	1
Total stockholders' equity	47,962	46,6
Total liabilities and stockholders' equity	$577,796	$549,3

The accompanying notes are an integral part of these consolidated financial statements.

SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Dollars in Thousands, except per share data)	Six Months Ended June 30, 2005	2004
Interest and dividend income:		
Interest and fees on loans	$ 10,993	$ 9,867
Interest and dividends on securities	2,605	1,207
Interest on federal funds sold	157	161
Other interest	11	2
Total interest and dividend income	13,766	11,237
Interest expense:		
Interest on deposits	2,616	2,447
Interest on Federal Home Loan Bank advances	1,985	1,173
Interest on subordinated debentures	291	118
Total interest expense	4,892	3,738
Net interest and dividend income	8,874	7,499
Provision for loan losses	65	376
Net interest and dividend income, after provision for loan losses	8,809	7,123
Noninterest income:		
Service charges on deposit accounts	191	272
Overdraft service charges	229	255
Gain on sales of assets	51	-
Gain on sales and calls of available-for-sale securities, net	17	39
Increase in cash surrender value of life insurance policies	258	258
Other income	363	339
Total noninterest income	1,109	1,163
Noninterest expense:		
Salaries and employee benefits	4,095	4,082
Occupancy expense	451	420
Equipment expense	358	280
Professional fees	614	477
Marketing expense	328	198
Other expense	1,091	976
Total noninterest expense	6,937	6,433
Income before income taxes	2,981	1,853
Income taxes	1,033	643
Net income	$ 1,948	$ 1,210
Earnings per common share - basic	$ 0.48	$ 0.30
Earnings per common share - diluted	$ 0.47	$ 0.30
Average common shares outstanding - basic	4,094,939	4,028,706
Average common shares outstanding - diluted	4,123,796	4,077,206

Dividends declared per share	$ 0.18	$ 0.18

The accompanying notes are an integral part of these consolidated financial statements.

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SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Dollars in Thousands, except per share data)	Three Months Ended June 30, 2005	2004
Interest and dividend income:		
Interest and fees on loans	$ 5,727	$ 4,975
Interest and dividends on securities	1,283	678
Interest on federal funds sold	92	104
Other interest	7	-
Total interest and dividend income	7,109	5,757
Interest expense:		
Interest on deposits	1,457	1,325
Interest on Federal Home Loan Bank advances	1,074	578
Interest on subordinated debentures	155	102
Total interest expense	2,686	2,005
Net interest and dividend income	4,423	3,752
Provision for loan losses	15	130
Net interest and dividend income after provision for loan losses	4,408	3,622
Noninterest income:		
Service charges on deposit accounts	93	127
Overdraft service charges	119	132
Gain on sales of assets	11	-
Gain on sales and calls of available-for-sale securities, net	15	4
Increase in cash surrender value of life insurance policies	111	120
Other income	191	217
Total noninterest income	540	600
Noninterest expense:		
Salaries and employee benefits	2,120	2,011
Occupancy expense	212	189
Equipment expense	188	133
Professional fees	307	250
Marketing expense	229	141
Other expense	566	496

Total noninterest expense	3,622	3,220
Income before income taxes	1,326	1,002
Income taxes	478	377
Net income	$ 848	$ 625
Earnings per common share - basic	$ 0.21	$ 0.15
Earnings per common share - diluted	$ 0.21	$ 0.15
Average common shares outstanding - basic	4,112,969	4,044,758
Average common shares outstanding - diluted	4,132,712	4,088,168
Dividends declared per share	$ 0.09	$ 0.09

The accompanying notes are an integral part of these consolidated financial statements.

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SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
SIX MONTHS ENDED JUNE 30, 2005 AND DECEMBER 31, 2004
(Unaudited)

(Dollars in Thousands, except per share data)	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	To
Balance, December 31, 2004	$41	$29,976	$16,459	$ 125	$46
Comprehensive income:					
Net income	-	-	1,948	-	1
Other comprehensive (loss)	-	-	-	(576)	
Comprehensive income					1
Issuance of common stock from dividend reinvestment plan	-	296	-	-	
Stock issuance relating to optional cash contribution plan	-	20	-	-	
Stock options exercised	-	316	-	-	
Tax benefit of stock options exercised	-	95	-	-	
Dividends declared ($.18 per share)	-	-	(738)	-	
Balance, June 30, 2005	$41	$30,703	$17,669	$(451)	$4

The accompanying notes are an integral part of these consolidated financial statements.

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SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Dollars in Thousands)	Six Months Ended June 30, 2005	2004
Cash flows from operating activities:		
Net income	$ 1,948	$ 1,210
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization, net of accretion of securities	152	72
Gain on sales and calls of available-for-sale securities, net	(17)	(39)
Change in unearned income	40	128
Provision for loan losses	65	376
Deferred tax expense	127	(26)
Depreciation and amortization	392	320
Gain on sales of assets	51	-
Increase in cash surrender value of life insurance policies	(246)	(258)
(Increase) decrease in other assets	146	(619)
Increase in accrued interest receivable	(214)	(333)
Increase in other liabilities	512	179
Net cash provided by operating activities	2,854	1,010
Cash flows from investing activities:		
Decrease in interest bearing time deposits with other banks	-	100
Purchases of available-for-sale securities	(20,769)	(38,643)
Proceeds from sales of available-for-sale securities	1,826	-
Proceeds from maturities of available-for-sale securities	6,548	9,241
Purchases of held-to-maturity securities	-	-
Proceeds from maturities of held-to-maturity securities	4,256	1,777
Purchases of Federal Home Loan Bank stock	(1,255)	(105)
Loan originations and principal collections, net	(29,200)	(27,610)
Recoveries of loans previously charged off	57	69
Capital expenditures	(1,046)	(202)
Proceeds from sale of property and equipment	28	-
Proceeds from sale of investment real estate	653	
Investment in life insurance policies	-	(135)
Redemption of life insurance policy	120	-
Net cash used in investing activities	(38,782)	(55,508)

The accompanying notes are an integral part of these consolidated financial statements.

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SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Continued)

(Dollars in Thousands)	Six Months Ended June 30, 2005	2004
Cash flows from financing activities:		
Net increase in demand deposits, NOW and savings accounts	3,426	52,809
Net increase in time deposits	3,307	25,738
Short-term advances from Federal Home Loan Bank	-	(3,824)
Long-term advances from Federal Home Loan Bank	20,000	-
Payments on Federal Home Loan Bank long-term advances	(208)	(169)
Proceeds from issuance of common stock	316	380
Stock options exercised	316	532
Retirement of shares of common stock	-	(32)
Dividends paid	(738)	(722)
Proceeds from issuance of subordinated debentures	-	10,310
Net cash provided by financing activities	26,419	85,022
Net increase (decrease) in cash and cash equivalents	(9,509)	30,524
Cash and cash equivalents at beginning of period	35,194	22,706
Cash and cash equivalents at end of period	$ 25,685	$ 53,230
Supplemental disclosures:		
Interest paid	$ 4,772	$ 3,700
Income taxes paid	$ 883	$ 629

The accompanying notes are an integral part of these consolidated financial statements.

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SLADE'S FERRY BANCORP. AND SUBSIDIARY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
June 30, 2005

Note A - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and the instructions to Form 10-Q and, accordingly, do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of the management of Slade's Ferry Bancorp. (the "Company"), all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

The year-end consolidated financial data was derived from audited financial statements, but does not include all disclosures required by GAAP. This form 10-Q should be read in conjunction with the Company's Annual Report filed on Form 10-K/A for the year ended December 31, 2004.

Note B - Accounting Policies

The accounting principles followed by Slade's Ferry Bancorp. and subsidiary and the methods of applying these principles which materially affect the determination of financial position, results of operations, or changes in financial position are consistent with those used for the year ended December 31, 2004.

The consolidated financial statements of Slade's Ferry Bancorp. include its wholly-owned subsidiary, Slade's Ferry Trust Company, and its subsidiaries, Slade's Ferry Realty Trust, Slade's Ferry Securities Corporation, Slade's Ferry Securities Corporation II and Slade's Ferry Loan Company. Slade's Ferry Loan Company was dissolved in May 2005. All significant intercompany balances have been eliminated.

Slade's Ferry Statutory Trust I, a subsidiary of the Company, was formed to sell capital securities to the public through a third party trust pool. In accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46R, "Consolidation of Variable Interest Entities" ("FIN 46R"), the subsidiary has not been included in the consolidated financial statements.

Note C - Stock Based Compensation

The Company has a stock-based employee compensation plan. The Company accounts for the plan under the recognition and measurement principles of Accounting Principle Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost is reflected in net income (except for appreciation from options surrendered), as all options granted under this plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

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The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

	Three Months Ended June 30,		Six Months En
(Dollars in Thousands, except per share data)	2005	2004	2005

Net income, as reported	$ 848	$ 625	$1,948
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	26	88	63
Pro forma net income	$ 822	$ 537	$1,885
Earnings per share:			
Basic - as reported	$0.21	$0.15	$ 0.48
Basic - pro forma	$0.20	$0.13	$ 0.46
Diluted - as reported	$0.21	$0.15	$ 0.47
Diluted - pro forma	$0.20	$0.13	$ 0.46

Note D - Pension Benefits

The following summarizes the net periodic benefit cost for the periods presented:

	Six Months Ended June 30,		Three Months Ended June 30,	
Dollars in Thousands	2005	2004	2005	2004
Interest cost	$ 43	$ 53	$ 21	$ 26
Expected return on plan assets	(74)	(54)	(37)	(27)
Settlement charge	-	58	-	1
Recognized net actuarial loss	17	21	9	11
Net periodic benefit cost (income)	$(14)	$ 78	$ (7)	$ 11

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2004 that it expects to make no contributions to the plan in 2005.

Note E - Impact of New Accounting Standards

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). This Statement revises FASB Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. It establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. This Statement was originally to be effective for the Company as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. On April 14, 2005, the Securities and

Exchange Commission adopted a rule which allows companies to adopt SFAS 123R at the beginning of their next fiscal year. Accordingly, the Company will adopt SFAS 123R effective January 1, 2006. The Company does not believe the adoption of this Statement will have a material impact on the Company's financial position or results of operations.

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Slade's Ferry Bancorp, a Massachusetts corporation, is a bank holding company headquartered in Somerset, Massachusetts with consolidated assets of $577.8 million, consolidated net loans and leases of $391.3 million, consolidated deposits of $406.6 million and consolidated shareholders' equity of $48.0 million as of June 30, 2005. We conduct our business principally through our wholly-owned subsidiary, Slade's Ferry Trust Company (referred to herein as the "Bank"), a Massachusetts-chartered trust company. Our common stock is quoted on the Nasdaq Small Cap Market under the symbol "SFBC."

Forward-looking Statements

This Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding the strength of the company's capital and asset quality. Such statements may be identified by words such as "believes," "will," "expects," "project," "may," "could," "developments," "strategic," "launching," "opportunities," "anticipates," "estimates," "intends," "plans," "targets" and similar expressions. These statements are based upon the current beliefs and expectations of Slade's Ferry Bancorp's management and are subject to significant risks and uncertainties. Actual results may differ materially from those set forth in the forward-looking statements as a result of numerous factors.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements:

(1) enactment of adverse government regulation;
(2) competitive pressures among depository and other financial institutions may increase significantly and have an effect on pricing, spending, third-party relationships and revenues;
(3) the strength of the United States economy in general and specifically the strength of the New England economies may be different than expected, resulting in, among other things, a deterioration in overall credit quality and borrowers' ability to service and repay loans, or a reduced demand for credit, including the resultant effect on the Bank's loan portfolio, levels of charge-offs and non-performing loans and allowance for loan losses;
(4) changes in the interest rate environment may reduce interest margins and adversely impact net interest income; and
(5) changes in assumptions used in making such forward-looking statements.

Should one or more of these risks materialize or should underlying beliefs or assumptions prove incorrect, Slade's Ferry Bancorp's actual results could differ materially from those discussed.

All subsequent written and oral forward-looking statements attributable to Slade's Ferry Bancorp or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements set forth above. Slade's Ferry Bancorp does not intend or undertake any obligation to update any forward-looking statement to reflect circumstances or events that occur after the date the forward-looking statements are made.

As used throughout this report, the terms "we," "our," "us," or the "Bank" or the "Company" refer to Slade's Ferry Bancorp and its consolidated subsidiaries.

Critical Accounting Policies

Our significant accounting policies are incorporated by reference from Note 3 to our Consolidated Financial Statements filed within Form 10-K/A for the year ended December 31, 2004. In preparing financial information, management is required to make significant judgements, estimates, and assumptions that impact the reported amounts of certain assets, liabilities, revenues and expenses. The accounting principles we follow and the methods of applying these principles conform to accounting principles generally accepted in the United States, and general banking practices. We consider the following to be our critical accounting policies: allowance for loan losses; goodwill and other intangible assets other than temporary impairment of investments; and deferred taxes.

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon our periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Other than temporary impairment. We record a writedown impairment charge when we believe an investment experiences a decrease in value that is other than temporary. In making a decision whether an investment is permanently impaired, we review current and forecasted information about the underlying investment that is available, applicable industry data, and analyst reports. When an investment is deemed to be permanently impaired, it is written down to current fair market value. Future adverse changes in economic and market conditions, deterioration in credit quality, and continued poor financial results of underlying investments or other factors could result in further losses that may not be reflected in an investment's current book value that could result in future writedown charges due to impairment.

Deferred tax estimates. We use the asset and liability method for accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis. We also assess the probability that deferred tax assets will be recovered from future taxable income, and establish a valuation allowance for any assets determined not likely to be recovered. Our management exercises judgement in evaluating the amount and timing of recognition of the resulting deferred tax assets and liabilities, including projections of future taxable income. These judgements are estimates and assumptions and are reviewed on a continuing basis.

Comparison of Financial Condition at June 30, 2005 and December 31, 2004

General

Total assets increased by $28.4 million, or 5.2%, from $549.4 million at December 31, 2004 to $577.8 million at June 30, 2005. The increase mainly is the result of growth in the loan portfolio, which increased by $29.0 million or 8.0%, from $362.3 million (net of allowance for loan losses) to $391.3 million. The total investment securities portfolio increased from $126.4 million at December 31, 2004 to $134.7 million at June 30, 2005. The increase in loans and the investment portfolio was partially offset by a decrease in cash and cash equivalents of $9.5 million. During the same time period, deposits increased by $6.7 million, or 1.7%, from

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$399.9 million to $406.6 million, while advances from the Federal Home Loan Bank of Boston (the "FHLB") increased by $19.8 million or 21.9%. The growth in deposits and the additional FHLB advances were used to fund our loan growth during the year.

Cash and Cash Equivalents

Cash and cash equivalents decreased by $9.5 million, from $35.2 million reported at year-end 2004 to $25.7 million at June 30, 2005. The decrease is the result of our election to invest excess cash into the bond portfolio. We believe that there are opportunities to enhance income using the bond portfolio, while remaining within our interest rate risk guidelines. Accordingly, we selectively invested additional cash into the bond portfolio.

Investment Portfolio

Total investments, excluding Federal Home Loan Bank stock, increased by $7.1 million from $121.7 million reported at December 31, 2004 to $128.7 million at June 30, 2005, an increase of 5.8%. The main objective of the investment portfolio is to provide adequate liquidity to meet reasonable declines in deposits and any anticipated increases in the loan portfolio, to provide safety of principal and interest, to generate earnings adequate to provide a stable income, and to fit within our overall asset/liability management objectives. We do not purchase free standing derivative instruments, such as sweeps, options or futures.

We utilize both a "held-to-maturity" portfolio and an "available-for-sale" portfolio, as defined in Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities", to manage investments. Our investment policy requires Board approval before a trading account can be established. The held-to-maturity portfolio was originally established for holding high-yielding municipal securities. During 2004, certain mortgage-backed securities designated as collateral for FHLB advances were also designated as held-to-maturity. Management has the ability and intent to hold these securities to their contractual maturity. We primarily utilize U.S. Government agency securities and agency-insured mortgage-backed securities as investment vehicles. High-quality corporate bonds and municipal securities are purchased when an exceptional opportunity to enhance investment yields arises. Purchases of these investments are limited to securities that carry a rating of "Baa1" (Moody's) or "BBB+" (Standard and Poor's), in order to control credit risk within the investment portfolio. Among other investment criteria, it is management's goal to maintain a total bond portfolio duration of less than five years. At June 30, 2005, the portfolio duration was estimated at 2.75 years.

The following table presents the amortized cost, unrealized gains and losses, and fair value of our portfolio of Investment Securities Held-to-Maturity at June 30, 2005:

(Dollars in Thousands)	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses
Debt securities issued by states of the United States and political subdivisions of the states	$ 7,704	$208	$ 7
Federal agency mortgage-backed securities	25,700	35	95
Total	$33,404	$243	$102

Securities in the Available-for-Sale portfolio are securities that we intend to hold for an indefinite period of time, but not necessarily to maturity. These securities may be sold in response to interest rate changes, liquidity needs or other factors. Any unrealized gain or loss, net of taxes, for the Available-for-Sale securities is reflected in stockholders' equity.

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The Available-for-Sale portfolio consists primarily of Federal agency obligations, agency-insured mortgage-backed securities, and high-quality corporate bonds. We also have a portfolio of common and preferred marketable equity securities. The equity securities carry a greater level of risk as they are subject to market fluctuations. These securities are constantly monitored and evaluated to determine their suitability for sale, retention in the portfolio, or possible write-downs due to impairment issues. We minimize risk by limiting the total amount invested in marketable equity securities. At June 30, 2005, the amount invested in marketable equity securities was 3.5% of the total market value of the investment portfolio distributed over various industry sectors.

The following table presents the amortized cost, unrealized gains and losses, and fair value of our portfolio of Investment Securities Available-for-Sale at June 30, 2005:

(Dollars in Thousands)	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses
Debt securities issued by the U.S. Treasury and other U.S. Government corporations and agencies	$51,926	$ 23	$ 444
Federal agency mortgage-backed securities	29,562	199	129
Corporate debt securities	9,810	54	272
Mutual funds	1,215	17	-
Marketable equity securities	3,521	124	272
Total	$96,034	$417	$1,118

Loans

The loan portfolio consists of loans originated primarily in our market area. There are no foreign loans outstanding. The interest rates we charge on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and the rates offered by its competitors. Total net loans increased from 65.9% of total assets at December 31, 2004, to 67.7% of total assets at June 30, 2005.

Commercial real estate loans represent 52.6% of gross loans. Residential real estate, including home equity loans, represents 33.2% of gross loans. We require a loan-to-value ratio of 80% in both commercial and residential mortgages. These mortgages are secured by real properties which have a readily ascertainable appraised value. Home equity loans are generally revolving lines of credit and are typically secured by second mortgages on one-to-four family owner-occupied properties.

Generally, commercial real estate loans have a higher degree of credit risk than residential real estate loans because they depend primarily on unit supply and demand and various conditions. When granting these loans, we evaluate the financial condition of the borrower(s), the location of the real estate, the quality of management, and general economic and competitive conditions. When granting a residential mortgage, we review the borrower's repayment history on past debt, and assess the borrower's ability to meet existing obligations and payments on the proposed loan. Real estate construction loans comprise both residential and commercial construction loans throughout our market area.

Commercial loans consist of loans predominantly collateralized by inventory, furniture and fixtures, and accounts receivable. In assessing the collateral for this type of loan, we apply a 50% liquidation value to inventories; 25% to furniture, fixtures and equipment; and 70% to accounts receivable less than 90 days of invoice date. Commercial loans represent 7.7% of the loan portfolio as of June 30, 2005.

Consumer loans are both secured and unsecured borrowings and, at June 30, 2005 represent only .60% of our total loan portfolio. These loans have a higher degree of risk than residential mortgage loans. The underlying collateral of a secured consumer loan tends to depreciate in value. Consumer loans are typically made based on the borrower's ability to repay the loan through continued financial stability. We endeavor to minimize risk by reviewing the borrower's repayment history on past debts, and assessing the borrower's ability to meet existing obligations on the proposed loan.

The following table shows the amount of loans by category at June 30, 2005 and December 31, 2004.

(Dollars in Thousands)	June 30, 2005	December 31, 2004	Per Increase
Commercial, financial and agricultural	$ 30,278	$ 26,606	1
Real estate - construction and land development	23,709	24,240	-
Real estate - residential	110,154	97,496	1
Real estate - commercial	208,127	192,822	
Home equity lines of credit	21,418	23,131	-
Consumer	2,319	2,510	-
Total loans	396,005	366,805	
Allowance for loan losses	(4,223)	(4,101)	
Unearned income	(479)	(439)	
Net loans, carrying amount	$391,303	$362,265	

The increases in the loan portfolio are the result of the normal origination process. We have been successful in both retention of existing loans and the origination of new loans, particularly commercial and commercial real estate loans.

The following table presents information with respect to nonaccrual and past due loans during the periods indicated.

Information With Respect to Nonaccrual and Past Due Loans
at June 30, 2005 and December 31, 2004

(Dollars in Thousands)	At June 30, 2005	At D

Non-accrual loans	$ 364
Interest income that would have been recorded during the period under original terms	34
Interest income recorded during period	17
Loans 90 days or more past due and still accruing real estate acquired by foreclosure or substantively repossessed	166
Percentage of non-accrual loans to total gross loans	0.09%
Percentage of non-accrual loans, restructered loans, and real estate acquired by foreclosure or substantively repossessed to total assets	0.06%
Percentage of allowance for loan losses to non-accrual loans	1160.20%

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The $364,000 in non-accrual loans as of June 30, 2005 consists of $362,000 of real estate mortgages and $2,000 attributed to commercial loans. There were no restructured loans included in nonaccrual loans for the first six months of 2005.

We stop accruing interest on a loan once it becomes past due 90 days unless there is adequate collateral and the financial condition of the borrower is sufficient. When a loan is placed on nonaccrual status, all previously accrued but unpaid interest is reversed and charged against current income. Interest is thereafter recognized only when payments are received and the loan is no longer past due.

Loans in the nonaccrual category will remain in that category until the possibility of collection no longer exists, the loan is paid off, or the loan becomes current. When a loan is determined to be uncollectible, it is then charged off against the allowance for loan losses.

Statement of Financial Accounting Standards No. 114 "Accounting by Creditors for Impairment of a Loan" ("SFAS No. 114") applies to all loans except large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, loans measured at fair value or at the lower of cost or fair value. SFAS No. 114 requires that impaired loans be valued at the present value of expected future cash flows discounted at the loan's effective interest rate or as a practical expedient, at the market value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual consumer and residential loans for impairment disclosures. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principle or interest when due according to the contractual terms of the loan agreement. At June 30, 2005 there were $56,400 of loans which we have determined to be impaired, with a related allowance for credit losses of $2,800.

Analysis of Allowance for Loan Losses

The table below illustrates the changes in the Allowance for Loan Losses for the periods indicated.

(Dollars in Thousands)	Six months ended June 30, 2005	2004
Balance at beginning of period	$4,101	$4,154
Charge-offs:		
Commercial	-	-
Real estate - Construction	-	-
Real estate - Mortgage	-	-
Installment/Consumer	-	(4)
Total charge-offs	-	(4)
Recoveries:		
Commercial	32	36
Real estate - Construction	-	-
Real estate - Mortgage	15	24
Installment/Consumer	10	9
Total recoveries	57	69
Net Charge-offs	57	65
Provision charged to operations	65	376
Balance at end of period	$4,223	$4,595
Allowance for Loan Losses as a percent of loans	1.08%	1.27%
Ratio of net charge-offs to average loans outstanding	0.00%	0.00%

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We maintain an allowance for possible losses that are inherent in the loan portfolio. The allowance for loan losses is increased by provisions charged to operations based on the estimated loan loss exposure inherent in the portfolio. Management uses a methodology to systematically measure the amount of estimated loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology includes three elements: an analysis of individual loans deemed to be impaired in accordance with the terms of Statement of Financial Accounting Standard No. 114, "Accounting by Creditors for Impairment of a Loan", general loss allocations for various loan types based on loss experience factors and other qualitative factors, and an unallocated allowance which is maintained based on management's assessment of many factors including the risk characteristics of the portfolio, concentrations of credit, economic conditions that may effect borrowers' ability to pay, and trends in loan delinquencies and charge-offs. Realized losses, net of recoveries, are charged directly to the allowance. While management uses the currently available information in establishing the allowance for loan losses, adjustments to the allowance may be necessary if future economic conditions differ from the assumptions used in making the evaluation. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses.

Due to stronger underwriting guidelines, and the sale of loans previously deemed non-performing, the overall credit risk profile of the loan portfolio has improved, allowing a lesser provision for loan losses in 2005. As a result, the allowance for loan losses remained relatively constant, increasing from $4,101,000, or 1.11% of total gross loans at December 31, 2004 to $4,223,000, or 1.07% of total gross loans at June 30, 2005. After thorough review and analysis of the adequacy of the loan loss allowance, we recorded a provision for loan losses of $65,000 for the six months ended June 30, 2005, compared to a provision of $376,000 for the six months ended June 30, 2004. The decreased provision is primarily the result of the enhanced credit quality achieved with the actions taken in 2004. Management believes that the Allowance for Loan Losses of $4,223,000 at June 30, 2005 is adequate to cover potential losses in the loan portfolio, based on current information available to management.

This table shows an allocation of the allowance for loan losses as of the end of each of the periods indicated.

	June 30, 2005		December 31, 2004	
(Dollars in Thousands)	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
Commercial (4)	$ 514(1)	7.65%	$ 743(1)	7.26%
Real estate Construction	268	5.99%	236	6.62%
Real estate - residential	448	27.82%	421	32.87%
Real estate - commercial	2,944	57.96%	2,568	52.57%
Consumer (2)	49(3)	0.58%	133(3)	0.68%
	$4,223	100.00%	$4,101	100.00%