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COMMUNITY BANKSHARES INC /SC/
Form 10-Q
May 12, 2006

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 March 31, 2006 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.)

102 Founders Court
Orangeburg, South Carolina 29118

(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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

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

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or stated value, 4,434,898 shares outstanding on May 2, 2006.

COMMUNITY BANKSHARES, INC.

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

COMMUNITY BANKSHARES, INC.
Consolidated Balance Sheets

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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 \$1,828 for 2006 and \$1,820 for 2005)	
Other investments	
Loans held for sale	
Loans receivable	
Less, allowance for loan losses	
Net loans	
Premises and equipment - net	
Accrued interest receivable	
Net deferred income tax assets	
Goodwill	
Core deposit intangible assets	
Prepaid expenses and other assets	
Total assets	

Liabilities

Deposits	
Noninterest bearing	
Interest-bearing	
Total deposits	
Short-term borrowings	
Long-term debt	
Accrued interest payable	
Accrued expenses and other liabilities	
Total liabilities	

Shareholders' equity

Common stock - no par value; 12,000,000 shares authorized; issued and outstanding - 4,426,648 for 2006 and 4,404,303 for 2005	
Retained earnings	
Accumulated other comprehensive income (loss)	
Total shareholders' equity	
Total liabilities and shareholders' equity	

See accompanying notes to unaudited consolidated financial statements.

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COMMUNITY BANKSHARES, INC.
Consolidated Statements of Income

	(Unaudited) Three Months Ended March 31,	
	2006	2005
	-----	-----
	(Dollars in thousands, except per share)	
Interest and dividend income		
Loans, including fees	\$ 7,683	\$ 6,716
Interest-bearing deposits with other banks	20	8
Debt securities	553	437
Dividends	34	24
Federal funds sold	323	68
	-----	-----
Total interest and dividend income	8,613	7,253
	-----	-----
Interest expense		
Deposits		
Time deposits \$100M and over	859	527
Other deposits	1,944	1,208
	-----	-----
Total interest expense on deposits	2,803	1,735
Short-term borrowings	101	43
Long-term debt	482	438
	-----	-----
Total interest expense	3,386	2,216
	-----	-----
Net interest income	5,227	5,037
Provision for loan losses	615	450
	-----	-----
Net interest income after provision	4,612	4,587
	-----	-----
Noninterest income		
Service charges on deposit accounts	832	762
Mortgage brokerage income	837	692
Net securities gains or (losses)	1	(10)
Other	264	221
	-----	-----
Total noninterest income	1,934	1,665
	-----	-----
Noninterest expenses		
Salaries and employee benefits	2,579	2,278
Premises and equipment	624	535
Other	1,424	1,306
	-----	-----
Total noninterest expenses	4,627	4,119
	-----	-----
Income before income taxes	1,919	2,133
Income tax expense	718	773

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Net income	----- \$ 1,201 =====	----- \$ 1,360 =====
Per share		
Net income	\$ 0.27	\$ 0.31
Net income - diluted	0.27	0.30
Cash dividends declared	0.11	0.10

See accompanying notes to unaudited consolidated financial statements.

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

	(Unaudited)		
	Common Stock		
	Number of Shares -----	Amount -----	Retain Earni -----
	(Dollars in thousand)		
Balance, January 1, 2005	4,390,784	\$ 30,042	\$ 20
Comprehensive income			
Net income	-	-	1
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of \$203	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of \$3	-	-	
Total other comprehensive income (loss)	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	12,232	140	
Cash dividends declared, \$.10 per share	-	-	
Balance, March 31, 2005	4,403,016 =====	\$ 30,182 =====	\$ 20 =====
Balance, January 1, 2006	4,404,303	\$ 30,202	\$ 19
Comprehensive income			
Net income	-	-	1

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Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of \$25	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of \$0	-	-	
Total other comprehensive income (loss)	-	-	
Total comprehensive income	-	-	
Proceeds of sale of common stock	1,000	16	
Exercise of employee stock options	21,345	239	
Cash dividends declared, \$.11 per share	-	-	
	-----	-----	-----
Balance, March 31, 2006	4,426,648	\$ 30,457	\$ 20
	=====	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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COMMUNITY BANKSHARES, INC. Consolidated Statements of Cash Flows

Operating activities

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

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Net cash provided by operating activities	
Investing activities	
Net (increase) decrease in interest-bearing deposits with other banks	
Purchases of available-for-sale securities	
Maturities, calls and paydowns of available-for-sale securities	
Proceeds of sales of available-for-sale securities	
Purchases of other investments	
Net increase in loans made to customers	
Purchases of premises and equipment	
Net cash used by investing activities	
Financing activities	
Net (decrease) increase in deposits	
Net increase in short-term borrowings	
Proceeds from issuing long-term debt	
Repayment of long-term debt	
Proceeds from sale of stock	
Exercise of employee stock options	
Cash dividends paid	
Net cash (used) 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 and the audited financial statements for 2005 are included in Community Bankshares, Inc.'s (the "Company" or "CBI") Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission. Certain amounts in the 2005 financial statements have been reclassified to conform to the current presentation.

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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 2005 Annual Report on Form 10-K.

Nonperforming Loans - As of March 31, 2006, there were \$14,779,000 in nonaccrual loans and \$1,678,000 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:

Net income per share, basic

Numerator - net income

Denominator

Weighted average common shares issued and outstanding

Net income per share, basic

Net income per share, assuming dilution

Numerator - net income

Denominator

Weighted average common shares issued and outstanding

Effect of dilutive stock options

Total shares

Net income per share, assuming dilution

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Stock Based Compensation - Effective January 1, 2006, the Company began accounting for compensation expenses related to stock options granted to employees and directors under the recognition and measurement principles of Statement of Accounting Standards No. 123(R) "Share-Based Payment" ("SFAS 123(R)) using the modified prospective application method. The Company had previously 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 until the mandatory effective date for SFAS 123(R).

Options previously issued under the Company's plans had no intrinsic value at the grant date and no compensation cost was recognized in accordance with APB No. 25. Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation," required 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. Under the modified prospective application method of SFAS 123(R), the Company is required to apply SFAS 123(R) only to new awards and to awards modified, repurchased or cancelled after the required effective date. Also, compensation cost would be recognized for the portions of previously granted awards outstanding which had not vested on the effective date. The Company had no such awards outstanding as of January 1, 2006.

Variable Interest Entities - On March 8, 2004, CBI sponsored the creation of a Delaware trust, SCB Capital Trust I (the "Trust"), and is the sole owner of the common securities issued by the Trust. 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 perform under other obligations that are not senior to the junior subordinated Debentures.

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

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

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of Operations

Forward Looking Statements

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

References to our Website Address

References to our website address throughout this Quarterly Report on Form 10-Q and in any documents incorporated into this Form 10-Q by reference are for informational purposes only, or to fulfill specific disclosure requirements of the Securities and Exchange Commission's rules or the American Stock Exchange listing standards. These references are not intended to, and do not, incorporate the contents of our website by reference into this Form 10-Q or the accompanying materials.

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 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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

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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 2005 for a detailed description of CBI's estimation process and methodology related to the allowance for loan losses.

RESULTS OF OPERATIONS

Changes in Financial Condition

During the three months ended March 31, 2006, deposits decreased by \$4,544,000, or 1.0%, primarily due to a net seasonal outflow of deposits related to local government tax receipts. Loans increased by \$3,467,000 during the period. Funding for these changes was provided primarily by decreasing the Company's cash and federal funds sold positions and by allowing some maturities, calls and paydowns of the Company's investments in securities available-for-sale to occur without reinvestment.

Earnings Performance

For the quarter ended March 31, 2006, CBI earned consolidated net income of \$1,201,000, compared with \$1,360,000 for the comparable period of 2005. This represents a decrease of \$159,000 or 11.7%. Basic earnings per share were \$.27 in the 2006 period, compared with \$.31 for the 2005 quarter. Diluted earnings per share were \$.27 for the 2006 period and \$.30 for the 2005 period.

Operating results for the first quarter of 2006 were affected by increased net interest income resulting from both higher average amounts of loans and higher rates earned on those assets, partially offset by higher interest expenses resulting mainly from higher interest rates paid for interest bearing deposit accounts. The Federal Reserve's Open Market Committee (the "Committee") continued to raise the federal funds rates throughout the 2006 first quarter. It is expected that such actions will continue until the Committee is satisfied that inflation does not pose a significant threat to the economy. The principal effect of those rate increases has been to increase market rates of interest for instruments with short-to-medium term maturities, while longer term interest rates have been affected to a lesser degree. For the Company, the changes in interest rates have generally resulted in increases in rates associated with pre-existing variable rate loans, increased rates charged for new and renewed loans, and higher rates realized for federal funds sold and new investments in securities. Since the Company's funding sources generally are short-term deposits, rates associated with those sources, as well as any short-term borrowings, have also been subject to the increases.

The results for the 2006 period were affected adversely by the regular re-evaluation of the Company's allowance for loan losses, which resulted in an increase of \$165,000 in the provision for loan losses compared with the same period of 2005.

Noninterest income for the 2006 first quarter was \$269,000 more than for the same period of 2005 due to an increase of \$145,000 in mortgage brokerage income and a \$70,000 increase in service charges assessed on deposit accounts

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and for other services. Mortgage brokerage income for the 2006 period increased due to continued strength in demand for mortgage loan originations.

Noninterest expense for the first quarter of 2006 was \$508,000 more than for the same period of 2005 due to increases of \$301,000 in salaries and employee benefits, \$89,000 in premises and equipment expenses and \$118,000 in other expenses. The increase in salaries and employee benefits in the 2006 quarter was caused primarily by the addition of a Chief Credit Officer, a director of human resources and other management personnel after the first quarter of 2005, higher commission-based compensation in the mortgage brokerage subsidiary, and normal salary increases. Also, during the 2006 first quarter, the Company increased its 401K matching contributions. Increased expenses for premises and equipment resulted from the Company's moving into its newly constructed headquarters and operations center building in the first quarter of 2006 and the leasing of other office space to provide for the needs of certain management and other personnel who are located away from the corporate headquarters.

	Summary Income Statement		
		(Dollars in thousands)	
For the Three Months Ended March 31,	2006	2005	2004
-----	----	----	----
Interest income	\$ 8,613	\$ 7,253	\$ 6,716
Interest expense	3,386	2,216	1,735
	-----	-----	-----
Net interest income	5,227	5,037	4,981
Provision for loan losses	615	450	500
Noninterest income	1,934	1,665	1,500
Noninterest expenses	4,627	4,119	3,900
Income tax expense	718	773	700
	-----	-----	-----
Net income	\$ 1,201	\$ 1,360	\$ 1,376
	=====	=====	=====

Net Interest Income

Net interest income is the amount of interest income earned on interest earning assets (primarily 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 the Company's earnings. Net interest income is affected by the level of interest rates, volume and mix of interest earning assets and interest bearing liabilities and the relative funding of those assets.

Interest income increased by \$1,360,000, or 18.8%, in the 2006 first quarter compared with the same 2005 period. Interest income from loans increased from \$6,716,000 in the 2005 period to \$7,683,000 in the 2006 period primarily due to higher rates charged on loans outstanding, supplemented by higher average volumes of loans outstanding. The amounts of interest earned on all other categories of interest earning assets increased by \$393,000, in the aggregate, due to increases in both the average amounts of, and rates associated with, federal funds sold and taxable investments and other securities.

Interest expense for deposits increased from \$1,735,000 for the 2005

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period to \$2,803,000 for the 2006 period primarily due to increased rates associated with all categories of interest bearing deposits. Larger average amounts of interest-bearing deposits, primarily time deposits, also contributed to this increased interest expense.

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During the first quarter of 2004, CBI sponsored the creation of a Trust that issued \$10,000,000 in trust preferred securities. The Trust invested the proceeds of this issuance and \$310,000 of capital provided by CBI into \$10,310,000 of junior subordinated debentures ("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. Under current regulatory guidelines, the trust preferred securities issued by the Trust are includible in Tier 1 capital for risk-based capital purposes.

In the first quarter of 2006, interest expense for long-term debt, which includes the Debentures and advances obtained from the Federal Home Loan Bank of Atlanta, totaled \$482,000, an increase of \$44,000, or 10.0%, over the amount for the same period of 2005. Average amounts of long-term debt outstanding increased by \$1,623,000, or 5.2%, and the interest rate paid for such borrowings increased by 27 basis points.

Interest expenses for short-term borrowings in the first quarter of 2006 were \$101,000, an increase of \$58,000, or 134.9%, over the amount for the same period of 2005. An increase of 193 basis points in the average rate associated with those borrowings was primarily responsible for the increased expense.

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		Average Balances Three Months -----	
		2006 ----	
	Average Balances -----	Interest Income/ Expense -----	Yields/ Rates (1) ----- (Dollars i
Assets			
Interest earning deposits	\$ 1,538	\$ 20	5.27%
Investment securities - taxable	57,868	540	3.78%
Investment securities - tax exempt (2)	5,423	47	3.51%
Federal funds sold	29,592	323	4.43%
Loans, including loans held for sale (2)	430,109	7,683	7.24%
	-----	-----	
Total interest earning assets	524,530	8,613	6.66%

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Cash and due from banks	16,236
Allowance for loan losses	(11,343)
Premises and equipment	6,516
Intangible assets	10,446
Other assets	7,978

Total assets	\$ 554,363
	=====

Liabilities and shareholders' equity

Interest bearing deposits

Interest bearing transaction accounts	\$ 73,906	\$ 219	1.20%
Savings	85,521	451	2.14%
Time deposits	236,100	2,133	3.66%
	-----	-----	
Total interest bearing deposits	395,527	2,803	2.87%
Short-term borrowings	10,276	101	3.99%
Long-term debt	32,711	482	5.98%
	-----	-----	
Total interest bearing liabilities	438,514	3,386	3.13%
Noninterest bearing demand deposits	63,186		
Other liabilities	2,972		
Shareholders' equity	49,691		

Total liabilities and shareholders' equity	\$ 554,363		
	=====		

Interest rate spread			3.53%
Net interest income and net yield			
on earning assets		\$ 5,227	4.04%

(1) Yields and rates are annualized.

(2) Yields on tax-exempt securities and loans have not been stated on a tax-equivalent basis.

Provision and Allowance for Loan Losses

The provision for loan losses for the 2006 first quarter was \$615,000, an increase of \$165,000, or 36.7%, over the \$450,000 provided for the same period of 2005. This increase was due primarily to an increase in net charge-offs and non-performing loans during the 2006 first quarter, as discussed below.

Net charge-offs during the three months ended March 31, 2006 were \$1,162,000, compared with \$75,000 for the same period of 2005. The allowance for

loan losses as of March 31, 2006 was 2.66% of loans outstanding, compared with 2.81% as of December 31, 2005 and 1.16% as of March 31, 2005.

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

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Ended
March 31,
2006

(Dollars in thousands)

Allowance at beginning of period	\$ 11,641
Transfer of allowance for off-balance-sheet contingencies to other liabilities	-
Provision for loan losses	615
Net charge-offs	(1,162)

Allowance at end of period	\$ 11,094
	=====
Allowance as a percentage of loans outstanding	2.66%
Loans at end of period	\$ 417,451
	=====

During the first quarter of 2006, net charge-offs included \$1,100,000 of partial charge-offs related to two borrowers in the manufactured housing business. Loans to these borrowers were placed in nonaccrual status in the third quarter of 2005.

Non-performing loans, consisting of nonaccrual loans and loans 90 or more days past due which are still accruing interest, totaled \$16,457,000 as of March 31, 2006, compared with \$12,380,000 as of December 31, 2005, an increase of \$4,077,000 or 32.9%. The majority of non-performing loans at March 31, 2006 were secured by commercial real estate and other collateral. Accordingly, the amount of problem loans does not reflect the amount of probable loss that management estimates will be incurred with respect to problem loans. The amount of such estimated loss is included in the allowance for loan losses.

Following is a summary of non-performing loans as of March 31, 2006 and December 31, 2005:

	March 31, 2006 ----	December 31, 2005 ----
	(Dollars in thousands)	
Non-performing loans		
Nonaccrual loans	\$14,779	\$11,651
Past due 90 days or more and still accruing	1,678	729
	-----	-----
Total	\$16,457	\$12,380
	=====	=====
Nonperforming loans as a percentage of:		
Loans outstanding	3.94%	2.99%
Allowance for loan losses	148.34%	106.35%

The following table shows quarterly changes in nonperforming and potential problem loans since December 31, 2004.

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	Nonaccrual Loans -----	90 Days or More Past Due and Still Accruing -----	Total Nonperforming Loans -----	Perce of To Loa ---
(Dollars in thousands)				
December 31, 2004	\$ 4,941	\$ 137	\$ 5,078	1.
Net change	118	215	333	
March 31, 2005	5,059	352	5,411	1.
Net change	200	(9)	191	
June 30, 2005	5,259	343	5,602	1.
Net change	4,954	74	5,028	
September 30, 2005	10,213	417	10,630	2.
Net change	1,438	312	1,750	
December 31, 2005	11,651	729	12,380	2.
Net change	3,128	949	4,077	
March 31, 2006	\$14,779	\$ 1,678	\$16,457	3.

The \$3,128,000 increase in nonaccrual loans in the first quarter of 2006 represents the further deterioration of loans aggregating \$2,867,000 that were previously identified as potential problem loans, \$107,000 of loans that were previously 90 days or more past due and still accruing, and loans aggregating \$1,896,000 that were not previously included in potential problem or nonperforming loans. Of these loans, approximately \$951,000 are unsecured, \$1,819,000 are collateralized by real estate and the remainder are collateralized by accounts receivable, commercial equipment, and automobiles.

Subsequent to March 31, 2006, the collateral underlying one borrower's nonaccrual loans was sold and the Company's loans were settled. The original amount of this borrower's relationship was approximately \$3,452,000. During 2004 the Company charged the value of the loans down by \$1,000,000. During 2005 the Company provided an additional specific allocation of \$1,000,000 against the loans. In early April 2006 the Company realized a final settlement of the loans in the amount \$1,800,000, for a net life-to-date loss of \$1,652,000, all of which was recognized in prior years, as noted above.

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

Noninterest Income

Noninterest income for the first quarter of 2006 increased by \$269,000, or 16.2%, from the \$1,665,000 reported for the 2005 period. Service charges on deposit accounts increased by \$70,000 from the prior year amount. This increase was primarily the result of increased returned check revenue. Mortgage brokerage income increased by \$145,000 or 21.0%, from \$692,000 for the 2005 period, due to fees derived from a larger number of loans originated in the quarter.

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Noninterest Expenses

Salaries and employee benefits for the first quarter of 2006 were \$301,000 or 13.2%, more than in the same 2005 period. This increase resulted primarily from expenses associated with the hiring of several administrative officers since the end of the first quarter of 2005, higher commission-based compensation related to the mortgage-brokerage operation, and increased matching contributions for the Company's 401K retirement plan for employees. During 2005, the Company built a new headquarters office building where it now provides office space for many of its management officers and operations personnel. This facility was initially occupied in early 2006. In addition, other recently hired management personnel occupy offices in recently leased facilities located more centrally within the Company's geographic footprint. As a result, expenses associated with premises and equipment were \$89,000, or 16.6%, higher in the 2006 period.

During the first quarter of 2006, CBI's Board of Directors directed management to plan for a transition to a single bank charter. Contingent upon receiving required legal and regulatory approvals, implementation of this change is expected by year-end 2006. CBI expects that this change ultimately will result in significant financial savings, improved operational efficiency and effectiveness, improved customer service through unified selection of banking products and services, accelerated approval of loan requests, and better availability of ATM and in-bank services for all customers.

Income Taxes

Income tax expense for the first quarter of 2006 decreased \$55,000, or 7.1%, from the amount for the first quarter of 2005. The average tax rate for 2006 was 37.4% compared with 36.2% in 2005.

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 net proceeds of issuing \$10,000,000 of trust preferred securities. 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 March 31, 2006 were \$459,665,000, a decrease of \$4,544,000, or 1.0%, from the amount as of December 31, 2005. As of March 31, 2006 the loan to deposit ratio was 90.8%, compared with 89.2% at December 31, 2005 and 94.4% at March 31, 2005. Loans held-for-sale have not been included in the numerator of the calculation of the loan to deposit ratio. The banking subsidiaries have significant amounts of long-term debt available under agreements with the Federal Home Loan Bank of Atlanta.

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 "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 March 31, 2006 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:

	March 31, 2006		
	Tier 1	Total Capital	Leverage
	-----	-----	-----
Community Bankshares, Inc.	12.89%	14.16%	9.76%
Orangeburg National Bank	11.44%	12.69%	8.25%
Sumter National Bank	9.83%	11.15%	7.46%
Florence National Bank	9.83%	11.08%	8.73%
Bank of Ridgeway	11.28%	12.53%	8.79%
Minimum "well capitalized" requirement	6.00%	10.00%	6.00%
Minimum requirement	4.00%	8.00%	5.00%

As shown in the table above, each of the banks' 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.

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 March 31, 2006, CBI held an equity interest in, and guarantees the liabilities of, a non-consolidated variable interest entity, SCB Capital Trust I.

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:

	March 31, 2006

	(Dollars in thousands)
Loan commitments	\$ 61,239
Standby letters of credit	2,360

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.

Neither the Company nor the Bank is involved in other off-balance sheet contractual relationships or transactions that could result in liquidity needs or other commitments or significantly impact earnings.

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

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CBI's accounting for such commitments. CBI issues mortgage loan rate lock

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commitments to potential borrowers to facilitate its origination of home mortgage loans that are intended to be sold. Between the time that CBI issues its commitments and the time that the loans close and are sold, CBI is subject to variability in the selling prices related to those commitments due to changes in market rates of interest. However, CBI offsets this variability through the use of so-called "forward sales contracts" to investors in the secondary market. Under these arrangements, an investor agrees to purchase the closed loans at a predetermined price. CBI generally enters into such forward sales contracts at the same time that rate lock commitments are issued. These arrangements effectively insulate CBI from the effects of changes in interest rates during the time the commitments are outstanding, but the arrangements do not qualify as fair value hedges. These derivative financial instruments are carried in the balance sheet at estimated fair value and changes in the estimated fair values of these derivatives are recorded in the statement of income in net gains or losses on loans held for sale.

Derivative financial instruments are written in amounts referred to as notional amounts. Notional amounts only provide the basis for calculating payments between counterparties and do not represent amounts to be exchanged between parties or a measure of financial risk. The following table includes the notional principal amounts of rate lock commitments and forward sales contracts as of March 31, 2006, and the estimated fair values of those financial instruments included in other assets and liabilities in the balance sheet as of that date.

	March 31, 2006	
	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	\$23,686	\$ (190)
Forward sales contracts with investors of mortgage loans to be held for sale	\$23,686	\$ 190

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

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risk. According to the model, as of March 31, 2006, CBI is positioned so that net interest income would increase \$123,000 and net income would increase \$73,000 in the next twelve months if interest rates rose 100 basis points. Conversely, net interest income would decline \$123,000 and net income would decline \$73,000 in the next twelve months if interest rates declined 100 basis

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points. 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 March 31, 2006 there was no significant change from the interest rate sensitivity analysis for the various changes in interest rates calculated as of December 31, 2005. 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 2005 Annual Report on Form 10-K.

Item 4. Controls and Procedures

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

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

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PART II--OTHER INFORMATION

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

On February 10, 2006, the Company sold 1,000 shares of its common stock to an executive officer for an aggregate purchase price of \$16,100. Issuance of the securities was not registered under the Securities Act of 1933 in reliance on the exemption provided by Section 4(2) thereof because no public offering was involved.

Item 6. Exhibits

Exhibits	31-1	Rule 13a-14(a)/15d-14(a) Certification of principal executive officer
	31-2	Rule 13a-14(a)/15d-14(a) Certification of principal financial officer

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

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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: May 12, 2006

COMMUNITY BANKSHARES, INC.

By: s/ Samuel L. Erwin

Samuel L. Erwin
Chief Executive Officer

By: s/ William W. Traynham

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

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EXHIBIT INDEX

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

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