SLADES FERRY BANCORP
Form 10-Q
November 14, 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 September 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 by check mark whether the registrant is a shell company (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) 4,131,887 shares as of October 31, 2005.

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PART I

ITEM 1

FINANCIAL STATEMENTS

SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands)	September 30, 2005	Decem
Assets		
Cash and due from banks	$ 21,037	
Interest-bearing deposits with other banks	110	
Federal Home Loan Bank overnight deposit	-	
Federal funds sold	-	
Cash and cash equivalents	21,147	
Interest-bearing time deposits with other bank	100	
Investments in available-for-sale securities (at fair value)	99,213	
Investments in held-to-maturity securities (fair values of $32,137 as of September 30, 2005 and $38,112 as of December 31, 2004)	32,226	
Federal Home Loan Bank stock	6,304	
Loans, net of allowance for loan losses of $4,274 at September 30, 2005 and $4,101 at December 31, 2004	395,673	
Premises and equipment	6,072	
Goodwill	2,173	
Accrued interest receivable	2,276	
Cash surrender value of life insurance	11,779	
Deferred taxes	1,614	
Other assets	2,242	
Total assets	$580,819	
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 78,781	
Interest-bearing	326,558	
Total deposits	405,339	
Federal Home Loan Bank advances	113,774	
Subordinated debentures	10,310	
Other liabilities	2,926	
Total liabilities	532,349	
Stockholders' equity:		
Common stock, par value $0.01 per share; authorized 10,000,000 shares; issued and outstanding 4,124,353 shares on September 30, 2005 and 4,068,423 shares on December 31, 2004	41	
Paid-in capital	30,869	
Retained earnings	18,197	
Accumulated other comprehensive income (loss)	(637)	
Total stockholders' equity	48,470	
Total liabilities and stockholders' equity	$580,819	

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 September 3 2005	2004
Interest and dividend income:		
Interest and fees on loans	$ 5,943	$ 5,194
Interest and dividends on securities	1,471	998
Interest on federal funds sold	41	57
Other interest	7	1
Total interest and dividend income	7,462	6,250
Interest expense:		
Interest on deposits	1,672	1,280
Interest on Federal Home Loan Bank advances	1,142	627
Interest on subordinated debentures	166	118
Total interest expense	2,980	2,025
Net interest and dividend income	4,482	4,225
Provision for loan losses	44	-
Net interest and dividend income, after provision for loan losses	4,438	4,225
Noninterest income:		
Service charges on deposit accounts	81	132
Overdraft service charges	122	149
Gain on sales and calls of available-for-sale securities, net	10	7
Gain on sale of loans	50	196
Gain (loss) on sale of other assets	(1)	-
Increase in cash surrender value of life insurance policies	106	100
Other income	234	229
Total noninterest income	602	813
Noninterest expense:		
Salaries and employee benefits	2,148	1,945
Occupancy expense	251	179
Equipment expense	193	67
Professional fees	372	302
Marketing expense	162	211
Other expense	556	758
Total noninterest expense	3,682	3,462
Income before income taxes	1,358	1,576
Income taxes	458	500

Net income	$ 900	$ 1,076
Earnings per common share - basic	$ 0.22	$ 0.27
Earnings per common share - diluted	$ 0.22	$ 0.26
Average common shares outstanding - basic	4,122,631	4,058,086
Average common shares outstanding - diluted	4,145,566	4,101,223
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 STATEMENTS OF INCOME
(Unaudited)

	Nine Months Ended September 30	
(Dollars in thousands, except per share data)	2005	2004
Interest and dividend income:		
Interest and fees on loans	$ 16,937	$ 15,061
Interest and dividends on securities	4,075	2,206
Interest on federal funds sold	198	218
Other interest	18	2
Total interest and dividend income	21,228	17,487
Interest expense:		
Interest on deposits	4,288	3,727
Interest on Federal Home Loan Bank advances	3,127	1,800
Interest on subordinated debentures	457	236
Total interest expense	7,872	5,763
Net interest and dividend income	13,356	11,724
Provision for loan losses	109	376
Net interest and dividend income, after provision for loan losses	13,247	11,348
Noninterest income:		
Service charges on deposit accounts	272	404
Overdraft service charges	351	404
Gain on sales and calls of available-for-sale securities, net	27	46

Gain on sales of loans	50	196
Gain on sale of other assets	51	-
Increase in cash surrender value of life insurance policies	363	358
Other income	597	568
Total noninterest income	1,711	1,976
Noninterest expense:		
Salaries and employee benefits	6,243	6,027
Occupancy expense	702	599
Equipment expense	551	418
Professional fees	986	779
Marketing expense	490	410
Other expense	1,647	1,661
Total noninterest expense	10,619	9,894
Income before income taxes	4,339	3,430
Income taxes	1,491	1,143
Net income	$ 2,848	$ 2,287
Earnings per common share - basic	$ 0.69	$ 0.57
Earnings per common share - diluted	$ 0.69	$ 0.56
Average common shares outstanding - basic	4,104,304	4,038,499
Average common shares outstanding - diluted	4,132,128	4,086,415
Dividends declared per share	$ 0.27	$ 0.27

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SLADE'S FERRY BANCORP. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 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	-	-	2,848	-	2
Other comprehensive loss	-	-	-	(762)	
Comprehensive income					2

Issuance of common stock from dividend reinvestment plan	-	428	-	-	
Stock issuance relating to optional cash contribution plan	-	54	-	-	
Stock options exercised	-	316	-	-	
Tax benefit of stock options	-	95	-	-	
Dividends declared ($.27 per share)	-	-	(1,110)	-	(1
Balance, September 30, 2005	$41	$30,869	$18,197	$(637)	$48

(Dollars in thousands, except per share data)	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	To
Balance, December 31, 2003	$40	$28,609	$14,300	$(412)	$42
Comprehensive income:					
Net income	-	-	2,287	-	2
Other comprehensive income	-	-	-	235	
Comprehensive income					2
Issuance of common stock from dividend reinvestment plan	-	462	-	-	
Stock issuance relating to optional cash contribution plan	-	89	-	-	
Stock options exercised	1	531	-	-	
Tax benefit of stock options	-	157	-	-	
Retirement of 3,412 shares of common stock	-	(32)	-	-	
Dividends declared ($.27 per share)	-	-	(1,092)	-	(1
Balance, September 30, 2004	$41	$29,816	$15,495	$(177)	$45

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)

	Nine Months Ended September 30	
(Dollars in thousands)	2005	2004
Cash flows from operating activities:		
Net income	$ 2,848	$ 2,287
Adjustments to reconcile net income to net cash provided by		

operating activities:		
Amortization of securities, net of accretion	202	122
Gain on sales and calls of available-for-sale securities, net	(27)	(46)
Change in unearned income	3	170
Provision for loan losses	109	376
Deferred tax expense	127	132
Depreciation and amortization	604	483
Gain on sale of property and equipment	(11)	-
Gain on sale of investment real estate	(40)	-
Gain on sale of loans	(50)	(196)
Increase in cash surrender value of life insurance policies	(351)	(358)
Decrease (increase) in other assets	282	(465)
Increase in interest receivable	(307)	(540)
Increase in community investment fund	-	(10)
Increase in other liabilities	630	502
Net cash provided by operating activities	4,019	2,457
Cash flows from investing activities:		
Decrease in interest bearing time deposits with other banks	-	100
Purchases of available-for-sale securities	(27,665)	(48,904)
Proceeds from sales of available-for-sale securities	2,263	625
Proceeds from maturities of available-for-sale securities	8,811	11,348
Purchases of held-to-maturity securities	-	(31,428)
Proceeds from maturities of held-to-maturity securities	5,404	2,098
Purchases of Federal Home Loan Bank stock	(1,654)	(1,181)
Loan originations and principal collections, net	(33,584)	(39,533)
Recoveries of loans previously charged off	64	92
Capital expenditures	(1,167)	(433)
Proceeds from sale of property and equipment	29	-
Proceeds from sale of investment real estate	653	-
Proceeds from sales of loans	-	8,198
Proceeds from sale of charged-off loan	50	-
Investment in life insurance policies	-	(135)
Redemption of life insurance policy	120	-
Net cash used in investing activities	(46,676)	(99,153)

(Continued)

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)
(Concluded)

	Nine Months Ended September 30	
(Dollars in thousands)	2005	2004

Cash flows from financing activities:		
Net increase (decrease) in non-interest bearing deposits	(1,451)	3,929
Net increase in interest-bearing deposits	6,885	66,381
Short-term advances from Federal Home Loan Bank	10,800	-
Long-term advances from Federal Home Loan Bank	33,000	24,000
Payments on Federal Home Loan Bank long-term advances	(12,312)	(263)
Payments on Federal Home Loan Bank short-term advances	(8,000)	(3,824)
Proceeds from issuance of common stock	482	551
Stock options exercised	316	532
Retirement of shares of common stock	-	(32)
Dividends paid	(1,110)	(1,086)
Proceeds from issuance of subordinated debentures	-	10,310
Net cash provided by financing activities	28,610	100,498
Net increase (decrease) in cash and cash equivalents	(14,047)	3,802
Cash and cash equivalents at beginning of year	35,194	22,706
Cash and cash equivalents at end of period	$ 21,147	$ 26,508
Supplemental disclosures:		
Interest paid	$ 4,772	$ 4,587
Income taxes paid	$ 883	$ 825

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)
September 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 nine months ended September 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 Company's investment in this subsidiary is presented on the equity method of accounting 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.

	Nine Months Ended September 30,		Three Months Ended September 30,	
(Dollars in thousands, except per share data)	2005	2004	2005	2004
Net income, as reported	$2,848	$2,287	$ 900	$1,076
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	99	88	31	-
Pro forma net income	$2,749	$2,199	$ 869	$1,076

Earnings per share:				
Basic - as reported	$ 0.69	$ 0.57	$0.22	$ 0.27
Basic - pro forma	$ 0.67	$ 0.54	$0.21	$ 0.27
Diluted - as reported	$ 0.69	$ 0.56	$0.22	$ 0.26
Diluted - pro forma	$ 0.67	$ 0.54	$0.21	$ 0.26

Note D - Pension Benefits

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

(Dollars in thousands)	Nine Months Ended September 30, 2005	2004	Three Months Ended September 2005	2004
Interest cost	$ 64	$ 79	$ 21	$ 26
Expected return on plan assets	(111)	(81)	(37)	(27)
Settlement charge	167	98	167	40
Recognized net actuarial loss	26	32	9	11
Net periodic benefit cost	$ 146	$ 128	$160	$ 50

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. 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.

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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 $580.8 million, consolidated net loans of $395.7 million, consolidated deposits of $405.3 million and consolidated shareholders' equity of $48.5 million as of September 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 Capital 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.

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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 judgments, 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. 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 an 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 analysts' 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 write-down 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. Management exercises judgment in evaluating the amount and timing of recognition of the resulting deferred tax assets and liabilities, including projections of future taxable income. These judgments are estimates and assumptions and are reviewed on a continuing basis.

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

General

Total assets increased by $31.4 million, or 5.7%, from $549.4 million at December 31, 2004 to $580.8 million at September 30, 2005. The increase is primarily the result of growth in the loan portfolio, which increased by $33.5 million or 9.2%, from $362.3 million (net of allowance for loan losses) to $395.7 million. The total investment securities portfolio increased $11.4 million, or 9.0%, from $126.4 million at December 31, 2004 to $137.8 million at September 30, 2005. The increase in loans and the investment portfolio was partially offset by a decrease in cash and cash equivalents of $14.1 million. During the same time period, deposits increased by $5.4 million, or 1.4%, from $399.9 million to $405.3 million, while advances from the Federal Home Loan Bank of Boston (the "FHLB") increased by $23.5 million or 26.0%. The growth in deposits and the additional FHLB advances were used to fund our loan and investment growth during the year.

Cash and Cash Equivalents

Cash and cash equivalents decreased by $14.1 million, from $35.2 million at December 31, 2004 to $21.1 million at September 30, 2005. Our federal funds sold balance at the end of December 2004 was abnormally high due to anticipated runoff from a retail promotion in the first quarter of 2005 and the election to invest excess cash into the bond and loan portfolios. The deployment of this excess cash represented an opportunity to enhance income, while remaining within our interest rate risk guidelines. Management reviews the levels of cash and cash equivalents daily in order to maintain a mix of short-term investments, investment securities and loans that allows us to optimize interest income while remaining within our interest rate risk limits.

Investment Portfolio

Total investments, excluding Federal Home Loan Bank stock, increased by $9.8 million from $121.7 million reported at December 31, 2004 to $131.5 million at September 30, 2005, an increase of $9.8 million or 8.0%. The main objectives of the investment portfolio are 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 currently purchase free standing derivative instruments, such as swaps, options or futures. Among other investment criteria, it is management's goal to maintain a total bond portfolio duration of less than five years. At September 30, 2005, the portfolio duration was estimated at 3.09 years.

We primarily utilize U.S. Government agency securities and agency-insured, mortgage-backed securities as investment vehicles for the investment portfolio. 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. Additionally, we maintain a small portfolio of marketable equity securities.

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.

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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.

Securities Held-to-Maturity

The following table presents the amortized cost, unrealized gains and losses, and fair value of our portfolio of investment securities held-to-maturity at September 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	$ 7,702	$199	$ 7
Federal agency mortgage-backed securities	24,524	-	281
Total	$32,226	$199	$288

The following table presents the amortized cost, unrealized gains and losses, and fair value of our portfolio of investment securities held-to-maturity at December 31, 2004:

(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	$ 8,588	$340	$ -
Federal agency mortgage-backed securities	29,185	15	16

Total	$37,773	$355	$ 16

Securities Available-for-Sale

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.

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 September 30, 2005, the amount invested in marketable equity securities was 3.2% of the total market value of our investment portfolio and was distributed over various industry sectors. The change in unrealized losses in the available-for-sale portfolio was reflective of the interest rate environment and not credit related.

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The following table presents the amortized cost, unrealized gains and losses, and fair value of our portfolio of investment securities available-for-sale at September 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	$ 51,934	$ -	$ 617
Federal agency mortgage-backed securities	33,894	146	142
Corporate debt securities	9,787	49	239
Mutual funds	1,215	-	5
Marketable equity securities	3,390	123	322
Total	$100,220	$318	$1,325

The following table presents the amortized cost, unrealized gains and losses, and fair value of our portfolio of investment securities available for sale at December 31, 2004:

(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	$41,419	$ 73	$286
Federal agency mortgage-backed securities	27,804	468	65
Corporate debt securities	9,364	149	29
Mutual funds	1,217	17	-
Marketable equity securities	3,859	203	311
Total	$83,663	$910	$691

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 our competitors. Total net loans increased from 65.9% of total assets at December 31, 2004, to 68.1% of total assets at September 30, 2005.

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 8.2% of our loan portfolio as of September 30, 2005.

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Construction loans are used to finance either the development of raw land in anticipation of further improvement or the actual construction of improvements on previously developed land for both commercial and residential purposes. Prior to construction advances, an independent inspector evaluates work progress. Construction loans represent 4.8% of the loan portfolio as of September 30, 2005.

Commercial real estate loans represent 52.9% of total loans as of September 30, 2005 while residential real estate, including home equity loans, represents 33.6% of total 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.

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, economic conditions and indicators. When granting these loans, we evaluate the financial condition of the borrower, 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.

Home equity loans are generally revolving lines of credit and are typically secured by second mortgages on one-to-four family owner-occupied properties with maturities up to twenty years. During the first ten years, only interest payments are required. For the remaining ten years, payments are converted to principal and interest. Home equity lines of credit represent 5.2% of our loan portfolio as of September 30, 2005.

Consumer loans are both secured and unsecured borrowings and, at September 30, 2005 represent only .6% 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 September 30, 2005 and December 31, 2004.

(Dollars in thousands)	September 30, 2005	December 31, 2004	Inc
Commercial, financial and agricultural	$ 32,851	$ 26,606	
Real estate - construction and land development	19,114	24,240	
Real estate - residential	113,674	97,496	
Real estate - commercial	211,653	192,822	
Home equity lines of credit	20,658	23,131	
Consumer	2,439	2,510	
Total loans	400,389	366,805	
Allowance for loan losses	(4,274)	(4,101)	
Unearned income	(442)	(439)	
Net loans, carrying amount	$395,673	$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 non-accrual and past due loans during the periods indicated.

(Dollars in thousands)	At September 30, 2005
Nonaccrual loans	$1,142
Interest income that would have been recorded during the period under original terms	32
Interest income recorded during the period	27
Loans 90 days or more past due and still accruing	-
Real estate acquired by foreclosure or substantively repossessed	-
Percentage of nonaccrual loans to total gross loans	0.29%
Percentage of nonaccrual loans, restructured loans, and real estate acquired by foreclosure or substantively repossessed to total assets	0.20%
Percentage of allowance for loan losses to nonaccrual loans	374.26%

The $1.1 million in non-accrual loans as of September 30, 2005 consists of $867,000 of commercial real estate loans and $275,000 of residential real estate mortgages. There were no restructured loans included in non-accrual loans for the first nine 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 non-accrual 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 non-accrual 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 principal or interest when due according to the contractual terms of the loan agreement. At September 30, 2005 there was $59,200 of loans which we have determined to be impaired, with a related allowance for loan losses of $2,600.

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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)	Nine Months Ended September 30, 2005	2004
Balance at beginning of period	$4,101	$4,154
Charge-offs:		
Commercial, financial and agricultural	-	(62)
Real estate - construction and land development	-	(4)
Real estate - residential	-	(18)
Real estate - commercial	-	(425)
Home equity lines of credit	-	-
Consumer	-	(11)
Total charge-offs	-	(520)
Recoveries:		
Commercial, financial and agricultural	39	57
Real estate - construction and land development	-	-
Real estate - residential	-	-
Real estate - commercial	-	8
Home equity lines of credit	16	17
Consumer	9	10
Total recoveries	64	92
Net (charge-offs) or recoveries	64	(428)
Provision charged to operations	109	376
Balance at end of period	$4,274	$4,102
Allowance for loan losses as a percent of loans at end of period	1.07%	1.12%
Ratio of net recoveries (charge-offs) to average loans outstanding	0.01%	(0.15)%

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 Standards 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 loan sale in the third quarter of 2004 of loans previously deemed non-performing, the overall credit risk profile of our loan portfolio has improved, allowing a lesser provision for loan losses in 2005. Management assesses the allowance for loan losses on a monthly basis.

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After a thorough review and analysis of the adequacy of the loan loss allowance, we recorded a provision for loan losses of $109,000 for the nine months ended September 30, 2005, compared to a provision of $376,000 for the nine months ended September 30, 2004. The decreased provision is primarily the result of the enhanced credit quality achieved with the actions taken in 2004. As a result of the provision, together with net recoveries of charged-off loans, the allowance for loan losses increased from $4.1 million, or 1.1% of total gross loans at December 31, 2004 to $4.3 million, or 1.1% of total gross loans at September 30, 2005. Management believes that the allowance for loan losses of $4.3 million at September 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 dates indicated.

	September 30, 2005		December	
(Dollars in thousands)	Amount	Percent of Loans in Each Category to Total Loans	Amount	Pe in t
Commercial, financial and agricultural(5)	511(1)	8.20%	$ 743(1)	
Real estate construction and land development	100	4.77%	236	
Real estate - residential	466(2)	33.56%	421(2)	
Real estate - commercial	3,146	52.86%	2,568	
Consumer (3)	51(4)	0.61%	133(4)	
	$4,274	100.00%	$4,101	