COMMUNITY BANKSHARES INC /SC/
Form 10-Q
August 10, 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 June 30, 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 [X] 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 [X]

Indicate by check mark whether the registrant is 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 practicable date: Common Stock, no par or

stated value, 4,438,158 shares outstanding on August 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

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 $1,802 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 - 4,435,898 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

(
Period

Three Months

2006 2005

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	(Dollars in th	
Interest and dividend income		
Loans, including fees	$ 8,156	$ 7,202
Interest bearing deposits with other banks	35	11
Debt securities	556	432
Dividends	41	34
Federal funds sold	315	95
Total interest and dividend income	9,103	7,774
Interest expense		
Deposits		
Time deposits $100M and over	939	630
Other deposits	2,233	1,361
Total interest expense on deposits	3,172	1,991
Short-term borrowings	89	44
Long-term debt	475	468
Total interest expense	3,736	2,503
Net interest income	5,367	5,271
Provision for loan losses	675	585
Net interest income after provision	4,692	4,686
Noninterest income		
Service charges on deposit accounts	862	853
Mortgage loan brokerage income	987	859
Net securities gains or (losses)	-	-
Other	211	254
Total noninterest income	2,060	1,966
Noninterest expenses		
Salaries and employee benefits	2,753	2,334
Premises and equipment	613	550
Other	1,266	1,341
Total noninterest expenses	4,632	4,225
Income before income taxes	2,120	2,427
Income tax expense	747	876
Net income	$ 1,373	$ 1,551
Per share		
Net income	$ 0.31	$ 0.35
Net income - diluted	0.30	0.35
Cash dividends declared	0.11	0.10

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.

Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

	Common Stock		Reta
	Number of Shares	Amount	Earn
	(Dollars in thous		
Balance, January 1, 2005	4,390,784	$ 30,042	$
Comprehensive income:			
Net income	-	-	
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $118	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $3	-	-	
Total other comprehensive income	-	-	
Total comprehensive income	-	-	
Proceeds of sale of common stock	775	14	
Exercise of employee stock options	12,744	146	
Cash dividends declared, $.20 per share	-	-	
Balance, June 30, 2005	4,404,303	$ 30,202	$
Balance, January 1, 2006	4,404,303	$ 30,202	$
Comprehensive income:			
Net income	-	-	
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $75	-	-	
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	30,595	328	
Cash dividends declared, $.22 per share	-	-	
Balance, June 30, 2006	4,435,898	$ 30,546	$

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.
Consolidated Statements of Cash Flows

Operating activities

Net income ....
Adjustments to reconcile net income to net
cash (used) provided by operating activities
Provision for loan losses ....
Depreciation and amortization ....
Net amortization of securities ....
Net securities (gains) or losses ....
Proceeds of sales of loans held for sale ....
Originations of loans held for sale ....
Increase in accrued interest receivable ....
(Increase) decrease in other assets ....
Gains on sales of other real estate ....
Increase in accrued interest payable ....
Increase in other liabilities ....

Net cash (used) 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 ....
Net decrease (increase) in other investments ....
Net increase in loans made to customers ....
Purchases of premises and equipment ....
Proceeds from sales of other real estate ....

Net cash used by investing activities ....

Financing activities
Net (decrease) increase in deposits ....
Net increase in short-term borrowings ....
Proceeds from issuing long-term debt ....
Repayment of long-term debt ....
Exercise of employee stock options ....
Sale of common stock ....
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 Activities
Transfer to net deferred income tax assets from prepaid current income taxes ....

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.

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 June 30, 2006, there were $11,151,000 in nonaccrual loans and $202,000 of loans 90 or more days past due and still accruing interest.

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

	(Unau	
	Period End	
	Three Months	
	2006	2005
	(Dollars in thousands, e	
Net income per share, basic		
Numerator - net income	$ 1,373	$ 1,551
Denominator		
Weighted average common shares		
issued and outstanding	4,434,012	4,404,045
Net income per share, basic	$ .31	$ .35
Net income per share, assuming dilution		
Numerator - net income	$ 1,373	$ 1,551
Denominator		
Weighted average common shares		
issued and outstanding	4,434,012	4,404,045
Effect of dilutive stock options	69,624	100,142
Total shares	4,503,636	4,504,187
Net income per share, assuming dilution	$ .30	$ .35

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 Entity - On March 8, 2004, CBI sponsored the creation of a Variable Interest Entity ("VIE"), SCB Capital Trust I (the "Trust"), and is the sole owner of the common securities issued by the Trust. On March 10, 2004, the Trust issued $10,000,000 in floating rate capital securities. The proceeds of this issuance, and the amount of CBI's capital investment, were used to acquire $10,310,000 principal amount of CBI's floating rate junior subordinated deferrable interest debt securities ("Debentures") due April 7, 2034, which securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, was established

initially at 3.91% and is adjustable quarterly at 3 month LIBOR plus 280 basis points. The index rate (LIBOR) may not be lower than 1.11%. CBI may defer interest payments on the Debentures for up to twenty consecutive quarters, but not beyond the stated maturity date of the Debentures. In the event that such interest payments are deferred by CBI, the Trust may defer distributions on the common securities. In such an event, CBI would be restricted in its ability to pay dividends on its common stock and to perform under other obligations that are not senior to the junior subordinated Debentures.

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

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.

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

Forward Looking Statements

Statements included in this report which are not historical in nature are intended to be, and are hereby identified as "forward-looking statements" for purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements 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 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.

CHANGES IN FINANCIAL CONDITION

During the six months ended June 30, 2006, loans held for sale increased by $8,345,000, or 67.0% and loans increased by $5,186,000, or 1.3%, over the respective amounts as of December 31, 2005. The growth in these earning asset categories was funded largely by reducing cash and due from banks and federal funds sold since the aggregate amounts of deposits and short-term and

long-term borrowings decreased by $7,525,000, or 1.5%, from the December 31, 2005 amounts. Also during the first six months of 2006, charge-offs of loans totaled $3,847,000, including $2,649,000 in the second quarter. Those charge-offs decreased both loans and the allowance for loan losses.

Management expects that the Company will solicit deposit accounts more aggressively in order to fund anticipated growth. However, given the recent increases in interest rates, such a strategy would significantly increase the probability that the Company's net interest margin in future reporting periods would be affected adversely.

RESULTS OF OPERATIONS

Earnings Performance

Three Months Ended June 30, 2006 and 2005

For the quarter ended June 30, 2006, CBI recorded consolidated net income of $1,373,000, compared with $1,551,000 for the comparable period of 2005. This represents a decrease of $178,000 or 11.5%. Basic earnings per share were $.31 in the 2006 period, compared with $.35 for the 2005 quarter. Diluted earnings per share were $.30 for the 2006 period and $.35 for the 2005 period.

Compared with the second quarter of 2005, operating results for the second quarter of 2006 were affected primarily by higher noninterest expenses and provision for loan losses in the 2006 period, increased mortgage loan brokerage income, and an increase in net interest income resulting primarily from growth in loans. Generally, market interest rates, as well as the rates associated with the Company's interest earning assets and its interest-bearing liabilities were higher in the 2006 period as a result of continued Federal Reserve efforts to slow the U. S. economy and control inflation.

Higher noninterest expenses and provision for loan losses more than offset the gains made in net interest income and noninterest income. The provision for loan losses continues to be affected by high levels of non-performing and potential problem loans, and by growth in the Company's loan portfolio. During the second quarter of 2006, net charge-offs were $1,898,000 compared with $495,000 during the same period of 2005.

Noninterest expenses increased in part because of changes in the corporate management structure designed to enhance controls and risk management activities, particularly in the lending function, and due to higher expenses associated with the commission-based salary structure used in the mortgage-brokerage subsidiary. Also, in 2006, the Company increased its formula for matching employees' contributions to the 401(k) defined contribution retirement plan. This resulted in higher levels of employee participation in the plan. In addition, expenses of premises and equipment increased in the 2006 quarter due to the Company's moving into its newly constructed headquarters and operations center in the first quarter of 2006 and the leasing of other office space for certain management personnel who are located away from the corporate headquarters.

Summary Income

(Dollars in t

For the Three Months Ended June 30,	2006	2005
Interest income	$ 9,103	$ 7,774
Interest expense	3,736	2,503
Net interest income	5,367	5,271
Provision for loan losses	675	585
Noninterest income	2,060	1,966
Noninterest expenses	4,632	4,225
Income tax expense	747	876
Net income	$ 1,373	$ 1,551

Six Months Ended June 30, 2006 and 2005

CBI's consolidated net income for the six months ended June 30, 2006 was positively affected by increased levels of net interest income, primarily related to increased loan volumes and yields, and higher amounts of mortgage

loan brokerage income which reflect continued strength in the housing markets within the Company's market areas. A significant proportion of the banking subsidiaries' loan portfolios are made up of variable rate loans. Those loans have been repriced favorably several times during 2006. The prime rate, which is the index to which most of those variable rate loans are related, increased four times totaling 100 basis points during 2006, and eight times totaling 200 basis points since June 30, 2005.

Interest expense, noninterest expenses and the provision for loan losses negatively affected results for the 2006 year-to-date period because of the same factors discussed above for the second quarter.

Summary Inc

(Dollars i

For the Six Months Ended June 30,	2006	2005
Interest income	$17,716	$15,027
Interest expense	7,122	4,719
Net interest income	10,594	10,308
Provision for loan losses	1,290	1,035
Noninterest income	3,994	3,631
Noninterest expenses	9,259	8,344
Income tax expense	1,465	1,649
Net income	$ 2,574	$ 2,911

Net Interest Income

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

Three Months Ended June 30, 2006 and 2005

Net interest income for the three months ended June 30, 2006 was $5,367,000, an increase of $96,000, or 1.8%, over the amount reported for the second quarter of 2005. Interest income and interest expense for the 2006 quarter were both significantly higher than during the same period of 2005, due to increases in the related balance sheet items and increases in interest rates earned on, or paid for, those items.

The average rate earned on loans, including loans held for sale, was 7.54% and 6.80% for the second quarters of 2006 and 2005, respectively. The average yield on earning assets was 6.99% for the second quarter of 2006, compared with 6.30% for the second quarter of 2005. The average cost of time deposits increased to 4.03% for the second quarter of 2006, compared with 2.91% for the same period of 2005. The average cost of all interest-bearing liabilities was 3.40% for the 2006 quarter and 2.47% for the same period of 2005. Accordingly, the interest rate spread (interest earning assets yield minus the rate paid for interest-bearing liabilities) for the 2006 second quarter narrowed to 3.59%, or 24 basis points lower than for the same period of 2005 and

net yield on earning assets (net interest income divided by average interest earning assets) for the 2006 quarter was 4.12%, or 15 basis points lower than for the same period of 2005.

Average amounts of interest earning assets were significantly higher in the 2006 period than in the 2005 period. However, that growth was overshadowed by growth in the average amounts of interest-bearing liabilities. During the second quarter of 2006, the Company was significantly more reliant on interest-bearing liabilities to fund earning assets than it was during the 2005 second quarter.

	Average Balances, Quarter Ende		
	2006		
	Average Balances	Interest Income / Expense	Yields / Rates (1)
	(Dollars in		
Assets			

Interest earning deposits	$ 1,791	$ 35	7.84%
Investment securities - taxable	56,700	553	3.91%
Investment securities - tax exempt (2)	4,966	44	3.55%
Federal funds sold	25,220	315	5.01%
Loans, including loans held for sale (2) (3)	433,767	8,156	7.54%
Total interest earning assets	522,444	9,103	6.99%
Cash and due from banks	14,438		
Allowance for loan losses	(10,665)		
Premises and equipment, net	9,827		
Intangible assets	7,670		
Other assets	8,724		
Total assets	$ 552,438		
Liabilities and shareholders' equity			
Interest bearing deposits			
Savings	$ 89,000	$ 576	2.60%
Interest bearing transaction accounts	73,212	179	0.98%
Time deposits	240,609	2,417	4.03%
Total interest bearing deposits	402,821	3,172	3.16%
Short-term borrowings	7,718	89	4.63%
Long-term debt	30,145	475	6.32%
Total interest bearing liabilities	440,684	3,736	3.40%
Noninterest bearing demand deposits	57,052		
Other liabilities	2,493		
Shareholders' equity	52,209		
Total liabilities and shareholders' equity	$ 552,438		
Interest rate spread			3.59%
Net interest income and net yield on earning assets		$ 5,367	4.12%

(1) Yields and rates are annualized.
(2) Yields on tax-exempt securities and loans have not been stated on a tax-equivalent basis.
(3) Nonaccruing loans are included in the average balances and income from such loans is recognized on a cash basis.

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Six Months Ended June 30, 2006 and 2005

Net interest income for the six months ended June 30, 2006 increased by $286,000, or 2.8% over the amount for the same period of 2005. Both interest income and interest expense increased significantly in the 2006 period due to continued increases in market interest rates and higher levels of interest earning assets and interest-bearing liabilities.

For the 2006 year-to-date period, the interest rate spread and net yield on earning assets both decreased as compared with the same period of 2005. Interest rate spread decreased by 27 basis points and net yield on earning assets decreased by 15 basis points. These decreases resulted primarily from higher rates paid on interest-bearing liabilities, which increased slightly more than rates earned on earning assets. Net interest income increased despite this narrowing of interest margins, however, because of higher amounts of interest

earning assets, especially loans and federal funds sold.

	Average Balances, Six Months En		
	2006		
	Average Balances	Interest Income / Expense	Yields / Rates (1)
			(Dollars in t
Assets			
Interest earning deposits	$ 1,665	$ 55	6.66%
Investment securities - taxable	57,281	1,093	3.85%
Investment securities - tax exempt (2)	5,193	91	3.53%
Federal funds sold	27,394	638	4.70%
Loans, including loans held for sale (2) (3)	431,948	15,839	7.39%
Total interest earning assets	523,481	17,716	6.82%
Cash and due from banks	15,332		
Allowance for loan losses	(11,002)		
Premises and equipment, net	10,135		
Intangible assets	7,096		
Other assets	8,353		
Total assets	$ 553,395		
Liabilities and shareholders' equity			
Interest bearing deposits			
Savings	$ 87,270	$ 1,027	2.37%
Interest bearing transaction accounts	73,557	398	1.09%
Time deposits	238,367	4,550	3.85%
Total interest bearing deposits	399,194	5,975	3.02%
Short-term borrowings	8,990	190	4.26%
Long-term debt	31,421	957	6.14%
Total interest bearing liabilities	439,605	7,122	3.27%
Noninterest bearing demand deposits	60,102		
Other liabilities	2,731		
Shareholders' equity	50,957		
Total liabilities and shareholders' equity	$ 553,395		
Interest rate spread			3.55%
Net interest income and net yield on earning assets		$ 10,594	4.08%

(1) Yields and rates are annualized.
(2) Yields on tax-exempt securities and loans have not been stated on a tax-equivalent basis.
(3) Nonaccruing loans are included in the average balances and income from such

loans is recognized on a cash basis.

Provision and Allowance for Loan Losses

The provision for loan losses for the 2006 three month period was $675,000, an increase of $90,000, or 15.4%, from $585,000 for the same period of 2005. The provision for loan losses increased to $1,290,000 for the 2006 six month period from $1,035,000 for the 2005 six month period, an increase of $255,000 or 24.6%. High levels of non-performing and potential problem loans

continue to affect the Company's allowance and provision for loan losses negatively. Management continues to use new information about these loans to refine its estimates of the loans' ultimate collectibility and the adequacy of its loan loss allowance.

Net charge-offs during the six months ended June 30, 2006 were $3,060,000, compared with $570,000 for the same period of 2005. The coverage ratio (allowance for loan losses divided by non-performing loans) was .87x as of June 30, 2006 and .94x as of December 31, 2005.

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

	Six Months Ended June 30, 2006	(Doll
Allowance at beginning of period	$ 11,641	
Transfer of allowance for off-balance-sheet contingencies to other liabilities	-	
Provision for loan losses	1,290	
Net charge-offs	(3,060)	
Allowance at end of period	$ 9,871	
Allowance as a percentage of loans outstanding	2.35%	
Loans at end of period	$ 419,170	

Following is a summary of non-performing loans as of June 30, 2006 and December 31, 2005:

	June 30
Non-performing loans	
Nonaccrual loans	$11,
Past due 90 days or more and still accruing	
Total	$11,

Nonperforming loans as a percentage of:	
Loans outstanding	2
Allowance for loan losses	115

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

	Nonaccrual Loans	90 Days or More Past Due and Still Accruing	Total Nonperforming Loans	Percentage of Total Loans
			(Dollars in thousan	
December 31, 2004	$ 4,941	$ 137	$ 5,078	1.29%
Net change	118	215	333	
March 31, 2005	5,059	352	5,411	1.33%
Net change	200	(9)	191	
June 30, 2005	5,259	343	5,602	1.35%
Net change	4,954	74	5,028	
September 30, 2005	10,213	417	10,630	2.57%
Net change	1,438	312	1,750	
December 31, 2005	11,651	729	12,380	2.99%
Net change	3,128	949	4,077	
March 31, 2006	14,779	1,678	16,457	3.94%
Net change	(3,628)	(1,476)	(5,104)	
June 30, 2006	$ 11,151	$ 202	$ 11,353	2.71%

During the second quarter of 2006, nonperforming loans decreased by $5,104,000 and potential problem loans decreased by $3,461,000. These improvements were the results of net charge-offs of $3,060,000 coupled with collections and improvements in the remaining loans. For example, management settled a loan relationship of $1,450,000 that was included in nonaccrual loans as of March 31, 2006, realizing a recovery of approximately $350,000 and a charge-off of $1,100,000. Management also completed a project in the 2006 second quarter that involved reviewing, and establishing workout or collection plans or providing other credit enhancements for, all significant nonperforming and potential problem loans.

Management will continue to monitor the levels of non-performing loans and address the weaknesses in these credits to enhance the ultimate collection or recovery of these assets. Management considers the levels and trends in non-performing assets and potential problem loans in determining how the provision and allowance for loan losses is estimated and adjusted. In the opinion of management, the Corporation's allowance for loan losses at June 30,

2006 is adequate to provide for losses that may be inherent in the loan portfolio.

Noninterest Income

Noninterest income for the 2006 second quarter increased $94,000, or 4.8%, over the $1,966,000 reported for the same 2005 period. Mortgage loan brokerage income for the 2006 quarter increased by $128,000, or 14.9%, over the $859,000 in the 2005 period.

For the six months ended June 30, 2006, noninterest income increased $363,000, or 10.0%, over noninterest income for the first six months of 2005. Mortgage loan brokerage income for the first six months of 2006 increased $273,000, and service charge income increased by $79,000, as compared to the same period of 2005.

Noninterest Expenses

Noninterest expenses for the second quarter of 2006 were $407,000, or 9.6%, higher than the amounts reported for the same period of 2005. Salaries and employee benefits expenses were $419,000, or 18.0%, higher in the 2006 period, due to higher commission-based compensation expenses resulting from increased activity in mortgage lending as well as additions made to the Company's executive managment. Expenses related to premises and equipment increased by $63,000 in the 2006 period, primarily due to the Company's occupancy of its new headquarters and operations center building during the first quarter of 2006.

Noninterest expense for the first six months of 2006 was $915,000, or 11.0%, more than for the same period of 2005. Salaries and employee benefits for the 2006 six month period were $720,000, or 15.6%, more than for the same period of 2005. This expense increased due to higher levels of mortgage loan brokerage commission-based compensation incurred in the 2006 period, additions made to the Company's executive management, increased employee participation in the Company's 401(k) plan, and normal periodic wage and salary adjustments. Expenses associated with premises and equipment were $152,000, or 14.0%, higher in the 2006 period, primarily due to the Company's occupancy of its new headquarters and operations center building during the first quarter of 2006.

Income Taxes

Income tax expense was $129,000 less in the 2006 second quarter than for the 2005 period, as a result of lower net income before taxes. Income tax expense for the 2006 six month period was $184,000 less than for the same period of 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 service areas. Individual and commercial deposits are the primary source of funds for credit activities, along with long-term borrowings from the

Federal Home Loan Bank of Atlanta and the proceeds of issuing $10,000,000 of subordinated debentures. Cash and amounts due from banks and federal funds sold

are CBI's primary sources of asset liquidity. These funds provide a cushion against short-term fluctuation in cash flow from both loans and deposits. Securities available-for-sale are CBI's principal source of secondary asset liquidity. However, the availability of this source is limited by pledging commitments for public deposits and securities sold under agreements to repurchase, and is influenced by market conditions.

CBI's banking subsidiaries maintain various federal funds lines of credit with correspondent banks. The banks are also able to borrow from the Federal Home Loan Bank of Atlanta ("FHLB") and the Federal Reserve Bank's discount window using their loan portfolios as security. During the second quarter of 2006, the FHLB suspended the ability of one of the Company's subsidiary banks to obtain additional financing from the FHLB because of the increase in nonperforming and potential problem loans at that bank. This action reduced by approximately $10,078,000 the amount previously reported as of December 31, 2005 as available to the Company from the FHLB. The suspension does not, however, accelerate repayment of any of that subsidiary bank's outstanding obligations. The bank has not obtained any advances under that line for several years, had no immediate or short-term plans to do so and, accordingly, does not anticipate that this will materially impair the bank's liquidity planning.

Total deposits as of June 30, 2006 were $459,243,000, a decrease of $4,966,000, or 1.1%, from the amount as of December 31, 2005. During the first six months of 2006, there was a notable movement of funds from noninterest bearing demand deposit accounts and interest-bearing transaction accounts into savings and certificate of deposit accounts. Such transfers of funds are the expected result of higher rates of interest, and larger differentials from rates paid for highly liquid interest-bearing deposit accounts, that are currently paid for longer-term, fixed rate deposits. As of June 30, 2006 the loan to deposit ratio, excluding loans held for sale, was 91.3%, compared with 89.2% at December 31, 2005 and 95.5% at June 30, 2005.

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

CAPITAL RESOURCES

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

During the first quarter of 2004, CBI sponsored the creation of a Trust that issued $10,000,000 in trust preferred securities. The Trust invested the proceeds of this issuance and $310,000 of capital provided by CBI into $10,310,000 of junior subordinated debentures due in 2034 ("Debentures") issued by CBI. Interest payments on the Debentures are due quarterly at a variable interest rate. CBI used the proceeds of the Debentures to repay certain pre-existing debt obligations, to enhance the capital position of two of the

subsidiary banks, to provide an additional funding mechanism for its mortgage loan brokerage activities, and for other general corporate purposes. Under current regulatory guidelines, the trust preferred securities issued by the Trust are includible in CBI's Tier 1 capital for risk-based capital purposes.

The June 30, 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:

	Tier 1
Community Bankshares, Inc.	13.28%
Orangeburg National Bank	11.35%
Sumter National Bank	10.69%
Florence National Bank	10.11%
Bank of Ridgeway	11.13%
Minimum "well capitalized" requirement	6.00%
Minimum requirement	4.00%

As shown in the table above, each of the capital ratios exceeds the regulatory requirement to be considered "well capitalized." In the opinion of management, the current and projected capital positions of CBI and its banking subsidiaries are adequate.

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.

Variable Interest Entity

As discussed under "Capital Resources" and in the notes to unaudited consolidated financial statements under "Variable Interest Entity," as of June 30, 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:

	June 30, 2006 (Dollars in thousands)
Loan commitments	$ 54,598
Standby letters of credit	2,533

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 fully 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.

In mid-2005, CBI reached an agreement with Jack Henry & Associates, Inc. to obtain licensing rights for a new core management information software system, known as Silverlake, which will be used by each of its subsidiaries. The cost of this core system conversion will be approximately $1,000,000. The agreement also requires CBI to pay various support and maintenance costs throughout the licensing period. CBI estimates that during the next five years these costs will range from approximately $200,000 to $300,000 per year. However, the exact amounts will be determined by future events, such as asset growth, and cannot be exactly determined at this time. The Orangeburg National Bank subsidiary was converted to the new system in June 2006 and the three remaining banks are expected to be converted early in the fourth quarter of 2006.

Derivative Financial Instruments

In April, 2003, the Financial Accounting Standards Board issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." Among other requirements, this Statement provides that loan commitment contracts entered into or modified after June 30, 2003 that relate to the origination of mortgage loans that will be held for sale shall be accounted for as derivative instruments by the issuer of the loan commitment. In March, 2004, the SEC issued its Staff Accounting Bulletin No 105 "Application of Accounting Principles to Loan Commitments," which resulted in no changes in CBI's accounting for such commitments. CBI issues mortgage loan rate lock

commitments to potential borrowers to facilitate its origination of home mortgage loans that are intended to be sold. Between the time that CBI issues its commitments and the time that the loans close and are sold, CBI is subject to variability in the selling prices related to those commitments due to changes in market rates of interest. However, CBI offsets this variability through the use of so-called "forward sales contracts" to investors in the secondary market. Under these arrangements, an investor agrees to purchase the closed loans at a predetermined price. CBI generally enters into such forward sales contracts at the same time that rate lock commitments are issued. These arrangements 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 June 30, 2006, and the estimated fair values of those financial instruments included in other assets and liabilities in the balance sheet as of that date.

	June 30, 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	$ 33,426	$ (359)
Forward sales contracts with investors of mortgage loans to be held for sale	33,426	359

Status of Plans for Transition to a Single Bank Charter

During the first and second quarters of 2006, CBI's Board of Directors and the boards of the subsidiary banks approved a plan for a transition to a single bank charter under the name of Community Resource Bank, NA. Contingent upon receiving required legal and regulatory approvals, implementation of this change is expected early in the fourth quarter of 2006. CBI expects that this change ultimately will result in significant financial savings, improved operational efficiency and effectiveness, improved customer service through unified banking products and services, accelerated approval of loan requests, and better availability of ATM and in-bank services for all customers. Significant planning activities are ongoing for the transition phase of the project.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

CBI's Asset/Liability Committee uses a simulation model to assist in achieving consistent growth in net interest income while managing interest rate risk. According to the model, as of June 30, 2006, CBI is positioned so that net interest income would increase $120,000 and net income would increase $72,000 in the next twelve months if interest rates rose 100 basis points. Conversely, net interest income would decline $120,000 and net income would decline $72,000 in

the next twelve months if interest rates declined 100 basis points. Computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates and loan prepayment, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions CBI and its customers could undertake in response to changes in interest rates.

As of June 30, 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 quarterly 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.

PART II--OTHER INFORMATION

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

On Monday, May 16, 2006, the shareholders of Community Bankshares, Inc. held their regular annual meeting. At the meeting, one matter was submitted to a vote with results as follows:

1. Election of four directors to hold office for three-year terms:

DIRECTORS	SHARES VOTED FOR	AGAINST OR AUTHORITY WITHHELD	BROKER NON-VOTES
Three-Year Terms			
E. J. Ayers, Jr.	3,124,186	18,717	0
Alvis J. Bynum	3,137,169	5,734	0
J. V. Nicholson, Jr.	3,080,013	62,890	0
J. Otto Warren, Jr.	3,137,169	5,734	0

The following directors continue to serve until the expiration of their terms at the annual meetings to be held in the years indicated and were not voted on at the 2006 annual meeting: Samuel L. Erwin - 2007; Anna O. Dantzler - 2007; Richard L Havekost - 2007 and Samuel F. Reid, Jr. - 2007; Thomas B. Edmunds - 2008; Martha Rose C. Carson - 2008; J. M. Guthrie - 2008; Wm. Reynolds Williams - 2008; and Charles E. Fienning - 2008.

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

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

SIGNATURES

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

DATED: August 10, 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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