SUSSEX BANCORP
Form 10QSB
August 09, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2005

Or

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

For the transition period from ____________________ to ____________________

Commission file number 0-29030

SUSSEX BANCORP.
(Exact name of registrant as specified in its charter)

New Jersey	22-3475473
(State of other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)
399 Route 23, Franklin, New Jersey	07416
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number, including area code) (973) 827-2914

(Former name, former address and former fiscal year, if changed since last report)

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 and 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 ___

As of August 5, 2005 there were 3,018,463 shares of common stock, no par value, outstanding.

SUSSEX BANCORP
FORM 10-QSB

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SUSSEX BANCORP
CONSOLIDATED BALANCE SHEETS
(Dollars In Thousands)
(Unaudited)

ASSETS	June 30, 2005	December 31,
Cash and due from banks	$ 14,186	$ 10
Federal funds sold	2,195	18
Cash and cash equivalents	16,381	29
Interest bearing time deposits with other banks	500	3
Securities available for sale	72,652	74
Federal Home Loan Bank Stock, at cost	700	
Loans receivable, net of unearned income	186,278	156
Less: allowance for loan losses	2,158	2

Net loans receivable	184,120	154
Premises and equipment, net	5,830	5
Accrued interest receivable	1,567	1
Goodwill	2,334	2
Other assets	6,362	5
Total Assets	$ 290,446	$ 278
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 36,719	$ 34
Interest bearing	199,613	195
Total Deposits	236,332	229
Borrowings	14,000	10
Accrued interest payable and other liabilities	2,365	1
Junior subordinated debentures	5,155	5
Total Liabilities	257,852	246
Stockholders' Equity:		
Common stock, no par value, authorized 5,000,000 shares; issued and outstanding 3,017,213 in 2005 and 2,994,874 in 2004	25,580	25
Retained earnings	6,881	6
Accumulated other comprehensive income	133	
Total Stockholders' Equity	32,594	31
Total Liabilities and Stockholders' Equity	$ 290,446	$ 278

See Notes to Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Dollars In Thousands Except Per Share Data)
(Unaudited)

	Three Months Ended June 30,	
	2005	2004

INTEREST INCOME		
Loans receivable, including fees	$ 2,869	$ 2,161
Securities:		
Taxable	433	419
Tax-exempt	299	205
Federal funds sold	79	17
Interest bearing deposits	4	7
Total Interest Income	3,684	2,809
INTEREST EXPENSE		
Deposits	695	493
Borrowings	161	132
Junior subordinated debentures	86	61
Total Interest Expense	942	686
Net Interest Income	2,742	2,123
PROVISION FOR LOAN LOSSES	206	105
Net Interest Income after Provision for Loan Losses	2,536	2,018
OTHER INCOME		
Service fees on deposit accounts	315	191
ATM and debit card fees	86	78
Insurance commissions and fees	622	604
Mortgage banking fees	103	161
Investment brokerage fees	66	48
Other	132	85
Total Other Income	1,324	1,167
OTHER EXPENSES		
Salaries and employee benefits	1,609	1,514
Occupancy, net	233	208
Furniture, equipment and data processing	271	210
Stationary and supplies	40	46
Professional fees	134	74
Advertising and promotion	150	96
Insurance	46	49
Postage and freight	45	48
Amortization of intangible assets	63	48
Other	331	349
Total Other Expenses	2,922	2,642
Income before Income Taxes	938	543
PROVISION FOR INCOME TAXES	272	152
Net Income	$ 666	$ 391
EARNINGS PER SHARE		
Basic	$ 0.22	$ 0.21

Diluted	$ 0.22	$ 0.20

See Notes to Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Six Months Ended June 30, 2005 and 2004
(Dollars in thousands, except per share amounts)
(Unaudited)

	Number of Shares Outstanding	Common Stock	Retained Earnings	Accum Compreh Income
Balance December 31, 2003	1,811,460	$ 9,616	$ 5,040	$
Comprehensive income:				
Net income	--	--	762	
Change in unrealized gains (losses) on securities available for sale, net of tax	--	--	--	
Total Comprehensive Income				
Treasury shares purchased	(96)	--	--	
Treasury shares retired	--	(2)	--	
Exercise of stock options	17,985	167	--	
Income tax benefit of stock options exercised	--	35	--	
Shares issued through dividend reinvestment plan	5,736	97	--	
Dividends on common stock ($.14 per share)	--	--	(255)	
Balance June 30, 2004	1,835,085	$ 9,913	$ 5,547	($
Balance December 31, 2004	2,994,874	$ 25,397	$ 6,116	$
Comprehensive income:				
Net income	--	--	1,186	
Change in unrealized gains (losses) on securities available for sale, net of tax	--	--	--	
Total Comprehensive Income				
Treasury shares purchased	(2,000)	--	--	
Treasury shares retired	--	(27)	--	
Exercise of stock options	18,931	101	--	
Income tax benefit of stock options exercised	--	58	--	
Shares issued through dividend reinvestment plan	5,408	76	--	
Additional expenses for stock offering	--	(25)	--	
Dividends on common stock ($.14 per share)	--	--	(421)	

Balance June 30, 2005	3,017,213	$ 25,580	$ 6,881	$

See Notes to Consolidated Financial Statements

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SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Six Months Ended June 30	
	2005	2004
Cash Flows from Operating Activities		
Net income	$ 1,186	$ 7
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	341	2
Provision for depreciation and amortization	469	3
Net amortization of securities premiums and discounts	135	3
Earnings on investment in life insurance	(44)	(
(Increase) decrease in assets:		
Accrued interest receivable	(237)	
Other assets	(441)	(9
Increase in accrued interest payable and other liabilities	782	4
Net Cash Provided by Operating Activities	2,191	1,2
Cash Flows from Investing Activities		
Securities available for sale:		
Purchases	(4,396)	(13,7
Maturities, calls and principal repayments	6,336	14,0
Net increase in loans	(30,089)	(9,9
Purchases of premises and equipment	(554)	(1,0
(Increase) decrease in FHLB stock	(10)	
Net decrease in interest bearing time deposits with other banks	3,400	3,0
Purchase of investment in life insurance	--	(1,5
Net Cash Used in Investing Activities	(25,313)	(9,1
Cash Flows from Financing Activities		
Net increase in deposits	6,505	9,7
Increase in borrowings	4,000	
Proceeds from the exercise of stock options	101	1
Purchase of treasury stock	(27)	
Expenses paid related to stock offering	(25)	
Dividends paid, net of reinvestments	(345)	(1

Net Cash Provided by Financing Activities	10,209	9,7
Net Increase (Decrease) in Cash and Cash Equivalents	(12,913)	1,8
Cash and Cash Equivalents - Beginning	29,294	15,4
Cash and Cash Equivalents - Ending	$ 16,381	$ 17,3
Supplementary Cash Flows Information		
Interest paid	$ 1,684	$ 1,3
Income taxes paid	$ 55	$ 4
Supplementary Schedule of Noncash Investing and Financing Activities		
Foreclosed real estate acquired in settlement of loans	$ 270	$

See Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The consolidated financial statements include the accounts of Sussex Bancorp (the "Company") and its wholly-owned subsidiary Sussex Bank (the "Bank"). The Bank's wholly-owned subsidiaries are Sussex Bancorp Mortgage Company, Inc., SCB Investment Company, Inc., and Tri-State Insurance Agency, Inc., ("Tri-State") a full service insurance agency located in Sussex County, New Jersey. All inter-company transactions and balances have been eliminated in consolidation. Sussex Bank is also a 49% partner of Sussex Settlement Services, L.P, a title insurance agency whose registered office is located in King of Prussia, Pennsylvania. During the second quarter, the Bank also became the owner of 49% of the equity of SussexMortgage.com, LLC, an Indiana limited liability company and mortgage banking joint venture with National City Mortgage, Inc. SussexMortgage.com is expected to commence operations in the third quarter of 2005. The Bank operates eight banking offices all located in Sussex County, New Jersey. The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "FRB"). The Bank's deposits are insured by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits. The operations of the Company and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the "Department") and the operations of Tri-State are subject to the supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the six-month period ended June 30,

2005, are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company's Annual Report on Form 10-KSB for the fiscal period ended December 31, 2004.

2. Earnings per Share

Basic earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance of potential common shares that may be issued by the Company relating to outstanding stock options and guaranteed and contingently issuable shares from the acquisition of Tri-State. Potential common shares related to stock options are determined using the treasury stock method.

The following table sets forth the computations of basic and diluted earnings per share.

(In thousands, except per share data)	Three Months Ended June 30, 2005 Income (Numerator)	Shares (Denominator)	Per Share Amount	Three Month Income (Numerator)
Basic earnings per share:				
Net income applicable to common stockholders	$ 666	3,015	$ 0.22	$ 391
Effect of dilutive securities:				
Stock options	-	31		-
Deferred common stock payments for purchase of insurance agency	-	-		1
Diluted earnings per share:				
Net income applicable to common stock-holders and assumed conversions	$ 666	3,046	$0.22	$ 392

(In thousands, except per share data)	Six Months Ended June 30, 2005 Income (Numerator)	Shares (Denominator)	Per Share Amount	Six Months Income (Numerator)
Basic earnings per share:				
Net income applicable to common stockholders	$ 1,186	3,009	$ 0.39	$ 762
Effect of dilutive securities:				
Stock options	-	39		-
Deferred common stock payments for purchase of insurance agency	-	-		1
Diluted earnings per share:				

Net income applicable to common stock-holders and assumed conversions	$ 1,186	3,048	$ 0.39	$ 763

3. Comprehensive Income

The components of other comprehensive income (loss) and related tax effects are as follows:

(Dollars in thousands)	Three Months Ended June 30, 2005	2004	Six Month 2005
Unrealized holding gains (losses) on available for sale securities	$ 859	($ 1,802)	($
Less: reclassification adjustments for gains included in net income	--	--	-
Net unrealized gains (losses)	859	(1,802)	(
Tax effect	(345)	720	
Other comprehensive income (loss), net of tax	$ 514	($ 1,082)	($

4. Segment Information

The Company's insurance agency operations are managed separately from the traditional banking and related financial services that the Company also offers. The insurance agency operation provides commercial, individual, and group benefit plans and personal coverage.

(Dollars in thousands)	Three Months Ended June 30, 2005			Three Months End	
	Banking and Financial Services	Insurance Services	Total	Banking and Financial Services	Insur Serv
Net interest income from external sources	$ 2,742	$ --	$ 2,742	$ 2,123	$
Other income from external sources	702	622	1,324	563	
Depreciation and amortization	199	42	241	152	
Income before income taxes	896	42	938	471	
Income tax expense	255	17	272	123	
Total assets	287,128	3,318	290,446	247,552	

(Dollars in thousands)	Six Months Ended June 30, 2005	Six Months End
	Banking and	Banking and

	Financial Services	Insurance Services	Total	Financial Services	Insur Serv
Net interest income from external sources	$ 5,378	$ --	$ 5,378	$ 4,255	$
Other income from external sources	1,208	1,217	2,425	1,147	
Depreciation and amortization	384	85	469	299	
Income before income taxes	1,573	64	1,637	913	
Income tax expense	425	26	451	233	
Total assets	287,128	3,318	290,446	247,552	

5. Stock Option Plans

The Company accounts for stock option plans under the recognition and measurement principles of APB Opinion No. 25. "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under the Company's plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based compensation for the periods presented:

(Dollars in thousands)	Three Months Ended June 30, 2005	2004	Six Months E 2005
Net income, as reported	$ 666	$ 391	$ 1,186
Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(53)	(35)	(205)
Pro forma net income	$ 613	$ 356	$ 981
Basic earnings per share:			
As reported	$ 0.22	$ 0.21	$ 0.39
Pro forma	$ 0.20	$ 0.19	$ 0.33
Diluted earnings per share:			
As reported	$ 0.22	$ 0.20	$ 0.39
Pro forma	$ 0.20	$ 0.19	$ 0.32

6. Guarantees

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued have expiration dates within one year. The credit risk

involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Company, generally, holds collateral and/or personal guarantees supporting these commitments. The Company had $850,000 of standby letters of credit as of June 30, 2005. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required under the corresponding guarantees. The current amount of the liability as of June 30, 2005 for guarantees under standby letters of credit issued is not material.

7. New Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123(R), "Share-Based Payment." Statement No. 123(R) replaces Statement No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." Statement No. 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements over the period that an employee provides service in exchange for the award. Public companies are required to adopt the new standard using a modified prospective method and may elect to restate prior periods using the modified retrospective method. Under the modified prospective method, companies are required to record compensation cost for new and modified awards over the related vesting period of such awards prospectively and record compensation cost prospectively for the unvested portion, at the date of adoption, of previously issued and outstanding awards over the remaining vesting period of such awards. No change to prior periods presented is permitted under the modified prospective method. Under the modified retrospective method, companies record compensation costs for prior periods retroactively through restatement of such period using the exact pro forma amounts disclosed in the companies' footnotes. Also, in the period of adoption and after, companies record compensation cost based on the modified prospective method. Statement No. 123(R) is effective for periods beginning after December 15, 2005 (i.e. first quarter 2006 for the Company). Early application of Statement No. 123(R) is encouraged, but not required.

The Company will adopt the modified prospective method. Using the modified prospective method, the Company estimates that total stock-based compensation expense, based on awards currently outstanding that will vest in 2006, net of related tax effects, will be $94,000 for the year ending December 31, 2006.

In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB No. 107"), "Share-Based Payment", providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123(R), and the disclosures in MD&A subsequent to the adoption. The Company will provide SAB No. 107 required disclosures upon adoption of SFAS No. 123(R) on January 1, 2006.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations - an interpretation of SFAS No. 143," ("FIN 47"). This Interpretation provides clarification with respect to the timing of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation are conditional on a future event. FIN 47 is effective for all fiscal years

ending after December 15, 2005 (December 31, 2005, for calendar-year companies). Retrospective application for interim financial information is permitted but is

not required. Early adoption of this Interpretation is encouraged. We do not expect the adoption of FIN 47 to materially impact our condensed consolidated financial statements.

In May 2005, FASB issued SFAS 154, "Accounting Changes and Error Corrections". The Statement requires retroactive application of a voluntary change in accounting principle to prior period financial statements unless it is impracticable. SFAS 154 also requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS 154 replaces APB Opinion 20, "Accounting Changes", and SFAS 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management currently believes that adoption of the provisions of SFAS 154 will not have a material impact on the Company's condensed consolidated financial statements.

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

MANAGEMENT STRATEGY

The Company's goal is to serve as a community-oriented financial institution serving the Northwestern New Jersey, Northeastern Pennsylvania and New York tri-state marketplace. Our market presence has been expanded by opening loan production offices in early 2005 in Milford, Pennsylvania and Warwick, New York with added availability of all of our financial services in those counties contiguous to our existing New Jersey market. While offering traditional community bank loan and deposit products and services such as residential mortgages originated for the Company's portfolio, the Company obtains significant non-interest income through its Tri-State Insurance Agency, Inc. ("Tri-State") insurance brokerage operations, the sale of non-deposit products and the residential mortgage banking/brokerage division, which offers 30-year fixed residential mortgages that are funded by third party investors. In the second quarter, the Company acquired a 49% equity interest in SussexMortgage.com LLC, a mortgage banking joint venture with National City Mortgage Inc. SussexMortgage.com LLC is expected to commence operations in the third quarter of 2005, and substantially replace the mortgage banking business now being undertaken by the Bank's residential mortgage banking division. Loans originated by SussexMortgage.com LLC will be funded by third parties that will generate fee income net of origination costs.

CRITICAL ACCOUNTING POLICIES

Disclosure of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements of the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004. Some of these policies are particularly sensitive, requiring significant judgments, estimates and assumptions to be made by management, most particularly in connection with determining the provision for loan losses and the appropriate level of the allowance for loan losses. Additional information is contained on pages 13, 15 and 17 of this Form 10-QSB for the provision and allowance for loan losses.

FORWARD LOOKING STATEMENTS

When used in this discussion the words: "believes", "anticipates",

"contemplated", "expects" or similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include changes to interest rates, the ability to control costs and expenses, general economic conditions and economic conditions in the Company's Sussex, New Jersey marketplace, and the success of the Company's efforts to diversify its revenue base by developing additional sources of non-interest income while continuing to manage its existing fee based business. The Company undertakes no obligation to publicly release the results of any revisions to those forward looking statements that may be made to reflect events or circumstances after this date or to reflect the occurrence of unanticipated events.

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RESULTS OF OPERATIONS

Three Months ended June 30, 2005 and June 30, 2004

Overview

The Company realized net income of $666 thousand for the second quarter of 2005, an increase of $275 thousand, or 70.3%, from the $391 thousand reported for the same period in 2004. Basic earnings per share increased from $0.21 in the second quarter of 2004 to $0.22 for the second quarter of 2005 and diluted earnings per share increased from $0.20 in the second quarter of 2004 to $0.22 for the quarter ended June 30, 2005.

The results reflect an increase in net interest income, primarily due to increased loan interest income, coupled with increases in non-interest income associated with an increase in service fees on deposit accounts, partially offset by increases in non-interest expenses due to advertising promotions and professional fees.

Comparative Average Balances and Average Interest Rates

The following table presents, on a fully taxable equivalent basis, a summary of the Company's interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the three month period ended June 30, 2005 and 2004.

(dollars in thousands)	2005			Three Months Ended June 30,	
Earning Assets:	Average Balance	Interest (1)	Average Rate (2)	Average Balance	Inter
Securities:					
Tax exempt (3)	$ 27,997	$ 426	6.10%	$ 22,083	$
Taxable	47,033	433	3.69%	52,209	
Total securities	75,030	859	4.59%	74,292	
Total loans receivable (4)	175,554	2,869	6.55%	142,103	

Other interest-earning assets	11,120	82	2.96%	9,107	
Total earning assets	261,704	$ 3,810	5.84%	225,502	$
Non-interest earning assets	23,830			24,869	
Allowance for loan losses	(1,903)			(1,907)	
Total Assets	$ 283,631			$ 248,464	
Sources of Funds:					
Interest bearing deposits:					
NOW	$ 43,490	$ 67	0.62%	$ 44,319	$
Money market	21,027	107	2.04%	13,357	
Savings	63,977	111	0.70%	66,557	
Time	64,439	410	2.55%	57,879	
Total interest bearing deposits	192,933	695	1.45%	182,113	
Borrowed funds	14,000	161	4.55%	11,000	
Junior subordinated debentures	5,155	86	6.60%	5,155	
Total interest bearing liabilities	212,088	$ 942	1.78%	198,268	$
Non-interest bearing liabilities:					
Demand deposits	38,016			32,668	
Other liabilities	1,530			2,231	
Total non-interest bearing liabilities	39,546			34,899	
Stockholders' equity	31,997			15,297	
Total Liabilities and Stockholders'Equity	$ 283,631			$ 248,464	
Net Interest Income and Margin (5)		$ 2,868	4.40%		$

(1) Includes loan fee income
(2) Average rates on securities are calculated on amortized costs
(3) Full taxable equivalent basis, using a 39% effective tax rate and adjusted for "TEFRA"(Tax and Equity Fiscal Responsibility Act) disallowance
(4) Loans outstanding include non-accrual loans
(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets

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Net Interest Income

Net interest income is the difference between interest and fees on loans and other interest-earning assets and interest paid on interest-bearing liabilities. Net interest income is directly affected by changes in volume and mix of interest-earning assets and interest-bearing liabilities that support those assets, as well as changing interest rates when differences exist in repricing dates of assets and liabilities.

Net interest income, on a fully taxable equivalent basis (a 39% tax rate), increased $657 thousand, or 29.7%, to $2.9 million for the three months ended

June 30, 2005 compared to $2.2 million for the same three month period in 2004. The net interest margin increased, on a fully taxable equivalent basis, by 46 basis points to 4.40% for the three months ended June 30, 2005 compared to 3.94% for the same period in 2004.

Interest Income

Total interest income, on a fully taxable equivalent basis, increased by $913 thousand to $3.8 million for the three months ended June 30, 2005 compared to $2.9 million in the same period in 2004. Total average earning assets increased by $36.2 million to $261.7 million from $225.5 million for the three months ended June 30, 2004. The repositioning of average balances in higher yielding loans and the increase in market rates of interest have increased the average rate earned 67 basis points from 5.17% for the second quarter of 2004 to 5.84% in the same period in 2005.

Total interest income on securities, on a fully taxable equivalent basis, increased $147 thousand, or 20.6%, from the three months ended June 30, 2004 to the same period in 2005. As the average balance of total securities increased $738 thousand, the average rate earned increased 73 basis points, from 3.86% in the second quarter of 2004 to 4.59% for the second quarter of 2005. The increase in the average balances of the securities portfolio reflects a $5.2 million reduction in taxable securities and a $5.9 million increase in tax-exempt securities. The increase in yield was accomplished through the repositioning of these securities and the tax equivalent effect on the interest earned in an increasing market rate environment.

Comparing the average balance in the loan portfolio for the three months ended June 30, 2004 to same period in 2005, the average balance in loans increased $33.5 million, or 23.5%, while the interest earned on total loans increased $708 thousand, or 32.8%. The average rate earned on loans increased 43 basis points from 6.12% for the three months ended June 30, 2004 to 6.55% for the same period in 2005. The increase in our loan portfolio reflects our continuing efforts to enhance our loan origination capacity and continue to grow our commercial portfolio.

Interest Expense

The Company's interest expense for the three months ended June 30, 2005 increased $256 thousand, or 37.3 %, to $942 thousand from $686 thousand for the same period in 2004, as the balance in average interest-bearing liabilities increased $13.8 million, or 7.0% to $212.1 million from $198.3 million between the same two periods. The average rate paid on total interest-bearing liabilities has increased by 39 basis points from 1.39% for the three months ended June 30, 2004 to 1.78% for the same period in 2005.

The increases in both interest expense and rate reflect both a restructuring of the deposit portfolio as time deposits continue to reprice at higher market rates of interest and increased balances in money market accounts. Several large municipal accounts transferred balances from our public fund NOW account to the public fund money market account from the second quarter of 2004 to the same period in 2005. To attract municipal accounts, a higher incentive rate was offered on the public fund money market account. As municipal balances were transferred from NOW accounts, the NOW accounts average balance decreased $829 thousand and the money market accounts average balance increased $7.7 million in the second quarter of 2005 compared to three month period ended June 30, 2004. The average balance in time deposits increased $6.6 million from $57.9 million in the second quarter of 2004 to $64.4 million during the same period in 2005 due to the Company actively promoting competitive market rates of interest.

For the quarter ended June 30, 2005, the Company's average borrowed funds were $14.0 million compared to average borrowed funds of $11.0 million during the second quarter of 2004. The balance at June 30, 2005 consisted of four convertible notes totaling $12.0 million and $2.0 million in repurchase agreements from the Federal Home Loan Bank. The average rate paid on total borrowed funds has decreased 20 basis points from the second quarter of 2004 to the same period in 2005, as the rates paid on the newer borrowings were at lower market rates of interest. In the third quarter of 2002, the Company issued $5.2 million in junior subordinated debentures. The debentures bear a floating rate of interest, which averaged 6.60% for the three months ended June 30, 2005, up 192 basis points from 4.68% in the same period of 2004.

Provision for Loan Losses

The provision for loan losses for the second quarter of 2005 was $206 thousand compared to a provision of $105 thousand in the second quarter of 2004, an increase of $101 thousand. The increase in the provision from the second quarter of 2004 to the same quarter in 2005 was due to substantial loan growth mainly in commercial and non-residential real estate. The provision for loan losses reflects management's judgment concerning the risks inherent in the Company's existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as the average balance of the portfolio over both periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

Non-Interest Income

The Company's non-interest income is primarily generated through insurance commissions earned through the operation of Tri-State, service charges on deposit accounts and mortgage banking fees.

The Company's non-interest income increased by $157 thousand, or 13.5%, to $1.3 million for the three months ended June 30, 2005 from $1.2 million for the same period in 2004. In February of 2005 the Company began a new "no-return" overdraft privilege program. Service fees on deposit accounts have consequently increased $124 thousand, or 64.9%, to $315 thousand in the second quarter of 2005 from $191 thousand during the same period in 2004. ATM and debit card income increased 10.25% as customer usage has increased, and investment brokerage fee income increased 37.5% due to a slightly stronger market in the second quarter of 2005 over the same period in 2004. Mortgage banking fee income decreased 36.0% between the same two periods, due to a decline in originations and greater competition. Insurance commission income from Tri-State increased by $18 thousand to $622 thousand in the current second quarter from $604 thousand in the second quarter of 2004.

Non-Interest Expense

Total non-interest expense increased from $2.6 million in the second quarter of 2004 to $2.9 million in the second quarter of 2005, an increase of $280 thousand, or 10.6%. Salaries and employee benefits, the largest component of non-interest expense, increased $95 thousand, or 6.3%. This increase reflects customary annual salary increases for the Bank's and Tri-State's existing staff. Furniture and equipment expense has increased $61 thousand, or 29.0%, to $271 thousand from the three months ended June 30, 2004 to the same period in 2005 from a major computer hardware upgrade and system software conversion in May of

2004 and the additional expenses associated with increased office locations. Professional fees have increased $60 thousand in the second quarter of 2005 to $134 thousand due to the preparation for implementation of the Sarbanes Oxley Act Section 404 and the hiring of an internal audit firm to administer the documentation and review of the Company's internal controls. Advertising and promotion expenses have increased $54 thousand in the second quarter of 2005 over the same period in 2004 due to increased advertisements for deposit product rate promotions and the fees associated with a new cross-selling initiative program.

Although insurance commissions and fees increased 3.0% over the three month period ended June 30, 2005 from 2004, our insurance operations reported reduced net earnings in the three month period of 2005 compared to 2004. For the three months ended June 30, 2005, our insurance operations earned income before income taxes of $42 thousand, a decline from the $72 thousand earned in the year ago period. The decline in reported net earnings of our insurance operations reflects increased amortization expense of $15 thousand from the purchase of the book of business on an acquired insurance agency in 2003. Under the terms of the 2003 purchase, the amortization expense increased to $30 thousand in the second quarter of 2005 from $15 thousand in the second quarter of 2004. Amortization of this book of business will end in December of 2005. In addition, net income from insurance operations declined in the first quarter of 2005 by $18 thousand, reflecting a more competitive insurance market and greater salary expense due to the hiring of additional staff.

Income Taxes

The Company's income tax provision, which includes both federal and state taxes, was $272 thousand and $152 thousand for the three months ended June 30, 2005 and 2004, respectively. This increase in income taxes resulted from an increase in income before taxes of $395 thousand, or 72.7% for the three months ended June 30, 2005 as compared to the same period in 2004. The Company's effective tax rate of 29% and 28% for the three months ended June 30, 2005 and 2004, respectively, is below the statutory tax rate due to tax-exempt interest on securities and earnings on the investment in life insurance.

Six Months ended June 30, 2005 and June 30, 2004

Overview

For the six months ended June 30, 2005, net income was $1.2 million, an increase of $424 thousand, or 55.6%, from the $762 thousand reported for the same period in 2004. Basic earnings per share were $0.39 for the six months ended June 30, 2005 compared to $0.42 for the six-month period ended June 30, 2004. Diluted earnings per share were $0.39 for the six months ended June 30, 2005, a decrease from $0.40 from the first six months of 2004. The decrease in both basic earnings per share and diluted earnings per share was due to a capital offering that closed in December 2004. As a result of the offering, common stock outstanding increased by 1,131,150 shares, or 60.7%, to 2,994,874 shares outstanding at December 31, 2004.

Comparative Average Balances and Average Interest Rates

The following table presents, on a fully taxable equivalent basis, a

summary of the Company's interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the six month period ended June 30, 2005 and 2004.

(Dollars in thousands)	2005			Six Months Ended June 30,	
Earning Assets:	Average Balance	Interest (1)	Average Rate (2)	Average Balance	Inte
Securities:					
Tax exempt (3)	$ 27,749	$ 845	6.14%	$ 22,172	$
Taxable	47,954	880	3.70%	52,349	
Total securities	75,703	1,725	4.60%	74,521	
Total loans receivable (4)	169,676	5,489	6.52%	138,719	
Other interest-earning assets	11,098	146	2.64%	9,255	
Total earning assets	256,477	$ 7,360	5.79%	222,495	$
Non-interest earning assets	23,813			24,527	
Allowance for loan losses	(2,051)			(1,842)	
Total Assets	$ 278,239			$ 245,180	
Sources of Funds:					
Interest bearing deposits:					
NOW	$42,573	$124	0.59%	$ 47,066	$
Money market	21,143	199	1.90%	8,784	
Savings	65,214	226	0.70%	66,097	
Time	62,039	724	2.35%	57,941	
Total interest bearing deposits	190,969	1,273	1.34%	179,888	
Borrowed funds	12,484	292	4.65%	11,000	
Junior subordinated debentures	5,155	164	6.32%	5,155	
Total interest bearing liabilities	208,608	$ 1,729	1.67%	196,043	$
Non-interest bearing liabilities:					
Demand deposits	36,295			31,826	
Other liabilities	1,451			2,159	
Total non-interest bearing liabilities	37,746			33,985	
Stockholders' equity	31,885			15,152	
Total Liabilities and Stockholders' Equity	$ 278,239			$ 245,180	
Net Interest Income and Margin (5)		$ 5,631	4.43%		$

(1) Includes loan fee income
(2) Average rates on securities are calculated on amortized costs
(3) Full taxable equivalent basis, using a 39% effective tax rate and adjusted for TEFRA (Tax and Equity Fiscal Responsibility Act) interest expense disallowance

(4) Loans outstanding include non-accrual loans
(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets

Net Interest Income

Net interest income, on a fully taxable equivalent basis (a 39% tax rate), increased $1.2 million, or 27.1%, to $5.6 million for the six months ended June 30, 2005 compared to $4.4 million for the same six month period in 2004. The

net interest margin increased, on a fully taxable equivalent basis, by 42 basis points to 4.43% for the six months ended June 30, 2005 compared to 4.01% for the same period in 2004.

Interest Income

Total interest income, on a fully taxable equivalent basis, increased by $1.6 million, or 27.2%, to $7.4 million for the six months ended June 30, 2005 compared to $5.8 million in the first six months of 2004. Total average earning assets increased by $34.0 million to $256.5 million in the current six month period from $222.5 million for the six months ended June 30, 2004. The growth in higher yielding loan average balances in an increasing market rate of interest environment have increased the average rate earned on earning assets 56 basis points from 5.23% for the first six months of 2004 to 5.79% in the same period in 2005.

Total interest income on securities, on a fully taxable equivalent basis, increased $251 thousand, or 17.0%, from the six months ended June 30, 2004 to the same period in 2005. As the average balance of total securities increased $1.2 million, the average rate earned increased 62 basis points, from 3.98% in the first six months of 2004 to 4.60% for the same period in 2005. The increase in yield was accomplished by repositioning taxable securities with tax-exempt securities and the tax equivalent effect on the interest earned in an increasing market rate environment.

The average balance in the loan portfolio for the six months ended June 30, 2005 increased $30.1 million, or 22.3%, from the first six months of 2004. The interest earned on total loans increased $1.2 million, or 28.8% as the average rate earned on loans increased 34 basis points from 6.18% for the six months ended June 30, 2004 to 6.52% for the same period in 2005. The growth in our loan portfolio is a result of the reorganization of our loan department undertaken after our retention of Tammy Case, our Executive Vice-President, Loan Administration in July 2004.

Interest Expense

Interest expense increased $376 thousand to $1.7 million for the six months ended June 30, 2005 from $1.4 million for the six months ended June 30, 2004 as the average balance in interest bearing liabilities increased $12.6 million, to $208.6 million for the first six months of 2005 from $196.0 million in the same period in 2004 as a result of increases in market rates of interest and time deposit promotions. The average rate paid on interest bearing liabilities increased 28 basis points to 1.67% for the first six months of 2005 from 1.39% for the six months ended June 30, 2004.

The Company's interest expense on deposit liabilities for the six months ended June 30, 2005 increased $306 thousand, or 31.6 %, to $1.3 million from $967 thousand for the same period in 2004, as the balance in average interest-bearing liabilities increased $12.6 million, or 6.4% to $208.6 million from $196.0 million between the same two periods.

The average rate paid on total interest-bearing deposits has increased by 26 basis points from 1.08% for the six months ended June 30, 2004 to 1.34% for the same period in 2005. The increase reflects the growth in time deposits through promotional rate incentives and money market deposits, largely through the increase in municipal deposits. As municipal NOW account balances were transferred to higher incentive rate money market accounts, the NOW accounts average balance decreased $4.5 million and the money market accounts average balance increased $12.4 million in the first six months of 2005 compared to the six month period ended June 30, 2004. Time deposit average balances increased by $4.1 million, or 7.1%, to $62.0 million for the first six months of 2005 from $57.9 million during the first half of 2004.

For the six months ended June 30, 2005, the Company's average borrowed funds increased $1.5 million to $12.5 million from $11.0 million for the first six months of 2004. The Company's $5.2 million in junior subordinated debentures bear a floating rate of interest, which averaged 6.32% for the six months ended June 30, 2005, up 168 basis points from 4.64% in the same period of 2004.

Provision for Loan Losses

The provision for loan losses for the first half of 2005 was $341 thousand compared to a provision of $253 thousand in the first six months of 2004, an increase of $88 thousand. The increase in the provision between periods was due to substantial loan growth mainly in commercial and non-residential real estate.

Non-Interest Income

The Company's non-interest income is primarily generated through insurance commissions earned through the operation of Tri-State and service charges on deposit accounts.

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The Company's non-interest income increased by $108 thousand, or 4.7%, to $2.4 million for the six months ended June 30, 2005 from $2.3 million for the same period in 2004. Service fees on deposit accounts increased $169 thousand to $551 thousand in the first six months of 2005 from $382 thousand during the same period in 2004. Fees from the Company's new "no-return" overdraft privilege program have increase overdraft fee income 44.2% in the first six months of 2005 from the same period last year. Mortgage banking fees have decreased 102.5% to $161 thousand for the first six months of 2005 from $326 thousand during the same period in 2004 due to a decline in originations and greater competition.

Non-Interest Expense

Total non-interest expense increased from $5.3 million in the first six months of 2004 to $5.8 million in the first six months of 2005, an increase of $555 thousand, or 10.5%. The largest percent increases were in professional fees, advertising and promotion and amortization of intangible assets. Professional fees have increased $92 thousand or 58.6% in the first six months of 2005 to $249 thousand due to higher costs associated with the implementation

of Sarbanes Oxley Act Section 404. Advertising and promotion expenses have increased $83 thousand or 45.4% in the first six months of 2005 over the same period in 2004 due to increased advertisements for deposit product rate promotions and the fees associated with a new cross-selling initiative program.

As insurance commissions and fees increased 4.0% over the six month period ended June 30, 2005 from the same period in 2004, our insurance operations reported a reduction in income before income taxes of $72 thousand or 52.9% as depreciation and amortization on intangible assets increased $33 thousand or 63.5% in the six month period ending June 30, 2005 compared to 2004. In addition, net income from insurance operations declined in the first half of 2005 by $44 thousand, due to a competitive insurance policy renewal market and an increase in staff resulting in higher salary and benefit expenses.

Income Taxes

The Company's federal and state income tax provision was $451 thousand for the six months ended June 30, 2005 compared to $287 thousand recorded for the first half of 2004. This increase in income taxes resulted from an increase in income before taxes of $588 thousand, or 56.1% for the six months ended June 30, 2005 as compared to the same period in 2004. The Company's effective tax rate of 27% for both six month periods is below the statutory tax rate due to tax-exempt interest on securities and earnings on the investment in life insurance.

FINANCIAL CONDITION

June 30, 2005 as compared to December 31, 2004

At June 30, 2005 the Company had total assets of $290.4 million compared to total assets of $278.3 million at December 31, 2004, an increase of $12.1 million. Loans receivable increased $29.4 million, or 18.7%, to $186.3 million at June 30, 2005 from $156.9 million at December 31, 2004. Total deposits increased to $236.3 million at June 30, 2005 from $229.8 million at December 31, 2004 and borrowings increased $4.0 million to $14.0 million at June 30, 2005.

Cash and Cash Equivalents

The Company's cash and cash equivalents decreased by $12.9 million at June 30, 2005 to $16.4 million from $29.3 million at December 31, 2004. This decrease reflects the Company's decrease in federal funds sold of $16.7 million to $2.2 million at June 30, 2005 from $18.9 million at year-end 2004. This decrease in federal funds sold funded the Company's growth in the loan portfolio.

Securities Portfolio

The Company's securities, available for sale, at fair value, decreased $2.1 million from $74.7 million at December 31, 2004 to $72.7 million at June 30, 2005. The Company purchased $4.4 million in new securities during the first half of 2005, $5.3 million in available for sale securities matured or were repaid, $1.0 million in available for sale securities were called and there were no sales in the first six months of 2005. Six month balances increased in state and municipal tax-exempt securities, at fair value, by $1.7 million to $27.6 million as paydowns exceeded purchases in taxable securities, at fair value, for a net decrease of $3.8 million to $45.0 million. The securities portfolio contained no high-risk securities or derivatives as of June 30, 2005. There were no held to maturity securities at June 30, 2005 or at December 31, 2004.

Loans

Total loans at June 30, 2005 increased $29.4 million, or 18.7% to $186.3 million from $156.9 million at year-end 2004. The Company is emphasizing the origination of commercial, industrial, and non-residential real estate loans to increase the yield in its loan portfolio. The Company has also increased its activity in the loan participation market. The majority of the originated and sold participations are commercial real estate related loans which exceed the Company's legal lending limit. The balances in all major loan categories have increased from December 31, 2004 to June 30, 2005. The largest increases were a $19.3 million, or 27.7%, increase in non-residential real estate loans, a $2.9 million, or 28.5%, increase in construction and land development loans and a $2.0 million, or 14.1%, increase in commercial and industrial loans.

The increase in loans was funded during the first six months of 2005 by a decrease in the Company's federal funds sold, cash flows from repayments on securities as well as increased deposits and borrowings from the Federal Home Loan Bank. The loan to deposit ratios at June 30, 2005 and December 31, 2004 were 78.8% and 68.3%, respectively.

Loan and Asset Quality

Non-performing assets consist of non-accrual loans and all loans over ninety days delinquent and foreclosed real estate owned ("OREO"). The Company's non-accrual loans decreased to $1.0 million at June 30, 2005 from $1.3 million at December 31, 2004. There were $75 thousand in past due loans over 90 days and still accruing and $50 thousand in renegotiated loans at June 30, 2005. The Company had one OREO property valued at $270 thousand at June 30, 2005 and none at December 31, 2004.

The Company seeks to actively manage its non-performing assets. In addition to active monitoring and collecting on delinquent loans, management has an active loan review process for customers with aggregate relationships of $250,000 or more if the credit(s) are unsecured or secured, in whole or substantial part, by collateral other than real estate and $1,000,000 or more if the credit(s) are secured in whole or substantial part by real estate.

Management continues to monitor the Company's asset quality and believes that the non-accrual loans are adequately collateralized and anticipated material losses have been adequately reserved for in the allowance for loan losses.

The following table provides information regarding risk elements in the loan portfolio at each of the periods presented:

(Dollars in thousands)	June 30, 2005	December 31, 2004
Non-accrual loans	$1,005	$1,304
Non-accrual loans to total loans	0.54%	0.83%
Non-performing assets to total assets	0.48%	0.48%
Allowance for loan losses as a % of non-performing loans	190.97%	169.96%
Allowance for loan losses to total loans	1.16%	1.45%

Allowance for Loan Losses

The allowance is allocated to specific loan categories based upon management's classification of problem loans under the bank's internal loan grading system and to pools of other loans that are not individually analyzed. Management makes allocations to specific loans based on the present value of expected future cash flows or the fair value of the underlying collateral for impaired loans and to other classified loans based on various credit risk factors. These factors include collateral values, the financial condition of the borrower and industry and current economic trends.

Allocations to commercial loan pools are categorized by commercial loan type and are based on management's judgment concerning historical loss trends and other relevant factors. Installment and residential mortgage loan allocations are made at a total portfolio level based on historical loss experience adjusted for portfolio activity and current conditions. Additionally, all other delinquent loans are grouped by the number of days delinquent with this amount assigned a general reserve amount.

In April of 2005 the Company began an allowance for overdraft losses, providing for losses in conjunction with the new no-return overdraft privilege program. Included in the total allowance for loan losses was a provision of $11

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thousand, and net charge-offs of $9 thousand for the first six months of 2005, as the first charge-offs were recorded under the new program.

At June 30, 2005, the allowance for loan losses was $2.2 million, a decrease of $116 thousand from the $2.3 million at December 31, 2004. The provision for loan losses was $341 thousand and there were $609 thousand in charge-offs and $152 thousand in recoveries for the first six months of 2005. The allowance for loan losses as a percentage of total loans was 1.16% at June 30, 2005 compared to 1.45% on December 31, 2004. At December 31, 2004 the allowance held specific reserves for the potential charge off of several loans in the loan portfolio. During the first half of 2005, $418 thousand was charged off relating to delinquent loans, $180 thousand was charged off on the write down of a property the Company foreclosed on and $150 thousand was recovered on a loan previously charged off.

Management regularly assesses the appropriateness and adequacy of the loan loss reserve in relation to credit exposure associated with individual borrowers, overall trends in the loan portfolio and other relevant factors, and believes the reserve is reasonable and adequate for each of the periods presented.

Deposits

Total deposits increased $6.5 million, or 2.8%, from $229.8 million at December 31, 2004 to $236.3 million at June 30, 2005. Non-interest bearing deposits increased $2.3 million, or 6.6% to $36.7 million at June 30, 2005 from $34.5 million at December 31, 2004 and interest-bearing deposits increased $4.2 million, or 2.2%, to $199.6 million at June 30, 2005 from $195.4 million at December 31, 2004. Total time deposits balances increased $8.0 million, or 12.8%, from $63.2 million at December 31, 2004 to $71.2 million at June 30, 2005 while other interest bearing deposit account balances decreased $3.8 million, or

2.9%, to $128.4 million at June 30, 2005 from $132.2 million at December 31, 2004. The shift from other interest-bearing deposits to time deposits, mainly from public fund accounts and a select savings account product for senior citizens, is market driven as the Company has increased interest rates paid on short term time deposits. Management continues to monitor the shift in deposits through its Asset/Liability Committee.

Borrowings

Borrowings consist of long term advances and repurchase agreements from the Federal Home Loan Bank. The advances are secured under terms of a blanket collateral agreement by a pledge of qualifying investment securities and certain mortgage loans. As of June 30, 2005 the Company had $12.0 million in notes outstanding at an average interest rate of 4.71% compared to $10.0 million in notes outstanding at an average rate of 4.85% for the year ended December 31, 2004. The long-term borrowings consist of three notes that mature on December 21, 2010 and one that matures on March 29, 2015 all with a convertible quarterly option which allows the Federal Home Loan Bank to change the note to then current market rates. The interest rate on these borrowings ranges from 3.48% to 5.14%. In March of 2005 the Company purchased $2.0 million in securities sold under agreements to repurchase at an average rate of 3.62%; $1.0 million matures in September of 2005 and the second $1.0 million matures in March of 2006.

Junior Subordinated Debentures

On July 11, 2002, the Company raised an additional $4.8 million, net of offering costs, in capital through the issuance of junior subordinated debentures to a statutory trust subsidiary. The subsidiary in turn issued $5.0 million in variable rate capital trust pass through securities to investors in a private placement. The interest rate is based on the three-month LIBOR rate plus 365 basis points and adjusted quarterly. The rate at June 30, 2005 was 6.59%. The rate is capped at 12.5% through the first five years, and the securities may be called at par anytime after October 7, 2007 or if the regulatory capital or tax treatment of the securities is substantially changed. These trust preferred securities are included in the Company's and the Bank's capital ratio calculations.

As a result of the adoption of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, and Interpretation of ARB No. 51", we deconsolidated our wholly-owned subsidiary Sussex Capital Trust I, referred to as the "Trust", from our consolidated financial statements as of March 31, 2004. For regulatory reporting purposes, the Federal Reserve is allowing trust preferred securities to continue to qualify as Tier 1 Capital subject to specified limitations. The adoption of FIN 46 did not have an impact on our results of operations or liquidity.

Interest Rate Sensitivity

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. Interest rate sensitivity is the volatility of a Company's earnings from a movement in market interest rates. Interest rate "gap" analysis is a common, though, imperfect, measure

of interest rate risk. We do not employ gap analysis as a rate risk management tool, but rather we rely upon earnings at risk analysis to forecast the impact

on our net interest income of instantaneous 100 and 200 basis point increases and decreases in market rates. In assessing the impact on earnings, the rate shock analysis assumes that no change occurs in our funding sources or types of assets in response to the rate change.

Our board of directors has established limits for interest rate risk based on the percentage change in interest income we would incur in differing interest rate scenarios. Through the first six months of 2005, we sought to remain relatively balanced, and our policies provide for a variance of no more than 25% of net interest income, at a 100 and 200 basis point increase or decrease. At June 30, 2005 the percentages of change were within policy limits.

Our financial modeling simulates our cash flows, interest income and interest expense from earning assets and interest bearing liabilities for a twelve month period in each of the different interest rate environments, using actual individual deposit, loan and investment maturities and rates in the model calculations. Assumptions regarding the likelihood of prepayments on residential mortgage loans and investments are made based on historical relationships between interest rates and prepayments. Commercial loans with prepayment penalties are assumed to pay on schedule to maturity. In actual practice, commercial borrowers may request and be granted interest rate reductions during the life of a commercial loan due to competition from financial institutions and declining interest rates.

The following table sets forth our interest rate risk profile at June 30, 2005 and 2004. The interest rate sensitivity of our assets and liabilities, and the impact on net interest income, illustrated in the following table would vary substantially if different assumptions were used or if actual experience differs from that indicated by the assumptions.

	June 30, 2005		June 30, 2004	
(Dollars in thousands)	Change in Net Interest Income	Gap as a % of Total Assets	Change in Net Interest Income	Gap as a % of Total Assets
Down 200 basis points	($792)	13.79%	($584)	11.66%
Down 100 basis points	(190)	6.62%	(147)	5.86%
Up 100 basis points	(58)	-2.04%	(70)	-2.80%
Up 200 basis points	(172)	-2.99%	(211)	-4.22%

Liquidity

It is management's intent to fund future loan demand with deposits and maturities and pay downs on investments. In addition, the bank is a member of the Federal Home Loan Bank of New York and as of June 30, 2005, had the ability to borrow up to $18.2 million against its one to four family mortgages and selected investment securities as collateral for borrowings, of which the Company had outstanding long-term borrowings totaling $12.0 million and $2.0 million in securities sold under an agreement to repurchase. The bank also has available an overnight line of credit and a one-month overnight repricing line of credit, each in an amount of $12.3 million at the Federal Home Loan Bank and an overnight line of credit in the amount of $4.0 million at the Atlantic Central Bankers Bank.

At June 30, 2005, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational customer credit needs could be

satisfied. At June 30, 2005, liquid investments totaled $16.4 million, and all mature within 30 days.

At June 30, 2005, the Company had $72.7 million of securities classified as available for sale. Of these securities, $36.6 million had $456 thousand of unrealized losses and therefore are not available for liquidity purposes because management's intent to hold them until market recovery.

The Company has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

The Company is not aware of any known trends or any known demands, commitments, events or uncertainties, which would result in any material increase or decrease in liquidity.

Off-Balance Sheet Arrangements

The Company's financial statements do not reflect off-balance sheet arrangements that are made in the normal course of business. These off-balance sheet arrangements consist of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. These unused commitments, at June 30, 2005 totaled $58.1 million.

This consisted of $32.0 million in commitments to grant commercial real estate, construction and land development loans, $12.4 million in home equity lines of credit, and $13.7 million in other unused commitments. These instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Company.

Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

Capital Resources

Stockholders' equity inclusive of accumulated other comprehensive income (loss), net of income taxes, was $32.6 million at June 30, 2005, an increase of $942 thousand from the $31.6 million at year-end 2004. Activity in stockholders' equity consisted of net proceeds from common stock issuances of $183 thousand, a net increase in retained earnings of $765 thousand derived from $1.2 million in net income earned in the first half of 2005, offset by $421 thousand for the payment of cash dividends and a $6 thousand unrealized loss on securities available for sale, net of income tax of $3 thousand.

At June 30, 2005 the Company and the Bank both meet the well-capitalized regulatory standards applicable to them. The table below presents the capital ratios at June 30, 2005, for the Company and the Bank, as well as the minimum regulatory requirements.

(Dollars in thousands)	Amount	Ratio	Minimum Amount	Minimum Ratio
The Company:				
Leverage Capital	$34,784	12.37%	$>11,245	4%
Tier 1 - Risk Based	34,784	16.85%	>8,258	4%

Total Risk-Based	36,953	17.90%	>16,516	8%
The Bank:				
Leverage Capital	27,092	9.73%	>11,138	4%
Tier 1 Risk-Based	27,092	13.18%	>8,219	4%
Total Risk-Based	29,261	14.24%	>16,439	8%

Effect of Inflation

Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, the level of interest rates has a more significant impact on a financial institution's performance than effects of general levels of inflation. Interest rates do not necessarily move in the same direction or change with the same magnitude as the price of goods and services, which prices are affected by inflation. Accordingly, the liquidity, interest rate sensitivity and maturity characteristics of the Company's assets and liabilities are more indicative of its ability to maintain acceptable performance levels. Management of the Company monitors and seeks to mitigate the impact of interest rate changes by attempting to match the maturities of assets and liabilities to gap, thus seeking to minimize the potential effect of inflation.

Item 3. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are, as of the end of the period covered by this report, effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

(b) Changes in internal controls.

Not applicable

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company and the Bank are periodically involved in various legal proceedings as a normal incident to their businesses. In the opinion of management, no material loss is expected from any such pending lawsuit.

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

On April 16, 1999 the Company announced a stock repurchase plan whereby the Company may purchase up to 50,000 shares of outstanding stock. There is no expiration date to this plan. On April 27, 2005, the Company's Board increased this plan to 100,000 shares of the Company's common stock. The Company has previously repurchased 32,000 shares under this program.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1, 2005 through April 30, 2005	-	-	-	-
May 1, 2005 through May 31, 2005	2,000	$13.55	2,000	65,992
June 1, 2005 through June 30, 2005	-	-	-	-
Total	2,000	$13.55	2,000	65,992

Item 3. Defaults upon Senior Securities

Not applicable

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

On April 27, 2005, the Registrant held its annual meeting of shareholders to elect members of the Company's Board of Directors and approval of the Company's 2004 Equity Incentive Plan.

Nominees for election to the Board of Directors received the following votes:

Nominees:	For	Withhold Authority
Patrick Brady	2,705,593	60,665
Edward J. Leppert	2,728,189	38,069
Richard Scott	2,728,689	37,569
Joseph Zitone	2,475,386	290,872
Richard Branca	2,703,261	62,997

Proposal for the 2004 Equity Incentive Plan:

For	Against

1,536,144 320,224

Item 5. Other Information

Not applicable

Item 6. Exhibits

Number	Description
31.1	Certification of Donald L. Kovach pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Candace A. Leatham pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SUSSEX BANCORP
By: /s/ Candace A. Leatham

CANDACE A. LEATHAM
Executive Vice President and
Chief Financial Officer
Date: