SUSSEX BANCORP
Form 10QSB
November 14, 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 September 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 November 9, 2005 there were 3,021,284 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	September 30, 2005	Dec
Cash and due from banks	$ 9,800	$
Federal funds sold	8,900	
Cash and cash equivalents	18,700	
Interest bearing time deposits with other banks	500	
Securities available for sale	66,203	
Federal Home Loan Bank Stock, at cost	900	

Loans receivable, net of unearned income	203,653	
Less: allowance for loan losses	2,394	
Net loans receivable	201,259	
Premises and equipment, net	5,806	
Accrued interest receivable	1,523	
Goodwill	2,334	
Other assets	6,728	
Total Assets	$ 303,953	$

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:		
Deposits:		
Non-interest bearing	$ 37,355	$
Interest bearing	207,767	
Total Deposits	245,122	
Borrowings	18,000	
Accrued interest payable and other liabilities	2,652	
Junior subordinated debentures	5,155	
Total Liabilities	270,929	
Stockholders' Equity:		
Common stock, no par value, authorized 5,000,000 shares; issued and outstanding 3,177,325 in 2005 and 2,994,874 in 2004	27,688	
Retained earnings	5,382	
Accumulated other comprehensive income (loss)	(46)	
Total Stockholders' Equity	33,024	
Total Liabilities and Stockholders' Equity	$ 303,953	$

See Notes to Consolidated Financial Statements

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

	Three Months Ended September 30,	
	2005	2004

INTEREST INCOME		
Loans receivable, including fees	$ 3,259	$ 2,260
Securities:		
Taxable	400	483
Tax-exempt	285	221
Federal funds sold	65	10
Interest bearing deposits	14	13
Total Interest Income	4,023	2,987
INTEREST EXPENSE		
Deposits	877	493
Borrowings	169	130
Junior subordinated debentures	92	66
Total Interest Expense	1,138	689
Net Interest Income	2,885	2,298
PROVISION FOR LOAN LOSSES	206	120
Net Interest Income after Provision for Loan Losses	2,679	2,178
OTHER INCOME		
Service fees on deposit accounts	334	175
ATM and debit card fees	90	87
Insurance commissions and fees	536	526
Mortgage banking fees	48	130
Investment brokerage fees	104	96
Net gain on sale of securities, available for sale	42	11
Other	113	84
Total Other Income	1,267	1,109
OTHER EXPENSES		
Salaries and employee benefits	1,610	1,564
Occupancy, net	246	225
Furniture, equipment and data processing	267	247
Stationary and supplies	43	43
Professional fees	136	81
Advertising and promotion	108	96
Insurance	33	41
Postage and freight	41	39
Amortization of intangible assets	61	51
Other	311	354
Total Other Expenses	2,856	2,741
Income before Income Taxes	1,090	546
PROVISION FOR INCOME TAXES	338	143
Net Income	$ 752	$ 403
EARNINGS PER SHARE		
Basic	$ 0.24	$ 0.21

Diluted	$ 0.23	$ 0.20

See Notes to Consolidated Financial Statements

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

	Number of Shares Outstanding	Common Stock	Retained Earnings	Accu Compr Incom
Balance December 31, 2003	1,811,460	$ 9,616	$ 5,040	$
Comprehensive income:				
Net income	--	--	1165	
Change in unrealized gains (losses) on securities available for sale, net of tax	--	--	--	
Total Comprehensive Income	1,295			
Treasury shares purchased	(1,346)	--	--	
Treasury shares retired	--	(23)	--	
Exercise of stock options	23,807	205	--	
Income tax benefit of stock options exercised	--	52	--	
Shares issued through dividend reinvestment plan	8,267	137	--	
Dividends on common stock ($.20 per share)	--	--	(384)	
Balance September 30, 2004	1,842,188	$ 9,987	$ 5,821	$
Balance December 31, 2004	2,994,874	$ 25,397	$ 6,116	$
Comprehensive income:				
Net income	--	--	1,938	
Change in unrealized gains (losses) on securities available for sale, net of tax	--	--	--	
Total Comprehensive Income	1,753			
Treasury shares purchased	(13,150)	--	--	
Treasury shares retired	--	(187)	--	
Exercise of stock options	36,527	278	--	
Income tax benefit of stock options exercised	--	77	--	
Shares issued through dividend reinvestment plan	7,773	109	--	
Additional expenses for stock offering	--	(25)	--	
Dividends on common stock ($.20 per share)	--	--	(633)	
5% Stock Dividend	151,301	2,039	(2,039)	

Balance September 30, 2005	3,177,325	$ 27,688	$ 5,382	($

See Notes to Consolidated Financial Statements

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

	Nine Months
	2005
Cash Flows from Operating Activities	
Net income	$ 1,93
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	54
Provision for depreciation and amortization	68
Net amortization of securities premiums and discounts	19
Net realized gain on sale of securities	(4
Net gain on sale of equipment	(1
Income tax benefit of stock options exercised	7
Earnings on investment in life insurance	(6
(Increase) decrease in assets:	
Accrued interest receivable	(19
Other assets	(70
Increase in accrued interest payable and other liabilities	1,01
Net Cash Provided by Operating Activities	3,43
Cash Flows from Investing Activities	
Securities available for sale:	
Purchases	(4,94
Proceeds from sale of securities	2,99
Maturities, calls and principal repayments	10,02
Net increase in loans	(47,43
Purchases of premises and equipment	(69
(Increase) decrease in FHLB stock	(21
(Increase) decrease in interest bearing time deposits with other banks	3,40
Purchase of investment in life insurance	-
Net Cash Used in Investing Activities	(36,86
Cash Flows from Financing Activities	
Net increase in deposits	15,29
Increase in federal funds purchased	-
Increase (decrease) in borrowings	8,00
Proceeds from the exercise of stock options	27
Purchase of treasury stock	(18
Expenses paid related to stock offering	(2

Dividends paid, net of reinvestments	(52
Net Cash Provided by Financing Activities	22,83
Net Increase (Decrease) in Cash and Cash Equivalents	(10,59
Cash and Cash Equivalents - Beginning	29,29
Cash and Cash Equivalents - Ending	$ 18,70
Supplementary Cash Flows Information	
Interest paid	$2,802
Income taxes paid	$361
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 of 2005, 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 commenced 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 nine-month period ended September 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. Stockholders' Equity and Subsequent Events

On October 19, 2005, the Board of Directors declared a 5% common stock dividend payable on November 29, 2005 to shareholders of record as of November 3, 2005. Accordingly, 151,301 shares of common stock will be issued to the Company's stockholders and $2,039,000 will be transferred from retained earnings to common stock. The effect of the stock dividend has been retroactively reflected as of September 30, 2005 in the consolidated balance sheet and the consolidated statement of stockholders' equity. The earnings per share amounts and dividend per share amounts disclosed in the consolidated financial statements and related footnote reflect the effect of the stock dividend on the number of outstanding shares for all periods.

On November 8, 2005, Sussex Bancorp announced that its Sussex Bank subsidiary had entered into an agreement to purchase the Port Jervis, New York branch office of NBT Bank, N.A. As part of the transaction, Sussex Bank will assume approximately $6.0 million in deposits and acquire approximately $3.7 million in loans. The transaction is subject to regulatory approval and is expected to close in the first quarter of 2006.

3. 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, as adjusted for the stock dividend discussed in note 2. 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, for the 2004 period, guaranteed and contingently issuable shares from the acquisition of Tri-State. As of the fourth quarter of 2004, the Company had no additional obligation to issue further shares in connection with 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 as retroactively adjusted for the 5% stock dividend declared October 19, 2005.

	Three Months Ended September 30, 2005			Three Month
(In thousands, except per share data)	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)
Basic earnings per share:				
Net income applicable to common				

	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)
stockholders	$ 752	3,170	$ 0.24	$ 403
Effect of dilutive securities:				
Stock options	--	31		--
Deferred common stock payments for purchase of insurance agency	--	--		--
Diluted earnings per share:				
Net income applicable to common stock-holders and assumed conversions	$ 752	3,201	$0.23	$ 403

(In thousands, except per share data)	Nine Months Ended September 30, 2005			Nine Months
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)
Basic earnings per share:				
Net income applicable to common stockholders	$ 1,938	3,163	$ 0.61	$ 1,165
Effect of dilutive securities:				
Stock options	--	38		--
Deferred common stock payments for purchase of insurance agency	--	--		2
Diluted earnings per share:				
Net income applicable to common stock-holders and assumed conversions	$ 1,938	3,201	$ 0.61	$ 1,167

4. Comprehensive Income

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

(Dollars in thousands)	Three Months Ended September 30, 2005	2004	Nine
Unrealized holding gains (losses) on available for sale securities	($256)	$ 1,340	
Reclassification adjustments for gains included in net income	(42)	(11)	
Net unrealized gains (losses)	(298)	1,329	
Tax effect	119	(532)	
Other comprehensive income (loss), net of tax	($179)	$ 797	

5. 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 September 30, 2005			Three
	Banking and Financial Services	Insurance Services	Total	Bank Financial
Net interest income from external sources	$ 2,885	$ --	$ 2,885	$
Other income from external sources	731	536	1,267	
Depreciation and amortization	178	40	218	
Income (loss) before income taxes	1,072	18	1,090	
Income tax expense (benefit)	331	7	338	
Total assets	300,604	3,349	303,953	

(Dollars in thousands)	Nine Months Ended September 30, 2005			Nine
	Banking and Financial Services	Insurance Services	Total	Bank Financial
Net interest income from external sources	$ 8,263	$ --	$ 8,263	$
Other income from external sources	1,939	1,753	3,692	
Depreciation and amortization	562	125	687	
Income before income taxes	2,646	81	2,727	
Income tax expense	757	32	789	
Total assets	300,604	3,349	303,953	

6. 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 September 30, 2005	2004

Net income, as reported	$	752	$	403
Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects		(26)		(39
Pro forma net income	$	726	$	364
Basic earnings per share:				
As reported	$	0.24	$	0.21
Pro forma	$	0.23	$	0.19
Diluted earnings per share:				
As reported	$	0.23	$	0.20
Pro forma	$	0.23	$	0.18

7. 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 $1,108,000 of standby letters of credit as of September 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 September 30, 2005 for guarantees under standby letters of credit issued is not material.

8. 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 January 2003, the FASB's Emerging Issues Task Force (EITF) issued EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investors" ("EITF 03-1"), and in March 2004, the EITF issued an update. EITF 03-1 addresses the meaning of other-than-temporary impairment and its application to certain debt and equity securities. EITF 03-1 aids in the determination of impairment of an investment and gives guidance as to the measurement of impairment loss and the recognition and disclosures of other-than-temporary investments. EITF 03-1 also provides a model to determine other-than-temporary impairment using evidence-based judgment about the recovery of the fair value up to the cost of the investment by considering the severity and duration of the impairment in relation to the forecasted recovery of the fair value. In July 2005, FASB adopted the recommendation of its staff to nullify key parts of EITF 03-1. The staff's recommendations were to nullify the guidance on the determination of whether an investment is impaired as set forth in paragraphs 10-18 of Issue 03-1 and not to provide additional guidance on the meaning of other-than-temporary impairment. Instead, the staff recommends entities recognize other-than-temporary impairments by applying existing accounting literature such as paragraph 16 of SFAS 115.

In July 2005, the FASB issued a proposed interpretation of FAS 109, "Accounting for Income Taxes", to clarify certain aspects of accounting for uncertain tax positions, including issues related to the recognition and measurement of those tax positions. If adopted as proposed, the interpretation would be effective in the fourth quarter of 2005, and any adjustments required to be recorded as a result of adopting the interpretation would be reflected as a cumulative effect from a change in accounting principle. We are currently in the process of determining the impact of adoption of the interpretation as proposed on our financial position or results of operations.

In June 2005, the FASB's Emerging Issues Task Force (EITF) reached a consensus on Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination" ("EITF 05-6"). This guidance requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are reasonably assured at the date of the business combination or purchase. This guidance is applicable only to leasehold improvements that are purchased or acquired in reporting periods beginning after June 29, 2005. The Company is evaluating the impact, if any, of EITF 05-6 on its financial statements.

In October 2005, the FASB issued FASB Staff Position FAS 13-1 ("FSP FAS 13-1"), which requires companies to expense rental costs associated with ground or building operating leases that are incurred during a construction period. As a result, companies that are currently capitalizing these rental costs are

required to expense them beginning in its first reporting period beginning after December 15, 2005. FSP FAS 13-1 is effective for our Company as of the first quarter of fiscal 2006. We evaluated the provisions of FSP FAS 13-1 and do not believe that its adoption will have a material impact on our Company's financial condition or results of operations.

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 and the sale of non-deposit products. In the second quarter of 2005, the Company acquired a 49% equity interest in SussexMortgage.com LLC; a mortgage banking joint venture with National City Mortgage Inc. SussexMortgage.com LLC commenced operations in the third quarter of 2005. Loans originated by SussexMortgage.com LLC are funded by third parties and will generate fee income net of origination costs.

On November 8, 2005, Sussex Bancorp announced that its Sussex Bank subsidiary had entered into an agreement to purchase the Port Jervis, New York branch office of NBT Bank, N.A. As part of the transaction, Sussex Bank will assume approximately $6.0 million in deposits and acquire approximately $3.7 million in loans. The transaction is subject to regulatory approval and is expected to close in the first quarter of 2006.

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.

RESULTS OF OPERATIONS

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

Overview

The Company realized net income of $752 thousand for the third quarter of 2005, an increase of $349 thousand, or 86.6%, from the $403 thousand reported for the same period in 2004. Basic earnings per share, as retroactively adjusted for the 5% stock dividend declared October 19, 2005, increased from $0.21 in the third quarter of 2004 to $0.24 for the third quarter of 2005 and diluted earnings per share increased from $0.20 in the third quarter of 2004 to $0.23 for the quarter ended September 30, 2005. During the third quarter of 2005, we had 3,169,592 average shares outstanding, compared to 1,930,731 average shares outstanding in the prior year period, reflecting the impact of our capital offering which closed in December, 2004.

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 salary and employee benefits 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 September 30, 2005 and 2004.

(dollars in thousands)	Three Months Ended September 30, 2005			
Earning Assets:	Average Balance	Interest (1)	Average Rate (2)	Average Balance
Securities:				
Tax exempt (3)	$ 26,495	$ 399	5.98%	$ 21,984
Taxable	43,719	400	3.63%	53,367
Total securities	70,214	799	4.52%	75,351
Total loans receivable (4)	194,053	3,259	6.66%	145,451
Other interest-earning assets	9,107	80	3.47%	5,648
Total earning assets	273,374	$ 4,138	6.01%	226,450
Non-interest earning assets	24,314			25,831

Allowance for loan losses	(2,250)			(2,011)
Total Assets	$295,438			$250,270
Sources of Funds:				
Interest bearing deposits:				
NOW	$ 43,922	$76	0.69%	$42,910
Money market	19,965	127	2.52%	16,551

Savings	61,937	118	0.76%	67,314
Time	75,036	556	2.94%	55,290
Total interest bearing deposits	200,860	877	1.73%	182,066
Borrowed funds	14,576	169	4.54%	10,499
Junior subordinated debentures	5,155	92	7.00%	5,155
Total interest bearing liabilities	220,591	$ 1,138	2.05%	197,719
Non-interest bearing liabilities:				
Demand deposits	40,005			35,093
Other liabilities	2,135			1,982
Total non-interest bearing liabilities	42,140			37,075
Stockholders' equity	32,707			15,476
Total Liabilities and Stockholders' Equity	$295,438			$250,270
Net Interest Income and Margin (5)		$ 3,000	4.35%	

(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

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 $607 thousand, or 25.4%, to $3.0 million for the three months ended September 30, 2005 compared to $2.4 million for the same three month period in 2004. The net interest margin increased, on a fully taxable equivalent basis, by 15 basis points to 4.35% for the three months ended September 30, 2005 compared to 4.20% for the same period in 2004.

Interest Income

Total interest income, on a fully taxable equivalent basis, increased by $1.1 million to $4.1 million for the three months ended September 30, 2005 compared to $3.1 million in the same period in 2004. Total average earning assets increased by $46.9 million to $273.4 million from $226.5 million for the three months ended September 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 60 basis points from 5.41% for the third quarter of 2004 to 6.01% in the same period in 2005.

Total interest income on securities, on a fully taxable equivalent basis, was unchanged at $799 thousand for the three month periods ended September 30, 2005 and 2004. As the average balance of total securities decreased $5.1 million, the average rate earned increased 30 basis points, from 4.22% in the third quarter of 2004 to 4.52% for the third quarter of 2005. The decrease in the average balances of the securities portfolio reflects a $9.6 million reduction in taxable securities and a $4.5 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 September 30, 2004 to same period in 2005, the average balance in loans increased $48.6 million, or 33.4%, while the interest earned on total loans increased $999 thousand, or 44.2%. The average rate earned on loans increased 48 basis points from 6.18% for the three months ended September 30, 2004 to 6.66% 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 September 30, 2005 increased $449 thousand, or 65.2%, to $1.1 million from $689 thousand for the same period in 2004, as the balance in average interest-bearing liabilities increased $22.9 million, or 11.6% to $220.6 million from $197.7 million between the same two periods. The

average rate paid on total interest-bearing liabilities has increased by 66 basis points from 1.39% for the three months ended September 30, 2004 to 2.05% for the same period in 2005, largely due to increased market rates of interest.

The average balance in time deposits increased $19.7 million from $55.3 million in the third quarter of 2004 to $75.0 million during the same period in 2005 due to the Company actively promoting competitive market rates of interest. To attract municipal accounts, a higher incentive rate was offered on the public fund money market account. The average balance in money market accounts increased $3.4 million in the third quarter of 2005 compared to three month period ended September 30, 2004, as the rate of interest paid increased 131 basis points to 2.52% for the three months ended September 31, 2005 from 1.21% for the same period in 2004.

For the quarter ended September 30, 2005, the Company's average borrowed funds increased $4.1 million to $14.6 million compared to average borrowed funds of $10.5 million during the third quarter of 2004. The balance at September 30,

2005 consisted of four convertible notes totaling $12.0 million, one ninety day note for $5.0 million and $1.0 million in a repurchase agreement from the Federal Home Loan Bank. The average rate paid on total borrowed funds has decreased 29 basis points from the third 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 7.00% for the three months ended September 30, 2005, up 195 basis points from 5.05% in the same period of 2004.

Provision for Loan Losses

The provision for loan losses for the third quarter of 2005 was $206 thousand compared to a provision of $120 thousand in the third quarter of 2004, an increase of $86 thousand. The increase in the provision from the third 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 investment brokerage fees.

The Company's non-interest income increased by $158 thousand, or 14.2%, to $1.3 million for the three months ended September 30, 2005 from $1.1 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 accounted for the increase in non-interest income as they increased $159 thousand, or 90.9%, to $334 thousand in the third quarter of 2005 from $175 thousand during the same period in 2004. Insurance commission income from Tri-State and investment brokerage fee income have marginally increased in the third quarter of 2005 over the same period in 2004. This was offset by a decrease in mortgage banking fee income between the same two periods, as the Company's newly formed mortgage banking joint venture with National City Mortgage Inc., SussexMortgage.com LLC, commenced operations in the third quarter of 2005.

Non-Interest Expense

Total non-interest expense increased $115 thousand, or 4.2%, from $2.7 million in the third quarter of 2004 to $2.9 million in the third quarter of 2005. Salaries and employee benefits, the largest component of non-interest expense, increased $46 thousand, or 2.9%. Professional fees have increased $55 thousand, or 67.9%, in the third quarter of 2005 to $136 thousand, due to the preparation for implementation of Sarbanes Oxley Act Section 404 and the retention of consultants to assist with the documentation and review of the Company's internal controls. Occupancy expense increased $21 thousand to $246 thousand for the third quarter of 2005 from $225 for the same period in 2004, as the rental expense for Tri-State increased $11 thousand due to the expansion of their office space in August of 2005.

Income Taxes

The Company's income tax provision, which includes both federal and state taxes, was $338 thousand and $143 thousand for the three months ended September 30, 2005 and 2004, respectively. This increase in income taxes resulted from an increase in income before taxes of $544 thousand, or 99.6% for the three months ended September 30, 2005 as compared to the same period in 2004. The Company's effective tax rate of 31% and 26% for the three months ended

September 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.

Nine Months ended September 30, 2005 and September 30, 2004

Overview

For the nine months ended September 30, 2005, net income was $1.9 million, an increase of $773 thousand, or 66.4%, from the $1.2 million reported for the same period in 2004. Basic earnings per share, as retroactively adjusted for the 5% stock dividend declared October 19, 2005, were $0.61 for each of the nine month periods ended September 30, 2005 and 2004. The weighted number of basic shares increased by 1,241,364 shares, or 64.6%, between the nine months ended September 30, 2004 and the nine months ended September 30, 2005 as a result of a capital offering in December 2004. Diluted earnings per share were $0.61 for the nine months ended September 30, 2005, an increase from $0.58 from the first nine months of 2004, as the weighted number of diluted shares increased by 1,187,026 shares, or 58.9%, in the current nine month period.

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 nine month period ended September 30, 2005 and 2004.

(dollars in thousands)	Nine Months Ended September 30, 2005			2004	
Earning Assets:	Average Balance	Interest (1)	Average Rate (2)	Average Balance	Interest (1)
Securities:					
Tax exempt (3)	$ 27,326	$ 1,245	6.09%	$ 22,109	$ 905
Taxable	46,527	1,280	3.68%	52,691	1,368
Total securities	73,853	2,525	4.57%	74,800	2,273
Total loans receivable (4)	177,891	8,748	6.57%	140,980	6,522
Other interest-earning assets	10,427	225	2.89%	8,044	71
Total earning assets	262,171	$11,498	5.86%	223,824	$8,866
Non-interest earning assets	23,982			25,012	

Allowance for loan losses	(2,118)			(1,899)	
Total Assets	$284,035			$ 246,937	
Sources of Funds:					
Interest bearing deposits:					
NOW	$ 43,028	$ 200	0.62%	$45,671	$ 152
Money market	20,746	326	2.10%	11,392	93
Savings	64,110	345	0.72%	66,505	324
Time	66,419	1,279	2.57%	57,051	891
Total interest bearing deposits	194,303	2,150	1.48%	180,619	1,460
Borrowed funds	13,189	461	4.61%	10,832	395
Junior subordinated debentures	5,155	256	6.55%	5,155	187
Total interest bearing liabilities	212,647	$2,867	1.80%	196,606	$2,042
Non-interest bearing liabilities:					
Demand deposits	37,545			32,923	
Other liabilities	1,682			2,100	
Total non-interest bearing liabilities	39,227			35,023	
Stockholders' equity	32,161			15,308	
Total Liabilities and Stockholders' Equity	$284,035			$ 246,937	
Net Interest Income and Margin (5)		$ 8,631	4.40%		$6,824

(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 $1.8 million, or 26.5%, to $8.6 million for the nine months ended September 30, 2005 compared to $6.8 million for the same nine month period in 2004. The net interest margin increased, on a fully taxable equivalent basis, by 34 basis points to 4.40% for the nine months ended September 30, 2005 compared to 4.07% for the same period in 2004.

Interest Income

Total interest income, on a fully taxable equivalent basis, increased by $2.6 million, or 29.7%, to $11.5 million for the nine months ended September 30, 2005 compared to $8.9 million in the first nine months of 2004. Total average

earning assets increased by $38.3 million to $262.2 million in the current nine month period from $223.8 million for the nine months ended September 30, 2004. The growth in higher yielding loan average balances in an increasing interest rate environment have increased the average rate earned on earning assets 57 basis points from 5.29% for the first nine months of 2004 to 5.86% in the same period in 2005.

Total interest income on securities, on a fully taxable equivalent basis, increased $252 thousand, or 11.1%, from the nine months ended September 30, 2004 to the same period in 2005. As the average balance of total securities decreased $947 thousand, the average rate earned increased 51 basis points, from 4.06% in the first nine months of 2004 to 4.57% for the same period in 2005. The increase in yield was accomplished by replacing taxable securities in the portfolio 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 nine months ended September 30, 2005 increased $36.9 million, or 26.2%, from the first nine months of 2004. The interest earned on total loans increased $2.2 million, or 34.1% as the average rate earned on loans increased 39 basis points from 6.18% for the nine months ended September 30, 2004 to 6.57% for the same period in 2005. The growth in our loan portfolio is a result of the reorganization of our loan department and success in marketing our loan products.

Interest Expense

Interest expense increased $825 thousand to $2.9 million for the nine months ended September 30, 2005 from $2.0 million for the nine months ended September 30, 2004 as the average balance in interest bearing liabilities increased $16.0 million, to $212.6 million for the first nine months of 2005 from $196.7 million in the same period in 2004. These increases were due to increases in market rates of interest and time deposit promotions. The average rate paid on interest bearing liabilities increased 41 basis points to 1.80% for the first nine months of 2005 from 1.39% for the nine months ended September 30, 2004.

The Company's interest expense on deposit liabilities for the nine months ended September 30, 2005 increased $690 thousand, or 47.3%, to $2.2 million from $1.5 million for the same period in 2004, as the average balance in interest bearing deposits increased 7.6% to $194.3 million during the first nine months of 2005 from $180.6 million for the same period a year earlier. The increase reflects the growth in time deposits through promotional rate incentives and money market deposits, largely through the increase in municipal deposits.

The average rate paid on total interest-bearing deposits has increased by 40 basis points from 1.08% for the nine months ended September 30, 2004 to 1.48% for the same period in 2005. A higher incentive rate paid on money market accounts has increased money market balances $9.4 million, or 82.1%, to $20.7 million for the first nine months of 2005 compared to $11.4 million for the nine month period ended September 30, 2004. Time deposit average balances increased by $9.4 million, or 16.4%, to $66.4 million for the first nine months of 2005 from $57.1 million for the nine month period ended 2004.

For the nine months ended September 30, 2005, the Company's average borrowed funds increased $2.4 million to $13.2 million from $10.8 million for the first nine months of 2004. The Company's $5.2 million in junior subordinated debentures bear a floating rate of interest, which averaged 6.55% for the nine months ended September 30, 2005, up 177 basis points from 4.78% in the same period of 2004.

Provision for Loan Losses

The provision for loan losses for the first nine months of 2005 was $547 thousand compared to a provision of $373 thousand in the first nine months of 2004, an increase of $174 thousand. The increase in the provision between periods was due to substantial loan growth, mainly in commercial and non-residential real estate.

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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.

The Company's non-interest income increased by $266 thousand, or 7.8%, to $3.7 million for the nine months ended September 30, 2005 from $3.4 million for the same period in 2004. Insurance commissions and fees increased 3.4% for the nine month period ended September 30, 2005 to $1.8 million from $1.7 million in the same period of 2004. Service fees on deposit accounts increased $328 thousand to $885 thousand in the first nine months of 2005 from $557 thousand during the same period in 2004. Fees from the Company's new "no-return" overdraft privilege program have increased overdraft fee income 58.9% in the first nine months of 2005 from the same period last year. Mortgage banking fees have decreased 54.2% to $209 thousand for the first nine months of 2005 from $456 thousand during the same period in 2004 due to a decline in originations during the organization of the Company's 49% joint venture with National City Mortgage, Inc. The Company recorded a $12 thousand gain on the sale of assets and $42 thousand gain on the sale of securities, available for sale during the first nine months of 2005 compared to an $11 thousand gain on the sale of securities, available for sale in the same period in 2004.

Non-Interest Expense

Total non-interest expense increased from $8.0 million in the first nine months of 2004 to $8.7 million in the first nine months of 2005, an increase of $670 thousand, or 8.4%. The largest percent increases were in professional fees, advertising and promotion and amortization of intangible assets. Professional fees have increased $147 thousand, or 61.8%, in the first nine months of 2005 to $385 thousand due to higher costs associated with the implementation of Sarbanes Oxley Act Section 404. Advertising and promotion expenses have increased $95 thousand, or 34.1%, in the first nine 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.

Income Taxes

The Company's federal and state income tax provision was $789 thousand for the nine months ended September 30, 2005 compared to $430 thousand recorded for the first nine months of 2004. This increase in income taxes resulted from an increase in income before taxes of $1.1 million, or 71.0% for the nine months ended September 30, 2005 as compared to the same period in 2004. The Company's effective tax rate of 29% for the nine month period ended September 30, 2005 and 27% for the same period in 2004 are below the statutory tax rate due to tax-exempt interest on securities and earnings on the investment in life insurance.

FINANCIAL CONDITION

September 30, 2005 as compared to December 31, 2004

At September 30, 2005 the Company had total assets of $304.0 million compared to total assets of $278.3 million at December 31, 2004, an increase of $25.7 million. Loans receivable increased $46.7 million, or 29.8%, to $203.7 million, as cash and cash equivalents, interest bearing time deposits and securities available for sale, cumulatively decreased $22.5 million at September 30, 2005 from $156.9 million at December 31, 2004. Total deposits increased to $245.1 million at September 30, 2005 from $229.8 million at December 31, 2004 and borrowings increased $8.0 million to $18.0 million at September 30, 2005.

Cash and Cash Equivalents

The Company's cash and cash equivalents decreased by $10.6 million at September 30, 2005 to $18.7 million from $29.3 million at December 31, 2004. This decrease reflects the Company's decrease in federal funds sold of $10.0 million to $8.9 million at September 30, 2005 from $18.9 million at year-end 2004. This decrease in federal funds sold helped to fund the growth in the Company's loan portfolio.

Securities Portfolio

The Company's securities, available for sale, at fair value, decreased $8.5 million from $74.7 million at December 31, 2004 to $66.2 million at September 30, 2005. The Company purchased $4.9 million in new securities during the first nine months of 2005, $9.0 million in available for sale securities matured or were repaid, $1.0 million in available for sale securities were called and there were $3.0 million in sales. Balances in state and municipal tax-exempt

securities decreased, at fair value, by $1.3 million to $24.6 million as paydowns exceeded purchases in taxable securities, at fair value, for a net decrease of $7.2 million to $41.6 million. The securities portfolio contained no high-risk securities or derivatives as of September 30, 2005. There were no held to maturity securities at September 30, 2005 or at December 31, 2004.

Loans

Total loans at September 30, 2005 increased $46.7 million, or 29.8% to $203.7 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, both bought and sold. 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 September 30, 2005. The largest increase was a $31.1 million, or 44.6%, increase in non-residential real estate loans from $69.8 million at December 31, 2004 to $100.9 million at September 30, 2005.

The increase in loans was funded during the first nine months of 2005 by a decrease in the Company's federal funds sold, cash flows from repayments and

maturities on securities as well as increased deposits and borrowings from the Federal Home Loan Bank. The loan to deposit ratios at September 30, 2005 and December 31, 2004 were 83.1% 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 $1.2 million at September 30, 2005 from $1.3 million at December 31, 2004. There were $290 thousand in past due loans over 90 days and still accruing and $49 thousand in renegotiated loans at September 30, 2005. The Company had one OREO property valued at $270 thousand at September 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)	September 30, 2005	December 31, 2
Non-accrual loans	$ 1,163	$ 1,3
Non-accrual loans to total loans	0.57%	0.
Non-performing assets to total assets	0.59%	0.
Allowance for loan losses as a % of non-performing loans	159.39%	169.
Allowance for loan losses to total loans	1.18%	1.

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. The provisions, charge-offs and recoveries for this new program are included the Company's total allowance for loan losses. At September 30, 2005, the total allowance for loan losses was $2.4 million, an increase of $120 thousand from the $2.3 million at December 31, 2004. The total provision for loan losses was $547 thousand and there were $632 thousand in charge-offs and $203 thousand in recoveries for the first nine months of 2005. The allowance for loan losses as a percentage of total loans was 1.18% at September 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 nine months of 2005, $421 thousand was charged off relating to delinquent loans and $180 thousand was charged off on the write down of a property the Company foreclosed on.

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 $15.3 million, or 6.7%, from $229.8 million at December 31, 2004 to $245.1 million at September 30, 2005. Non-interest bearing deposits increased $2.9 million, or 8.4% to $37.4 million at September 30, 2005 from $34.5 million at December 31, 2004 and interest-bearing deposits increased $12.4 million, or 6.3%, to $207.8 million at September 30, 2005 from $195.4 million at December 31, 2004. Total time deposits balances increased $13.8 million, or 21.8%, from $63.2 million at December 31, 2004 to $77.0 million at September 30, 2005 while other interest bearing deposit account balances decreased $1.4 million, or 1.1%, to $130.8 million at September 30, 2005 from $132.2 million at December 31, 2004. The shift from other interest-bearing deposits, mainly from a select savings account product for senior citizens, to time deposits, 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 advances and repurchase agreements from the Federal Home Loan Bank ("FHLB"). The advances are secured under terms of a blanket collateral agreement by a pledge of qualifying investment securities and certain mortgage loans. As of September 30, 2005 the Company had $17.0 million in notes outstanding at an average interest rate of 4.60% compared to $10.0 million in notes outstanding at an average rate of 4.85% for the year ended December 31, 2004. The borrowings consist of three long-term notes totaling $10.0 million that mature on December 21, 2010 and one $2.0 million long-term note that matures on March 29, 2015, all four with a convertible quarterly option which allows the FHLB to change the note to then current market rates. In September of 2005 the Bank took an additional $5.0 million ninety day advance from the FHLB that matures on December 20, 2005. In March of 2005 the Company purchased $2.0 million in securities sold under agreements to repurchase at an average rate of 3.63%; $1.0 million matured September 29, 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 plus 365 basis points and adjusts quarterly. The rate at September 30, 2005 was 7.25%. 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 nine 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 September 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 September 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.

	September 30, 2005			September 30,	
(Dollars in thousands)	Change in Net Interest Margin	Percent Change in Net Interest Margin	Gap as a % of Total Assets	Change in Net Interest Margin	Percent Change in Interest Mar
Down 200 basis points	($682)	-0.23%	11.39%	($681)	-0.26%
Down 100 basis points	(134)	-0.04%	4.47%	(193)	-0.07%
Up 100 basis points	(110)	-0.04%	-3.67%	(52)	-0.02%
Up 200 basis points	(279)	-0.09%	-4.66%	(165)	-0.06%

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 September 30, 2005, had the ability to borrow up to $23.9 million against its one to four family mortgages and selected investment securities as collateral for borrowings, of which the Company had outstanding borrowings totaling $17.0 million and $1.0 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 $27.7 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 September 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 September 30, 2005, liquid investments totaled $18.7 million, and all mature within 30 days.

At September 30, 2005, the Company had $66.2 million of securities classified as available for sale. Of these securities, $37.9 million had $588 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 September 30, 2005 totaled $67.9 million and consisted of $36.9 million in commitments to grant commercial real estate, construction and land development loans, $12.2 million in home equity lines of credit, and $18.9 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 $33.0 million at September 30, 2005, an increase of $1.4 million from the $31.6 million at year-end 2004. Activity in stockholders' equity consisted of net proceeds from common stock issuances of $252 thousand, a net increase in retained earnings of $1.3 million derived from $1.9 million in net income earned in the first nine months of 2005, offset by $633 thousand for the payment of cash dividends and a $185 thousand unrealized loss on securities available for sale, net of income tax of $123 thousand. The five percent stock dividend, as retroactively adjusted to stockholders' equity, reclassified $2.0 million to common stock from retained earnings.

At September 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 September 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	$35,450	12.11%	$>11,714 -	4%
Tier 1 - Risk Based	35,450	15.71.%	> 9,027 -	4%
Total Risk-Based	37,844	16.77%	>18,054 -	8%
The Bank:				
Leverage Capital	27,746	9.58%	>11,587 -	4%
Tier 1 Risk-Based	27,746	12.42%	> 8,933 -	4%
Total Risk-Based	30,140	13.50%	>17,866 -	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.

	Total Number of Shares	Average Price	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maxi Numbe Shares May Y Purch Under th

Period	Purchased	Paid per Share	or Programs	or Pro
July 1, 2005 through July 31, 2005	--	--	--	-
August 1, 2005 through August 31, 2005	11,045	$14.31	45,053	54,
September 1, 2005 through September 30, 2005	105	$14.30	45,158	54,
Total	11,150	$14.31	45,158	54,

Item 3. Defaults upon Senior Securities

Not applicable

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

Not applicable

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: November 14, 2005