COMMUNITY BANCORP /VT
Form 10-Q
May 10, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

# FORM 10-Q

[ x ] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2006

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 000-16435

COMMUNITY BANCORP.

| | |
|---|---|
| Vermont | 03-0284070 |
| (State of Incorporation) | (IRS Employer Identification Number) |
| 4811 US Route 5, Derby, Vermont | 05829 |
| (Address of Principal Executive Offices) | (zip code) |

Registrant's Telephone Number: (802) 334-7915

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file for such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ( X ) No ( )

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer ( ) Accelerated filer ( ) Non-accelerated filer ( X )

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES ( ) NO(X)

At May 10, 2006, there were 4,084,653 shares outstanding of the Corporation's common stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements (Unaudited)

The following are the consolidated financial statements for Community Bancorp. and Subsidiary, "the Company".

COMMUNITY BANCORP. AND SUBSIDIARY

Consolidated Balance Sheets

| | March 31 2006 (Unaudited) | December 31 2005 | March 31 2005 (Unaudited) |
|---|---|---|---|
| Assets | | | |
| Cash and due from banks | $ 7,950,121 | $ 11,066,745 | $ 7,743,945 |
| Federal funds sold and overnight deposits | 21,037 | 6,508,194 | 0 |
| Total cash and cash equivalents | 7,971,158 | 17,574,939 | 7,743,945 |
| Securities held-to-maturity (fair value $28,522,000 at 03/31/06, $28,444,000 at 12/31/05 and $33,514,777 at 03/31/05) | 28,464,535 | 28,391,665 | 33,514,777 |
| Securities available-for-sale | 33,389,975 | 36,454,426 | 47,690,222 |
| Restricted equity securities, at cost | 3,252,150 | 3,252,150 | 2,688,850 |
| Loans held-for-sale | 1,014,344 | 1,586,582 | 895,875 |
| Loans | 258,802,897 | 250,622,955 | 228,801,112 |
| Allowance for loan losses | (2,220,719 ) | (2,189,187 ) | (2,163,445 ) |
| Unearned net loan fees | (693,118 ) | (684,106 ) | (709,729 ) |
| Net loans | 255,889,060 | 247,749,662 | 225,927,938 |
| Bank premises and equipment, net | 11,861,406 | 11,617,119 | 8,512,366 |
| Accrued interest receivable | 1,923,659 | 1,789,251 | 1,890,800 |
| Other real estate owned, net | 0 | 0 | 10,000 |
| Other assets | 5,496,346 | 5,411,770 | 4,748,084 |
| Total assets | $ 349,262,633 | $ 353,827,564 | $ 333,622,857 |

Liabilities and Shareholders' Equity

Liabilities

| | | | |
|---|---|---|---|
| Deposits: | | | |
| Demand, non-interest bearing | $ 45,250,947 | $ 45,848,972 | $ 41,737,763 |
| NOW and money market accounts | 83,853,164 | 100,078,793 | 87,579,159 |
| Savings | 45,763,070 | 45,281,605 | 47,626,726 |
| Time deposits, $100,000 and over | 26,925,642 | 25,621,541 | 22,536,282 |
| Other time deposits | 82,905,518 | 77,481,500 | 75,337,328 |
| Total deposits | 284,698,341 | 294,312,411 | 274,817,258 |
| Federal funds purchased and other borrowed funds | 16,017,000 | 10,040,000 | 14,764,000 |
| Repurchase agreements | 16,309,660 | 17,347,140 | 14,157,457 |
| Accrued interest and other liabilities | 2,944,159 | 3,004,679 | 1,802,259 |
| Total liabilities | 319,969,160 | 324,704,230 | 305,540,974 |
| Shareholders' Equity | | | |
| Common stock - $2.50 par value; 6,000,000 shares authorized and 4,293,939 shares issued at 03/31/06, 4,279,884 shares issued at 12/31/05 and 4,050,235 shares issued at 03/31/05 | 10,734,847 | 10,699,709 | 10,125,586 |
| Additional paid-in capital | 21,507,605 | 21,324,481 | 17,961,410 |
| Retained earnings | 142,079 | 165,983 | 2,853,526 |
| Accumulated other comprehensive loss | (476,326 ) | (452,118 ) | (422,244 ) |
| Less: treasury stock, at cost; 209,511 shares at 03/31/06, 209,510 shares at 12/31/05, and 198,446 shares at 03/31/05 | (2,614,732 ) | (2,614,721 ) | (2,436,395 ) |
| Total shareholders' equity | 29,293,473 | 29,123,334 | 28,081,883 |
| Total liabilities and shareholders' equity | $ 349,262,633 | $ 353,827,564 | $ 333,622,857 |

The accompanying notes are an integral part of these consolidated financial statements.

COMMUNITY BANCORP. AND SUBSIDIARY

Consolidated Statements of Income

( Unaudited )

| For The First Quarter Ended March 31, | 2006 | 2005 |
|---|---|---|
| Interest income | | |
| Interest and fees on loans | $ 4,266,090 | $ 3,693,361 |
| Interest on debt securities | | |
| Taxable | 305,811 | 409,849 |
| Tax-exempt | 244,785 | 225,464 |

| | | |
|---|---|---|
| Dividends | 42,443 | 26,201 |
| Interest on federal funds sold and overnight deposits | 15,317 | 2,288 |
| Total interest income | 4,874,446 | 4,357,163 |
| Interest expense | | |
| Interest on deposits | 1,407,864 | 1,037,048 |
| Interest on federal funds purchased and other borrowed funds | 131,911 | 109,004 |
| Interest on repurchase agreements | 77,202 | 33,834 |
| Total interest expense | 1,616,977 | 1,179,886 |
| Net interest income | 3,257,469 | 3,177,277 |
| Provision for loan losses | 37,500 | 37,500 |
| Net interest income after provision | 3,219,969 | 3,139,777 |
| Non-interest income | | |
| Service fees | 312,185 | 285,554 |
| Other income | 357,439 | 409,035 |
| Total non-interest income | 669,624 | 694,589 |
| Non-interest expense | | |
| Salaries and wages | 1,164,530 | 1,138,471 |
| Pension and other employee benefits | 416,168 | 404,664 |
| Occupancy expenses, net | 571,898 | 513,907 |
| Other expenses | 960,630 | 894,773 |
| Total non-interest expense | 3,113,226 | 2,951,815 |
| Income before income taxes | 776,367 | 882,551 |
| Applicable income taxes | 110,425 | 152,410 |
| Net Income | $ 665,942 | $ 730,141 |
| Earnings per share based on weighted average shares outstanding | $0.16 | $0.18 |
| Weighted average number of common shares used in computing earnings per share | 4,075,565 | 4,035,562 |
| Dividends declared per share | $0.17 | $0.16 |
| Book value per share on shares outstanding at March 31, | $7.17 | $6.94 |

Per share data for 2005 has been restated to reflect a 5% stock dividend declared in May 2005.

The accompanying notes are an integral part of these consolidated financial statements.

COMMUNITY BANCORP. AND SUBSIDIARY

Consolidated Statements of Cash Flows

| (Unaudited) | | |
|---|---|---|
| For the Three Months Ended March 31, | 2006 | 2005 |
| Reconciliation of Net Income to Net Cash Provided by Operating Activities: | | |
| Net Income | $ 665,942 | $ 730,141 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| Depreciation and amortization | 217,593 | 201,389 |
| Provision for loan losses | 37,500 | 37,500 |
| Provision for deferred income taxes | (30,013 ) | 80,939 |
| Net gain on sale of loans | (56,016 ) | (80,509 ) |
| Loss on sale or disposal of fixed assets | 396 | 0 |
| Gain on investment in Trust LLC | (30,416 ) | (2,828 ) |
| Amortization of bond premium, net | 27,772 | 72,097 |
| Proceeds from sales of loans held for sale | 4,637,746 | 5,993,270 |
| Originations of loans held for sale | (4,009,492 ) | (4,975,239 ) |
| Increase (decrease) in taxes payable | 140,438 | (230,678 ) |
| Increase in interest receivable | (134,408 ) | (237,973 ) |
| Increase in mortgage servicing rights | (7,538 ) | (29,007 ) |
| Increase in other assets | (124,128 ) | (18,861 ) |
| Increase (decrease) in unamortized loan fees | 9,012 | (54,045 ) |
| (Decrease) increase in interest payable | (6,531 ) | 19,751 |
| Decrease in accrued expenses | (167,993 ) | (36,644 ) |
| Increase (decrease) in other liabilities | 9,705 | (19,996 ) |
| Net cash provided by operating activities | 1,179,569 | 1,449,307 |
| Cash Flows from Investing Activities: | | |
| Investments - held to maturity | | |
| Maturities and paydowns | 3,187,227 | 2,170,953 |
| Purchases | (3,260,096 ) | (4,102,716 ) |
| Investments - available for sale | | |
| Sales and maturities | 3,000,000 | 4,000,000 |
| Purchases | 0 | (1,000,000 ) |
| Purchase of restricted equity securities | 0 | (373,400 ) |
| Decrease (increase) in investment in limited partnership, net | 84,662 | (559,049 ) |
| (Increase) decrease in loans, net | (8,208,255 ) | (1,055,015 ) |
| Capital expenditures, net | (462,276 ) | (656,635 ) |
| Proceeds from sales of other real estate owned | 0 | 82,800 |

| | | |
|---|---|---|
| Recoveries of loans charged off | 22,345 | 16,264 |
| Net cash used in investing activities | (5,636,393 ) | (1,476,798 ) |
| Cash Flows from Financing Activities: | | |
| Net decrease in demand, NOW, money market and savings accounts | (16,342,189 ) | (7,572,915 ) |
| Net increase (decrease) in certificates of deposit | 6,728,119 | (215,698 ) |
| Net decrease in repurchase agreements | (1,037,480 ) | (750,061 ) |
| Net increase in other borrowed funds | 5,977,000 | 8,357,000 |
| Payments to acquire treasury stock | (11 ) | (33 ) |
| Dividends paid | (472,396 ) | (437,663 ) |
| Net cash used in financing activities | (5,146,957 ) | (619,370 ) |
| Net decrease in cash and cash equivalents | (9,603,781 ) | (646,861 ) |
| Cash and cash equivalents: | | |
| Beginning | 17,574,939 | 8,390,806 |
| Ending | $ 7,971,158 | $ 7,743,945 |
| Supplemental Schedule of Cash Paid During the Period | | |
| Interest | $ 1,623,508 | $ 1,160,135 |
| Income taxes | $ 0 | $ 350,000 |
| Supplemental Schedule of Noncash Investing and Financing Activities: | | |
| Change in unrealized loss on securities available-for-sale | $ (36,678 ) | $ (384,189 ) |
| Other real estate owned acquired in settlements of loans | $ 0 | $ 10,000 |
| Investments in limited partnerships | | |
| Amortization of limited partnerships | $ 84,756 | $ 84,750 |
| Decrease in contributions payable | (94 ) | (643,799 ) |
| | $ 84,662 | $ (559,049 ) |
| Dividends Paid | | |
| Dividends declared | $ 689,846 | $ 652,627 |
| Increase in dividends payable attributable to dividends declared | (91 ) | (2,178 ) |
| Dividends reinvested | (217,359 ) | (212,786 ) |
| | $ 472,396 | $ 437,663 |

The accompanying notes are an integral part of these consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1. BASIS OF PRESENTATION AND CONSOLIDATION

The interim consolidated financial statements of Community Bancorp. and Subsidiary are unaudited. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments necessary for fair presentation of the financial condition and results of operations of the Company contained herein have been made. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2005, contained in the Company's Annual Report on Form 10-K, as amended on Form 10-K/A, for the year ended December 31, 2005.

## NOTE 2. RECENT ACCOUNTING DEVELOPMENTS

Statement of Financial Accounting Standards (SFAS) No. 156, *Accounting for Servicing of Financial Assets-an amendment to FASB Statement No. 140*, requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. Servicing assets and servicing liabilities will subsequently be reported using the amortization method or the fair value measurement method. An entity should adopt this Statement as of the beginning of its first fiscal year that begins after September 15, 2006 with earlier application permitted with certain restrictions. The initial application of the fair value measurement method would be reported as a cumulative effect adjustment to beginning retained earnings. The Statement requires certain disclosures about the basis for measurement and regarding risks, activity, and fair value of servicing assets and of servicing liabilities. Management does not expect this SFAS to have a material impact on the Company's financial statements.

## NOTE 3. EARNINGS PER SHARE

Earnings per common share amounts are computed based on the weighted average number of shares of common stock issued during the period and reduced for shares held in Treasury.

## NOTE 4. COMPREHENSIVE INCOME

Accounting principles generally require recognized revenue, expenses, gains, and losses to be included in net income. Certain changes in assets and liabilities, such as the after-tax effect of unrealized gains and losses on available-for-sale securities, are not reflected in the income statement, but the cumulative effect of such items from period-to-period is reflected as a separate component of the equity section of

the balance sheet (accumulated other comprehensive income or loss). Other comprehensive income, along with net income, comprises the Company's total comprehensive income.

The Company's total comprehensive income for the quarterly comparison periods is calculated as follows:

| For the first quarter ended March 31, | 2006 | 2005 |
|---|---|---|
| Net Income | $ 665,942 | $ 730,141 |
| Other comprehensive loss, net of tax: | | |
| Change in unrealized holdings losses on available-for-sale securities arising during the period | (36,678 ) | (384,189 ) |
| Tax effect | 12,470 | 130,624 |
| Other comprehensive loss, net of tax | (24,208 ) | (253,565 ) |
| Total comprehensive income | $ 641,734 | $ 476,576 |

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
for the Period Ended March 31, 2006

FORWARD-LOOKING STATEMENTS

The Company's Management's Discussion and Analysis of Financial Condition and Results of Operations may contain certain forward-looking statements about the Company's operations, financial condition and business. When used therein, the words "believes," "expects," "anticipates," "intends," "estimates," "plans," "predicts," or similar expressions, indicate that management of the Company is making forward-looking statements.

Forward-looking statements are not guarantees of future performance. They necessarily involve risks, uncertainties and assumptions. Future results of the Company may differ materially from those expressed in these forward-looking statements. Examples of forward looking statements included in this discussion include, but are not limited to, management's expectations as to future asset growth, income trends, results of operations and other matters reflected in the Overview section, estimated contingent liability related to the Company's participation in the Federal Home Loan Bank (FHLB) Mortgage Partnership Finance (MPF) program, assumptions made within the asset/liability management process, and management's expectations as to the future interest rate environment and the Company's related liquidity level. Although these statements are based on management's current expectations and estimates, many of the factors that could influence or determine actual results are unpredictable and not within the Company's control. Readers are cautioned not to place undue reliance on such statements as they speak only as of the date they are made. The Company claims the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995.

Factors that may cause actual results to differ materially from those contemplated by these forward-looking statements include, among others, the following possibilities: (1) competitive pressures increase among financial services providers in the Company's northern New England market area or in the financial services industry generally, including competitive pressures from nonbank financial service providers, from increasing consolidation and integration of financial service providers, and from changes in technology and delivery systems; (2) interest rates change in such a way as to reduce the Company's margins; (3) general economic or monetary conditions, either nationally or regionally, are less favorable than expected, resulting in a deterioration in credit quality or a diminished demand for the Company's products and services; and (4) changes in laws or government rules, or the way in which courts interpret those laws or rules, adversely affect the Company's business.

## OVERVIEW

The following Management's Discussion and Analysis explains in detail the results of the first quarter of 2006.

Net income for the first quarter of 2006 was $665,942 or $0.16 per share versus $730,141 or $0.18 per share for the same period last year, restated for the 5% stock dividend paid on July 1, 2005. Net interest income for the first quarter of 2006 was $3.2 million compared to $3.1 million for the first quarter of 2005. The persistently flat yield curve continues to put pressure on our spreads. Loan growth with a decrease in deposits has resulted in an increased need for borrowed funds. Short-term interest rates continue to rise, but the long-term rates have stayed relatively flat. We do not expect the yield curve to steepen until some expectation of inflation introduces itself to the U. S. economy, driving long-term rates upward, or the economy weakens driving short-term rates down.

Total assets at March 31, 2006 were $349.3 million compared to $353.8 million at December 31, 2005. It is typical for the Company to see a decrease in total assets during the first quarter of the year. As of the end of the quarter, total assets had declined $4.6 million from the December 2005 levels, however total assets were $15.6 million ahead of March 2005. Asset growth, year-to-year has been primarily in loans. While our loans increased during the first quarter, our normal growth pattern for deposits is from late second quarter through early November. Many of our customers use their seasonal nest eggs to sustain them through the long winter, and replenish these funds over the summer and into the fall to then repeat the process the following year. Our municipal customers follow a similar pattern, with the bulk of their tax collections occurring during the last part of the year, which then starts their cycle of spending.

Non-interest income was down this quarter compared to the first quarter of 2005 mainly due to a decrease in real estate mortgage activity, resulting in lower fee income from sold mortgages. Non-interest expense increased by $161,411 this quarter compared to last year. While most expenses were normal increases in the cost of doing business, the amount of increase in occupancy expense from the new operation center was approximately $58,000, mainly from increases in depreciation expense and property taxes. Outside agency expenses continue to be higher than in previous years as the Company requires more frequent legal and other consulting services to maintain compliance with increased regulation.

The following pages describe the financial results of our first quarter in much more detail. Please take the time to read them to more fully understand first quarter 2006 in relation to the 2005 comparison period. The discussion below should be read in conjunction with the Consolidated Financial Statements of the Company and related notes included in this report and with the Company's Annual Report on Form 10-K, as amended on Form 10-K/A, for the year ended December 31, 2005. This report includes forward-looking statements within the meaning of the Securities and Exchange Act of 1934 (the "Exchange Act").

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared according to accounting principles generally accepted in the United States of America. The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities in the consolidated financial statements and related notes. The Securities and Exchange Commission (SEC) has defined a company's critical accounting policies as the ones that are most important to the portrayal of the Company's financial condition and results of operations, and which require the Company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Because of the significance of these estimates and assumptions, there is a high likelihood that materially different amounts would be reported for the Company under different conditions or using different assumptions or estimates.

Management evaluates on an ongoing basis its judgment as to which policies are considered to be critical. Management believes that the calculation of the allowance for loan losses (ALL) is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of the Company's consolidated financial statements. In estimating the ALL, management utilizes historical experience as well as other factors including the effect of changes in the local real estate market on collateral values, use of current economic indicators and their probable impact on borrowers and changes in delinquent, non-performing or impaired loans. Management's estimates used in the ALL may increase or decrease based on changes in these factors resulting in adjustments to the Company's provision for loan losses. Actual results could differ significantly from these estimates under different assumptions, judgments or conditions.

Occasionally, the Company acquires property in connection with foreclosures or in satisfaction of debt previously contracted. To determine the value of property acquired in foreclosure, management often obtains independent appraisals for significant properties. Because the extent of any recovery on these loans depends largely on the amount the Company is able to realize upon liquidation of the underlying collateral, the recovery of a substantial portion of the carrying amount of foreclosed real estate is susceptible to changes in local market conditions. The amount of the change that is reasonably possible cannot be estimated. In addition, the Office of the Comptroller of the Currency (OCC), the Company's primary regulatory agency, as an integral part of their examination process, periodically review the Company's allowance for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

Companies are required to perform periodic reviews of individual securities in their investment portfolios to determine whether decline in the value of a security is other than temporary. A review of other-than-temporary impairment requires companies to make certain judgments regarding the materiality of the decline, its effect on the financial statements and the probability, extent and timing of a valuation recovery and the company's intent and ability to hold the security. Pursuant to these requirements, management assesses valuation declines to determine the extent to which such changes are attributable to fundamental factors specific to the issuer, such as financial condition, business prospects or other factors or market-related factors, such as interest rates. Declines in the fair value of securities below their cost that are deemed to be other than temporary are recorded in earnings as realized losses.

Mortgage servicing rights associated with loans originated and sold, where servicing is retained, are capitalized and included in other assets in the consolidated balance sheet. Mortgage servicing rights are amortized into noninterest income in proportion to, and over the period of, estimated future net servicing income of the underlying financial assets. Mortgage servicing rights are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. The value of capitalized servicing rights represents the present value of the future servicing fees arising from the right to service loans in the portfolio. Critical accounting policies for mortgage servicing rights relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of mortgage servicing rights requires the development and use of a number of estimates, including anticipated principal amortization and prepayments of that principal balance. Events that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans. The carrying value of the mortgage servicing rights is periodically reviewed for impairment based on a determination of fair value. Impairment, if any, is recognized through a valuation allowance and is recorded as amortization of other assets.

Management utilizes numerous techniques to estimate the carrying value of various assets held by the Company, including, but not limited to, property, plant and equipment, mortgage servicing rights, and deferred taxes. The assumptions management considers in making these estimates are based on historical experience and on various other factors that are believed to be reasonable under the circumstances. Nevertheless, predictions are inherently uncertain and management acknowledges that the use of different estimates or assumptions could produce different estimates of carrying values.

RESULTS OF OPERATIONS

The Company's net income for the first quarter of 2006 was $665,942, representing a decrease of 8.8% over net income of $730,141 for the first quarter of 2005. This resulted in earnings per share of $0.16 and $0.18, respectively, for the first quarter of 2006 and 2005. Although net income after taxes was lower in the comparison, core earnings (net interest income) for the first quarter of 2006 have increased over the first quarter of 2005.

Return on average assets (ROA), which is net income divided by average total assets, measures how effectively a corporation uses its assets to produce earnings. Return on average equity (ROE), which is net income divided by average shareholders' equity, measures how effectively a corporation uses its equity capital to produce earnings. Average assets increased while net income decreased resulting in lower ROA for the first quarter of 2006 compared to the same period in 2005, and an increase in average equity coupled with a decrease in income resulted in lower ROE for the same periods. The following table shows these ratios annualized for the comparison periods.

| For the quarter ended March 31, | 2006 | 2005 |
|---|---|---|
| Return on Average Assets | .78% | .89% |
| Return on Average Equity | 9.26% | 10.57% |

INTEREST INCOME LESS INTEREST EXPENSE (NET INTEREST INCOME)

Net interest income, the difference between interest income and expense, represents the largest portion of the Company's earnings, and is affected by the volume, mix, and rate sensitivity of earning assets as well as by interest bearing liabilities, market interest rates and the amount of non-interest bearing funds which support earning assets. The three tables below provide a visual comparison of the consolidated figures, and are stated on a tax equivalent basis assuming a federal tax rate of 34%. The Company's corporate tax rate is 34%, therefore, to equalize tax-free and taxable income in the comparison, we must divide the tax-free income by 66%, with the result that every tax-free dollar is equal to $1.52 in taxable income.

The following table shows the reconciliation between reported net interest income and tax equivalent, net interest income for the three-month comparison period, of 2006 and 2005:

| For the three months ended March 31, | 2006 | 2005 |
|---|---|---|
| Net interest income as presented | $ 3,257,469 | $ 3,177,277 |
| Effect of tax-exempt income | 126,101 | 116,148 |
| Net interest income, tax equivalent | $ 3,383,570 | $ 3,293,425 |

AVERAGE BALANCES AND INTEREST RATES

The table below presents average earning assets and average interest-bearing liabilities supporting earning assets. Interest income (excluding interest on non-accrual loans) and interest expense are both expressed on a tax equivalent basis, both in dollars and as a rate/yield for the 2006 and 2005 comparison periods. Loans are stated before deduction of non-accrual loans, unearned discount and allowance for loan losses.

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| | For the Three Months Ended March 31: | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | |
| | Average Balance | Income/ Expense | Rate/ Yield | Average Balance | Income/ Expense | Rate/ Yield |
| INTEREST EARNING ASSETS | | | | | | |
| Loans (gross) | $ 256,932,478 | $ 4,266,090 | 6.73% | $ 229,456,571 | $ 3,693,361 | 6.53% |
| Taxable Investment Securities | 34,754,454 | 305,811 | 3.57% | 49,691,584 | 409,849 | 3.34% |
| Tax Exempt Investment Securities | 27,568,087 | 370,886 | 5.46% | 31,031,646 | 341,612 | 4.46% |
| Federal Funds Sold | 749,222 | 6,952 | 3.76% | 243,389 | 1,345 | 2.24% |
| Sweep Account | 705,296 | 8,365 | 4.81% | 161,461 | 943 | 2.37% |
| Other Securities | 3,284,650 | 42,443 | 5.24% | 2,570,774 | 26,201 | 4.13% |
| TOTAL | $ 323,994,187 | $ 5,000,547 | 6.26% | $ 313,155,425 | $ 4,473,311 | 5.79% |
| | | | | | | |
| INTEREST BEARING LIABILITIES | | | | | | |
| Savings Deposits | $ 45,212,425 | $ 38,852 | 0.35% | $ 46,835,239 | $ 40,333 | 0.35% |
| NOW & Money Market Funds | 91,195,121 | 444,140 | 1.98% | 90,013,517 | 302,087 | 1.36% |
| Time Deposits | 106,712,277 | 924,872 | 3.51% | 98,388,864 | 694,628 | 2.86% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Federal Funds Purchased and Other Borrowed Funds | 11,317,269 | 131,911 | 4.73% | 12,033,067 | 108,326 | 3.65% |
| Notes Payable | 0 | 0 | 0.00% | 50,000 | 678 | 5.50% |
| Repurchase Agreements | 17,495,079 | 77,202 | 1.79% | 12,685,911 | 33,834 | 1.08% |
| TOTAL | $ 271,932,171 | $ 1,616,977 | 2.41% | $ 260,006,598 | $ 1,179,886 | 1.84% |
| Net Interest Income | | $ 3,383,570 | | | $ 3,293,425 | |
| Net Interest Spread | | | 3.85% | | | 3.95% |
| Interest Differential | | | 4.24% | | | 4.27% |

(2) Net interest spread is the difference between the yield on earning assets and the rate paid on interest-bearing liabilities.

(3) Interest differential is tax equivalent net interest income divided by average earning assets.

An increase of $10.8 million is noted in the average volume of earning assets for the first three months of 2006 compared to the same period of 2005, with an increase of 47 basis points in the average yield. Interest earned on the loan portfolio accounts for approximately 85.3% of total interest income for 2006 and 82.6% for 2005. This increase is a result of an increase in short-term rates as well as an increase in loan volume throughout the 2005 and 2006 comparison periods.

In comparison, the average volume of interest bearing liabilities for the first three months of 2006 increased approximately $11.9 million over the 2005 comparison period, and the rate paid on these accounts increased 57 basis points. Interest paid on time deposits comprises 57.2% and 58.9%, respectively, of total interest expense for the 2006 and 2005 comparison periods.

As time deposits mature, some are renewing at shorter terms with lower rates, while others are being placed in CD specials at competitive rates. Some of the increase in CD balances has been due to the customers shifting money from non-maturing products into CD's. With recent increase in interest rates, the Company has seen some benefit from its asset sensitive position, as a portion of the adjustable rate loans repriced to the higher interest rates over the past few months. However, the increase in short-term rates continues to pose a challenge to the Company to manage the cost of funds. Growth in loans continues to outpace growth in deposits, requiring an increase in short-term borrowings, a more costly funding source than deposits. The yield curve remains flat (short-term rates are relatively close to long-term rates) minimizing spread income.

CHANGES IN INTEREST INCOME AND INTEREST EXPENSE

The following table summarizes the variances in interest income and interest expense on a fully tax-equivalent basis for the first three months of 2006 and 2005 resulting from volume changes in average assets and average liabilities and fluctuations in rates earned and paid.

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| | Variance | Variance |
|---|---|---|

| RATE / VOLUME | Due to Rate(1) | Due to Volume(1) | Total Variance |
|---|---|---|---|
| Loans(2) | $ 130,329 | $ 442,400 | $ 572,729 |
| Taxable Investment Securities | 27,450 | (131,488 ) | (104,038 ) |
| Tax Exempt Investment Securities | 75,904 | (46,630 ) | 29,274 |
| Federal Funds Sold | 2,813 | 2,794 | 5,607 |
| Sweep Account | 4,244 | 3,178 | 7,422 |
| Other Securities | 8,972 | 7,270 | 16,242 |
| Total Interest Earnings | $ 249,712 | $ 277,524 | $ 527,236 |
| Savings Deposits | $ (80 ) | $ (1,401 ) | $ (1,481 ) |
| NOW & Money Market Funds | 138,091 | 3,962 | 142,053 |
| Time Deposits | 171,547 | 58,697 | 230,244 |
| Other Borrowed Funds | 31,933 | (8,348 ) | 23,585 |
| Notes Payable | (678 ) | 0 | (678 ) |
| Repurchase Agreements | 30,561 | 12,807 | 43,368 |
| Total Interest Expense | $ 371,374 | $ 65,717 | $ 437,091 |
| Change in Net Interest Income | $ (121,662 ) | $ 211,807 | $ 90,145 |

(1) Items which have shown a year-to-year increase in volume have variances allocated as follows:

Variance due to rate = Change in rate x new volume

Variance due to volume = Change in volume x old rate

Items which have shown a year-to-year decrease in volume have variances allocated as follows:

Variance due to rate = Change in rate x old volume

Variances due to volume = Change in volume x new rate

(2) Loans are stated before deduction of unearned discount and allowance for loan losses. The principal balances of non-accrual loans is included in calculations of the yield on loans, while the interest on these non-performing assets is excluded.

NON INTEREST INCOME AND NON INTEREST EXPENSE

The decrease in non-interest income for the first three months of 2006 compared to the first three months of 2005 was attributable primarily to a decrease in secondary real estate market activity, generating less income from loan sales and associated fees.

The increase in non-interest expense is attributable in part to an increase of $57,991 in occupancy expenses. The

Company anticipated an increase in the form of additional depreciation expenses associated with the newly finished addition and renovations to the Company's main office. An increase of $26,059 in salaries was recognized as the result of normal salary increases. Other expense increased $65,857 in total through increases in many of the components including audit, consulting fees, and postage. Increased regulations and current legislative issues concerning banks and public companies have caused the Company to seek legal advice more frequently than in the past. Compliance with the Sarbanes Oxley Act continues to impact both legal and audit fees as the Company prepares to meet the requirements of Section 404 of the Sarbanes Oxley Act.

Management monitors all components of other non-interest expenses; however, a quarterly review is performed to assure that the accruals for these expenses are accurate. This helps alleviate the need to make significant adjustments to these accounts that in turn affect the net income of the Company.

## APPLICABLE INCOME TAXES

Consistent with the decrease in income, provisions for income taxes decreased $41,985 with figures of $110,425 for the first quarter of 2006 versus $152,410 for the same period in 2005.

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## CHANGES IN FINANCIAL CONDITION

The following table reflects the composition of the Company's major categories of assets and liabilities as of the dates indicated:

| ASSETS | March 31, 2006 | | December 31, 2005 | | March 31, 2005 | |
|---|---|---|---|---|---|---|
| Loans (gross) | $ 259,817,241 | 74.39% | $ 252,209,537 | 71.28% | $ 229,696,987 | 68.85% |
| Available for Sale Securities | 33,389,975 | 9.56% | 36,454,426 | 10.30% | 47,690,222 | 14.29% |
| Held to Maturity Securities | 28,464,535 | 8.15% | 28,391,665 | 8.02% | 33,514,777 | 10.05% |
| LIABILITIES | | | | | | |
| Savings Deposits | $ 45,763,070 | 13.10% | $ 45,281,605 | 12.80% | $ 47,626,726 | 14.28% |
| NOW & Money Market Funds | 83,853,164 | 24.01% | 100,078,793 | 28.28% | 87,579,159 | 26.25% |
| Time Deposits | 109,831,160 | 31.45% | 103,103,041 | 29.14% | 97,873,610 | 29.34% |

The Company's commercial loan portfolio increased during the first quarter of 2006, due primarily to new loans of substantial size. The goal of the Company for 2005 was to increase the in-house loan portfolio. This goal was accomplished, accounting for the increase in loans from March 31, 2005 to December 31, 2005. Funding for these new loans was accomplished in part through maturities in the Company's available-for-sale investment portfolio, accounting for the decrease in these assets from March 31, 2005 to March 31, 2006. The Company's goal for 2006 is to increase secondary real estate market activity in the residential mortgage portfolio and to increase the commercial loan portfolio. Competitive Certificate of Deposit rates were offered throughout 2005 and into the first quarter of 2006, accounting for the increase in this deposit category throughout the comparison periods, while also adding another source of funding, with the difference coming in the form of short-term borrowings and maturities in the available-for-sale securities portfolio.

## RISK MANAGEMENT

*Interest Rate Risk and Asset and Liability Management* - Management actively monitors and manages its interest rate risk exposure and attempts to structure the balance sheet to maximize net interest income while controlling its exposure to interest rate risk. The Company's Asset/Liability Management Committee (ALCO) formulates strategies to manage interest rate risk by evaluating the impact on earnings and capital of such factors as current interest rate forecasts and economic indicators, potential changes in such forecasts and indicators, liquidity, and various business strategies. The ALCO meets monthly to review financial statements, liquidity levels, yields and spreads to better understand, measure, monitor and control the Company's interest rate risk. In the ALCO process, the committee members apply policy limits set forth in the Asset Liability, Liquidity and Investment policies approved by the Company's Board of Directors. The ALCO's methods for evaluating interest rate risk include an analysis of the effects of interest rate changes on net interest income and an analysis of the Company's interest rate sensitivity "gap", which provides a static analysis of the maturity and repricing characteristics of the entire balance sheet.

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with the Company's interest sensitive assets and liabilities also change, thereby impacting net interest income (NII), the primary component of the Company's earnings. Fluctuations in interest rates can also have an impact on liquidity. The ALCO uses an outside consultant to perform quarterly rate shock simulations to the Company's net interest income, as well as a variety of other analyses. It is the ALCO's function to provide the assumptions used in the modeling process. The ALCO utilizes the results of this simulation model to quantify the estimated exposure of NII and liquidity to sustained interest rate changes. The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. Furthermore, the model simulates the balance sheet's sensitivity to a prolonged flat rate environment. All rate scenarios are simulated assuming a parallel shift of the yield curve; however further simulations are performed utilizing a flattening yield curve as well. This sensitivity analysis is compared to the ALCO policy limits which specify a maximum tolerance level for NII exposure over a 1-year horizon, assuming no balance sheet growth, given a 200 basis point (bp) shift upward and a 100 bp shift downward in interest rates. The analysis also provides a summary of the Company's liquidity position. Furthermore, the analysis provides testing of the assumptions used in previous simulation models by comparing the projected NII with actual NII. The asset/liability simulation model provides management with an important tool for making sound economic decisions regarding the balance sheet.

While assumptions are developed based upon current economic and local market conditions, the Company cannot provide any assurances as to the predictive nature of these assumptions, including how or when customer preferences or competitor influences might change.

***Credit Risk*** - A primary concern of management is to reduce the exposure to credit loss within the loan portfolio. Management follows established underwriting guidelines, and any exceptions to the policy must be approved by a loan officer with higher authority than the loan officer originating the loan. The adequacy of the loan loss coverage is reviewed quarterly by the risk management committee of the Board of Directors. This committee meets to discuss, among other matters, potential exposures, historical loss experience, and overall economic conditions. Existing or potential problems are noted and addressed by senior management in order to assess the risk of probable loss or delinquency. A variety of loans are reviewed periodically by an independent firm in order to assure accuracy of the Company's internal risk ratings and compliance with various internal policies and procedures, as well as those set by the regulatory authorities. The Company also employs a Credit Administration Officer whose duties include monitoring and reporting on the status of the loan portfolio including delinquent and non-performing loans.

The expansion into Central Vermont has given the Company an opportunity to diversify the geographic risk in the loan portfolio with loans from a stronger economic community. When the Company expanded into the new market in Central Vermont, experienced lenders were hired and trained to be sure that the same high level of standards would be followed for the loans originated in this new market; all credit administration and underwriting is centralized to ensure consistency.

*The following table reflects the composition of the Company's loan portfolio as of the dates indicated:*

| | March 31, 2006 | | December 31, 2005 | |
|---|---|---|---|---|
| | Total Loans | % of Total | Total Loans | % of Total |
| Real Estate Loans | | | | |
| Construction & Land Development | $ 12,579,663 | 4.84% | $ 13,931,238 | 5.52% |
| Farm Land | 2,771,877 | 1.07% | 2,870,364 | 1.14% |
| 1-4 Family Residential | 137,515,666 | 52.93% | 133,612,177 | 52.97% |
| Home Equity Lines | 11,415,271 | 4.39% | 11,165,413 | 4.43% |
| Commercial Real Estate | 50,730,395 | 19.53% | 48,504,553 | 19.23% |
| Loans to Finance Agricultural Production | 187,929 | 0.07% | 213,692 | 0.09% |
| Commercial & Industrial | 23,719,868 | 9.13% | 20,049,163 | 7.95% |
| Consumer Loans | 20,148,748 | 7.75% | 21,295,619 | 8.44% |
| All Other Loans | 747,824 | 0.29% | 567,318 | 0.23% |
| Gross Loans | 259,817,241 | 100% | 252,209,537 | 100% |
| Less: | | | | |
| Allowance for Loan Losses | (2,220,719 ) | -0.85% | (2,189,187 ) | -0.87% |
| Deferred Loan Fees | (693,118 ) | -0.27% | (684,106 ) | -0.27% |
| Net Loans | $ 256,903,404 | 98.88% | $ 249,336,244 | 98.86% |

Allowance for loan losses and provisions

- The Company continues to maintain an allowance for loan losses at a level that management believes is adequate to absorb losses inherent in the loan portfolio. As of March 31, 2006, the Company maintained a residential loan portfolio (including home equity lines of credit) of $148.9 million, compared to $144.8 million at December 31, 2005, accounting for 57.3% and 57.4%, respectively, of the total loan portfolio. The commercial real estate portfolio (including construction, land development and farmland loans) totaled $66.1 million and $65.3 million, respectively, for March 31, 2006 and December 31, 2005, comprising 25.4% and 25.9%, respectively, of the total loan portfolio. The Company's commercial loan portfolio includes loans that carry guarantees from government programs, thereby mitigating the Company's credit risk on such loans. In addition, at March 31, 2006, the Company had $18.1 million in guaranteed loans, compared to $18.7 million at December 31, 2005. The volume of residential and commercial loans secured by real estate, together with the low historical loan loss experience in these portfolios, helps to support the Company's basis for loan loss coverage. Furthermore, the Company is committed to a conservative lending philosophy and maintains high credit and underwriting standards. In establishing the ALL, management uses qualitative factors to simulate current lending conditions. The lenders and credit administration staffs are highly skilled and dedicated to the high standards and expectations of the Company.

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The following table summarizes the Company's loan loss experience for the three months ended March 31,

| | 2006 | 2005 |
|---|---|---|
| Loans Outstanding End of Period | $ 259,817,241 | $ 229,696,987 |
| Average Loans Outstanding During Period | $ 256,932,478 | $ 229,456,571 |
| Loan Loss Reserve, Beginning of Period | $ 2,189,187 | $ 2,153,372 |
| Loans Charged Off: | | |
| Residential Real Estate | 0 | 4,602 |
| Commercial Real Estate | 0 | 0 |
| Commercial Loans not Secured by Real Estate | 13,266 | 10,000 |
| Consumer Loans | 15,047 | 29,089 |
| Total Loans Charged Off | 28,313 | 43,691 |
| Recoveries: | | |
| Residential Real Estate | 300 | 610 |
| Commercial Real Estate | 0 | 0 |
| Commercial Loans not Secured by Real Estate | 316 | 3,632 |
| Consumer Loans | 21,729 | 12,022 |
| Total Recoveries | 22,345 | 16,264 |
| Net Loans Charged Off | 5,968 | 27,427 |
| Provision Charged to Income | 37,500 | 37,500 |
| Loan Loss Reserve, End of Period | $ 2,220,719 | $ 2,163,445 |

Non-performing assets for the comparison periods were as follows:

| | March 31, 2006 | | December 31, 2005 | |
|---|---|---|---|---|
| | Balance | Percent of Total | Balance | Percent of Total |
| Non-Accruing loans | $ 840,621 | 77.97% | $ 436,419 | 71.16% |
| | 237,544 | 22.03% | 176,885 | 28.84% |

| | | | | |
|---|---|---|---|---|
| Loans past due 90 days or more and still accruing | | | | |
| Total | $ 1,078,165 | 100.00% | $ 613,304 | 100.00% |

Other Real Estate Owned consists of property that the Company has acquired by deed in lieu of foreclosure or through normal foreclosure proceedings, and property that the Company does not hold title to but is in actual control of, known as in-substance foreclosure. The estimated fair value of the property is determined prior to transferring the balance to Other Real Estate Owned. The balance transferred to OREO is the lesser of the estimated fair market value of the property, or the book value of the loan, less estimated cost to sell. Appraisals or loan officer evaluations are then done periodically in accordance with the OREO Policy and if deemed necessary, a write-down may be made to bring the book value of the loan equal to the appraised value, charging such subsequent write-down to the appropriate expense account.

A recent federal bankruptcy court decision held that, under Vermont law, when there is any significant equity value in excess of the debt owed to the foreclosing party, the forfeiture of the value through Strict Foreclosure may result in a challenge to the transfer in the event of a bankruptcy filing by the borrower who lost the property through foreclosure. The Vermont strict foreclosure process results in a foreclosure that is subject to challenge as a fraudulent transfer, whenever the value of the property exceeds the debt. Therefore, in a foreclosure situation where equity is available, we request an order for public sale rather than taking property into OREO directly through strict foreclosure or otherwise.

As of March 31, 2006 and December 31, 2005, the Company had no OREO properties in its portfolio.

Specific allocations are made in the allowance for loan losses in situations management believes may represent a greater risk for loss. In addition, a portion of the allowance (termed "unallocated") is established to absorb inherent losses that probably exist as of the valuation date although not identified through management's objective processes for estimated credit losses. A quarterly review of various qualitative factors, including levels of, and trends in, delinquencies and non-accruals and national and local economic trends and conditions, helps to ensure that areas with potential risk are noted and coverage increased or decreased to reflect the trends in delinquencies and non-accruals. Residential mortgage loans make up the largest part of the loan portfolio and have the lowest historical loss ratio, helping to alleviate the overall risk. While the allowance is described as consisting of separate allocated portions, the entire allowance is available to support loan losses, regardless of category.

*Market Risk* - In addition to credit risk in the Company's loan portfolio and liquidity risk, the Company's business activities also generate market risk. Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. The Company does not have any market risk sensitive instruments acquired for trading purposes. The Company's market risk arises primarily from interest rate risk inherent in its lending, investing, and deposit taking activities. Interest rate risk is directly related to the different maturities and repricing characteristics of interest-bearing assets and liabilities, as well as to loan prepayment risks, early withdrawal of time deposits, and the fact that the speed and magnitude of responses to interest rate changes vary by product. As discussed above under "Interest Rate Risk and Asset and Liability Management", the Company actively monitors and manages its interest rate risk through the ALCO process.

FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. During the first three months of 2006, there has not been any activity that has created any additional types of off-balance-sheet risk.

The Company generally requires collateral or other security to support financial instruments with credit risk. The Company's financial instruments whose contract amount represents credit risk as of March 31, 2006 are as follows:

| | Contract or Notional Amount |
|---|---|
| Unused portions commercial lines of credit | $ 5,833,960 |
| Unused portions of home equity lines of credit | 9,745,661 |
| Other commitments to extend credit | 10,225,440 |
| Unused portions of credit card lines | 9,479,248 |
| Standby letters of credit and commercial letters of credit | 1,271,135 |
| MPF credit enhancement obligation, net of liability recorded | 1,069,389 |

Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

AGGREGATE CONTRACTUAL OBLIGATIONS

The following table presents, as of March 31, 2006, significant fixed and determinable contractual obligations to third parties, by payment date:

| | Less than 1 year | 2-3 years | 4-5 years | More than 5 years | Total |
|---|---|---|---|---|---|
| Operating Leases | $ 166,604 | $ 337,087 | $ 346,046 | $ 972,334 | $ 1,822,071 |
| Housing Limited Partnerships | 433,233 | 123,527 | 0 | 0 | 556,760 |
| FHLB Borrowings | 10,977,000 | 30,000 | 0 | 5,010,000 | 16,017,000 |
| Total | $ 11,576,837 | $ 490,614 | $ 346,046 | $ 5,982,334 | $ 18,395,831 |

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LIQUIDITY AND CAPITAL RESOURCES

Managing liquidity risk is essential to maintaining both depositor confidence and stability in earnings. Liquidity management refers to the ability of the Company to adequately cover fluctuations in assets and liabilities. Meeting loan demand (assets) and covering the withdrawal of deposit funds (liabilities) are two key components of the liquidity management process. The Company's principal sources of funds are deposits, amortization and prepayment of loans and securities, maturities of investment securities, sales of loans available for sale, and earnings and funds provided from operations. Maintaining a relatively stable funding base, which is achieved by diversifying funding sources, competitively pricing deposit products, and extending the contractual maturity of liabilities, reduces the Company's exposure to roll over risk on deposits and limits reliance on volatile short-term borrowed funds. Short-term funding needs arise from declines in deposits or other funding sources and funding of loan commitments. The Company's strategy is to fund assets to the maximum extent possible with core deposits that provide a sizable source of relatively stable and low-cost funds.

The Company's investment portfolio has decreased approximately $3.0 million through maturities in its available-for-sale portfolio, while the loan portfolio increased $7.6 million during the first three months of 2006. On the liability side, NOW and money market accounts decreased $16.2 million, while time deposits increased approximately $6.7 million. Other borrowed funds increased $6 million in order to fund a portion of the increase in the loan portfolio.

The Company has a $4.3 million credit line with the Federal Home Loan Bank of Boston (FHLB) with an available balance of the same at March 31, 2006. Interest is chargeable at a rate determined daily approximately 25 basis points higher than the rate paid on federal funds sold. Additional borrowing capacity of approximately $85.6 million through the FHLB is secured by the Company's qualifying loan portfolio.

As of March 31, 2006, the Company had total advances of $16.0 million against the $85.6 million. The advances with maturity dates greater than a year with higher interest rates are subject to a substantial pre-payment penalty. Although the rates are higher than the current market, the imposed penalty far outweighs the interest charged. The Company's outstanding advances consist of the following:

| Purchase Date | Annual Rate | Maturity Date | Principal Balance |
|---|---|---|---|
| March 27, 2006 | 4.97% | June 27, 2006 | $ 3,000,000 |
| November 16, 1992 | 7.57% | November 16, 2007 | 30,000 |
| November 16, 1992 | 7.67% | November 16, 2012 | 10,000 |
| January 16, 2001 | 4.78% | January 18, 2011 | 5,000,000 |
| Total Long-term Advances | | | $ 8,040,000 |
| Federal Funds Purchased | | | $ 7,977,000 |

Under a separate agreement with FHLB, the Company has the authority to collateralize public unit deposits, up to its FHLB borrowing capacity ($85.6 million less outstanding advances noted above) with letters of credit issued by the FHLB. At March 31, 2006, approximately $52.3 million was pledged, under this agreement, as collateral for these deposits. Interest is charged to the Company quarterly based on the average daily balance for the quarter at an annual rate of 20 basis points. The average daily balance for the first quarter of 2006, was approximately $15.1 million.

In December 2005, the Company declared a cash dividend of $0.17 per share, payable in the first quarter of 2006, requiring an accrual of $691,964 during the fourth quarter of 2005. In March 2006, the Company declared a cash dividend of $0.17 per share, payable in the second quarter of 2006, requiring an accrual of $692,054 at March 31, 2006.

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The following table illustrates the changes in shareholders' equity from December 31, 2005 to March 31, 2006:

| | |
|---|---|
| Balance at December 31, 2005 (book value $7.15 per share) | $ 29,123,334 |
| Net income | 665,942 |
| Issuance of stock | 218,262 |
| Purchase of treasury stock (fractional share redemption) | (11 ) |
| Total Dividends declared | (689,846 ) |
| Change in unrealized gains on available-for-sale securities, net of tax | (24,208 ) |
| Balance at March 31, 2006 (book value $7.29 per share) | $ 29,293,473 |

At March 31, 2006, the Company reported that of the 405,000 shares authorized for the stock buyback plan, 178,890 shares have been purchased, leaving 226,110 shares available for repurchase. The repurchase price paid for these shares ranged from $9.75 per share in May of 2000 to $16.50 per share paid in September of 2005. During the first three months of 2006, the Company did not repurchase any shares pursuant to the buyback authority. The last purchase was December 23, 2005 in which 4,938 shares were repurchased at a price of $16.00 per share. For additional information on stock repurchases by the Company and affiliated purchasers (as defined in SEC Rule 10b-18) refer to Part II, Item 2 of this Report.

The primary source of funds for the Company's payment of dividends to its shareholders is dividends paid to the Company by the Bank. The Bank, as a national bank, is subject to the dividend restrictions set forth in the National Bank Act, implemented by the Office of the Comptroller of the Currency ("OCC"). Under such restrictions, the Bank may not, without the prior approval of the OCC, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained earnings (as defined) from the prior two years.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Under current guidelines, banks must maintain a risk-based capital ratio of 8.0%, of which at least 4.0% must be in the form of core capital (as defined). The risk-based ratios of the Company and its Subsidiary exceeded regulatory guidelines at March 31, 2006 with reported risk-weighted assets of $222.3 million compared to $216.8 million at December 31, 2005 and total capital of $32.0 million and $31.8 million, respectively. The Company's total risk-based capital to risk-weighted assets was 14.39% and 14.65% at March 31, 2006 and December 31, 2005, respectively. The Company's Tier 1 capital to risk-weighted assets was 13.39% and 13.64% at March 31, 2006 and December 31, 2005, respectively. In addition to risk-based capital requirements, bank holding companies are required to maintain minimum leverage capital ratios of core capital to average assets of $4.0%. The Company exceeded these requirements with leverage ratios of 8.55% as of March 31, 2006, and 8.37% at December 31, 2005.

Regulators have also established guidelines for minimum capital ratio requirements that define a bank as well-capitalized under prompt corrective action provisions. These minimums are risk-based capital ratio of 10.0% and Tier 1 capital ratio of 6.0%. As of March 31, 2006, the Company and its Subsidiary were deemed well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that time that management believes have changed the Company's classification.

The Company intends to continue the past policy of maintaining a strong capital resource position to support its asset size and level of operations. Consistent with that policy, management will continue to anticipate the Company's future capital needs.

From time to time the Company may make contributions to the capital of Community National Bank. At present, regulatory authorities have made no demand on the Company to make additional capital contributions.

## ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

The Company's management of the credit, liquidity and market risk inherent in its business operations is discussed in Part 1, Item 2 of this report under the caption "RISK MANAGEMENT", as well as in the Company's 2005 annual report on form 10-K. Management does not believe that there have been any material changes in the nature or categories of the Company's risk exposures from those disclosed in such 10-K report.

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## ITEM 4. Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, the Company has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chairman and Chief Executive Officer and its President and Chief Operating Officer (Chief Financial Officer). Based upon that evaluation, such officers concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. There were no changes during the Company's last fiscal quarter in the Company's internal control over financial reporting identified in connection with the evaluation of the Company's disclosure controls and procedures that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

# PART II. OTHER INFORMATION

## ITEM 1. Legal Proceedings

The Company and/or its Subsidiary are subject to various claims and legal actions that have arisen in the normal course of business. Management does not expect that the ultimate disposition of these matters, individually or in the aggregate, will have a material adverse impact on the Company's financial statements.

ITEM 1A. Risk Factors

There has been no material change in the Company's risk factors described in its Annual Report on Form 10-K, as amended on Form 10-K/A, for the year ended December 31, 2005.

ITEM 2. Unregistered Sales of Securities and Use of Proceeds

The following table provides information as to purchases of the Company's common stock during the first quarter ended March 31, 2006, by the Company and by any affiliated purchaser (as defined in SEC Rule 10b-18):

| For the month ended: | Total Number of Shares Purchased(1)(2) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan(3) | Maximum Number of Shares That May Yet Be Purchased Under the Plan at the End of the Period |
|---|---|---|---|---|
| January 1 - January 31 | 500 | $15.75 | 0 | 226,110 |
| February 1 - February 28 | 2,416 | $15.36 | 0 | 226,110 |
| March 1 - March 31 | 6,000 | $15.91 | 0 | 226,110 |
| Total | 8,916 | $15.75 | 0 | 226,110 |

(1) All 8,916 shares were purchased for the account of participants invested in the Company Stock Fund under the Company's Retirement Savings Plan by or on behalf of the Plan Trustee, the Human Resources Committee of Community National Bank. Such share purchases were facilitated through Community Financial Services Group, LLC ("CFSG"), which provides certain investment advisory services to the Plan. Both the Plan Trustee and CFSG may be considered affiliates of the Company under Rule 10b-18. All purchases by the Plan were made in the open market in brokerage transactions and reported on the OTC Bulletin Board©.

(2) Shares purchased during the period do not include fractional shares repurchased from time to time in connection with the participant's election to discontinue participation in the Company's Dividend Reinvestment Plan.

(3) The Company's Board of Directors in April, 2000 initially authorized the repurchase from time to time of up to 205,000 shares of the Company's common stock in open market and privately negotiated transactions, in management's discretion and as market conditions may warrant. The Board extended this authorization on October 15, 2002 to repurchase an additional 200,000 shares, with an aggregate limit for such repurchases under both authorizations of $3.5 million. The approval did not specify a termination date.

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ITEM 6. Exhibits

Exhibit 31.1 - Certification from the Chief Executive Officer of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2 - Certification from the Chief Financial Officer of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1 - Certification from the Chief Executive Officer of the Company pursuant to 18 U.S.C., Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002*
Exhibit 32.2 - Certification from the Chief Financial Officer of the Company pursuant to 18 U.S.C., Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002*

*This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Act of 1934.

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## SIGNATURES

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

COMMUNITY BANCORP.

By: /s/ Richard C. White

DATED: May 10, 2006

Richard C. White, Chairman &
Chief Executive Officer

DATED: May 10, 2006

By: /s/ Stephen P. Marsh
Stephen P. Marsh, President &
Chief Operating Officer
(Chief Financial Officer)