EAGLE BANCORP INC
Form 10-Q
August 09, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2005

OR

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

For the transition period from _____ to_____.

Commission File Number 0-25923

EAGLE BANCORP, INC
(Exact name of registrant as specified in its charter)

Maryland	52-2061461
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7815 Woodmont Avenue, Bethesda, Maryland	20814
(Address of principal executive offices)	(Zip Code)

(301) 986-1800
(Registrant's telephone number, including area code)

N/A
(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 Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes (X) No ( )

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act Yes (X) No ( )

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of July 26, 2005, the registrant had 7,096,047 shares of Common Stock outstanding.

ITEM 1 - FINANCIAL STATEMENTS

EAGLE BANCORP, INC.
Consolidated Balance Sheets
June 30, 2005 and December 31, 2004
(dollars in thousands)

ASSETS	June 30, 2005	December 31, 2004
Cash and due from banks	$ 24,577	$ 31,100
Interest bearing deposits with banks and other short term investments	10,689	9,594
Federal funds sold	2,002	15,035
Investment securities available for sale, at fair value	71,035	64,098
Loans held for sale	3,646	2,208
Loans	481,769	415,509
Less allowance for credit losses	(5,155)	(4,240)
Loans, net	476,614	411,269
Premises and equipment, net	5,962	5,726
Accrued interest, taxes and other assets	15,575	14,423
TOTAL ASSETS	$ 610,100	$ 553,453
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest bearing demand	$ 146,039	$ 130,309
Interest bearing transaction	74,525	57,063
Savings and money market	128,201	126,299
Time, $100,000 or more	116,183	99,882
Other time	51,492	48,734
Total deposits	516,440	462,287
Customer repurchase agreements and federal funds purchased	26,352	23,983
Other short-term borrowings	4,333	6,333
Other liabilities	1,920	2,316
Total liabilities	549,045	494,919
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value; shares authorized 20,000,000, shares issued and outstanding 7,095,397 (2005) and 5,421,730 (2004)	71	54
Additional paid in capital	47,505	47,014
Retained earnings	13,584	11,368
Accumulated other comprehensive (loss) gain	(105)	98
Total stockholders' equity	61,055	58,534

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 610,100	$ 553,453

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Operations
For the Six and Three Month Periods Ended June 30, 2005 and 2004 (unaudited)
(dollars in thousands, except per share data)

	Six months Ended June 30, 2005	Six months Ended June 30, 2004
INTEREST INCOME		
Interest and fees on loans	$ 14,859	$ 9,753
Taxable interest and dividends on investment securities	1,256	1,052
Interest on balances with other banks & short term investments	119	61
Interest on federal funds sold	128	123
Total interest income	16,362	10,989
INTEREST EXPENSE		
Interest on deposits	2,734	1,716
Interest on customer repurchase agreements and federal funds purchased	103	34
Interest on short-term borrowings	105	85
Interest on long-term borrowings	-	178
Total interest expense	2,942	2,013
NET INTEREST INCOME	13,420	8,976
PROVISION FOR CREDIT LOSSES	887	230
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	12,533	8,746
NONINTEREST INCOME		
Service charges on deposits	592	709
Gain on sale of loans	642	389
Gain on sale of investment securities	12	253
Other income	680	556
Total noninterest income	1,926	1,907
NONINTEREST EXPENSE		
Salaries and employee benefits	5,234	3,901
Premises and equipment expenses	1,617	1,270
Advertising	207	159
Outside data processing	385	286
Other expenses	1,933	1,508
Total noninterest expense	9,376	7,124

INCOME BEFORE INCOME TAX EXPENSE	5,083	3,529
INCOME TAX EXPENSE	1,874	1,277
NET INCOME	$ 3,209	$ 2,252
EARNINGS PER SHARE		
Basic	$ 0.45	$ 0.32
Diluted	$ 0.43	$ 0.31

See notes to consolidated financial statements.

EAGLE BANCORP, INC.
Consolidated Statements of Cash Flows
For the Six Month Periods Ended June 30, 2005 and 2004 (unaudited)
(dollars in thousands)

	Six months Ended June 30, 2005	Six Jun
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,209	$
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
(Decrease) in deferred income taxes	-	
Provision for credit losses	887	
Depreciation and amortization	522	
Gains on sale of loans	(642)	
Origination of loans held for sale	(17,983)	
Proceeds from sale of loans held for sale	17,187	
Gain on sale of investment securities	(12)	
Decrease in other assets	(1,152)	
(Decrease) Increase in other liabilities	(281)	
Net cash provided by operating activities	1,735	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in interest bearing deposits with other banks	(1,095)	
Purchases of available for sale investment securities	(13,029)	
Proceeds from maturities of available for sale securities	2,786	
Proceeds from sale / called of available for sale securities	3,000	
Decrease (Increase) in federal funds sold	13,033	
Net increase in loans	(66,232)	
Bank premises and equipment acquired	(758)	
Purchase of BOLI	-	
Net cash used in investing activities	(62,295)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in deposits	54,153	
Increase (decrease) in customer repurchase agreements and federal funds purchased	2,369	
Decrease in other short-term borrowings	(2,000)	
Decrease in long-term borrowings	-	

Issuance of common stock	512	
Payment of dividends	(997)	
Net cash provided by financing activities	54,037	
NET (DECREASE) INCREASE IN CASH	(6,523)	
CASH AND DUE FROM BANKS AT BEGINNING OF YEAR	31,100	
CASH AND DUE FROM BANKS AT END OF YEAR	$ 24,577	$
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Interest paid	$ 2,709	$
Income taxes paid	$ 2,410	$

EAGLE BANCORP, INC.
Consolidated Statements of Changes in Stockholders' Equity
For the Six Month Periods Ended June 30, 2005 and 2004 (unaudited)
(dollars in thousands)

	Common Stock	Additional Paid in Capital	Paid Retained Earnings	Acc Comp Inco
Balance, January 1, 2005	$ 54	$ 47,014	$ 11,368	
Net Income			3,209	
Cash Dividend ($ .14 per share)			(993)	
1.3 to one stock split in the form of a 30% stock dividend	17	(17)		
Cash paid in lieu of fractional shares		(4)		
Exercise of options for 48,214 shares of common stock		454		
Tax benefit on non-qualified options exercise		58		
Other Comprehensive Income Unrealized loss on securities available for sale (net of taxes)				
Balance, June 30, 2005	$ 71	$ 47,505	$ 13,584	
Balance, January 1, 2004	$ 54	$ 46,406	$ 6,281	
Net Income			2,252	
Exercise of options for 44,954 shares				

of common stock			338	
Other Comprehensive Income				
Unrealized gain on securities available for sale (net of taxes)				
Balance, June 30, 2004	$ 54	$ 46,744	$ 8,533	

EAGLE BANCORP, INC
Notes to Consolidated Financial Statements
For the six and three months ended June 30, 2005 and 2004
(unaudited)

1. BASIS OF PRESENTATION

General - The financial statements of Eagle Bancorp, Inc. (the "Company") included herein are unaudited; however, they reflect all adjustments consisting only of normal recurring accruals that, in the opinion of Management, are necessary to present fairly the results for the periods presented. The amounts as of December 31, 2004 were derived from audited consolidated financial statements. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. There have been no significant changes to the Company's Accounting Policies as disclosed in the 2004 Annual Report. The Company believes that the disclosures are adequate to make the information presented not misleading. The results of operations for the six and three months ended June 30, 2005 are not necessarily indicative of the results of operations to be expected for the remainder of the year, or for any other period.

2. NATURE OF BUSINESS

The Company, through its bank subsidiary, provides domestic financial services primarily in Montgomery County, Maryland and Washington, DC. The primary financial services include real estate, commercial and consumer lending, as well as traditional deposit and repurchase agreement products. The Bank is also active in the origination and sale of residential mortgages and small business loans. A new noninterest income business was organized in the first quarter of 2005, which provides professional services in connection with loan settlement processes.

3. INVESTMENT SECURITIES

Amortized cost and estimated fair value of securities available for sale are summarized as follows:

(in thousands)

JUNE 30, 2005	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses

U. S. Government agency securities	$ 44,005	$ 23	$ 441
GNMA mortgage backed securities	20,557	32	303
Federal Reserve and Federal Home Loan Bank stock	2,304	-	-
Other equity investments	4,339	522	3
	$ 71,205	$ 577	$ 747

DECEMBER 31, 2004	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
U. S. Government agency securities	$ 34,478	$ -	$ 294
GNMA mortgage backed securities	23,177	77	188
Federal Reserve and Federal Home Loan Bank stock	1,956	-	-
Other equity investments	4,339	555	2
	$ 63,950	$ 632	$ 484

Gross unrealized losses and fair value by length of time that the individual available securities have been in a continuous unrealized loss position as of June 30, 2005 are as follows:

JUNE 30, 2005 (IN THOUSANDS)	Estimated Fair Value	Less than 12 months	More than 12 months
U. S. Government agency securities	$ 43,587	$ 104	$ 337
GNMA mortgage backed securities	20,286	30	273
Federal Reserve and Federal Home Loan Bank stock	2,304	-	-
Other equity investments	4,858	-	3
	$ 71,035	$ 134	$ 613

DECEMBER 31, 2004 (IN THOUSANDS)	Estimated Fair Value	Less than 12 months	More than 12 months
U. S. Government agency securities	$ 34,184	$ 221	$ 73
GNMA mortgage backed securities	23,066	21	167
Federal Reserve and Federal Home Loan Bank stock	1,956	-	-
Other equity investments	4,892	-	2

$ 64,098	$ 242	$ 242

The unrealized losses that exist are the result of market changes in interest rates since the original purchases. All of the bonds are rated AAA. These factors coupled with the Company's ability and intent to hold these investments for a period of time sufficient to allow for any anticipated recovery in fair value substantiates that the unrealized losses are temporary in nature.

4. INCOME TAXES

The Company uses the liability method of accounting for income taxes as required by Statement of Financial Accounting Standards No. 109 (SFAS109), "Accounting for Income Taxes." Under the liability method, deferred-tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse.

5. EARNINGS PER SHARE

Earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period, including any potential dilutive common shares outstanding, such as options and warrants. As of June 30, 2005 there were no option shares excluded from the diluted net income per share computation. Earnings per share for the six and three month periods ended June 30, 2004, have been adjusted to reflect a 1.3 for one stock split in the form of a 30% stock dividend effected on February 28, 2005.

6. STOCK BASED COMPENSATION

The Company has adopted the disclosure-only provisions of SFAS No. 123 "Accounting for Stock-Based Compensation" and applies the intrinsic value method of recognition and measurement principles of Accounting Principles Board Opinion No.25 and related interpretations in accounting for its Plan. No compensation expense related to the Plan was recorded during the six or three month period ended June 30, 2005 and 2004. If the Company had elected to recognize compensation cost based on fair value at the grant dates for awards under the Plan consistent with the method prescribed by SFAS No. 123, net income and earnings per share would have been changed to the pro forma amounts as follows for the six and three month periods ended June 30, 2005 and 2004.

Stock Based Compensation

	Six Months Ended June 30,		Th End
(in thousands)	2005	2004	2005
Net income, as reported	$ 3,209	$ 2,252	$ 1,5

Less pro forma stock-based compensation expenses determined under the fair value method, net of related tax effects	(513)	(718)	(
Pro forma net income	$ 2,696	$ 1,534	$ 1,4
Net income per share:			
Basic - as reported	$ 0.45	$ 0.32	$ 0.
Basic - pro forma	$ 0.38	$ 0.22	$ 0.
Diluted - as reported	$ 0.43	$ 0.31	$ 0.
Diluted - proforma	$ 0.36	$ 0.22	$ 0.

7. NEW ACCOUNTING PRONOUNCEMENT

In May 2005, the Financial Accounting Standards Board ("FASB") issued SFAS No. 154 "Accounting Changes and Error Corrections" (Statement 154), which replaces APB Opinion No. 20 "Accounting Changes" and SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements". This Statement changes the requirements for and reporting of a change in accounting principle, and all voluntary changes in accounting principles, as well as changes required by an accounting pronouncement in the unusual instance it does not include specific transition provisions. Specifically, this statement requires retrospective application to prior periods' financial statements, unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. When it is impractical to determine the effects of the change, the new accounting principle must be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and a correspondent adjustment must be made to the opening balance of retained earnings for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of the change, the new principle must be applied as if it were adopted prospectively from the earliest date practicable. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. This statement does not change the transition provisions of any existing pronouncements. The Company does not believe that the adoption of Statement No. 154 will have a significant impact on its consolidated statement of income or financial condition.

ITEM 2 - MANAGEMENTS' DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

The following discussion provides information about the results of operations, and financial condition, liquidity, and capital resources of the Company and its subsidiary, the Bank. This discussion and analysis should be read in conjunction with the unaudited Consolidated Financial Statements and Notes thereto, appearing elsewhere in this report and the Management Discussion and Analysis in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

This report contains forward looking statements within the meaning of the Securities Exchange Act of 1934, as amended, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. In

some cases, forward looking statements can be identified by use of such words as "may", "will", "anticipate", "believes", "expects", "plans", "estimates", "potential", "continue", "should", and similar words or phases. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors and other conditions which, by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty. Because of these uncertainties and the assumptions on which this discussion and the forward looking statements are based, actual future operations and results in the future may differ materially from those indicated herein. Readers are cautioned against placing undue reliance on any such forward looking statements.

GENERAL

Eagle Bancorp, Inc. is a growth oriented, one-bank holding company headquartered in Bethesda, Maryland. We provide general commercial and consumer banking services through our wholly owned banking subsidiary EagleBank, a Maryland chartered bank which is a member of the Federal Reserve System. We were organized in October 1997, to be the holding company for the Bank. The Bank was organized as an independent, community oriented, full service banking alternative to the super regional financial institutions, which dominate our primary market area. The cornerstone of our philosophy is to provide superior, personalized service to our customers. We focus on relationship banking, providing each customer with a number of services, becoming familiar with and addressing customer needs in a proactive, personalized fashion. The Bank currently has five offices serving Montgomery County and three offices in the District of Columbia. In February 2004, the Company executed a lease for a new office to be opened in the first quarter 2006 in Chevy Chase, Montgomery County, Maryland. In February 2005, Eagle Land Title, LLC, a Bank subsidiary which performs professional services in connection with loan settlements, commenced operations.

The Company offers a broad range of commercial banking services to our business and professional clients as well as full service consumer banking services to individuals living and/or working in the service area. We emphasize providing commercial banking services to sole proprietors, small and medium-sized businesses, partnerships, corporations, non-profit organizations and associations, and investors living and working in and near our primary service area. A full range of retail banking services are offered to accommodate the individual needs of both corporate customers as well as the community we serve. These services include the usual deposit functions of commercial banks, including business and personal checking accounts, "NOW" accounts and savings accounts, business, construction, and commercial loans, equipment leasing, residential mortgages and consumer loans and cash management services. We have developed significant expertise and commitment as an SBA lender, have been designated a Preferred Lender by the Small Business Administration (SBA), and are one of the largest community bank SBA lenders in the Washington Metropolitan area.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements;

accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available.

The allowance for credit losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two principles of accounting: (a) Statement on Financial Accounting Standards ("SFAS") 5, "Accounting for Contingencies", which requires that losses be accrued when they are probable of occurring and are estimable and (b) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, can be determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows, or values observable in the secondary markets.

Three components comprise our allowance for credit losses: a specific allowance, a formula allowance and a nonspecific or environmental factors allowance. Each component is determined based on estimates that can and do change when the actual events occur.

The specific allowance individually allocates an allowance to identified loans. A loan for which reserves are individually allocated may show deficiencies in the borrower's overall financial condition, payment record, support available from financial guarantors and or the fair market value of collateral. When a loan is identified as impaired, a specific reserve is established based on the Company's assessment of the loss that may be associated with the individual loan.

The formula allowance is used to estimate the loss on internally risk rated loans, exclusive of those identified as requiring specific reserves. Loans identified as special mention, substandard, doubtful and loss, are segregated from non-rated loans. Each loan type is assigned an allowance factor based on management's estimate of the risk, complexity and size of individual loans within a particular category. Classified loans are assigned higher allowance factors than non-rated loans due to management's concerns regarding collectibility or management's knowledge of particular elements regarding the borrower. Allowance factors increase with the worsening of the internal risk rating.

The nonspecific or environmental factors allowance is used to estimate the loss of remaining loans (those not identified as either requiring specific reserves or having classified risk ratings). The loss estimates are based on more global factors incident to the overall portfolio, such as delinquency trends, loss history, trends in the volume and size of individual credits, effects of changes in lending policy, the experience and depth of management, national and local economic trends, any concentrations of credit, the quality of loan review system and the effect of external factors such as competition and regulatory requirements. The environmental factors allowance captures losses whose impact on the portfolio may have occurred but have yet to be recognized in either the formula or specific allowance.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses, including, in connection with the valuation of collateral, a borrower's prospects of repayment, and in establishing allowance factors on the formula allowance and nonspecific allowance components of the allowance. The establishment of allowance factors is a continuing evaluation, based on management's ongoing assessment of the global factors discussed above and their impact on the portfolio. The allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. Changes in allowance factors will have a direct impact on the amount of the provision, and a related, after tax effect on net income. Errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs. For additional information regarding the allowance for credit losses, refer to the discussion under the caption "Allowance for Credit Losses" below.

RESULTS OF OPERATIONS OVERVIEW

The Company reported net income of $3.2 million for the six months ended June 30, 2005, as compared to net income of $2.3 million for the six months ended June 30, 2004. Income per basic share was $0.45 for the six month period ended June 30, 2005, as compared to $0.32 for the same period in 2004. Income per diluted share was $0.43 for the six months ended June 30, 2005, as compared to $0.31 for the same period in 2004. For the three months ended June 30, 2005, the Company reported net income of $1.6 million as compared to $1.1 million for the same period in 2004. Income per basic share was $.22 and $.21 per diluted share for the three months ended June 30, 2005, as compared to $.15 per basic and diluted share for the same period in 2004. Earnings per share for the three and six months ended June 30, 2004 have been adjusted to reflect a 1.3 for one stock spilt in the form of a 30% stock dividend affected on February 28, 2005

The Company had an annualized return on average assets of 1.12% and an annualized return on average equity of 10.83% for the first six months of 2005, as compared to returns on average assets and average equity of 0.99% and 8.30%, respectively, for the same six months of 2004.

The increase in net income for the six months ended June 30, 2005 as compared to the same period in 2004 can be attributed substantially to an increase of 50% in net interest income, resulting from an increase of 28% in average earning assets and an increase in the net interest spread of 59 basis points and the net interest margin of 76 basis points between the comparable periods. Since June 2004, the Federal Reserve Bank has increased the federal funds target rate by 225 basis points to 3.25% in nine interest rate increases of 25 basis points each. The impact of these interest rate increases has contributed to the improvement in the Company's margin in the past several quarters. While the average rate on earning assets for the six month period has risen by 87 basis points from 5.21% to 6.08%, the cost of interest bearing liabilities has increased by only 28 basis points from 1.29% to 1.57%. Additionally, the growth in average noninterest bearing funding sources for the six months ended June 30, 2005 as compared to 2004 has been $53 million or 47%. This significant growth in noninterest bearing funding sources has increased the value of noninterest sources funding earning assets from 31 basis points for the first six months in 2004 to 48 basis points for the six months ended June 30, 2005. Thus, the Company has been able to increase its primary source of funds

(core deposits) at rates which have allowed its net interest spread and margin to increase in the first six months of 2005 as compared to the same period in 2004. As a result of competitive pressures, rates paid on deposits, which have not increased as much or as rapidly as interest rates on earning assets, may result in a higher cost of funding in future periods, which may not be offset by further increases in interest rates on earning assets. As a result of such potential margin compression, the Company's earnings could be adversely impacted.

Loans, which generally have higher yields than securities and other earning assets, increased from 78% of average earning assets in the first six months of 2004 to 82% of average earning assets for the same period of 2005. Investment securities for the first six months of 2005 amounted to 13% of average earning assets as compared to 16% for the first six months in 2004. This decline was directly related to average loan growth over the past twelve month period exceeding the growth of average deposit and other funding sources.

The provision for credit losses was $887 thousand for the first six months in 2005 as compared to $230 thousand for the same period in 2004. This increase was largely attributable to growth in the loan portfolio in the first six months of 2005, which was very favorable. As discussed in the section on Allowance for Credit Losses, the Company had $28 thousand of net recoveries on previously charged off loans in the first six months of 2005. This compared to net recoveries of $47 thousand for the first six months of 2004. At June 30, 2005, the allowance for credit losses was $5.2 million or 1.07% of total loans, as compared to $4.0 million or 1.14% of total loans at June 30, 2004 and $4.2 million or 1.02% of total loans at December 31, 2004. The provision for credit losses was $470 thousand for the three months ended June 30, 2005 as compared to $76 thousand for the same period in 2004, the increase being attributable primarily to growth in the level of outstanding loans.

Total noninterest income was $1.9 million for both the first six months of 2005 and 2004. However, noninterest income for the first six months of 2004 included investment securities gains of $253 thousand, while the first six months of 2005 had investment securities gains of just $12 thousand. Excluding gains on the sale of investment securities, noninterest income was $1.9 million in 2005 versus $1.7 million for 2004, an increase of 16%. This increase was due primarily to increased gains on the sale of SBA loans which amounted to $517 thousand for the first six months in 2005 versus $241 thousand for 2004. For the three months ended June 30, 2005, total noninterest income was $887 thousand as compared to $825 thousand for the same period in 2004. This modest overall increase was due substantially to an increase in other income relating primarily to loan prepayment fees being substantially offset by declines in the gain on sale of loans in the period.

Noninterest expenses increased from $7.1 million in the first six of 2004 to $9.4 million for the first six months of 2005, an increase of 32%. The increase was attributable primarily to increases in staff levels, and related personnel cost increases, higher amounts of incentive based compensation, increased occupancy costs, due in part to new banking offices, and to higher marketing and data processing costs associated with a larger organization. In spite of higher amounts of noninterest expenses, the Company's stronger growth in revenue as compared to noninterest expenses resulted in the efficiency ratio improving in the first six months of 2005 to 61.09% as compared to 65.46% for the first six months in 2004. For the three months ended June 30, 2005, total noninterest expenses were $4.9 million, as compared to $3.6 million for the same period in 2004. This increase was due to the same factors mentioned above which

affected the increase for the six month period.

The combination of increases in net interest income from both increased volume and favorable interest rate effects and noninterest income, offset in part by increases in the provision for credit losses due to growth, and increases in noninterest expenses, resulted in significant improvement in net income for the first six months of 2005 versus 2004 of 42% and for the three months ended June 30, 2005 of 45%.

NET INTEREST INCOME AND NET INTEREST MARGIN

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those earning assets. Earning assets are composed primarily of loans and investment securities. The cost of funds represents interest expense on deposits, customer repurchase agreements and other borrowings, which comprise federal funds purchased and advances from the Federal Home Loan Bank of Atlanta. Noninterest bearing deposits and capital are other components representing funding sources. Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income. Net interest income for the first six months of 2005 was $13.4 million compared to $9.0 million for the first six months of 2004, a 50% increase. For the three months ended June 30, 2005, net interest income amounted to $6.9 million, as compared to $4.6 million for the same period in 2004, a 52% increase.

The following table labeled "Average Balances, Interest Yields and Rates and Net Interest Margin" presents the average balances and rates of the various categories of the Company's assets and liabilities. Included in the table is a measurement of interest rate spread and margin. Interest spread is the difference (expressed as a percentage) between the interest rate earned on earning assets less the interest expense on interest bearing liabilities. While net interest spread provides a quick comparison of earnings rates versus cost of funds, management believes that the net interest margin provides a better measurement of performance, since the net interest margin includes the effect of noninterest bearing sources in its calculation, which are significant factors in the Company's financial performance. The net interest margin is net interest income (annualized) expressed as a percentage of average earning assets.

AVERAGE BALANCES, INTEREST YIELDS AND RATES, AND NET INTEREST MARGIN
(dollars in thousands)

	Six Months Ended June 30			
	2005			
	Average Balance	Interest	Average Yield/Rate	Average Balance
ASSETS:				
Interest earning assets:				
Interest bearing deposits with other banks and other short-term investments	$ 18,576	$ 308	3.34%	$ 5,033
Loans (1)	446,026	14,859	6.72%	332,108

Investment securities available for sale	68,439	1,067	3.14%	69,190
Federal funds sold	9,739	128	2.65%	17,928
Total interest earning assets	542,780	16,362	6.08%	424,259
Total noninterest earning assets	37,925			36,028
Less: allowance for credit losses	4,596			3,792
Total noninterest earning assets	33,329			32,236
TOTAL ASSETS	$ 576,109			$ 456,495
LIABILITIES AND STOCKHOLDERS' EQUITY				
Interest bearing liabilities:				
Interest bearing transaction	$ 55,427	$ 41	0.15%	$ 49,853
Savings and money market	133,215	803	1.22%	116,425
Time deposits	155,958	1,890	2.44%	114,321
Customer repurchase agreements and federal funds purchased	28,527	88	0.62%	15,224
Other short-term borrowings	5,442	120	4.45%	7,384
Long term borrowings	-	-		9,648
Total interest bearing liabilities	378,569	2,942	1.57%	312,855
Noninterest bearing liabilities:				
Noninterest bearing demand	135,039			87,772
Other liabilities	2,753			1,571
Total noninterest bearing liabilities	137,792			89,343
Stockholders' equity	59,748			54,297
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 576,109			$ 456,495
Net interest income		$ 13,420		
Net interest spread			4.51%	
Net interest margin			4.99%	

(1) includes Loans held for Sale

ALLOWANCE FOR CREDIT LOSSES

The provision for credit losses represents the amount of expense charged to earnings to fund the allowance for credit losses. The amount of the allowance for credit losses is based on many factors which reflect management's assessment of the risk in the loan portfolio. Those factors include economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company and Bank.

Management has developed a comprehensive analytical process to monitor the adequacy of the allowance for credit losses. This process and guidelines were developed utilizing among other factors, the guidance from federal banking regulatory agencies. The results of this process, in combination with conclusions of the Bank's outside loan review consultant, support management's assessment as to the adequacy of the allowance at the balance sheet date. Please refer to the discussion under the caption "Critical Accounting Policies" for an overview of the methodology management employs on a quarterly basis to assess the adequacy of the allowance and the provisions charged to expense.

Following are tables of comparative charge-offs and recoveries data as well as information on the Company's non-performing and potential problem loans.

During the first six months of 2005, a provision for credit losses was made in the amount of $887 thousand and the allowance for credit losses increased $915 thousand, including the impact of $28 thousand in net recoveries during the period. The provision for credit losses of $887 thousand in the first six months of 2005 compared to a provision for credit losses of $230 thousand in the first six months of 2004. The higher level of the provision in 2005 is primarily attributable to significant growth in the loan portfolio in the six months of 2005. For the three months ended June 30, 2005, a provision for credit losses was made in the amount of $470 thousand, as compared to $76 thousand for the same period in 2004, the substantially higher provision being due primarily to substantial growth in the portfolio in the three months ended June 30, 2005. Net recoveries amounted to $22 thousand in the three months ended June 30, 2005 as compared to $131 thousand for the same period in 2004.

At June 30, 2005, the Company had $132 thousand of loans classified as nonaccrual as compared to $156 thousand at December 31, 2004 and $151 thousand at March 31, 2005. The Company had no restructured loans or real estate owned at June 30, 2005, December 31, 2004 or June 30, 2004. Significant variation in these amounts may occur from period to period because the amount of nonperforming loans depends largely on the condition of a small number of individual credits and borrowers relative to the total loan portfolio. The balance of impaired loans was $132 thousand at June 30, 2005, with specific reserves against those loans of $57 thousand, compared to $156 thousand at December 31, 2004 with specific reserves of $31 thousand. The allowance for loan losses represented 1.07% of total loans at June 30, 2005, as compared to 1.02% at December 31, 2004. This increase was due to a slight mix shift in the loan portfolio composition toward more commercial real estate loans (49% versus 46%) which category tends to have larger transactions in the assessment of risk, resulting in an increase in the allocation factors contained in the allowance methodology and to modifications in the environmental factors allowance.

As part of its comprehensive loan review process, the Company's Board of Directors and the Bank Director's Loan Committee and or Board of Director's Credit Review Committee carefully evaluates loans which are past due 30 days or more. The Committee(s) make a thorough assessment of the conditions and circumstances surrounding each delinquent loan. The Bank's loan policy requires that loans be placed on nonaccrual if they are ninety days past due, unless they are well secured and in the process of collection.

The maintenance of a high quality loan portfolio, with an adequate allowance for possible loan losses will continue to be a primary management objective in the Company.

The following table sets forth activity in the allowance for credit

losses for the periods indicated.

(dollars in thousands)	Six Months Ended June 30, 2005	2004
Balance at beginning of year	$ 4,240	$ 3,680
Charge-offs:		
Commercial	-	(81)
Real estate - commercial	-	-
Construction	-	-
Home equity	-	-
Other consumer	(11)	(18)
Total	(11)	(99)
Recoveries:		
Commercial	39	146
Real estate - commercial	-	-
Construction	-	-
Home equity	-	-
Other consumer	-	-
Total	39	146
Net recoveries (charge-offs)	28	47
Additions charged to operations	887	230
Balance at end of period	$ 5,155	$ 3,957
Annualized ratio of net charge-offs (recoveries) during the period to average loans outstanding during the period	(.01)%	(.03)%

The following table reflects the allocation of the allowance for credit losses at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses or charge-offs and does not restrict the use of the allowance to absorb losses in any category.

	As of June 30,		As of December 31,	
	2005		2004	
	Amount	% (1)	Amount	% (1)
Commercial	$ 2,154	24%	$ 1,963	25%
Real estate - commercial	2,125	50%	1,426	46%
Real estate - residential	55	1%	105	3%
Construction	408	14%	431	14%
Home equity	168	10%	223	11%
Other consumer	82	1%	58	1%
Unallocated	163		34	
Total loans	$ 5,155	100%	$ 4,240	100%

(1) Represents the percent of loans in each category to total loans and not the allowance allocations.

NON-PERFORMING ASSETS

The Company's non-performing assets, which are comprised of loans delinquent 90 days or more, non-accrual loans, restructured loans and other real estate owned, totaled $132 thousand at June 30, 2005 compared to $464 thousand at June 30, 2004 and $156 thousand at December 31, 2004. The percentage of non-performing loans to total loans was 0.03% at June 30, 2005, compared to .13% at June 30, 2004, and .04% at December 31, 2004.

The following table shows the amounts of non-performing assets at the dates indicated.

	June 30, 2005		December 31
(dollars in thousands)	2005	2004	2004
Nonaccrual Loans			
Commercial	$ 132	$ 399	$ 156
Consumer	-	65	-
Real estate	-	-	-
Accrual loans-past due 90 days			
Commercial	-	-	-
Consumer	-	-	-
Real estate	-	-	-
Restructured loans	-	-	-
Real estate owned	-	-	-
Total non-performing assets	$ 132	$ 464	$ 156

At June 30, 2005, there were $3.3 million of performing loans considered potential problem loans, defined as loans which are not included in the past due, nonaccrual or restructured categories, but for which known information about possible credit problems causes management to be uncertain as to the ability of the borrowers to comply with the present loan repayment terms which may in the future result in disclosure in the past due, non-accrual or restructured loan categories.

NONINTEREST INCOME

Noninterest income consists primarily of deposit account service charges, gains on the sale of SBA and residential mortgage loans, other noninterest loan fees, income from bank owned life insurance ("BOLI") and other service fees. For the six months ended June 30, 2005, noninterest income was $1.9 million. This compared to $1.9 million of noninterest income for the six months ended June 30, 2004, which included $253 thousand in net gains on the sale of investment securities.

The Company is an active originator of SBA loans and its current practice is to sell the insured portion of those loans at a premium. Income from this source was $517 thousand for the six months ended June 30, 2005 compared to $241 thousand for the six months ended June 30, 2004, as the Company emphasized this lending activity in the first half of 2005. The Company also originates residential mortgage loans on a pre-sold basis, servicing released. Sales of

these mortgage loans yielded gains of $125 thousand in the first six months of 2005 compared to $148 thousand in the same period in 2004. Income for the six months ended June 30, 2005 included $592 thousand from deposit account service charges, $98 thousand from SBA loan service fees and $204 thousand from BOLI, versus $709 thousand from deposit account service charges, $65 thousand from SBA service fees and $173 thousand from BOLI for the six months ended June 30, 2004. Other noninterest income amounted to $378 thousand for the first six months of 2005, as compared to $318 thousand in the first six months of 2004. The decline in deposit service charges was primarily related to a decline in overdraft fees.

Noninterest income was $887 thousand for the three months ended June 30, 2005 compared to $825 thousand for the three months ended June 30, 2004, an increase of 8%.

NONINTEREST EXPENSES

Noninterest expense was $9.4 million for the six months ended June 30, 2005 compared to $7.1 million for the six months ended June 30, 2004, an increase of 32%.

Salaries and benefits were $5.2 million for the first six of 2005, as compared to $ 3.9 million for 2004, a 34% increase. This increase was due to staff additions and related personnel costs as well as to increases in incentive based compensation. At June 30, 2005 the Bank had 137 full time equivalent employees as compared to 111 at June 30, 2004.

Premises and equipment expenses amounted to $1.6 million for the first six months of 2005 versus $1.3 million for the same period in 2004. This increase of 27% was due in part to a new banking office opened in the first quarter of 2005 and one in the second quarter of 2004 and to ongoing operating expense increases associated with the Company's facilities, all of which are leased, and to increased equipment costs.

Advertising costs increased from $159 thousand in the six months ended June 30, 2004 to $207 thousand in the same period in 2005, the increases associated primarily with increased advertising for deposit products.

Outside data processing costs were $385 thousand for the first half of 2005, as compared to $286 thousand in 2004, or an increase of 35%. The higher than usual increase was due primarily to special charges associated with the Company's conversion of certain core processing systems to new operating platforms and to higher processing volumes.

Other expenses, increased from $1.5 million in the first six months of 2004 to $1.9 million for the six months ended June 30, 2005. The major components of costs in this category include professional and consulting fees, ATM expenses, telephone, courier, printing, business development, office supplies, charitable contributions, and dues. These costs have increased by 28% in the first six months of 2005 as compared to 2004.

Noninterest expense was $4.9 million for the three months ended June 30, 2005 compared to $3.6 million for the three months ended June 30, 2004, an increase of 35%. The same factors which contributed to increased noninterest expense for the six month period mentioned above also contributed to the increase in noninterest expenses for the three months ended June 30, 2005, as compared to the same period in 2004.

FINANCIAL CONDITION OVERVIEW

At June 30, 2005, total assets were $610.1 million, loans were $481.8 million, deposits were $516.4 million and stockholders' equity was $61.1 million. As compared to December 31, 2004, assets grew by $56.6 million (10%), loans by $66.3 million (16%), deposits by $54.1 million (12%) and stockholders' equity by $2.5 million (4%).

The Company paid an initial cash dividend of $0.07 per share in the first quarter of 2005, and $0.07 also for the second quarter of 2005.

LOANS

Loans, net of amortized deferred fees and costs, at June 30, 2005 and 2004 are summarized by type as follows:

	As of June 30,		As of December 31,		
	2005		2004		
(dollars in thousands)	Amount	%	Amount	%	Amo
Commercial	$ 114,080	24%	$ 101,911	25%	$ 84,
Real estate - commercial	239,301	50%	189,708	46%	173,
Real estate - residential	7,095	1%	11,717	3%	
Construction	69,625	14%	60,258	14%	49,
Home equity	48,055	10%	49,632	11%	38,
Other consumer	3,613	1%	2,283	1%	3,
Total loans	481,769	100%	415,509	100%	349,
less: Allowance for Credit Losses	(5,155)		(4,240)		(3,
Net Loans and Leases	$ 476,614		$ 411,269		$ 345,

DEPOSITS AND OTHER BORROWINGS

The principal sources of funds for the Bank are core deposits, consisting of demand deposits, NOW accounts, money market accounts, savings accounts and certificates of deposits from the local market areas surrounding the Bank's offices. The deposit base includes transaction accounts, time and savings accounts and accounts which customers use for cash management and which provide the Bank with a source of fee income and cross-marketing opportunities as well as an attractive source of lower cost funds. Time and savings accounts, including money market deposit accounts, also provide a relatively stable and low-cost source of funding.

For the six months ending June 30, 2005 deposits grew $54.1 million, from $462.3 million to $516.4 million or 12%.

Approximately 32% of the Bank's deposits are made up of certificates of deposits, which are generally the most expensive form of deposit because of

their fixed rate and term. Certificates of deposit in denominations of $100 thousand or more can be more volatile and more expensive than certificates of less than $100 thousand. However, because the Bank focuses on relationship banking, its historical experience has been that large certificates of deposit have not been more volatile or significantly more expensive than smaller denomination certificates. It has been the practice of the Bank to pay posted rates on its certificates of deposit whether under or over $100 thousand. From time to time, when appropriate in order to fund strong loan demand, the Bank accepts certificates of deposits, generally in denominations of less than $100 thousand from bank and credit union subscribers to a wholesale deposit rate line and may also accept brokered deposits, although none exists at June 30, 2005. These deposits amounted to approximately $16 million or 3% of total deposits at June 30, 2005, as compared to approximately $33 million of deposits at June 30, 2004 and approximately $25 million at December 31, 2004. The Bank has found rates on these deposits to be generally competitive with rates in our market given the speed and minimal noninterest cost at which deposits can be acquired. During the first six months of 2005, the Bank reduced its wholesale deposits in favor of its core sources, which provided adequate funding and liquidity and was in accordance with planned amounts.

At June 30, 2005, the Company had approximately $146 million in noninterest bearing demand deposits, representing 28% of total deposits. This compared to approximately $130 million of these deposits at December 31, 2004 or 28% of total deposits. These are primarily business checking accounts on which the payment of interest is prohibited by regulations of the Federal Reserve. Proposed legislation has been introduced in each of the last several sessions of Congress which would permit banks to pay interest on checking and demand deposit accounts established by businesses. If legislation effectively permitting the payment of interest on business demand deposits is enacted, of which there can be no assurance, it is likely that we may be required to pay interest on some portion of our noninterest bearing deposits in order to compete with other banks. Payment of interest on these deposits could have a significant negative impact on our net interest income and net interest margin, net income, and the return on assets and equity.

As an enhancement to the basic noninterest bearing demand deposit account, the Company offers a sweep account, or "customer repurchase agreement", allowing qualifying businesses to earn interest on short term excess funds which are not suited for either a CD investment or a money market account. The balances in these accounts were $26.4 million at June 30, 2005 compared to $24.0 million at December 31, 2004. Customer repurchase agreements are not deposits and are not insured but are collateralized by U.S. government agency securities. These accounts are particularly suitable to businesses with significant fluctuation in the levels of cash flows. Attorney and title company escrow accounts are an example of accounts which can benefit from this product, as are customers who may require collateral for deposits in excess of $100 thousand but do not qualify for other pledging arrangements. This program requires the Company to maintain a sufficient investment securities level to accommodate the fluctuations in balances which may occur in these accounts.

At June 30, 2005, the Company had no outstanding balances under its lines of credit provided by correspondent banks. The Bank had $4.3 million of FHLB borrowings, as compared to $6.3 million at December 31, 2004. These advances are secured 50% by U.S. government agency securities and 50% by a blanket lien on qualifying loans in the Bank's commercial mortgage loan portfolio.

LIQUIDITY MANAGEMENT

Liquidity is a measure of the Bank's ability to meet loan demand and to satisfy depositor withdrawal requirements in an orderly manner. The Bank's primary sources of liquidity consist of cash and cash balances due from correspondent banks, loan repayments, federal funds sold and other short term investments, maturities and sales of investment securities and income from operations. The Bank's entire investment securities portfolio is in an available for sale status which allows it maximum flexibility to generate cash from sales as needed to meet ongoing loan demand. These sources of liquidity are primary and are supplemented by the ability of the Company and Bank to borrow funds, which are termed secondary sources. The Company maintains secondary sources of liquidity, which includes a $10 million line of credit with a correspondent bank, against which there were no outstandings at June 30, 2005. Additionally, the Bank can purchase up to $27 million in federal funds on an unsecured basis from its correspondents, against which there were no borrowings outstanding at June 30, 2005 and may enter into reverse repurchase agreements up to $12.5 million, provided adequate collateral exists to secure the lending relationship. At June 30, 2005, the Bank was also eligible to make advances from the Federal Home Loan Bank of Atlanta (FHLB) up to $120 million, of which it had advances outstanding of $4.3 million.

The loss of deposits, through disintermediation, is one of the greater risks to liquidity. Disintermediation occurs most commonly when rates rise and depositors withdraw deposits seeking higher rates than the Bank may offer. The Bank was founded under a philosophy of relationship banking and, therefore, believes that it has less of an exposure to disintermediation and resultant liquidity concerns than do many banks. There is, however, a risk that some deposits would be lost if rates were to increase and the Bank elected not to remain competitive with its deposit rates. Under those conditions, the Bank believes that it is well positioned to use other liability management instruments such as FHLB borrowing, customer repurchase agreements and Bank lines to offset a decline in deposits in the short run. Over the long term, an adjustment in assets and change in business emphasis could compensate for a loss of deposits. The Bank also maintains a marketable investment portfolio to provide flexibility in the event of significant liquidity needs. The Bank's Asset Liability Board Committee recently adopted policy guidelines which emphasize the importance of core deposits and their continued growth.

At June 30, 2005, under the Bank's liquidity formula, it had $164 million of primary and secondary liquidity representing 27.3% of total bank assets.

The following is a schedule of significant funding commitments at June 30, 2005:

	(in thousands)
Unused lines of credit (consumer)	$ 49,992
Other commitments to extend credit	$ 144,870
Standby letters of credit	$ 3,962
	$ 198,824

ASSET/LIABILITY MANAGEMENT AND QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

A fundamental risk in banking is exposure to market risk, or interest rate risk, since a bank's net income is largely dependent on net interest income. The Bank's Asset Liability Committee (ALCO) of the Board of Directors formulates and monitors the management of interest rate risk through policies and guidelines

established by it and the full Board of Directors. In its consideration of risk limits, the ALCO considers the impact on earnings and capital, the level and direction of interest rates, liquidity, local economic conditions, outside threats and other factors. Banking is generally a business of managing the maturity mismatch inherent in its asset and liability cash flows and to provide net interest income growth consistent with the Company's profit objectives.

The Company, through its ALCO, monitors the interest rate environment in which it operates and adjusts the rates and maturities of its assets and liabilities to remain competitive and to achieve its overall financial objectives subject to established risk limits. In the current interest rate environment, the Company is managing its assets to be either variably priced or with relatively short maturities, so as to mitigate the risk to earnings and capital should interest rates increase from current levels. At the same time, the Bank seeks to acquire longer-term core deposits to lock in relatively lower cost funds. In the current market, due to competitive factors and customer preferences, the effort to attract longer term fixed priced liabilities has not been as successful as the Company's best case asset liability mix would prefer. There can be no assurance that the Company will be able to successfully carry out this intention, as a result of competitive pressures, customer preferences and the inability to perfectly forecast future interest rates.

One of the tools used by the Company to manage its interest rate risk is a static GAP analysis presented below. The Company also uses an earnings simulation model on a quarterly basis to closely monitor interest sensitivity and to model its balance sheet cash flows and its income statement effects in different interest rate scenarios. The model is based on current Bank and Company data and is adjusted for assumptions as to growth, noninterest income and noninterest expense and interest rate sensitivity, based on historical data, for both assets and liabilities. The data is then subjected to a "shock test", which assumes a simultaneous change in interest rate up 200 basis points or down 200 basis points, along the entire yield curve, but not below zero. The results are analyzed as to the impact on net interest income, net income over the next twelve months and to the market value of equity. The Company analysis at June 30, 2005 shows a positive effect on income when interest rates are shocked up 200 basis points, due to the significant level of variable rate loans. A negative impact occurs if rates were to decline. With rates at a relative low level, further interest rate declines would reduce income on earning assets, which could not be offset by a corresponding reduction in the cost of funds, potentially resulting in significant net interest margin contraction. The Company has recently concluded, based on market factors, that larger increases in its retail deposit rate assumptions are probable in a rising interest rate environment. While the impact of higher interest rates continues to be viewed as positive to future net interest income and market values of equity, this change in assumptions moderates the benefits of such higher interest rates, as compared to analyses in prior periods.

The following table reflects the result of a shock simulation on the June 30, 2005 balances.

Change in interest rates (basis points)	Percentage change in net interest income	Percentage change in net income	Percentage change in Market Value of Portfolio Equity
+200	+5.2%	+6.3%	+5.2%
+100	+2.7%	+12.1%	+1.8%
0	-	-	-
-100	-7.4%	-17.3%	-4.9%
-200	-17.8%	-41.3%	-12.8%

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or repricing periods, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features that limit changes in interest rates on a short-term basis and over the life of the loan. Further, in the event of a change in interest rates, prepayment and early w.ithdrawal levels could deviate significantly from those assumed in calculating the tables. Finally, the ability of many borrowers to service their debt may decrease in the event of a significant interest rate increase.

GAP POSITION

Banks and other financial institutions are dependent upon net interest income, which is the difference between interest earned on earning assets and interest expense on interest bearing liabilities.

In falling interest rate environments, net interest income is maximized with longer term, higher yielding assets being funded by lower yielding short-term funds, or what is referred to as a negative mismatch or GAP. Conversely, in a rising interest rate environment, net interest income is maximized with shorter term, higher yielding assets being funded by longer-term liabilities or what is referred to as a positive mismatch or GAP.

The current interest rate environment is signaling steady to possibly higher rates. Management has been emphasizing the acquisition of variable rate and shorter term assets and has been attempting to secure longer-term core deposits. While management believes that this overall position creates a good balance in managing its interest rate risk and maximizing its net interest margin within plan objectives, there can be no assurance as to actual results.

The GAP position, which is a measure of the difference in maturity and re-pricing volume between assets and liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indication of the rate sensitivity of the Company. A negative GAP indicates the degree to which the volume of repriceable liabilities exceeds repriceable assets in given time periods. At June 30, 2005, the Bank had a positive GAP of 22% out to three months and a cumulative negative GAP of 5% out to twelve months, as compared to a three month positive GAP of 38% and a cumulative twelve month positive GAP of 8% at December 31, 2004. The change in the GAP position at June 30, 2005 as compared to December 31, 2004 relates primarily to a change in the repricing assumption related to money market deposits to a shorter repricing timeframe. This change was made to reflect the Company's actual practices and experience over the past six months.

If interest rates continue to rise at a measured pace, as forecasters are predicting, the Bank's interest income and margin are expected to be stable to slightly up because of the present positive mismatch position. Because competitive market behavior does not necessarily track the trend of interest rates but at times moves ahead of financial market influences, the rise in the cost of liabilities may be greater than anticipated by the GAP model. If this were to occur, the benefits of a rising interest rate environment would not be as significant as management is expecting. Management has carefully considered its strategy to maximize interest income by reviewing interest rate levels, economic indicators and call features within its investment portfolio. These factors have been discussed with the Board of Directors Asset Liability Committee and management believes that current strategies are appropriate to current economic and interest rate trends.

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GAP ANALYSIS

JUNE 30, 2005

(dollars in thousand)

Repriceable in:	0-3 mos	4-12 mos	13-36 mos	37-60 mos	o
ASSETS:					
Investments and bank deposits	$ 7,149	$ 11,184	$ 26,591	$ 13,505	
Loans	264,561	11,493	58,079	101,217	
Fed funds/ equivalents/other equities	17,153	-	-	-	
Total repriceable assets	$ 288,863	$ 22,677	$ 84,670	$114,722	
LIABILITIES:					
Now/escrow manager	$ -	$ 37,263	$ 7,453	$ 29,810	
MMA	124,609	-	-	-	
CDs	28,597	122,752	15,214	1,110	
Other	-	3,593	-	-	
Customer repurchase agree.	7,906	10,541	2,635	5,270	
Federal funds purchased/rev repos	333	4,000	-	-	
Total repriceable liabilites	$ 161,455	$ 178,149	$ 25,302	$ 36,190	
GAP	$ 127,418	$(155,472)	$ 59,368	$ 78,532	
Cumulative GAP	$ 127,418	$ (28,054)	$ 31,314	$109,846	
Interval gap/earnings assets	22.39%	(27.32%)	10.43%	13.80%	
Cumulative gap/earning assets	22.39%	(4.93%)	5.50%	19.30%	

Although NOW accounts are subject to immediate repricing, the Bank's GAP model has incorporated a repricing schedule to account for a lag in rate changes based on our experience, as measured by the amount of those deposit rate changes relative to the amount of rate change in assets.

CAPITAL RESOURCES AND ADEQUACY

The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance, changing competitive conditions and economic forces, and the overall level of growth. The adequacy of the Company's current and future capital needs is monitored by management on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses.

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The capital position of both the Company and the Bank continues to exceed regulatory requirements to be considered well-capitalized. The primary indicators used by bank regulators in measuring the capital position are the tier 1 risk-based capital ratio, the total risk-based capital ratio, and the

tier 1 leverage ratio. Tier 1 capital consists of common and qualifying preferred stockholders' equity less intangibles. Total risk-based capital consists of Tier 1 capital, qualifying subordinated debt, and a portion of the allowance for credit losses. Risk-based capital ratios are calculated with reference to risk-weighted assets. The tier 1 leverage ratio measures the ratio of tier 1 capital to total average assets for the most recent three month period.

The ability of the Company to continue to grow is dependent on its earnings and the ability to obtain additional funds for contribution to the Bank's capital, through additional borrowing, the sale of additional common stock, the sale of preferred stock, or through the issuance of additional qualifying equity equivalents, such as subordinated debt or trust preferred securities.

The actual capital amounts and ratios for the Company and Bank as of June 30, 2005 and June 30, 2004 are presented in the table below:

Dollars in thousands	Company Actual Amount	Company Actual Ratio	Bank Actual Amount	Bank Actual Ratio	For Cap Adequa Purpos Rati
As of June 30, 2005					
Total capital to risk-weighted assets	$66,316	12.5%	$55,669	10.7%	8.00
Tier 1 capital to risk-weighted assets	$61,160	11.5%	$50,531	9.7%	4.00
Tier 1 capital to average assets (leverage)	$61,160	10.6%	$50,531	8.7%	3.00
As of June 30, 2004					
Total capital to risk-weighted assets	$59,288	16.2%	$42,236	11.0%	8.00
Tier 1 to risk-weighted assets	$55,331	15.1%	$38,293	10.0%	4.00
Tier 1 capital to average assets (leverage)	$55,331	12.1%	$38,293	9.0%	3.00

** Applies to Bank only

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extension of credit and transfers of assets between the Bank and the Company. At June 30, 2005, the Bank could pay dividends to the parent to the extent of its earnings so long as it maintained required capital ratios.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Please refer to Item 2 of this report, "Management's Discussion and Analysis of Financial Condition and Results of Operations", under the caption "Asset/Liability Management and Quantitative and Qualitative Disclosure About Market Risk".

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated as of the last day of the period covered by this report the effectiveness of the operation of the Company's disclosure controls and procedures, as defined in Rule 13a-14 under the Securities and Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the quarter ended June 30, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

From time to time the Company may become involved in legal proceedings. At the present time there are no proceedings which the Company believes will have an adverse impact on the financial condition or earnings of the Company.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Sales of Unregistered Securities.	None
(b) Use of Proceeds.	Not Applicable.
(c) Issuer Purchases of Securities.	None

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES None

ITEM 4 - SUBMISSION OF MATTERS TO AVOTE OF SECURITY HOLDERS

On May 17, 2005, the annual meeting of shareholders of the Company was held for the purpose of (1) electing eight directors to serve three year terms or until their successors are elected and (2) transact other business that may come before the meeting, of which there was none.

The names of each director elected at the meeting, and the votes for and against cast for such persons are set forth below:

	Votes For	Votes Withheld	Broker Non-Votes
Leonard L. Abel	5,739,984	139,252	None
Leslie M. Alperstein	5,878,936	300	None
Dudley C. Dworken	5,872,436	6,800	None
Michael T. Flynn	5,744,709	134,527	None
Eugene F. Ford Sr.	5,874,661	4,575	None
Philip N. Margolius	5,878,351	885	None
Ronald D. Paul	5,744,969	134,267	None
Leland M. Weinstein	5,878,936	300	None

ITEM 5 - OTHER INFORMATION

(a) Required 8-K Disclosures	None
(b) Changes in Procedures for Director Nominations	None

ITEM 6 - EXHIBITS

Exhibit No.	Description of Exhibit
3(a)	Certificate of Incorporation of the Company, as amended (1)
3(b)	Bylaws of the Company (2)
10.1	1998 Stock Option Plan (3)
10.2	Employment Agreement between Michael Flynn and the Company (4)
10.3	Employment Agreement between Thomas D. Murphy and the Bank (4)
10.4	Employment Agreement between Ronald D. Paul and the Company (4)
10.5	Director Fee Agreement between Leonard L. Abel and the Company (4)
10.6	Employment Agreement between Susan G. Riel and the Bank (4)
10.7	Employment Agreement between Martha F. Tonat and the Bank (4)
10.8	Employment Agreement between Wilmer L. Tinley and the Bank (4)
10.9	Employee Agreement for James H. Langmead (5)
10.10	Employee Stock Purchase Plan (6)
11	Statement Regarding Computation of Per Share Income
21	Subsidiaries of the Registrant
31.1	Rule 13a-14(a) Certification of Ronald D. Paul
31.2	Rule 13a-14(a) Certification of Wilmer L. Tinley
31.3	Rule 13a-14(a) Certification of Michael T. Flynn
31.4	Rule 13a-14(a) Certification of James H. Langmead
32.1	Section 1350 Certification of Ronald D. Paul
32.2	Section 1350 Certification of Wilmer L. Tinley
32.3	Section 1350 Certification of Michael T. Flynn
32.4	Section 1350 Certification of James H. Langmead

(1) Incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-QSB for the period ended September 30, 2002.

(2) Incorporated by reference to Exhibit 3(b) to the Company's Registration Statement on Form SB-2, dated December 12, 1997.

(3) Incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended December 31, 1998.

(4) Incorporated by reference to exhibits of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

(5) Incorporated by reference to exhibits of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2004

(6) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 (No. 333-116352)

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.

EAGLE BANCORP, INC.

Date: August 5, 2005

By: /s/ Ronald D. Paul

Ronald D. Paul, President and CEO

Date: August 5, 2005

By: /s/ Wilmer L. Tinley

Wilmer L. Tinley, Senior Vice President and Chief Financial Officer