SUSSEX BANCORP
Form 10QSB
August 10, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2004

Or

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

For the transition period from ________________________ to __________________

Commission file number 0-29030

SUSSEX BANCORP.

(Exact name of registrant as specified in its charter)

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

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

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

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

As of August 6, 2004 there were 1,838,537 shares of common stock, no par value, outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

SUSSEX BANCORP
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Data)
(Unaudited)

ASSETS	June 30, 2004	December 31, 2003
Cash and due from banks	$ 12,387	$ 11,301
Federal funds sold	4,990	4,195
Cash and cash equivalents	17,377	15,496
Interest bearing time deposits with other banks	500	3,500

Securities available for sale	74,759	76,545
Federal Home Loan Bank Stock, at cost	690	760
Loans receivable, net of unearned income	144,275	134,374
Less: allowance for loan losses	1,958	1,734
Net loans receivable	142,317	132,640
Premises and equipment, net	5,470	4,650
Accrued interest receivable	1,209	1,241
Goodwill	2,124	2,124
Other assets	6,669	3,661
Total Assets	$ 251,115	$ 240,617
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 35,710	$ 31,715
Interest bearing demand	181,689	175,942
Total Deposits	217,399	207,657
Borrowings	11,000	11,000
Accrued interest payable and other liabilities	2,520	2,056
Junior subordinated debentures	5,155	--
Mandatory redeemable capital debentures	--	5,000
Total Liabilities	236,074	225,713
Stockholders' Equity:		
Common stock, no par value, authorized 5,000,000 shares; issued and outstanding 1,835,085 in 2004 and 1,811,460 in 2003	9,913	9,616
Retained earnings	5,547	5,040
Accumulated other comprehensive income (loss)	(419)	248
Total Stockholders' Equity	15,041	14,904
Total Liabilities and Stockholders' Equity	$ 251,115	$ 240,617

See Notes to Consolidated Financial Statements

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

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003
INTEREST INCOME		
Loans receivable, including fees	$2,161	$2,033
Securities:		
Taxable	419	445
Tax-exempt	205	169
Federal funds sold	17	36
Interest bearing deposits	7	12
Total Interest Income	2,809	2,695
INTEREST EXPENSE		
Deposits	493	535
Borrowings	132	146
Junior subordinated debentures	61	63
Total Interest Expense	686	744
Net Interest Income	2,123	1,951
Provision for Loan Losses	105	120
Net Interest Income after Provision for Loan Losses	2,018	1,831
NON-INTEREST INCOME		
Service fees on deposit accounts	191	189
ATM fees	78	90
Insurance commissions and fees	604	523
Mortgage broker fees	161	0
Investment brokerage fees	48	75
Net gain on sale of loans held for sale	0	24
Net gain on sale of other real estate owned	0	63
Other	85	58
Total Non-Interest Income	1,167	1,022
NON-INTEREST EXPENSE		
Salaries and employee benefits	1,514	1,341
Occupancy, net	208	149
Furniture and equipment	210	195
Stationary and supplies	46	50
Audit and exams/Professional Fees	74	87
Advertising and promotion	96	94
Postage and freight	48	46
Amortization of intangible assets	48	39
Other	398	365
Total Non-Interest Expense	2,642	2,366
Income before Income Taxes	543	487
Provision for Income Taxes	152	127
Net Income	$ 391	$ 360

Earnings per share		
Basic	$ 0.21	$ 0.20
Diluted	$ 0.20	$ 0.20

See Notes to Consolidated Financial Statements

	Number of Shares Outstanding	Common Stock
	(Dollars in thousands, exce	
Balance December 31, 2002	1,688,130	$ 7,869
Comprehensive income:		
Net income	--	--
Change in unrealized gains (losses) on securities available for sale	--	--
Total Comprehensive Income		
Treasury shares purchased	(2,400)	--
Treasury shares retired	--	(25)
Issuance of common stock and exercise of stock options	5,186	40
Shares issued through dividend reinvestment plan	9,065	94
Dividends on common stock ($.14 per share)	--	--
Balance June 30, 2003	1,699,981	$ 7,978
Balance December 31, 2003	1,811,460	$ 9,616
Comprehensive income:		
Net income	--	--
Change in unrealized gains on securities available for sale, net of tax	--	--
Total Comprehensive Income		
Treasury shares purchased	(96)	--

Treasury shares retired	--	(2)
Issuance of common stock and exercise of stock options	17,985	167
Income tax benefit of stock options exercised	--	35
Shares issued through dividend reinvestment plan	5,736	97
Dividends on common stock ($.14 per share)	--	--
Balance June 30, 2004	1,835,085	$ 9,913

See Notes to Consolidated Financial Statements

	Treasury Stock	Total Stockholders Equity
Balance December 31, 2002	$ 0	$ 13,680
Comprehensive income:		
Net income	--	673
Change in unrealized gains (losses) on securities available for sale	--	201
Total Comprehensive Income		874
Treasury shares purchased	(25)	(25)
Treasury shares retired	25	--
Issuance of common stock and exercise of stock options	--	40
Shares issued through dividend reinvestment plan	--	94
Dividends on common stock ($.14 per share)	--	(237)
Balance June 30, 2003	$ 0	$ 14,426
Balance December 31, 2003	$ 0	$ 14,904
Comprehensive income:		
Net income	--	762
Change in unrealized gains on securities available for sale, net of tax	--	(667)

Total Comprehensive Income		95
Treasury shares purchased	(2)	(2)
Treasury shares retired	2	--
Issuance of common stock and exercise of stock options	--	167
Income tax benefit of stock options exercised	--	35
Shares issued through dividend reinvestment plan	--	97
Dividends on common stock ($.14 per share)	--	(255)
Balance June 30, 2004	$ 0	$ 15,041

See Notes to Consolidated Financial Statements

SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	Six Months Ended J	
	2004	
Cash Flows from Operating Activities		
Net income	$ 762	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	253	
Provision for depreciation and amortization	256	
Net amortization of securities premiums and discounts	352	
Net realized gain on sale of foreclosed real estate	--	
Proceeds from sale of loans	--	
Net gains on sale of loans	--	
Loans originated for sale	--	
Earnings on investment in life insurance	(55)	
(Increase) decrease in assets:		
Accrued interest receivable	32	
Other assets	(853)	
Increase in accrued interest payable and other liabilities	464	
Net Cash Provided by Operating Activities	1,211	
Cash Flows from Investing Activities		
Securities available for sale:		

Purchases	(13,775)	
Maturities, calls and principal repayments	14,097	
Net increase in loans	(9,930)	
Purchases of bank premises and equipment	(1,076)	
(Increase) decrease in FHLB stock	70	
Proceeds from sale of foreclosed real estate	--	
Decrease (increase) in interest bearing time deposits with other banks	3,000	
Purchase of investment in life insurance	(1,500)	
Net Cash Used in Investing Activities	(9,114)	
Cash Flows from Financing Activities		
Net increase in deposits	9,742	
Repayment of borrowings	0	
Proceeds from the exercise of stock options	202	
Purchase of treasury stock	(2)	
Dividends paid, net of reinvestments	(158)	
Net Cash Provided by Financing Activities	9,784	
Net (Decrease) Increase in Cash and Cash Equivalents	1,881	
Cash and Cash Equivalents - Beginning	15,496	
Cash and Cash Equivalents - Ending	$ 17,377	$
Supplementary Cash Flows Information		
Interest paid	$ 1,353	$
Income taxes paid	$ 431	$
Supplementary Schedule of Noncash Investing and Financing Activities		
Foreclosed real estate acquired in settlement of loans	$ --	$

See Notes to Consolidated Financial Statements

SUSSEX BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

The consolidated financial statements include the accounts of Sussex Bancorp (the "Company") and its wholly-owned subsidiary Sussex Bank (the "Bank"). The Bank's wholly-owned subsidiaries are Sussex Bancorp Mortgage Company, Inc., SCB Investment Company, Inc., and Tri-State Insurance Agency, Inc., ("Tri-State") a full service insurance agency located in Sussex County, New Jersey. All inter-company transactions and balances have been eliminated in consolidation. Sussex Bank is also a 49% limited partner of Sussex Settlement Services, L.P, a title insurance agency whose registered office is located in King of Prussia, Pennsylvania. The Bank operates eight banking offices all located in Sussex County, New Jersey. The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve

System (the "FRB"). The Bank's deposits are insured by the Bank Insurance Fund ("BIF") of the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits. The operations of the Company and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the "Department") and the operations of Tri-State are subject to the supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the six-month period ended June 30, 2004, are not necessarily indicative of the results that may be expected for the year ended December 31, 2004. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company's Annual Report on Form 10-KSB for the fiscal period ended December 31, 2003.

2. Earnings per Share

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

The following table sets forth the computations of basic and diluted earnings per share as retroactively adjusted for the 5% stock dividend declared October 15, 2003 (dollars in thousands, except per share data):

	Three Months Ended June 30, 2004			Three Mon
(Dollars in thousands, except per share data)	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator
Basic earnings per share:				
Net income applicable to common stockholders	$ 391	1,832	$ 0.21	$ 360
Effect of dilutive securities:				
Stock options	--	73		--
Deferred common stock payments for purchase of insurance agency	1	16		2
Diluted earnings per share:				
Net income applicable to common stock-holders and assumed conversions	$ 392	1,921	$ 0.20	$ 362

(Dollars in thousands, except per share data)	Six Months Ended June 30, 2004 Income (Numerator)	Shares (Denominator)	Per Share Amount	Six Months Income (Numerator
Basic earnings per share:				
Net income applicable to common stockholders	$ 762	1,826	$ 0.42	$ 673
Effect of dilutive securities:				
Stock options	--	81		--
Deferred common stock payments for purchase of insurance agency	1	14		5
Diluted earnings per share:				
Net income applicable to common stock-holders and assumed conversions	$ 763	1,921	$ 0.40	$ 678

3. Comprehensive Income

The components of other comprehensive income and related tax effects for the three and six months ended June 30, 2004 and 2003 are as follows:

	Three Months Ended June 30, 2004	2003
	(In thousands)	
Unrealized holding gains (losses) on available for sale securities	($ 1,802)	$ 622
Less: reclassification adjustments for gains included in net income	--	--
Net unrealized gains (losses)	(1,802)	622
Tax effect	(720)	249
Other comprehensive income (loss), net of tax	($ 1,082)	$ 373

4. Segment Information

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

	Three Months Ended June 30, 2004			Three
	Banking and Financial Services	Insurance Services	Total	Banki Financial Se
	(In Thousands)			
Net interest income and other income	$ 2,680	$ 610	$ 3,290	$ 2,450
Income before income taxes	471	72	543	445
Total assets	247,552	3,563	251,115	232,578

	Six Months Ended June 30, 2004			Six Mo
	Banking and Financial Services	Insurance Services	Total	Banki Financial Se
	(In Thousands)			
Net interest income and other income	$ 5,389	$ 1,183	$ 6,572	$ 4,794
Income before income taxes	913	136	1,049	816
Total assets	247,552	3,563	251,115	232,578

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5. Stock Option Plans

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

	Three Months Ended June 30, 2004	2003	Six 20
	(In thousands)		
Net income, as reported	$ 391	$ 360	$ 7
Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(35)	(11)	(
Pro forma net income	$ 356	$ 349	$ 6

Basic earnings per share:			
As reported	$ 0.21	$ 0.20	$ 0.
Pro forma	$ 0.19	$ 0.20	$ 0.
Diluted earnings per share:			
As reported	$ 0.20	$ 0.20	$ 0.
Pro forma	$ 0.19	$ 0.19	$ 0.

6. Guarantees

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Company, generally, holds collateral and/or personal guarantees supporting these commitments. The Company had $382,000 of standby letters of credit as of June 30, 2004. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required under the corresponding guarantees. The current amount of the liability as of June 30, 2004 for guarantees under standby letters of credit issued is not material.

7. New Accounting Standard

In January 2003, the Financial Accounting Standards Board issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" which was revised in December 2003. The Interpretation provides guidance for the consolidation of variable interest entities (VIEs). Sussex Capital Trust I qualifies as a variable interest entity under FIN 46. Sussex Capital Trust issued mandatory redeemable preferred securities (Trust Preferred Securities) to third-party investors and loaned the proceeds to the Company. Sussex Capital Trust I holds, as it sole asset, subordinated debentures issued by the Company.

FIN 46 required the Company to deconsolidate Sussex Capital Trust I from the consolidated financial statements as of March 31, 2004. There has been no restatement of prior periods. The impact of this deconsolidation was to increase junior subordinated debentures or long-term debt by $5,155,000 and reduce the mandatory capital debentures line item by $5,000,000 which had represented the trust preferred securities of the trust. The Company's equity interest in the trust subsidiary of $155,000, which had previously been eliminated in consolidation, is now reported in "Other assets". For regulatory reporting purposes, the Federal Reserve Board has indicated that the preferred securities will continue to qualify as Tier I Capital subject to previously specified limitations, until further notice. If regulators make a determination that Trust Preferred Securities can no longer be considered in regulatory capital, the securities become callable and the Company may redeem them. The adoption of FIN 46 did not have an impact on the Company's results of operations or liquidity.

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

Three and Six Months ended June 30, 2004 and June 30, 2003

CRITICAL ACCOUNTING POLICIES

Disclosure of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements of the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003. Some of these policies are particularly sensitive, requiring significant judgments, estimates and assumptions to be made by management, most particularly in connection with determining the provision for loan losses and the appropriate level of the allowance for loan losses. Additional information is contained on pages 11 and 12 of this Form 10-QSB for the provision and allowance for loan losses.

FORWARD LOOKING STATEMENTS

When used in this discussion, the words "believes", "anticipates", "contemplated", "expects", or similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include changes in interest rates, the ability to control costs and expenses, general economic conditions and economic conditions in the Company's Sussex, New Jersey marketplace. The Company undertakes no obligation to update those forward looking statements to reflect the occurrence of unanticipated events or otherwise.

OVERVIEW

The Company realized net income of $391 thousand for the second quarter of 2004, an increase of $31 thousand from the $360 thousand reported for the same period in 2003. Basic earnings per share, as retroactively adjusted for the 5% stock dividend declared October 15, 2003, increased from $0.20 in the second quarter of 2003 to $0.21 for the second quarter of 2004. Diluted earnings per share were $0.20 in both second quarters ending June 30, 2003 and 2004.

For the six months ended June 30, 2004, net income was $762 thousand, an increase of $89 thousand from the $673 thousand reported for the same period in 2003. Basic earnings per share were $0.42 for the six months ended June 30, 2004 compared to $0.38 for the six-month period ended June 30, 2003. Diluted earnings per share were $0.40 for the six months ended June 30, 2004, an increase from $0.37 from the first six months of 2003.

The results reflect an increase in net interest income, a result of both increasing interest income and decreasing interest expense, coupled with increases in non-interest income, primarily due to an increase in mortgage banking fees from our residential lending division, partially offset by increases in non-interest expenses associated with additions to staff and higher related salary and benefit expenses.

RESULTS OF OPERATIONS

Interest Income. Total interest income increased $114 thousand, or 4.2%, to $2.8 million for the quarter ended June 30, 2004 from the same period in 2003. This increase was primarily attributable to an increase of $12.7 million, or 6.0%, in the average earning assets to $225.5 million in the second quarter of 2004 from $212.8 million in the same quarter of 2003. The average yield on earning assets decreased 4 basis points, on a fully taxable equivalent basis, to 5.17% during the second quarter of 2004 from 5.21% in the second quarter of 2003. Interest income on loans increased $128 thousand from $2.0 million in the second quarter 2003 to $2.2 million during the same period in 2004, while the average balance of total loans receivable increased $19.5 million, or 15.9%, from $122.6 million during the second quarter of 2003 to $142.1 million for the same quarter in 2004. Income from other interest-earning assets decreased by fifty percent to $24 thousand for the second quarter of 2004 from $48 thousand for the second quarter of 2004 from the second quarter in 2003 while the average balance decreased $6.4 million, or $41.3%, to $9.1 million in the second quarter of 2004 from $15.5 million in the same period of 2003. The interest earned on total securities increased $27 thousand, or 3.9%, while the average balance in total securities decreased by $396 thousand, or 1.0%, to $74.3 million from $74.7 million from the second quarter of 2003. The average rate earned on total securities increased by 18 basis points from 3.68% for the quarter ended June 30, 2003 to 3.86% for the period ending June 30, 2004. This average rate increase was accomplished by investing in higher yielding tax-exempt securities. The volume increase in total average earning assets and the shifting of average balances to higher yielding interest-earning assets exceeded the impact of market declines in interest rates, resulting in the increase in interest income for the second quarter of 2004 compared to the second quarter of 2003.

For the six months ended June 30, 2004, interest income, on a fully taxable equivalent basis, increased $265 thousand, or 4.8%, to $5.8 million from the $5.5 million reported for the same period in 2003. During the first six months of 2004 average interest-earning assets increased $12.0 million to $222.5 million from $210.5 million during the same period in 2003. The average balance in the loan portfolio increased $19.9 million, tax-exempt securities increased $6.0 million, taxable securities decreased $6.1 million and the average balance of other interest-earning assets decreased $7.8 million during the first six months of 2004 over the same period in 2003. As total average interest bearing asset balances increased, the average rate earned decreased by 6 basis points on a fully taxable equivalent basis from 5.29% from the first half of 2003 to 5.23% for the same period of 2004.

Interest Expense. The Company's interest expense for the second quarter of 2004 decreased $58 thousand, or 7.8%, to $686 thousand from $744 thousand in the second quarter of 2003. Despite the decline in interest expense, the average balance of interest bearing liabilities increased $13.3 million, or 7.2% to $198.3 million during the second quarter of 2004 from $185.0 million in the same period of 2003. The increase in the average balance of interest bearing liabilities was offset by the reduction in rates, as the average cost of funds declined to 1.39% for the second quarter of 2004 from 1.61% in the second quarter of 2003. Average money market deposits increased $9.6 million, or 256.19%, while the average rate paid increased 33 basis points from 0.75% in the second quarter of 2003 to 1.08% in the second quarter of 2004. Several large municipal accounts transferred balances from our public fund NOW account to a newly offered public fund money market account. To attract municipal accounts, a higher incentive rate was offered on the public fund money market account. As municipal balances were transferred from NOW accounts, the NOW accounts average balance decreased $1.0 million, or 2.3%, to $44.3 million during the second quarter 2004 from $45.3 million in the second quarter of 2003. The interest expense on NOW accounts decreased $20 thousand from the second quarter of 2003, as the average interest rate paid decreased 17 basis points from 0.61% to 0.44% during the same period. Average borrowed funds and debenture balances decreased $2.1 million to $16.2 million in the second quarter of 2004 from $18.3 million in the second quarter of 2003, due primarily to the maturity of short-term advances from the Federal Home Loan Bank. At June 30, 2004, the Company's borrowed funds consisted of one $1.0 million short-tem FHLB advance and three convertible notes from the FHLB totaling $10.0 million. In the third quarter of 2002, the Company issued $5.2 million in junior subordinated debentures. The debentures bear a floating rate of interest, which averaged 4.68% in the second quarter of 2004, down 30 basis points from 4.98% in the second quarter of 2003.

For the six months ended June 30, 2004 interest expense decreased $163 thousand, or 10.8%, to $1.4 million from $1.5 million for the same period last year as average interest-bearing deposit balances increased $14.3 million, or 8.7% from $165.6 million for the first six months of 2003 to $179.9 million for the first half of 2004. The average rate paid on total interest-bearing deposits has decreased by 25 basis points from 1.33% for the first six months of 2003 to 1.08% for the same period in 2004. The Company's borrowed funds decreased $2.8 million, or 20.2%, from $13.8 million during the first six months of 2003 to $11.0 million for the first half of 2004. The junior subordinated debentures have an average deconsolidated balance of $5.2 million and an average rate of 4.64% during the first six months of 2004, compared to an average rate of 5.01% for the first six months of 2003. The average rate paid on total interest bearing liabilities decreased 27 basis points from 1.66% in the first six months of 2003 to 1.39% during the same period in 2004. With the decline in market rates, the decrease in the average cost of funds exceeded the increase in the average balance of total interest-bearing liabilities.

The following table presents, on a fully taxable equivalent basis, a summary of the Company's interest-earning assets and their average yields, and interest-bearing liabilities and their average costs and shareholders' equity for the six months ended June 30, 2004 and 2003. The average balance of loans includes non-accrual loans, and associated yields include loan fees, which are considered adjustment to yields.

	Six Months Ended June 30,			
(dollars in thousands)	2004			2003
Earning Assets:	Average Balance	Interest (1)	Average Rate (2)	Average Balance
Securities:				
Tax exempt (3)	$ 22,172	$ 589	5.34%	$ 16,191
Taxable	52,349	885	3.40%	58,475
Total securities	74,521	1,474	4.00%	74,666
Total loans receivable (4)	138,719	4,262	6.18%	118,822
Other interest-earning assets	9,255	48	1.05%	17,029
Total earning assets	222,495	$ 5,784	5.23%	210,517
Non-interest earning assets	24,527			21,191
Allowance for loan losses	(1,842)			(1,472)
Total Assets	$ 245,180			$ 230,236
Sources of Funds:				
Interest bearing deposits:				
NOW	$ 47,066	$ 107	0.46%	$ 44,059
Money market	8,784	42	0.97%	4,302
Savings	66,097	215	0.65%	63,938
Time	57,941	603	2.09%	53,264

Total interest bearing deposits	179,888	967	1.08%	165,563
Borrowed funds	11,000	265	4.77%	13,779
Junior subordinated debentures	5,155	121	4.64%	5,000
Total interest bearing liabilities	196,043	$ 1,353	1.39%	184,342
Non-interest bearing liabilities:				
Demand deposits	31,826			29,680
Other liabilities	2,159			2,296
Total non-interest bearing liabilities	33,985			31,976
Stockholders' equity	15,152			13,918
Total Liabilities and Stockholders' Equity	$ 245,180			$ 230,236
Net Interest Income and Margin (5)		$ 4,431	4.01%	$

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

Net-Interest Income. On a fully taxable equivalent basis, the net interest income for the second quarter of 2004 increased $189 thousand over the same period last year. This increase was largely the result of the rate for total interest bearing liabilities decreasing 22 basis points to 1.39% in the second quarter of 2004 from 1.61% in the same period of 2003, as the yield on total earning assets decreased only 4 basis points during the same two second quarterly periods. The increase in the volume of interest-bearing liabilities also exceeded the increase in the volume of interest earning assets by $640 thousand. The net interest margin increased, on a fully taxable equivalent basis, by 13 basis points to 3.94% in the second quarter of 2004 compared to 3.81% the year earlier.

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Net interest income for the six months ended June 30, 2004, on a fully taxable equivalent basis, increased $428 thousand, or 10.7%, over the same period last year. The net interest margin increased, on a fully taxable equivalent basis, 18 basis points from 3.83% for the first six months of 2003 to 4.01% for the first half of 2004. Comparing the first six months of 2003 to the first six months of 2004, the increase in the net interest margin was more a component of rate than of volume, as the average rate paid on interest bearing liabilities decreased 27 basis points and the average rate earned on interest earning assets decreased only 6 basis points.

Provision for Loan Losses. For the three months ended June 30, 2004 the provision for loan losses was $105 thousand compared to $120 thousand for the quarter ended June 30, 2003. The provision for loan losses was $253 thousand for the six months ended June 30, 2004 as compared to $245 thousand for the same period last year. The provision for loan losses reflects management's judgment concerning the risks inherent in the Company's existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as the average balance of the portfolio over both periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

Non-Interest Income. For the second quarter of 2004, total non-interest income increased $145 thousand, or 14.2%, from the same period in 2003. The majority of this increase is attributed to the Company's new residential lending division which began operation in the third quarter of 2003. In the second quarter of 2004 mortgage banking fees were $161 thousand compared to no mortgage banking fee income reported in the second quarter of 2003. Insurance commissions and fee income increased $81 thousand, or 15.5%, from $523 thousand in the second quarter of 2003 to $604 thousand in the quarter ended June 30, 2004. This increase was largely due to increases in new business and a stronger sales force.

For the six months ended June 30, 2004, non-interest income increased $300 thousand, or 14.9%, from the same period in 2003. Most of this increase is from the Company's new residential lending division. Mortgage banking fees were $326 thousand for the first half of 2003, compared to $44 thousand for the same period in 2003. Insurance commissions increased $83 thousand during the first six months of 2004 compared to 2003. Other income increased $43 thousand, or 34.4%, from $125 thousand during the first six months of 2003 to $168 thousand for the six months ended June 30, 2004. Of this increase, $36 thousand is from income recorded on a bank owned life insurance policy purchased in January of 2004. All other categories of non-interest income showed minor fluctuations. In the first six months of 2003, a $63 thousand gain on the sale of foreclosed real estate and a $24 thousand gain on the sale of loans held for sale were recorded, while there were no similar gains during the first six months of 2004.

Non-Interest Expense. For the quarter ended June 30, 2004, non-interest expense was $2.6 million, an increase of $276 thousand, or 11.7%, from $2.4 million for the six months ended June 30, 2003. This increase is attributed to the increase of the Company's salaries and employee benefits of $173 thousand, or 12.9%, for the addition of ten full time equivalent employees and commissions paid on the residential mortgage banking activity. Occupancy expense has increased $59 thousand, or 40.0%, from second quarter of 2003 to the same period in 2004, due to a new lease agreement for administrative and operations office space at Sterling Plaza, Franklin, New Jersey, which is being rented to accommodate the Company's growth and expansion needs. Furniture and equipment expense has increased $15 thousand from the second quarter of 2003 to the same period in 2004 from the purchase of computer hardware and software made in connection with a major hardware upgrade and system conversion in May of 2004.

For the six months ended June 30, 2004, non-interest expense increased $547 thousand, or 11.6%, to $5.3 million, from the first six months of 2003. Salaries and employee benefits increased $463 thousand, or 17.6%, relating to general staff increases and costs associated with an increased number of commission based employees. The other major non-interest expense increase for the first six months of 2004 over the same period in 2003 was an increase of $90 thousand for the lease and occupancy of new administrative offices at Sterling Plaza in Franklin, New Jersey.

Income Taxes. Income tax expense increased $25 thousand to $152 thousand (28% effective tax rate) for the three months ended, June 30, 2004 compared to $127 thousand (26% effective tax) rate for the same period in 2003. Income taxes increased $47 thousand for the six months ended June 30, 2004 to $287 thousand (27% effective tax rate) as compared to $240 thousand (26% effective tax rate) for the six months ended June 30, 2003. These increases in income taxes resulted from an increase in income before taxes for the three and six month periods ended June 30, 2004 compared to the same periods ended June 30, 2003.

FINANCIAL CONDITION
June 30, 2004 as compared to December 31, 2003

Total assets increased to $251.1 million at June 30, 2004, a $10.5 million increase from total assets of $240.6 million at December 31, 2003. Increases in total assets include increases of $9.7 million in net loans, $1.9 million in cash and cash equivalents and $3.0 million in other assets, partially offset by a $1.8 million reduction in securities available for sale and a $3.0 million decline in interest bearing time deposits with other banks. Asset increases were financed through an increase in total deposits of $9.7 million from $207.7 million at year-end 2003 to $217.4 million at June 30, 2004. Total stockholder's equity increased $137 thousand from $14.9 million at December 31, 2003 to $15.0 million at June 30, 2004. Due to the decline in the fair value of the available for sale investment portfolio during the first half of 2004, accumulated other comprehensive income decreased $667 thousand from $248 thousand on December 31, 2003 to an accumulated other comprehensive loss of $419 thousand at June 30, 2004.

Total loans at June 30, 2004 increased $9.9 million to $144.3 million from $134.4 million at year-end 2003. During the six-month period ending June 30, 2004, new originations have exceeded payoffs both through scheduled maturities and prepayments. The Company continues to see significant prepayment activity as borrowers seek to refinance loans in the current low interest rate environment. The Company is emphasizing the origination of commercial, industrial, and non-residential real estate loans to increase the yield in its loan portfolio and reduce its dependence on loans secured by 1-4 family properties. The Company has also increased its activity in the loan participation market. The majority of the originated and sold participations are commercial real estate related loans which exceed the Company's legal lending limit. The balance in non-residential real estate loans increased $5.5 million from $59.2 million at December 31, 2003 to $64.7 million on June 30, 2004, construction and land development loans increased $4.0 million, loans secured by farmland increased $2.2 million and commercial and industrial loans increased $1.8 million over the same six-month period. Residential 1-4 family real estate loans have decreased $3.6 million from December 31, 2003 to June 30, 2004 as residential mortgage applicants are being referred to our residential mortgage division for third party processing.

Federal funds sold increased by $795 thousand to $5.0 million at June 30, 2004 from $4.2 million on December 31, 2003. During the first six months of 2004, these funds were provided by the increase in total deposits and have been used to fund increased loan demand.

Securities, available for sale, at fair value, decreased $1.8 million from $76.5 million at year-end 2003 to $74.8 million at June 30, 2004. The Company purchased $13.8 million in new securities in the first six months of 2004 and $14.1 million in available for sale securities matured, were called and were repaid. There was a $1.1 million increase in unrealized losses in the available for sale portfolio and $352 thousand in net amortization expenses recorded during the first six months of 2004. There were no held to maturity securities at June 30, 2004 or at December 31, 2003.

Premises and equipment increased by $820 thousand, or 17.6%, from $4.7 million at December 31, 2003 to $5.5 million on June 30, 2004. This increase was due to a renovation project at the main office location in Franklin, NJ, leasehold improvements at the Company's new administrative and operations facility and the Company's purchase of new computer hardware and software attributed to a network upgrade and system conversion. Other assets increased from $3.7 million on December 31, 2003 to $6.7 million on June 30, 2004. This $3.0 million increase was generated from the purchase of a $1.5 million bank owned life insurance policy in January of 2004, the prepayment of the Company's insurance policies and receivable and deferred tax asset balances increasing during this six month period.

Total deposits increased $9.7 million, or 4.7%, to $217.4 million during the first six months of 2004 from $207.7 million at December 31, 2003. Non-interest bearing deposits increased $4.0 million to $35.7 million at June 30, 2004 from $31.7 million at December 31, 2003, interest-bearing and savings deposits increased $6.4 million, or 5.3%, and total time deposits decreased $634 thousand, from December 31, 2003 to June 30, 2004. Non-interest bearing business and business NOW deposit balances increased $3.3 million from December 31, 2003 to June 30, 2004 and non-core IOLTA and public fund account balances have recorded a $5.9 million increase in balances in the first six months of 2004. Management continues to monitor the shift in deposits through its Asset/Liability Committee.

LOAN AND ASSET QUALITY

Non-performing assets consist of non-accrual loans and all loans over ninety days delinquent and foreclosed real estate owned ("OREO"). At June 30, 2004, non-accrual loans increased by $250 thousand to $1.4 million, as compared to $1.2 million at December 31, 2003. There were no loans ninety days past due and still accruing or renegotiated loans at June 30, 2004. The Company had $223 thousand in OREO properties at June 30, 2004 and at December 31, 2003. In addition to active monitoring and collecting on delinquent loans, management has an active loan review process for customers with aggregate relationships of $250,000 or more if the credit(s) are unsecured or secured, in whole or substantial part, by collateral other than real estate and $1,000,000 or more if the credit(s) are secured, in whole or substantial part, by real estate. Management continues to monitor the Company's asset quality and believes that the non-accrual loans are adequately collateralized and anticipated material losses have been adequately reserved for in the allowance for loan losses.

The following table provides information regarding risk elements in the loan portfolio (dollars in thousands):

	June 30, 2004	December 31, 2003
	(Dollars in thousands)	
Non-accrual loans	$ 1,427	$ 1,177
Non-accrual loans to total loans	0.99%	0.88%
Non-performing assets to total assets	0.66%	0.63%
Allowance for loan losses as a % of non-performing loans	137.21%	130.67%
Allowance for possible loan losses to total loans	1.36%	1.29%

ALLOWANCE FOR LOAN LOSSES

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

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

At June 30, 2004, the allowance for loan losses was $2.0 million, an increase of 12.9% from the $1.7 million at year-end 2003. The provision for loan losses was $253,000 and there were $29,000 in charge offs and no recoveries reported in the first six months of 2004. The allowance for loan losses as a percentage of total loans was 1.36% at June 30, 2004 compared to 1.29% on December 31, 2003.

INTEREST RATE SENSITIVITY

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. Interest rate sensitivity is the volatility of a company's earnings from a movement in market interest rates. Interest rate "gap" analysis is a common, though imperfect, measure of interest rate risk. We do not employ gap analysis as a rate risk management tool, but rather we rely upon earnings at risk analysis to forecast the impact on our net interest income of instantaneous 100 and 200 basis point increases and decreases in market rates. In assessing the impact on earnings, the rate shock analysis assumes that no change occurs in our funding sources or types of assets in response to the rate change.

Our financial modeling simulates our cash flows, interest income and interest expense from earning assets and interest bearing liabilities in each of the different interest rate environments, using actual individual deposit, loan and investment maturities and rates in the model calculations. Assumptions regarding the likelihood of prepayments on residential mortgage loans and investments are made based on historical relationships between interest rates and prepayments. Commercial loans with prepayment penalties are assumed to pay on schedule to maturity. In actual practice, commercial borrowers may request and be granted interest rate reductions during the life of a commercial loan due to competition from financial institutions and declining interest rates. The interest rate sensitivity of the Company's assets and liabilities, and the impact on net interest income would vary substantially if different assumptions were used or if actual experience differs from that indicated by the assumptions.

The following table sets forth the Company's interest rate risk profile at June 30, 2004 and 2003.

(Dollars in Thousands)	June 30, 2004 Change in Net Interest Income	June 30, 2004 Gap as a % of Total Assets	June 30, 2003 Change in Net Interest Income	June 30, 2003 Gap as % of Total Ass
Down 200 basis points	($584)	11.66%	($154)	3
Down 100 basis points	(147)	5.86%	(33)	1
Up 100 basis points	(70)	-2.80%	(213)	-9
Up 200 basis points	(211)	-4.22%	(517)	-10

LIQUIDITY MANAGEMENT

It is management's intent to fund future loan demand primarily with deposits and maturities and paydowns on investments. In addition, the Bank is a member of the Federal Home Loan Bank of New York and as of June 30, 2004, had the ability to borrow up to $16.5 million against its one to four family mortgages and selected investment securities as collateral for borrowings. The Bank also has available an overnight line of credit and a one-month overnight repricing line of credit, each in the amount of $11.8 million at the Federal Home Loan Bank and an overnight line of credit in the amount of $4 million at the Atlantic Central Bankers Bank. The Company at June 30, 2004 had borrowings totaling $11 million secured by the pledge of its one to four family mortgages and selected securities. One short-term borrowing of $1 million has a maturity in July of 2004 with an interest rate of 3.01%. The remaining $10 million in borrowings consist of three notes that mature on December 21, 2010 with a convertible quarterly option which allows the Federal Home Loan Bank to change the note to then current market rates. The interest rates on these three borrowings range from 4.77% to 5.14%.

At June 30, 2004, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied. At June 30, 2004, liquid investments totaled $17.4 million, and all mature within 30 days.

The following table represents the Company's contractual obligations to make future payments.

(In thousands)	Payments due by period Total	Less than 1 year	1-3 years	3-5 year
Borrowings	$ 11,000	$ 1,000	$ --	$ --
Operating lease obligations	857	236	365	134
Purchase obligations	389	389	--	--
Time deposits	55,847	43,661	8,756	2,945

Junior subordinated debentures	5,155	--	--	--
Total	$ 73,248	$ 45,286	$ 9,121	$ 3,079

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

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

OFF-BALANCE SHEET ARRANGEMENTS

The Company's financial statements do not reflect off-balance sheet arrangements that are made in the normal course of business. These off-balance sheet arrangements consist of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. These unused commitments, at June 30, 2004 totaled $31,183,000. This consisted of $9,164,000 in commercial construction lines of credit, $9,496,000 in home equity lines of credit, $7,275,000 in commercial lines of credit, $3,184,000 in commitments to grant commercial and residential loans and the remainder in other unused commitments. These instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Company.

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

CAPITAL RESOURCES

Total stockholders' equity increased $137 thousand to $15.0 million at June 30, 2004 from $14.9 million at year-end 2003. Activity in stockholders' equity consisted of a net increase in retained earnings of $507 thousand derived from $762 thousand in net income earned during the first six months of 2004, offset by $255 thousand for the payments of cash dividends. Other increases were $202 thousand in stock options exercised and $97 thousand for shares issued through the dividend reinvestment plan. An unrealized loss on securities available for sale, net of income tax, reduced stockholders' equity by $667 thousand as well as the retirement of $2 thousand in treasury shares.

On July 11, 2002, the Company raised an additional $4.8 million, net of offering costs, in capital through the issuance of junior subordinated debentures to a statutory trust subsidiary. The subsidiary in turn issued $5.0 million in variable rate capital trust pass through securities to investors in a private placement. The interest rate is based on the three-month LIBOR rate plus 365 basis points and is adjusted quarterly. Beginning July 7, 2004, the new quarterly rate of interest on the debentures will be 5.25%. The rate is capped at 12.5% through the first five years, and the securities may be called at par any time after October 7, 2007, or if the regulatory capital or tax treatment of the securities is substantially changed. These trust preferred securities are included in the Company's and the Bank's capital ratio calculations.

At June 30, 2004 the Company and the Bank both meet the well-capitalized regulatory standards applicable to them. The table below presents the capital ratios at June 30, 2004, for the Company and the Bank, as well as the minimum regulatory requirements.

(Dollars in thousands)	Amount	Ratio	Amount	Minimum Ratio
The Company:				
Leverage Capital	$ 17,805	7.24%	$ >= 9,833	4%
Tier 1 - Risk Based	17,805	10.84%	>= 6,570	4%
Total Risk-Based	19,763	12.03%	>= 13,139	8%
The Bank:				
Leverage Capital	17,255	7.03%	>= 9,819	4%
Tier 1 Risk-Based	17,255	10.54%	>= 6,548	4%
Total Risk-Based	19,213	11.74%	>= 13,096	8%

ITEM 3 - CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

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

(b) Changes in internal controls.

Not applicable

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 2. Changes in Securities and Small Business Issuer Purchases of Equity Securities

There were no changes in securities. The Company did not have any common stock repurchases during the second quarter of 2004. On April 16, 1999 the Company announced a stock repurchase plan whereby the Company may purchase up to 50,000 shares of outstanding stock. There is no expiration date to this plan.

Item 3. Defaults upon Served Securities

Not applicable

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

On April 28, 2004, the Registrant held its annual meeting of shareholders to elect members of the Company's Board of Directors whose terms expired. Nominees for election to the Board of Directors received the following votes:

Nominees:	For	Withhold Authority
Irvin Ackerson	1,552,737	130,896
Terry H. Thompson	1,638,104	45,530

Item 5. Other Information

Not applicable

Item 6. Exhibits and Report on form 8-K

(a). Exhibits

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

(b). Reports on Form 8-K

Filing Date	Item Number	Description
April 23, 2004	7 & 12	Press release announcing first quarter 2004 results and cash dividend.

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.

SUSSEX BANCORP

By:/s/ Candace A. Leatham

CANDACE A. LEATHAM
Executive Vice President and
Chief Financial Officer

Date:

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