SALISBURY BANCORP INC
Form 10-Q
August 11, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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, 2006

OR

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

For the transition period from ________________________ to ____________________

Commission file number 0-24751

Salibury Bancorp, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Connecticut	06-1514263
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

5 Bissell Street Lakeville Connecticut 06039

(Address of principal executive offices) (Zip Code)

Registrants Telephone Number, Including Area Code (860) 435-9801

(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 a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated Filer" in Rule 12b-2 of the Exchange Act). (Check one):

Large Accelerated Filer [_] Accelerated Filer [_] Non-Accelerated Filer [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes[_] No [X]

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of August 4, 2006, there were 1,684,181 shares outstanding.

SALISBURY BANCORP, INC. AND SUBSIDIARY

TABLE OF CONTENTS

2

Part I-- FINANCIAL INFORMATION
Item 1. Financial Statements

3

SALISBURY BANCORP, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except per share data)
June 30, 2006 and December 31, 2005

	June 30, 2006	De
ASSETS		
(unaudited)		
Cash and due from banks	$ 7,208	$
Interest bearing demand deposits with other banks	305	
Money market mutual funds	824	
Cash and cash equivalents	8,337	
Investments in available-for-sale securities (at fair value)	145,191	
Investments in held-to-maturity securities (fair values of $77 as of June 30, 2006 and $147 as of December 31, 2005)	77	
Federal Home Loan Bank stock, at cost	4,553	
Loans held-for-sale	117	
Loans, less allowance for loan losses of $2,580 as of June 30, 2006 and $2,626 as of December 31, 2005	228,337	
Investment in real estate	75	
Premises and equipment	6,319	
Goodwill	9,509	
Core deposit intangible	1,576	
Accrued interest receivable	2,392	
Cash surrender value of life insurance policies	3,484	
Other assets	3,198	
Total assets	$ 413,165	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 67,992	$
Interest-bearing	230,442	
Total deposits	298,434	
Federal Home Loan Bank advances	70,413	
Other liabilities	3,313	

Total liabilities	372,160
Stockholders' equity:	
Common stock, par value $.10 per share; authorized 3,000,000 shares; issued and outstanding, 1,684,181 shares at June 30, 2006 and 1,683,341 shares at December 31, 2005	168
Paid-in capital	13,100
Retained earnings	32,379
Accumulated other comprehensive loss	(4,642)
Total stockholders' equity	41,005
Total liabilities and stockholders' equity	$ 413,165

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

SALISBURY BANCORP, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(amounts in thousands, except per share data)
June 30, 2006 and 2005
(unaudited)

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005	Three Months Ende June 30, 2006	Three Months Ende June 30, 2005
Interest and dividend income:				
Interest and fees on loans	$ 7,471	$ 6,449	$ 3,843	$ 3,239
Interest on debt securities:				
Taxable	2,562	2,239	1,294	1,137
Tax-exempt	1,057	1,282	562	626
Dividends on equity securities	130	101	70	53
Other interest	29	32	20	14
Total interest and dividend income	11,249	10,103	5,789	5,069
Interest expense:				
Interest on deposits	2,957	1,887	1,619	979
Interest on Federal Home Loan Bank advances	1,741	1,502	912	765
Total interest expense	4,698	3,389	2,531	1,744
Net interest and dividend income	6,551	6,714	3,258	3,325
Provision for loan losses	0	180	0	90
Net interest and dividend income after provision for loan losses	6,551	6,534	3,258	3,235

Noninterest income:				
Trust department income	935	777	450	389
Loan commissions	45	126	31	54
Service charges on deposit accounts	359	303	182	159
Gain (loss) on sales of available-for-sale securities, net	61	837	(13)	351
Gain on sales of loans held-for-sale	230	136	168	45
Other income	397	436	183	228
Total noninterest income	2,027	2,615	1,001	1,226
Noninterest expense:				
Salaries and employee benefits	3,410	3,510	1,707	1,702
Occupancy expense	352	349	176	163
Equipment expense	381	374	194	187
Data processing	610	556	327	359
Insurance	63	75	32	35
Printing and stationery	129	163	76	104
Professional fees	180	134	90	60
Legal expense	63	101	38	75
Amortization of core deposit intangible	82	82	41	41
Other expense	559	647	311	239
Total noninterest expense	5,829	5,991	2,992	2,965
Income before income taxes	2,749	3,158	1,267	1,496
Income taxes	596	521	261	188
Net income	$ 2,153	$ 2,637	$ 1,006	$ 1,308
Earnings per common share	$ 1.28	$ 1.57	$ .60	$ .78
Dividends per average share outstanding	$ .52	$ 50	$ .26	$ .25

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

SALISBURY BANCORP, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)
Six months ended June 30, 2006 and 2005
(unaudited)

	2006	2005
Cash flows from operating activities:		
Net income	$ 2,153	$ 2,637
Adjustments to reconcile net income to net cash provided by operating activities:		

Amortization of securities, net	67	152
Gain on sales of available-for-sale securities, net	(61)	(837)
Provision for loan losses	0	180
Change in loans held-for-sale	(117)	(23)
Net decrease in mortgage servicing rights	16	0
Depreciation and amortization	272	245
Amortization of core deposit intangible	82	82
Accretion of fair value adjustment on deposits/borrowings	(69)	(77)
Amortization of fair value adjustment on loans	63	107
Increase in interest receivable	(28)	(44)
Deferred tax benefit	(187)	(27)
Decrease (increase) in taxes receivable	280	(125)
Increase in prepaid expenses	(344)	(899)
Increase in cash surrender value of insurance policies	(60)	(60)
Decrease in other assets	0	291
Decrease in accrued expenses	(682)	(137)
Increase in interest payable	43	1
Increase in other liabilities	92	60
Issuance of shares for Directors' fees	32	36
Decrease in unearned income on loans	(54)	0
Net cash provided by operating activities	1,498	1,562
Cash flows from investing activities:		
Redemption of Federal Home Loan Bank stock	860	0
Purchases of available-for-sale securities	(33,644)	(49,235)
Proceeds from sales of available-for-sale securities	27,163	46,170
Proceeds from maturities of available-for-sale securities	4,900	26,419
Proceeds from maturities of held-to-maturity securities	70	11
Loan originations and principal collections, net	(12,381)	(4,523)
Recoveries of loans previously charged-off	22	14
Capital expenditures	(125)	(710)
Net cash (used in) provided by investing activities	(13,135)	18,146

6

SALISBURY BANCORP, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)
Six months ended June 30, 2006 and 2005
(unaudited)
(continued)

	2006	2005
Cash flows from financing activities:		
Net decrease in demand deposits, NOW and savings accounts	(7,443)	(5,780)

Net increase (decrease) in time deposits	18,609	(5,557)
Federal Home Loan Bank advances	10,000	11,560
Principal payments on advances from Federal Home Loan Bank	(9,943)	(20,786)
Net change in short term advances from Federal Home Loan Bank	(594)	0
Dividends paid	(859)	(828)
Net cash provided by (used in) financing activities	9,770	(21,391)
Net decrease in cash and cash equivalents	(1,867)	(1,683)
Cash and cash equivalents at beginning of year	10,204	11,678
Cash and cash equivalents at end of period	$ 8,337	$ 9,995
Supplemental disclosures:		
Interest paid	$ 4,724	$ 3,388
Income taxes paid	503	673

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

7

SALISBURY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 - BASIS OF PRESENTATION

The accompanying condensed consolidated interim financial statements are unaudited and include the accounts of Salisbury Bancorp, Inc. (the "Company"), its wholly owned subsidiary Salisbury Bank and Trust Company (the "Bank"), and the Bank's subsidiaries, S.B.T. Realty, Inc. and SBT Mortgage Service Corporation (the "PIC") formed in April 2004. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to SEC Form 10-Q. Accordingly, they do not include all the information and footnotes required by GAAP for complete financial statements. All significant intercompany accounts and transactions have been eliminated in the consolidation. These financial statements reflect, in the opinion of Management, all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company's financial position and the results of its operations and its cash flows for the periods presented. Operating results for the six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2005 Annual Report on Form 10-K.

The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

NOTE 2 - COMPREHENSIVE INCOME

Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income," establishes standards for disclosure of comprehensive income which includes net income and any changes in equity from non-owner sources that are not recorded in the income statement (such as changes in the net unrealized gains (losses) on securities). The purpose of reporting comprehensive income is to report a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. The Company's one source of other comprehensive income is the net unrealized holding gain (loss) on securities.

Comprehensive Income (Loss)

	Six months ended June 30, 2006	Six months ended June 30, 2005	Three months ended June 30, 2006	Three months ended June 30, 2005
	(amounts in thousands)		(amounts in thousands)	
Net income	$ 2,153	$ 2,637	$ 1,006	$ 1,308
Net change in unrealized holding (losses) or gains on securities during period	(1,747)	78	(2,060)	1,373
Comprehensive income (loss)	$ 406	$ 2,715	$(1,054)	$ 2,681

NOTE 3 - IMPACT OF NEW ACCOUNTING STANDARDS

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). This Statement revises FASB Statement No. 123, "Accounting for Stock Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the consolidated financial statements. It establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. This Statement is effective for the Company as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The adoption of this Statement is not anticipated to have a material impact on the Company's financial position or results of operations as there are no share-based payment arrangements with employees and the compensation expense related to the Directors Stock Retainer Plan is not anticipated to be material.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets- an amendment of FASB Statement No. 140. SFAS No. 156 requires any entity to recognize a servicing asset or servicing liability each time it

8

undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability shall be initially measured at fair value; however, an entity may elect the "amortization method" or "fair value method" for subsequent balance sheet reporting periods. SFAS No. 156 is effective as of an entity's first fiscal year beginning after September 15, 2006. Early adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. The Company does not expect the adoption of this statement to have a material impact on its financial condition, results of operations or cash flows.

NOTE 4 - DEFINED BENEFIT PENSION PLAN

The following summarizes the net periodic benefit cost for the six months and three months ended June 30:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2006	2005	2006	2005
Components of net periodic benefit cost:				
Service cost	$ 242,865	$ 233,285	$ 121,432	$ 149,743
Interest cost	163,496	145,413	81,748	84,483
Expected return on plan assets	(142,833)	(133,806)	(71,416)	(83,578)
Amortization of:				
Prior service costs	447	446	224	223
Transition obligation	0	1,386	0	693
Actuarial loss	48,263	32,668	24,131	15,256
Net periodic benefit cost	$ 312,238	$ 279,392	$ 156,119	$ 166,820

The following actuarial weighted average assumptions were used in calculating net periodic benefit cost:

Discount rate	6.00%	6.00%	6.00%	6.00%
Average wage increase	Graded table*	Graded table*	Graded table*	Graded table*
Return on plan assets	7.25%	7.25%	7.25%	7.25%

*5% at age 20 grading down to 3% at age 60 and beyond (roughly 3.25% on average).

9

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

Business

The following provides Management's comments on the financial condition and results of operations of Salisbury Bancorp, Inc. (the "Company"), a Connecticut corporation that is the holding company for Salisbury Bank and Trust Company (the "Bank"). The Company's sole subsidiary is the Bank, which has six (6) full service offices including a Trust and Investment Services Division located in the towns of Canaan, Lakeville, Salisbury and Sharon, Connecticut and Sheffield and South Egremont, Massachusetts. The Company and Bank were formed in 1998 and 1848, respectively. In order to provide a strong foundation for building shareholder value and servicing customers, the Company remains committed to investing in the technological and human resources necessary to developing new personalized financial products and services to meet the needs of customers. This discussion should be read in conjunction with Salisbury Bancorp, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2005.

RESULTS OF OPERATIONS

Overview

The Company's net income for the six months ended June 30, 2006 was $2,153,000. This compares to earnings of $2,637,000 for the same period in 2005. Earnings per share for the six months ended June 30, 2006 totaled $1.28 per share that compared to earnings per share of $1.57 for the corresponding period in 2005. The decrease in earnings is primarily attributable to a decrease in non-interest income; specifically, reduced income from gains in securities transactions when comparing the two periods. During the first six months of 2006, the Company's gains on sale of available-for-sale securities amounted to $61,000 as compared with $837,000 during the same period in 2005. In addition, the Federal Reserve Bank has moved interest rates upward. This action is raising short term rates flattening the yield curve. As a result, the cost of deposits and the cost of borrowed funds are increasing at a faster pace than the earnings yield on the loan and securities portfolios. This interest rate environment compresses the net interest margins for financial intermediaries like the Bank. Total non-interest expense for the first six months of 2006 decreased $162,000 or 2.70% when comparing the corresponding period in 2005. This decrease is primarily the result of managements continuing efforts to control operating expenses.

The Company's assets at June 30, 2006 totaled $413,165,000 compared to total assets of $402,922,000 at December 31, 2005. New business development efforts have resulted in growth in net loans outstanding which totaled $228,454,000 at June 30, 2006. This is an increase of $12,464,000 or 5.77% when compared to total net loans of $215,989,000 at December 31, 2005. Non-performing loans totaled $771,000 at June 30, 2006 as compared to non-performing loans totaling $773,000 at December 31, 2005. The Bank continues to monitor the quality of the loan portfolio to ensure that loan quality will not be sacrificed for growth or otherwise compromise the Company's objectives. Deposits at June 30, 2006 totaled $298,434,000 as compared to total deposits of $287,271,000 at December 31, 2005. The increase is primarily the result of the Bank's decision to begin using brokered deposits as part of a growth strategy. As of June 30, 2006, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. The Company's total risk based capital ratio was 16.13%; the Tier 1 capital ratio was 15.00% and the leverage ratio was 8.54%. The Board of Directors declared a second quarter cash dividend of $.26 per common share, which was paid on July 31, 2006 to shareholders of record as of June 30, 2006. This compared to a cash dividend of $.25 per common share that was paid for the second quarter of 2005. Year-to-date dividends total $.52 per common share outstanding for this year. This compares to total year-to-date dividends of $.50 per common share one year ago.

Critical Accounting Estimates

In preparing the Company's financial statements, management selects and applies numerous accounting policies. In applying these policies, management must make estimates and assumptions. The accounting policy that is most susceptible to critical estimates and assumptions is the allowance for loan losses. The determination of an

10

appropriate provision is based on an estimation of the probable amount of future credit losses in the loan portfolio. Many factors influence the amount of future loan losses, relating to both the specific characteristics of the loan portfolio and general economic conditions nationally and locally. While management carefully considers these factors in determining the amount of the allowance for loan losses, future adjustments may be necessary due to changed conditions, which could have an adverse impact on reported earnings in the future. See "Provisions and Allowance for Loan Losses."

SIX MONTHS ENDED JUNE 30, 2006
AS COMPARED TO SIX MONTHS ENDED JUNE 30, 2005

Net Interest Income

The Company's earnings are primarily dependent upon net interest and dividend income, and to a lesser extent its non-interest incomes. Net interest and dividend income is the difference between interest and dividends earned on the loan and securities portfolio and interest paid on deposits and advances from the Federal Home Loan Bank. Non-interest income is primarily derived from the trust and investment services division, service charges and other fees related to deposit and loan accounts and income from gains in securities transactions. For the following discussion, net interest and dividend income is presented on a fully taxable-equivalent ("FTE") basis. FTE interest income restates reported interest income on tax exempt securities as if such interest were taxed at the Company's federal tax rate of 34% for all periods presented.

(amounts in thousands)

Six Months Ended June 30,	2006	2005
Total Interest and Dividend Income (financial statements)	$11,249	$10,103
Tax Equivalent Adjustment	545	660
Total Interest and Dividend Income (on an FTE basis)	11,794	10,763
Total Interest Expense	4,698	3,389
Net Interest and Dividend Income-FTE	$ 7,096	$ 7,374

Total interest and dividend income on an FTE basis for the six months ended June 30, 2006, when compared to the same period in 2005, increased $1,031,000 or approximately 9.58%. The increase was primarily attributable to an economic environment experiencing an increase in interest rates as well as an increase in earning assets.

Interest expense on deposits for the first six months of 2006 totaled

$2,957,000, an increase of $1,070,000 or 56.70% which compared to $1,887,000 for the same period in 2005. This increase reflects an economic environment of generally higher interest rates as well as growth in deposits. Although Federal Home Loan Bank advances decreased less than 1% during the six month period ended June 30, 2006, interest expense on these advances increased 15.91% to $1,741,000. This increase in interest expense is also attributable to an economic environment of increasing interest rates. Total interest expense for the six months ended June 30, 2006 was $4,698,000, an increase of $1,309,000 or 38.62% when compared to the same period in 2005.

Overall, net interest and dividend income (on an FTE basis) decreased $278,000 or 3.77% to $7,096,000 for the period ended June 30, 2006 when compared to the same period in 2005.

Noninterest Income

Noninterest income totaled $2,027,000 for the six months ended June 30, 2006. This is a decrease of $588,000 or 22.49% compared to noninterest income of $2,615,000 for the six months ended June 30, 2005. Gains on sales of available-for-sale securities decreased 92.71% to $61,000 for the first six months of 2006 compared to the corresponding period in 2005. This decrease is primarily the result of the movement of market rates during the quarter. The yield curve continued to flatten and was inverted at times during the first six months of 2006 which limited opportunities to generate gains on sales of available-for-sale securities. However, continuing growth of the

11

trust and investment services division has resulted in an increase in trust income of $158,000 or 20.33% to $935,000 for the first six months of 2006, which compares to $777,000 for the same period in 2005.

Other income has remained consistent when comparing the first six months of 2006 to the same period in 2005. This category of income primarily consists of fees associated with transaction accounts and in addition, fees related to the origination and servicing of mortgage loans and gains related to the sale of mortgage loans.

Noninterest Expense

Noninterest expense decreased 2.7% for the first six months of 2006 as compared to the same period in 2005. Although there are some increases in noninterest expenses which are attributable to normal volumes of business, the overall decreases in the noninterest expenses listed in the table below are all primarily attributable to management's continuing efforts to control operating expenses. The components of noninterest expense and the changes in the period were as follows (amounts in thousands):

	2006	2005	Change%	Change
Salaries and employee benefits	$3,410	$3,510	$ (100)	(2.8)
Occupancy expense	352	349	3	.9
Equipment expense	381	374	7	1.9
Data processing	610	556	54	9.7
Insurance	63	75	(12)	(16.0)
Printing and stationery	129	163	(34)	(20.9)
Professional fees	180	134	46	34.3
Legal expense	63	101	(38)	(37.6)
Amortization of core deposit intangible	82	82	0	0
Other expense	559	647	(88)	(13.6)

Total noninterest expense	$5,829	$5,991	$ (162)	(2.7)

Income Taxes

The income tax provision for the first six months of 2006 totaled $596,000 in comparison to $521,000 for the same six month period in 2005. Pretax income in 2006 was $2,749,000 and included tax exempt income totaling $1,057,000. Pretax income in 2005 was $3,158,000 and included tax exempt income totaling $1,282,000. The increase in the income tax provision is primarily attributable to an increase in taxable income.

Net Income

Overall, net income totaled $2,153,000 for the six months ended June 30, 2006 and represents earnings of $1.28 per average share outstanding. This compares to net income of $2,637,000 or $1.57 per average share outstanding for the same period in 2005.

THREE MONTHS ENDED JUNE 30, 2006
AS COMPARED TO THREE MONTHS ENDED JUNE 30, 2005

Net Interest Income

For the following discussion, net interest and dividend income is presented on a fully taxable-equivalent ("FTE") basis. FTE interest income restates reported interest income on tax exempt loans and securities as if such interest were taxed at the Company's federal tax rate of 34% for all periods presented.

(amounts in thousands)

Three Months Ended June 30	2006	2005
Total Interest and Dividend Income (financial statements)	$ 5,789	$ 5,069
Tax Equivalent Adjustment	290	322
Total Interest and Dividend Income (on an FTE basis)	6,079	5,391
Total Interest (Expense)	(2,531)	(1,744)
Net Interest and Dividend Income-FTE	$ 3,548	$ 3,647

12

Total interest and dividend income on an FTE basis for the three months ended June 30, 2006 increased $688,000 or approximately 12.76% compared to the same period in 2005. The increase was primarily attributable to an economic environment with generally higher interest rates and an increase in earning assets. Interest expense on deposits increased $640,000 or 65.37% for the quarter to $1,619,000 compared to $979,000 for the same quarter in 2005. This increase is primarily the result of an economic environment of increasing interest rates coupled with an increased deposit base. Federal Home Loan Bank advances have decreased slightly during the three month period ended June 30, 2006 when compared to the corresponding period in 2005. Interest expense on these advances however, have increased $147,000 or 19.22% and totaled $912,000 for the three months ended June 30, 2006 compared to $765,000 for the corresponding period in 2005. Total interest expense for the three months ending June 30, 2006 was $2,531,000 compared to total interest expense for the same period in 2005 of $1,744,000, an increase of $787,000 or 45.13%. This increase is a reflection of an economic environment of rising interest rates and the result of generally higher interest rates on Federal Home Loan Bank advances. Overall, net interest and dividend income (on an FTE basis) decreased $99,000 or 2.71% to $3,548,000 for the three month period ended June 30, 2006 when compared to the corresponding period in 2005.

Noninterest Income

Noninterest income totaled $1,001,000 for the three months ended June 30, 2006 as compared to $1,226,000 for the three months ended June 30, 2005. This decrease of $225,000 or 18.35% is primarily attributable to reduced income from gains in securities transactions. Losses on sales of available-for-sale securities totaled $13,000 for the second quarter of 2006. This compares to gains on sales of available-for-sale securities of $351,000 for the corresponding period in 2005. This decrease is primarily the result of the movement of market rates during the quarter. The yield curve continued to flatten which limited opportunities to generate gains on sales of available-for-sale securities. However, income from the trust and investment services division increased $61,000 or 15.68% to $450,000 for the second quarter of 2006 compared to the same period in 2005. This is primarily the result of continued growth in assets under management. Other noninterest income is primarily related to fees associated with transaction accounts and fees related to the origination and servicing of mortgage loans and gains related to the sale of mortgage loans. The volumes of these transactions are driven primarily by consumer demand which results in variances from quarter to quarter. Year-to-date volumes however, are consistent when comparing 2006 to 2005.

Noninterest Expense

Noninterest expense totaled $2,992,000 for the three month period ended June 30, 2006 as compared to $2,965,000 for the same period in 2005, an increase of $27,000 or 0.91%. The components of noninterest expense and the changes in the period were as follows (amounts in thousands):

	2006	2005	Change%	Change
Salaries and employee benefits	$1,707	$1,702	$ 5	.3
Occupancy expense	176	163	13	8.0
Equipment expense	194	187	7	3.7
Data processing	327	359	(32)	(8.9)
Insurance	32	35	(3)	(.9)
Printing and stationery	76	104	(28)	(26.9)
Professional fees	90	60	30	50.0
Legal expense	38	75	(37)	(49.3)
Amortization of core deposit intangible	41	41	0	0
Other expense	311	239	(72)	(30.1)
Total noninterest expense	$2,992	$2,965	$ 27	91

Income Taxes

The income tax provision for the three month period ended June 30, 2006 totaled $261,000 in comparison to $188,000 for the same three month period in 2005. The increase in the income tax provision is attributable to an increase in taxable income.

13

Net Income

Overall, net income totaled $1,006,000 for the three months ended June 30, 2006 and represents earnings of $.60 per average share outstanding share. This compares to net income of $1,308,000 for the same period in 2005, a decrease of $302,000 or 23.09% and compares to earnings per share of $.78 for the period.

FINANCIAL CONDITION

Total assets at June 30, 2006 were $413,165,000, compared to $402,922,000 at December 31, 2005, an increase of approximately 2.54%. The increase is primarily the result of an increase in loans during the period that were funded by an increase in deposits.

Securities

During the six months ended June 30, 2006, the securities portfolio, including Federal Home Loan Bank stock, decreased $1,347,000 or .89% to $149,821,000 from $151,168,000 at December 31, 2005. The decrease is primarily a reflection of portfolio securities being sold and called during the period with the proceeds being used to fund loan growth.

The make up of the securities portfolio is diversified among U.S. Government sponsored agencies, mortgage-backed securities and securities issued by states of the United States and political subdivisions of the states.

Securities are classified in the portfolio as either securities available-for-sale or securities held-to-maturity. Almost all securities are classified as available-for-sale. The securities reported as available-for-sale are stated at fair value in the financial statements of the Company. Unrealized holding gains and losses on available-for-sale securities (accumulated other comprehensive income/loss) are not included in earnings, but are reported as a net amount (less expected tax) in a separate component of capital until realized. At June 30, 2006, the unrealized loss net of tax was $4,642,000. This compares to an unrealized loss net of tax of $2,895,000 at December 31, 2005. The unrealized losses in these securities are attributable to changes in market interest rates. Management deems the securities that are currently in an unrealized loss position as not other than temporarily impaired. The securities reported as securities held-to-maturity are stated at amortized cost.

Lending

New business development during the first half of 2006 coupled with an increase in loan demand resulted in an increase in total loans outstanding to $230,917,000 at June 30, 2006. This compares to total loans outstanding of $218,615,000 at December 31, 2005. This is an increase of $12,302,000 or 5.63%. Competition for loans remains aggressive in the Bank's market area, especially in the residential mortgage loan market.

The following table represents the composition of the loan portfolio comparing June 30, 2006 to December 31, 2005:

	June 30, 2006	December 31, 2005

	(amounts in thousands)	
Commercial, financial and agricultural	$ 14,903	$ 15,354
Real Estate-construction and land development	17,843	18,814
Real Estate-residential	139,692	135,619
Real Estate-commercial	50,806	40,889
Consumer	7,596	7,900
Other	82	47
	230,922	218,623
Unearned income	(5)	(8)
Allowance for loan losses	(2,580)	(2,626)
Net Loans	$ 228,337	$ 215,989

14

Provisions and Allowance for Loan Losses

Net loans at June 30, 2006 increased 5.72% to $228,337,000 when compared to net loans of $215,989,000 at December 31, 2005. At June 30, 2006 approximately 90% of the Bank's loan portfolio was related to real estate products. The concentration remained consistent as approximately 89% of the portfolio was related to real estate at December 31, 2005. There were no material changes in the composition of the loan portfolio during this period.

Credit risk is inherent in the business of extending loans. The Bank monitors the quality of the portfolio to ensure that loan quality will not be sacrificed for growth or otherwise compromise the Bank's objectives. Because of this risk associated with extending loans, the Bank maintains an allowance or reserve for loan and lease losses through charges to earnings. There was no provision expense for allowances for loan losses for the first six month period of 2006. This compares to a loan loss provision of $180,000 made during the comparable period in 2005.

The Bank evaluates the adequacy of the allowance no less frequently than on a quarterly basis. No material changes have been made in the estimation methods or assumptions that the Bank uses in making this determination during the period ended June 30, 2006. Such evaluations are based on assessments of credit quality and "risk rating" of loans by senior management, which is reviewed by the Bank's Loan Committee on a regular basis. Loans are initially risk rated when originated. If there is deterioration in the credit, the risk rating is adjusted accordingly.

The allowance also includes a component resulting from the application of the measurement criteria of Statements of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan ("SFAS 114"). Impaired loans receive individual evaluation of the allowance necessary on a monthly basis. Loans to be considered for impairment are defined in the Bank's Loan Policy as commercial loans with balances outstanding of $100,000 or more and residential real estate mortgages with balances of $300,000 or more. Such loans are considered impaired when it is probable that the Bank will not be able to collect all principal and interest due according to the terms of the note.

Any such commercial loan and/or residential mortgage will be considered impaired under any of the following circumstances:

1. Non-accrual status;
2. Loans over 90 days delinquent;
3. Troubled debt restructures consummated after December 31, 1994;
4. Loans classified as "doubtful", meaning that they have weaknesses, which make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

The individual allowance for any impaired loan is based upon the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. Specifically identifiable and quantifiable losses are immediately charged off against the allowance.

In addition, a risk of loss factor is applied in evaluating categories of loans generally as part of the periodic analysis of the Allowance for Loan Losses. This analysis reviews the allocations of the different categories of loans within the portfolio and it considers historical loan losses and delinquency figures as well as any recent delinquency trends.

The credit card delinquency and loss history is separately evaluated and given a special loan loss factor because management recognizes the higher risk involved in such loans. Concentrations of credit and local economic factors are also evaluated on a periodic basis. Historical average net losses by loan type are examined as well as trends by type. The Bank's loan mix over the same period of time is also analyzed. A loan loss allocation is made for each type of loan multiplied by the loan mix percentage for each loan type to produce a weighted average factor.

15

Nonperforming loans, which include all loans that are on a non-accrual status along with loans that are 90 days or more past due and still accruing, are closely monitored by management. At June 30, 2006, nonperforming loans totaled $771,000 or 0.33% of total loans outstanding of $230,917,000. The allowance for loan losses totaled $2,580,000 representing 334.63% of nonperforming loans. Nonperforming loans totaled $773,000 or 0.35% of total loans outstanding of $218,615,000 at December 31, 2005. The allowance for loan losses totaled $2,626,000 at December 31, 2005 and represented 339.71% of nonperforming loans. A total of $68,000 of loans were charged off by the Bank during the six months ended June 30, 2006. These charged-off loans consisted primarily of consumer loans. This compares to loans charged off during the six month period ended June 30, 2005 which totaled $33,000. A total of $22,000 of previously charged-off loans was recovered during the six month period ended June 30, 2006. Recoveries for the same period in 2005 totaled $14,000. While management estimates loan losses using the best available information, no assurances can be given that future additions to the allowance will not be necessary based on changes in economic and real estate market conditions, further information obtained regarding problem loans, identification of additional problem loans or other factors. Additionally, future additions to the allowance may be necessary to maintain adequate coverage ratios.

Deposits

The Company offers a variety of deposit accounts with a range of interest rates and terms. The following table illustrates the composition of the Company's deposits at June 30, 2006 and December 31, 2005:

	June 30, 2006	December 31, 2005

(amounts in thousands)

Demand	$ 67,992	$ 63,996
NOW	23,151	25,900
Money Market	53,034	57,401
Savings	47,244	51,567
Time	107,013	88,407
Total Deposits	$298,434	$287,271

Deposits constitute the principal funding source of the Company's assets.

Borrowings

The Company utilizes advances from the Federal Home Loan Bank as part of its operating strategy to supplement deposit growth and fund its asset growth, a strategy that is designed to increase interest income. These advances are made pursuant to various credit programs, each of which has its own interest rate and range of maturities. At June 30, 2006, the Company had $70,413,000 in outstanding advances from the Federal Home Loan Bank compared to $71,016,000 at December 31, 2005. Management expects that it will continue this strategy of supplementing deposit growth with advances from the Federal Home Loan Bank.

Off-Balance Sheet Arrangements

In the normal course of business the Company enters into certain relationships characterized as lending related off-balance sheet arrangements. These lending commitments have various terms and are designed to accommodate the financial needs of consumers, businesses and other entities. Many of these loan commitments have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of these commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future liquidity requirements.

Loan commitments have credit risk essentially the same as that involved in extending loans to customers. They are subject to normal credit approval procedures and policies. Collateral is obtained based on management's assessment of the customer's credit. The accompanying table summarizes the Company's off balance sheet lending-related financial instruments by remaining maturity at June 30, 2006:

June 30, 2006
(amounts in thousands)

By remaining maturity	Less than 1 year	1-3 years	4-5 years	After 5 y
Off balance sheet lending-related Financial Instruments				
Residential real estate related	$ 5,094	$ 2,539	$	$ 33,
Commercial related	4,478	7,233		1,
Consumer related				
Standby letters of credit		22		

Total	$ 9,572	$ 9,794	$ 34,386	$ 34,

Interest Rate Risk

Interest rate risk is the most significant market risk affecting the Company. Interest rate risk is defined as an exposure to a movement in interest rates that could have an adverse effect on net interest income. Net interest income is sensitive to interest rate risk to the degree that interest bearing liabilities mature or reprice on a different basis than earning assets. In an attempt to manage its exposure to changes in interest rates, the Bank's assets and liabilities are managed in accordance with policies established and reviewed by the Bank's Board of Directors. The Bank's Asset/Liability Management Committee monitors asset and deposit levels, developments and trends in interest rates, liquidity and capital. One of the primary financial objectives is to manage interest rate risk and control the sensitivity of earnings to changes in interest rates in order to prudently improve net interest income and manage the maturities and interest rate sensitivities of assets and liabilities.

To quantify the extent of these risks, both in its current position and in actions it might take in the future, interest rate risk is monitored using gap analysis which identifies the differences between assets and liabilities which mature or reprice during specific time frames and model simulation which is used to "rate shock" the Company's assets and liability balances to measure how much of the Company's net interest income is "at risk" from sudden rate changes.

An interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. At June 30, 2006, the Company maintains a liability sensitive (negative gap) position. This would suggest that during a period of declining interest rates, the Company would be in a better position to increase net interest income. To the contrary, during a period of rising interest rates, a negative gap would result in a decrease in interest income. The level of interest rate risk at June 30, 2006 is within the limits approved by the Board of Directors.

Liquidity

Liquidity is the ability to raise funds on a timely basis at an acceptable cost in order to meet cash needs. Adequate liquidity is necessary to handle fluctuations in deposit levels, to provide for customers' credit needs, and to take advantage of investment opportunities as they are presented. The Company manages liquidity primarily with readily marketable investment securities, deposits and loan repayments. The Company's subsidiary, the Bank, is a member of the Federal Home Loan Bank of Boston. This enhances the liquidity position by providing a source of available borrowings. At June 30, 2006 the Company had approximately $53,752,000 in loan commitments outstanding. Management believes that the current level of liquidity is ample to meet the Company's needs for both the present and foreseeable future.

Capital

At June 30, 2006, the Company had $41,005,000 in stockholders' equity, a decrease of 1.05% when compared to December 31, 2005 stockholders' equity totaling $41,442,000. Earnings for the six-month period ended June 30, 2006 totaled $2,153,000. Market conditions resulted in an increase in accumulated other comprehensive loss to $4,642,000 from $2,895,000 at December 31, 2005.

A review and analysis of securities has determined that there has been no credit deterioration and that the unrealized loss on securities available-for-sale is due to the current interest rate environment and management deems the securities to be not other than temporarily impaired. The Company has declared two quarterly dividends resulting in a decrease in capital of $875,000. The Company issued 840 new shares of common stock under the terms of the Director Stock Retainer Plan that resulted in an increase in capital of $32,000. Under current regulatory definitions, the Company and the Bank are considered to be "well capitalized" for capital adequacy purposes. As a result, the Bank pays the lowest federal deposit insurance premiums possible. One primary measure of capital adequacy for regulatory purposes is based on the ratio of risk-based capital to risk-weighted assets. This method of measuring capital adequacy helps to establish capital requirements that are more sensitive to the differences in risk associated with various assets. It takes into account off-balance sheet exposure in assessing capital adequacy and it minimizes disincentives to holding liquid, low-risk assets. At June 30, 2006, the Company had a total risk based capital ratio of 16.13% compared to 15.76% at December 31, 2005. Maintaining strong capital is essential to bank safety and soundness. However, the effective management of capital resources requires generating attractive returns on equity to build value for shareholders while maintaining appropriate levels of capital to fund growth, meet regulatory requirements and be consistent with prudent industry practices. Management believes that the capital levels of the Company and Bank are adequate to continue to meet the foreseeable capital needs of the institutions.

Impact of Inflation and Changing Prices

The Company's consolidated financial statements are prepared in conformity with generally accepted accounting principles which require the measurement of financial condition and operating results in terms of historical dollars without considering changes in the relative purchasing power of money, over time, due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of the Company are monetary and as a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation, although interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Although not a material factor in recent years, inflation could impact earnings in future periods.

Forward Looking Statements

This Form 10-Q and future filings made by the Company with the Securities and Exchange Commission, as well as other filings, reports and press releases made or issued by the Company and the Bank, and oral statements made by executive officers of the Company and the Bank, may include forward-looking statements relating to such matters as:

(a) assumptions concerning future economic and business conditions and their effect on the economy in general and on the markets in which the Company and the Bank do business; and

(b) expectations for revenues and earnings for the Company and Bank.

Such forward-looking statements are based on assumptions rather than historical or current facts and, therefore, are inherently uncertain and subject to risk. For those statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Act of 1995.

The Company notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may effect the operation, performance, development and results of the Company's and Bank's business include the following:

(a) the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Bank operates;
(b) changes in the legislative and regulatory environment that negatively impact the Company and Bank through increased operating expenses;
(c) increased competition from other financial and non-financial institutions;
(d) the impact of technological advances; and
(e) other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission.

Such developments could have an adverse impact on the Company's and the Bank's financial position and results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The main components of market risk for the Company are interest rate risk and liquidity risk. The Company manages interest rate risk and liquidity risk through an ALCO Committee comprised of outside Directors and senior management. The committee monitors compliance with the Bank's Asset/Liability Policy which provides guidelines to analyze and manage the interest rate sensitivity gap, which is the difference between the amount of assets and the amounts of liabilities which mature or reprice during specific time frames. Model simulation is used to measure earnings volatility under both rising and falling rate scenarios. Please refer to Interest Rate Risk and Liquidity under Item 2. The Company's interest rate risk and liquidity position has not significantly changed from year end 2005.

Item 4. Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer concluded that, based upon an evaluation as of June 30, 2006, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. During the six month period ended June 30, 2006 there were no changes in the Company's internal control over financial reporting that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1. - Legal Proceedings. Not applicable

Item 1A. Risk Factors. Not applicable

Item 2. - Unregistered Sales of Equity Securities and Use of Proceeds. Unregistered Sales of Equity Securities and Use of Proceeds. On May 10, 2006, the Company issued 840 shares of common stock to members of its Board of Directors under the terms of the Director Stock Retainer Plan. The shares were issued in a private transaction in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended. No cash consideration was received upon issuance of the shares.

Item 3. - Defaults Upon Senior Securities. Not applicable

Item 4. - Submission of Matters to a Vote of Security Holders. Incorporated by reference from Form 8-K filed May 12, 2006.

Item 5. - Other Information. Not applicable

Item 6. - Exhibits

11 Computation of Earnings per Share.

31.1 - Rule 13a-14(a)/15d-14(a) Certification.

31.2 - Rule 13a-14(a)/15d-14(a) Certification.

32 - Section 1350 Certifications

SALISBURY BANCORP, INC.

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.

Salisbury Bancorp, Inc.

Date: August 11, 2006 by: /s/ John F. Perotti

John F. Perotti
Chief Executive Officer

Date: August 11, 2006 by: /s/ John F. Foley

John F. Foley
Chief Financial Officer