SURREY BANCORP
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

for the quarterly period ended September 30, 2012

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**

For the transition period from __________ to __________

COMMISSION FILE NO. 000-50313

SURREY BANCORP

(Exact name of registrant as specified in its charter)

North Carolina	**59-3772016**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

145 North Renfro Street, Mount Airy, NC 27030

(Address of principal executive offices)

(336) 783-3900

(Registrant s telephone number)

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practical date:

On November 5, 2012 there were 3,542,984 common shares issued and outstanding.

PART I FINANCIAL INFORMATION

Consolidated Balance Sheets

September 30, 2012 (Unaudited) and December 31, 2011 (Audited)

	September 2012	December 2011
Assets		
Cash and due from banks	$ 5,536,529	$ 2,269,116
Interest-bearing deposits with banks	18,098,576	30,757,636
Federal funds sold	710,393	709,836
Investment securities available for sale	3,512,197	2,506,426
Restricted equity securities	738,324	809,754
Loans, net of allowance for loan losses of $3,733,177 at September 30, 2012 and $3,880,581 at December 31, 2011	183,238,489	175,446,206
Property and equipment, net	4,546,690	4,569,301
Foreclosed assets	599,877	560,018
Accrued income	1,044,455	962,614
Goodwill	120,000	120,000
Bank owned life insurance	5,255,659	3,389,447
Other assets	2,830,192	2,627,410
Total assets	$ 226,231,381	$ 224,727,764
Liabilities and Stockholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 40,569,998	$ 30,750,902
Interest-bearing	142,895,915	153,187,474
Total deposits	183,465,913	183,938,376
Long-term debt	7,750,000	8,100,000
Dividends payable	46,106	576,741
Accrued interest payable	221,152	185,362
Other liabilities	2,798,643	1,700,723
Total liabilities	194,281,814	194,501,202
Commitments and contingencies		
Stockholders equity		
Preferred stock, 1,000,000 shares authorized, 189,356 shares of Series A, issued and outstanding with no par value, 4.5% convertible non-cumulative, perpetual, with a liquidation value of $14 per share;	2,620,325	2,620,325
181,154 shares of Series D, issued and outstanding with no par value 5.0% convertible non-cumulative, perpetual; with a liquidationvalue of $7.08 per share;	1,248,482	1,248,482
Common stock, 10,000,000 shares authorized at no par value; 3,542,984 and 3,536,724 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	12,056,178	12,009,588
Retained earnings	16,074,632	14,405,467
Accumulated other comprehensive loss	(50,050)	(57,300)
Total stockholders equity	31,949,567	30,226,562
Total liabilities and stockholders equity	$ 226,231,381	$ 224,727,764

See Notes to Consolidated Financial Statements

Consolidated Statements of Income

Nine months ended September 30, 2012 and 2011 (Unaudited)

	2012	2011
Interest income		
Loans and fees on loans	$ 8,161,796	$ 8,138,762
Federal funds sold	1,168	1,210
Investment securities, taxable	38,935	40,275
Deposits with banks	35,176	11,645
Total interest income	8,237,075	8,191,892
Interest expense		
Deposits	1,049,473	1,368,776
Fed funds purchased	150	
Long-term debt	225,236	264,361
Total interest expense	1,274,859	1,633,137
Net interest income	6,962,216	6,558,755
Provision for loan losses	780,372	67,190
Net interest income after provision for loan losses	6,181,844	6,491,565
Noninterest income		
Service charges on deposit accounts	691,098	767,978
Fees and yield spread premiums on loans delivered to correspondents	103,022	78,865
Other service charges and fees	413,115	372,673
Other operating income	608,033	548,662
Total noninterest income	1,815,268	1,768,178
Noninterest expense		
Salaries and employee benefits	2,674,154	2,624,411
Occupancy expense	331,151	294,493
Equipment expense	184,254	179,090
Data processing	281,290	271,504
Foreclosed assets, net	41,662	140,190
Postage, printing and supplies	148,667	146,904
Professional fees	279,641	267,558
FDIC insurance premiums	110,233	176,286
Litigation settlement		130,000
Other expense	1,080,267	1,075,861
Total noninterest expense	5,131,319	5,306,297
Net income before income taxes	2,865,793	2,953,446
Income tax expense	1,059,312	1,128,365
Net income	1,806,481	1,825,081
Preferred stock dividends	(137,316)	(137,190)

Net income available to common stockholders	$ 1,669,165	$ 1,687,891
Basic earnings per common share	$ 0.47	$ 0.48
Diluted earnings per common share	$ 0.43	$ 0.44
Basic weighted average common shares outstanding	3,540,220	3,532,680
Diluted weighted average common shares outstanding	4,174,155	4,166,615

See Notes to Consolidated Financial Statements

Consolidated Statements of Income

Three months ended September 30, 2012 and 2011 (Unaudited)

	2012	2011
Interest income		
Loans and fees on loans	$ 2,726,346	$ 2,762,166
Federal funds sold	389	415
Investment securities, taxable	12,517	13,917
Deposits with banks	11,370	3,641
Total interest income	2,750,622	2,780,139
Interest expense		
Deposits	329,792	435,353
Long-term debt	73,382	81,461
Total interest expense	403,174	516,814
Net interest income	2,347,448	2,263,325
Provision for loan losses	41,384	188,118
Net interest income after provision for loan losses	2,306,064	2,075,207
Noninterest income		
Service charges on deposit accounts	229,368	259,093
Fees and yield spread premiums on loans delivered to correspondents	32,788	25,247
Other service charges and fees	136,411	125,646
Other operating income	184,613	188,683
Total noninterest income	583,180	598,669
Noninterest expense		
Salaries and employee benefits	885,633	862,414
Occupancy expense	105,938	97,313
Equipment expense	66,642	58,593
Data processing	98,871	85,916
Foreclosed assets, net	9,368	(142)
Postage, printing and supplies	51,434	44,150
Professional fees	72,968	77,098
FDIC insurance premiums	25,728	36,709
Litigation settlement		130,000
Other expense	337,885	381,421
Total noninterest expense	1,654,467	1,773,472
Net income before income taxes	1,234,777	900,404
Income tax expense	459,934	338,691
Net income	774,843	561,713
Preferred stock dividends	(46,106)	(46,233)
Net income available to common stockholders	$ 728,737	$ 515,480

Basic earnings per common share	$ 0.21	$ 0.15
Diluted earnings per common share	$ 0.19	$ 0.13
Basic weighted average common shares outstanding	3,542,984	3,536,118
Diluted weighted average common shares outstanding	4,176,919	4,170,053

See Notes to Consolidated Financial Statements

Consolidated Statements of Comprehensive Income

Nine months ended September 30, 2012 and 2011 (Unaudited)

	2012	2011
Net income	$ 1,806,481	$ 1,825,081
Other comprehensive income:		
Unrealized gains arising during the period	11,168	21,974
Tax expense benefits related to unrealized gains	(3,918)	(8,471)
Total other comprehensive income	7,250	13,503
Total comprehensive income	$ 1,813,731	$ 1,838,584

See Notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows

Nine months ended September 30, 2012 and 2011 (Unaudited)

	2012	2011
Cash flows from operating activities		
Net income	$ 1,806,481	$ 1,825,081
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	178,088	183,205
Gain on sale of property and equipment	(650)	(760)
(Gain)Loss on the sale of foreclosed assets	(74,806)	50,254
Stock-based compensation, net of tax benefit	16,479	17,155
Provision for loan losses	780,372	67,190
Deferred income taxes	5,308	(6,853)
Accretion of discount on securities, net of amortization of premiums	407	1,526
Increase in cash surrender value of life insurance	(116,212)	(78,475)
Changes in assets and liabilities:		
Accrued income	(81,841)	(88,211)
Other assets	(212,008)	361,314
Accrued interest payable	35,790	21,245
Other liabilities	1,097,920	596,170
Net cash provided by operating activities	3,435,328	2,948,841
Cash flows from investing activities		
Net (increase) decrease in interest-bearing deposits with banks	12,659,060	(10,999,806)
Net decrease in federal funds sold	(557)	(7,525)
Purchases of investment securities	(3,000,481)	(2,002,500)
Sales and maturities of investment securities	2,005,471	1,523,003
Purchase of Bank Owned Life Insurance	(1,750,000)	
Redemption of restricted equity securities	73,600	88,800
Purchase of restricted equity securities	(2,170)	(50)
Net increase in loans	(9,111,060)	(4,634,755)
Proceeds from the sale of foreclosed assets	573,352	463,323
Purchases of property and equipment	(155,477)	(89,720)
Proceeds from the sale of property and equipment	650	760
Net cash provided by (used in) investing activities	1,292,388	(15,658,470)
Cash flows from financing activities		
Net increase (decrease) in deposits	(472,463)	14,339,218
Maturity of long-term debt	(350,000)	(1,350,000)
Dividends paid	(667,951)	(126,472)
Common stock options exercised	30,111	18,825
Net cash provided by (used in) financing activities	(1,460,303)	12,881,571
Net increase in cash and cash equivalents	3,267,413	171,942
Cash and due from banks, beginning	2,269,116	2,398,433
Cash and due from banks, ending	$ 5,536,529	$ 2,570,375
Supplemental disclosures of cash flow information		
Interest paid	$ 1,239,069	$ 1,611,892

Taxes paid	$ 500,000	$ 626,319
Loans transferred to foreclosed properties	$ 538,405	$ 245,525

See Notes to Consolidated Financial Statements

Consolidated Statements of Changes in Stockholders Equity

Nine months ended September 30, 2012 and 2011 (Unaudited)

	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, January 1, 2011	$ 3,868,807	3,206,495	$ 9,464,178	$ 15,380,083	$ (68,913)	$ 28,644,155
Net income				1,825,081		1,825,081
Net change in unrealized gain on investment securities available for sale, net of income tax of $8,471					13,503	13,503
Common stock options exercised		9,269	18,825			18,825
Stock-based compensation, net of tax benefit			17,155			17,155
Dividends declared and accrued on convertible Series A preferred stock ($.47 per share)				(89,225)		(89,225)
Dividends declared and accrued on convertible Series D preferred stock ($.26 per share)				(47,965)		(47,965)
Balance, September 30, 2011	$ 3,868,807	3,215,764	$ 9,500,158	$ 17,067,974	$ (55,410)	$ 30,381,529
Balance, January 1, 2012	$ 3,868,807	3,536,724	$ 12,009,588	$ 14,405,467	$ (57,300)	$ 30,226,562
Net income				1,806,481		1,806,481
Net change in unrealized gain on investment securities available for sale, net of income tax of $3,918					7,250	7,250
Common stock options exercised		6,260	30,111			30,111
Stock-based compensation, net of tax benefit			16,479			16,479
Dividends declared and accrued on convertible Series A preferred stock ($.47 per share)				(89,308)		(89,308)
Dividends declared and accrued on convertible Series D preferred stock ($.26 per share)				(48,008)		(48,008)
Balance, September 30, 2012	$ 3,868,807	3,542,984	$ 12,056,178	$ 16,074,632	$ (50,050)	$ 31,949,567

See Notes to Consolidated Financial Statements

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and therefore, do not include all disclosures required by generally accepted accounting principles for a complete presentation of financial statements. In the opinion of management, the consolidated financial statements contain all adjustments necessary to present fairly the financial condition of Surrey Bancorp, (the Company), as of September 30, 2012, the results of operations for the nine and three months ended September 30, 2012 and 2011, and its changes in stockholders equity, comprehensive income and cash flows for the nine months ended September 30, 2012 and 2011. These adjustments are of a normal and recurring nature. The results of operations for the nine months ended September 30, 2012, are not necessarily indicative of the results expected for the full year. These consolidated financial statements should be read in conjunction with the Company s audited financial statements and related disclosures for the year ended December 31, 2011, included in the Company s Form 10-K. The balance sheet at December 31, 2011, has been taken from the audited financial statements at that date.

Organization

Surrey Bancorp began operation on May 1, 2003 and was created for the purpose of acquiring all the outstanding shares of common stock of Surrey Bank & Trust. Stockholders of the bank received six shares of Surrey Bancorp common stock for every five shares of Surrey Bank & Trust common stock owned. The Company is subject to regulation by the Federal Reserve.

Surrey Bank & Trust (the Bank) was organized and incorporated under the laws of the State of North Carolina on July 15, 1996 and commenced operations on July 22, 1996. The Bank currently serves Surry County, North Carolina and Patrick County, Virginia and surrounding areas through five banking offices. As a state chartered bank, which is not a member of the Federal Reserve, the Bank is subject to regulation by the State of North Carolina Banking Commission and the Federal Deposit Insurance Corporation.

Surrey Investment Services, Inc., (Subsidiary) was organized and incorporated under the laws of the State of North Carolina on February 10, 1998. The subsidiary provides insurance services through SB&T Insurance and investment advice and brokerage services through LPL Financial.

On July 31, 2000, Surrey Bank & Trust formed Freedom Finance, LLC, a subsidiary operation specializing in the purchase of sales finance contracts from local automobile dealers.

The accounting and reporting policies of the Company, the Bank, and its subsidiaries follow generally accepted accounting principles and general practices within the financial services industry. Following is a summary of the more significant policies.

Critical Accounting Policies

The notes to the audited consolidated financial statements for the year ended December 31, 2011 contain a summary of the significant accounting policies. The Company believes our policies with respect to the methodology for the determination of the allowance for loan losses, and asset impairment judgments, including the recoverability of intangible assets involve a higher degree of complexity and require management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed with the Audit Committee and our Board of Directors. See our Annual Report for full details on critical accounting policies.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank and the subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents includes cash and amounts due from depository institutions (including cash items in process of collection). Overnight interest bearing deposits and federal funds sold are shown separately. Federal funds purchased are shown with securities sold under agreements to repurchase.

Investment Securities

Investments classified as available for sale are intended to be held for indefinite periods of time and include those securities that management may employ as part of asset/liability strategy or that may be sold in response to changes in interest rates, prepayments, regulatory capital requirements or similar factors. These securities are carried at fair value and are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or significant other observable inputs.

Investment securities classified as held to maturity are those debt securities that the Bank has the ability and intent to hold to maturity. Accordingly, these securities are carried at cost adjusted for amortization of premiums and accretion of discount, computed by the interest-method over their contractual lives. At September 30, 2012 and December 31, 2011, the Bank had no investments classified as held to maturity.

Loans Held for Sale

The Bank originates and holds Small Business Administration (SBA) and United States Department of Agriculture (USDA) guaranteed loans in its portfolio in the normal course of business. Occasionally, the Bank sells the guaranteed portions of these loans into the secondary market. The loans are generally variable rate loans, which eliminates the market risk to the Bank and are therefore carried at cost. The Bank recognizes gains on the sale of the guaranteed portion upon the consummation of the transaction. The Bank plans to continue to originate guaranteed loans for sales, however no such loans were funded at September 30, 2012 and December 31, 2011.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal amount adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or cost on originated loans and unamortized premiums or discounts on purchased loans.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan using the interest method. Discounts and premiums on any purchased residential real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Discounts and premiums on any purchased consumer loans are recognized over the expected lives of the loans using methods that approximate the interest method.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management s opinion, the borrower may be unable to meet payments as they become due. When the interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. Payments received on nonaccrual loans are first applied to principal and any residual amounts are then applied to interest. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past due loans are determined on the basis of contractual terms.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures.

Recent Accounting Pronouncements

The following is a summary of recent authoritative pronouncements:

In September 2011, the Intangibles topic was amended to permit an entity to consider qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. These amendments were effective for the Company on January 1, 2012.

In April 2011, the criteria used to determine effective control of transferred assets in the Transfers and Servicing topic of the ASC was amended by ASU 2011-03. The requirement for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms and the collateral maintenance implementation guidance related to that criterion were removed from the assessment of effective control. The other criteria to assess effective control were not changed. The amendments were effective for the Company on January 1, 2012 and had no effect on the financial statements.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Recent Accounting Pronouncements, continued

ASU 2011-04 was issued in May 2011 to amend the Fair Value Measurement topic of the ASC by clarifying the application of existing fair value measurement and disclosure requirements and by changing particular principles or requirements for measuring fair value or for disclosing information about fair value measurements. The amendments were effective for the Company beginning January 1, 2012 and have been included in Note 8.

The Comprehensive Income topic of the ASC was amended in September 2011. The amendment eliminates the option to present other comprehensive income as a part of the statement of changes in stockholders equity and requires consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company on January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements. Companies should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect prior to the amendments while FASB redeliberates future requirements.

In July 2012, the Intangibles topic was amended to permit an entity to consider qualitative factors to determine whether it is more likely than not that indefinite-lived intangible assets are impaired. If it is determined to be more likely than not that indefinite-lived intangible assets are impaired, then the entity is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The amendments are not expected to have a material effect on the Company s financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company s financial position, results of operations or cash flows.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were issued and no subsequent events have occurred requiring accrual or disclosure.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SECURITIES

Debt and equity securities have been classified in the balance sheets according to management s intent. The amortized costs of securities available for sale and their approximate fair values at September 30, 2012 and December 31, 2011 follow:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2012				
Government-sponsored enterprises	$ 2,500,000	$ 4,570	$ (400)	$ 2,504,170
Mortgage-backed securities	44,315	1,496		45,811
Corporate bonds	550,000		(96,250)	453,750
Equities and mutual funds	499,960	9,293	(787)	508,466
	$ 3,594,275	$ 15,359	$ (97,437)	$ 3,512,197
December 31, 2011				
Government-sponsored enterprises	$ 2,000,374	$ 4,311	$	$ 2,004,685
Mortgage-backed securities	49,298	1,443		50,741
Corporate bonds	550,000		(99,000)	451,000
	$ 2,599,672	$ 5,754	$ (99,000)	$ 2,506,426

At September 30, 2012 and December 31, 2011, substantially all government-sponsored enterprises securities were pledged as collateral on public deposits and for other purposes as required or permitted by law. The mortgage-backed securities were pledged to the Federal Home Loan Bank.

Maturities of mortgage-backed bonds are stated based on contractual maturities. Actual maturities of these bonds may vary as the underlying mortgages are prepaid. The scheduled maturities of securities (all available for sale) at September 30, 2012, were as follows:

	Amortized Cost	Fair Value
Due in one year or less	$	$
Due after one year through five years	2,500,000	2,504,170
Due after five years through ten years	581,134	485,910
Due after ten years	13,181	13,651
	$ 3,094,315	$ 3,003,731

The following table shows investments gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at September 30, 2012 and December 31, 2011. These unrealized losses on investment securities are a result of volatility in interest rates and primarily relate to corporate bonds issued by other banks at September 30, 2012 and December 31, 2011.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2012						
Government-sponsored enterprises	$ 499,600	$ (400)	$	$	$ 499,600	$ (400)
Corporate bonds			453,750	(96,250)	453,750	(96,250)
Equities and mutual funds	51,022	(787)			51,022	(787)
	$ 550,622	$ (1,187)	$ 453,750	$ (96,250)	$ 1,004,372	(97,437)
December 31, 2011						
Corporate bonds	$	$	$ 451,000	$ (99,000)	$ 451,000	$ (99,000)
	$	$	$ 451,000	$ (99,000)	$ 451,000	$ (99,000)

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SECURITIES, CONTINUED

Management considers the nature of the investment, the underlying causes of the decline in the market value and the severity and duration of the decline in market value in determining if impairment is other than temporary. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Based upon this evaluation, there are two securities in the portfolio with unrealized losses for a period greater than 12 months. We have analyzed each individual security for Other Than Temporary Impairment (OTTI) purposes by reviewing delinquencies, loan-to-value ratios, and credit quality and concluded that all unrealized losses presented in the tables above are not related to an issuer s financial condition but are due to changes in the level of interest rates and no declines are deemed to be other than temporary in nature.

The Company had no gross realized gains or losses from the sales of investment securities for the nine and three month periods ended September 30, 2012 and 2011.

NOTE 3. EARNINGS PER SHARE

Basic earnings per share for the nine and three months ended September 30, 2012 and 2011 were calculated by dividing net income available to common stockholders by the weighted average number of shares outstanding during the period.

The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares. The potential dilutive shares are represented by common stock options and by the Series A and D convertible preferred stock. Each share of the Series A preferred is convertible into 2.2955 shares of common stock. Each share of Series D preferred is convertible into 1.10 shares of common stock.

NOTE 4. COMMITMENTS AND LETTERS OF CREDIT

At September 30, 2012, the Company had commitments to extend credit, including unused lines of credit of approximately $34,690,000 and letters of credit outstanding of $2,023,331.

NOTE 5. LOANS

The major components of loans in the balance sheets at September 30, 2012 and December 31, 2011 are below.

	2012	2011
Commercial	$ 84,317,344	$ 73,756,422
Real estate:		
Construction and land development	5,585,372	6,213,443
Residential, 1-4 families	36,853,785	39,499,189
Residential, 5 or more families	1,730,308	2,214,365
Farmland	2,398,007	2,722,872
Nonfarm, nonresidential	48,853,854	47,867,333
Agricultural	17,517	29,493
Consumer, net of discounts of $19,845 in 2012 and $21,742 in 2011	7,090,254	7,041,846
Other	37,976	
	186,884,417	179,344,963
Deferred loan origination costs, net of (fees)	87,249	(18,176)

	186,971,666	179,326,787
Allowance for loan losses	(3,733,177)	(3,880,581)
	$ 183,238,489	$ 175,446,206

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. LOANS, CONTINUED

Residential, 1-4 family loans pledged as collateral against FHLB advances approximated $18,888,000 and $19,112,000 at September 30, 2012 and December 31, 2011, respectively.

NOTE 6. ALLOWANCE FOR LOAN LOSSES

The activity of the allowance for loan losses by loan components during the nine months ending September 30, 2012 and 2011 was as follows:

	Construction & Development	1-4 Family Residential	Nonfarm, Nonresidential	Commercial & Industrial	Consumer	Other	Total
September 30, 2012							
Allowance for credit losses:							
Beginning balance	$ 103,200	$ 836,860	$ 865,854	$ 1,808,260	$ 210,807	$ 55,600	$ 3,880,581
Charge-offs	(7,286)	(271,224)	(21,831)	(710,645)	(151,102)		(1,162,088)
Recoveries	250	752	83,968	132,949	16,393		234,312
Provision	8,105	142,712	(5,404)	513,462	133,797	(12,300)	780,372
Ending balance	$ 104,269	$ 709,100	$ 922,587	$ 1,744,026	$ 209,895	$ 43,300	$ 3,733,177
Ending balance: individually evaluated for impairment	$ 3,869	$	$ 339,087	$ 185,726	$	$	$ 528,682
Ending balance: collectively evaluated for impairment	$ 100,400	$ 709,100	$ 583,500	$ 1,558,300	$ 209,895	$ 43,300	$ 3,204,495
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
Loans Receivable:							
Ending balance	$ 5,585,372	$ 36,853,785	$ 48,853,854	$ 84,317,344	$ 7,090,254	$ 4,183,808	$ 186,884,417
Ending balance: individually evaluated for impairment	$ 88,429	$ 290,489	$ 3,235,812 &				