SURREY BANCORP
Form 10QSB
May 12, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended March 31, 2005

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

For the transition period from ______ to ______

COMMISSION FILE NUMBER 0000-50313

SURREY BANCORP

(Exact name of small business issuer as specified in its charter)

North Carolina	**59-3772016**
(State or other jurisdiction of	**(IRS Employer**

incorporation or organization)	**Identification No.)**

145 North Renfro Street, Mount Airy NC 27030

(Address of principal executive offices)

(336) 783-3900

(Issuer s telephone number)

Not Applicable

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

Check whether the issuer (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 ¨

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

On April 30, 2005, there were 1,211,642 common shares issued and outstanding

Transitional Small Business Disclosure Format (Check one): Yes ¨ No x

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PART I FINANCIAL INFORMATION

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Consolidated Balance Sheets

March 31, 2005 and December 31, 2004

	Unaudited	Audited
	March 2005	**December 2004**
Assets		
Cash and due from banks	$ 2,333,243	$ 1,810,543
Interest-bearing deposits with banks	12,860,978	12,759,356
Federal funds sold	501,000	301,000
Investment securities available for sale	3,162,465	2,692,151
Restricted equity securities	908,130	790,660
Loans, net of allowance of loan losses of $2,342,023 in 2005 and $2,294,131 in 2004	138,453,515	133,046,165
Property and equipment, net	4,306,066	4,232,424
Accrued income	722,583	583,365
Goodwill	120,000	120,000
Bank owned life insurance	2,659,149	
Other assets	898,347	957,276
	$ 166,925,476	$ 157,292,940
Liabilities and Shareholders Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 21,665,752	$ 18,201,595
Interest-bearing	116,205,352	108,752,371
Total deposits	137,871,104	126,953,966
Federal funds purchased and securities sold under agreements to repurchase	596,059	3,447,823
Long-term debt	12,297,845	11,298,952
Dividends payable on preferred stock	29,415	29,987
Accrued interest payable	252,281	161,103
Other liabilities	469,071	355,688
	151,515,775	142,247,519
Commitments and contingencies		
Shareholders 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 liquidation value of $14 per share in 2005 and 2004	2,620,325	2,620,325
Common stock, 5,000,000 shares authorized at no par value 1,211,642 shares issued in 2005 and 1,211,008 shares issued in 2004.	8,104,161	8,100,261
Retained earnings	4,703,818	4,337,224
Accumulated other comprehensive income (loss)	(18,603)	(12,389)
	15,409,701	15,045,421
	$ 166,925,476	$ 157,292,940

See Notes to Consolidated Financial Statements.

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Consolidated Statements of Income Unaudited

Three months ended March 31, 2005 and 2004

	Three months ended March 31, 2005	2004
Interest income:		
Loans and fees on loans	$ 2,254,317	$ 1,960,933
Federal funds sold	2,179	
Investment securities, taxable	26,387	22,604
Investment securities, non taxable		456
Deposits with banks	60,117	3,977
	2,343,000	1,987,970
Interest expense:		
Deposits	650,262	459,723
Federal funds purchased	664	1,697
Securities sold under agreements to repurchase	2,110	762
Short-term borrowings		4,035
Long-term borrowings	109,346	50,401
	762,382	516,618
Net interest income	1,580,618	1,471,352
Provision for loan losses	120,006	85,159
Net interest income after provision for loan losses	1,460,612	1,386,193
Noninterest income:		
Service charges on deposit accounts	224,527	216,345
Other service charges and fees	83,992	129,143
Other operating income	153,890	147,274
	462,409	492,762
Noninterest expense:		
Salaries and employee benefits	636,449	636,879
Occupancy expense	85,763	80,164
Equipment expense	89,961	113,517
Data processing	87,633	91,435
Other expense	379,182	286,375
	1,278,988	1,208,370
Net income before income taxes	644,033	670,585
Income tax expense	248,024	258,300
Net income	396,009	412,285
Preferred stock dividend declared	(29,415)	(29,652)

Net income available for common shareholders	$ 366,594	$ 382,633
Basic earnings per share	$ 0.30	$ 0.32
Diluted earnings per share	$ 0.27	$ 0.29
Basic weighted average shares outstanding	1,211,135	1,181,010
Diluted weighted average shares outstanding	1,474,733	1,441,147

See Notes to Consolidated Financial Statements.

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Consolidated Statements of Cash Flows Unaudited

Three months ended March 31, 2005 and 2004

	Three months ended March 31,	
	2005	**2004**
Cash flows from operating activities:		
Net income	$ 396,009	$ 412,285
Adjustments to reconcile net income to net cash provided (used) by operations:		
Depreciation and amortization	83,276	97,547
Provision for loan losses	120,006	85,159
Deferred income taxes	(2,576)	
Accretion of discount on securities, net of amortization of premiums	(7,119)	(2,866)
Increase in cash surrender value of life insurance	(9,149)	
Changes in assets and liabilities:		
Accrued income	(139,218)	(418)
Other assets	65,403	13,444
Accrued interest payable	91,178	36,352
Other liabilities	113,384	73,235
Net cash provided (used) by operating activities	711,194	714,738
Cash flows from investing activities:		
Net increase in interest-bearing deposits with banks	(101,622)	(5,830,904)
Net increase in federal funds sold	(200,000)	
Purchase of investment securities	(1,989,666)	(1,497,376)
Sales and maturities of investment securities	1,516,359	3,120,996
(Purchase) redemption of restricted equity securities	(117,470)	37,500
Net increase in loans	(5,527,356)	(5,750,367)
Purchases of property and equipment	(156,918)	(29,327)
Purchase of bank owned life insurance	(2,650,000)	
Net cash used in investing activities	(9,226,673)	(9,949,478)
Cash flows from financing activities:		
Net increase in deposits	10,917,138	9,543,680
Net increase in fed funds purchased and securities sold under agreements to repurchase	(2,851,765)	(2,165,783)
Net (decrease) increase in long-term debt	998,893	1,607,956
Dividends paid on preferred stock	(29,987)	(30,070)
Common stock options exercised	3,900	152,178
Net cash provided by financing activities	9,038,179	9,107,961
Net increase in cash and cash equivalents	522,700	(126,779)
Cash and cash equivalents, beginning	1,810,543	1,956,473
Cash and cash equivalents, ending	$ 2,333,243	$ 1,829,694
Supplemental disclosure of cash flow information:		
Interest paid	$ 671,204	$ 480,266
Taxes paid	$ 32,074	$ 27,832

See Notes to Consolidated Financial Statements.

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Consolidated Statements of Changes in Shareholders Equity Unaudited

Three months ended March 31, 2005 and 2004

	Convertible Preferred Stock Shares	Convertible Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Retained Earnings	Unrealized Appreciation (Depreciation) on Securities	Total
Balance January 1, 2004	189,356	$ 2,620,325	1,170,189	$ 7,822,387	$ 2,627,529	$ 3,225	$ 13,073,466
Comprehensive income							
Net income					412,285		412,285
Net change in unrealized appreciation on investment securities available for sale, net of income taxes of $2,639						4,207	4,207
Total comprehensive income							416,492
Common stock issued							
Common stock options exercised			26,218	152,178			152,178
Dividends declared on convertible preferred stock					(29,652)		(29,652)
Balance, March 31, 2004	189,356	$ 2,620,325	1,196,407	$ 7,974,565	$ 3,010,162	$ 7,432	$ 13,612,484
Balance January 1, 2005	189,356	2,620,325	1,211,008	$ 8,100,261	$ 4,337,224	$ (12,389)	$ 15,045,421
Comprehensive income							
Net income					396,009		396,009
Net change in unrealized appreciation on investment securities available for sale, net of income tax benefits of $3,898						(6,214)	(6,214)
Total comprehensive income							389,795
Common stock issued							
Common stock options exercised			634	3,900			3,900
Dividends declared on convertible preferred stock					(29,415)		(29,415)
Balance, March 31, 2005	189,356	$ 2,620,325	1,211,642	$ 8,104,161	$ 4,703,818	$ (18,603)	$ 15,409,701

See Notes to Consolidated Financial Statements.

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SURREY BANCORP

NOTES TO FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited financial statements were prepared in accordance with instructions for Form 10-QSB 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 financial statements contain all adjustments necessary to present fairly the financial condition of Surrey Bancorp as of March 31, 2005 and December 31, 2004, the results of operations for the three months ended March 31, 2005 and 2004, and its changes in stockholders equity and cash flows for the three months ended March 31, 2005 and 2004. All adjustments are of a normal and recurring nature. The results of operations for the three months ended March 31, 2005 are not necessarily indicative of the results expected for the full year. These financial statements should be read in conjunction with the Company s audited financial statements and related disclosures for the year ended December 31, 2004 included in the Company s Form 10-KSB.

ORGANIZATION

Surrey Bancorp (the Company) 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. Shareholders of the bank received six shares of Surrey Bancorp common stock for every five shares of Surrey Bank & Trust common stock owned.

Surrey Bank & Trust (the Bank) was organized and incorporated under the laws of the State of North Carolina on July 15 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 U-VEST.

On July 31, 2000, Surrey Bank & Trust formed Friendly Finance, LLC., a subsidiary operation specializing in the purchase of sales finance contracts from local automobile dealers. The Bank originally had a 60% majority interest in the company. On March 1, 2003 the Bank acquired the minority interest in Friendly Finance, LLC in exchange for the satisfaction of other commitments of the holder of the minority interest. On January 1, 2005, Friendly Finance LLC s name was changed to Freedom Finance, LLC.

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

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CRITICAL ACCOUNTING POLICIES

The notes to our audited consolidated financial statements for the year ended December 31, 2004 contain a summary of our significant accounting policies. We believe our policies with respect to the methodology for our 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 with often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumption 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.

BUSINESS SEGMENTS

The Company reports its activities in two business segments. In determining the appropriateness of segment definition, the Company considers the materiality of potential business segments and components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment.

PRESENTATION OF CASH FLOWS

For purposes of reporting cash flows, cash and due from banks 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. Cash flows from demand deposits, NOW accounts and savings accounts are reported net since their original maturities are less than three months. Loans and time deposits are reported net per FASB Statement No. 104. Federal Funds purchased are shown separately.

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.

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 March 31, 2005 and December 31, 2004, the Bank had no investments classified as held to maturity.

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Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. At March 31, 2005 and December 31, 2004, the Bank had no loans classified as available for sale.

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.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. The Bank makes continuous credit reviews of the loan portfolio and considers economic conditions, historical loan loss experience, review of specific problem loans and other factors in determining the adequacy of the allowance balance.

Activity in the allowance for loan losses for the three months ended March 31, 2005 and 2004 follows:

	March 31,	
	2005	**2004**
Balance at beginning of year	$ 2,294,131	$ 2,109,820
Add provision charged to expense	120,006	85,159
Less net charge-offs	(72,114)	(72,911)
	$ 2,342,023	$ 2,122,068

Interest on all loans is accrued daily on the outstanding balance. Accrual of interest is discontinued on a loan when management believes, after considering collection efforts and other factors that the borrower s financial condition is such that collection of interest is doubtful.

Stock-based Compensation

The Company accounts for its stock-based compensation plans using the accounting prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees.* The Company is not required to adopt the fair value based recognition provisions prescribed under

SFAS No. 123, *Accounting for Stock Based Compensation*, but complies with the disclosure requirements set forth in the Statement (as amended by SFAS No. 148), which include disclosing pro forma net income as if the fair value based method of accounting had been applied.

NOTE 2. EARNINGS PER SHARE

Basic earnings per share for the three months ended March 31, 2005 and 2004 were calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period.

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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 convertible preferred stock which is convertible into .8695 shares of common stock.

NOTE 3. BALANCE SHEETS

The balance sheet at December 31, 2004, has been taken from the audited financial statements at that date.

NOTE 4. COMMITMENTS AND LETTERS OF CREDIT

At March 31, 2005, the Company had commitments to extend credit, including unused lines of credit of approximately $27,974,000. Letters of credit totaling $1,263,576 were outstanding.

NOTE 5. STOCK OPTION PLANS

The Company has adopted a qualified incentive stock option plan which reserves, as amended, 74,429 shares for purchase by eligible employees. Options granted under this plan vest at the rate of 20% per year, expire not more than ten years from the date of grant, and are exercisable at not less than the fair market value of the stock at the date of the grant.

The Company also adopted a non-qualified stock option plan which reserves, as amended, 101,912 shares for purchase by non-employee directors. Options granted under this plan are exercisable after six months from the date of the grant at not less than the fair market value of the stock at the date of the grant. The life of such options shall not extend more than ten years from the date of the grant.

Information related to pro forma net income for the periods presented is as follows:

	March 31,	
	2005	**2004**
Compensation cost recognized in income for all stock-based compensation awards	$	$
Pro forma net income available to common shareholders, based on SFAS No. 123	$ 361,318	$ 378,120

Pro forma earnings per common share, based on SFAS No. 123	$ 0.30	$ 0.32
Pro forma earnings per fully dilutive common share, based on SFAS No. 123	$ 0.25	$ 0.26

NOTE 6. SEGMENT REPORTING

The Company has two reportable segments, the Bank and Freedom Finance, LLC (subsidiary). The Bank provides mortgage, consumer and commercial loans. Freedom Finance, LLC specializes in the purchase of sales finance contracts from local automobile dealers. Information about reportable segments, and reconciliation of such information to the consolidated financial statements as of and for the years ended March 31, 2005 and 2004 is as follows:

	Bank	Freedom Finance, LLC	Intersegment Elimination	Consolidated Totals
March 31, 2005				
Net interest income	$ 1,521,117	$ 59,501	$	$ 1,580,618
Other revenue external customers	449,525	12,884		462,409
Depreciation and amortization	82,625	651		83,276
Provision for loan losses	120,006			120,006
Net income	386,827	9,182		396,009
Assets	167,321,690	1,670,077	(2,103,190)	166,888,577
March 31, 2004				
Net interest income	$ 1,390,773	$ 80,579	$	$ 1,471,352
Other revenue external customers	479,426	13,336		492,762
Depreciation and amortization	96,501	1,046		97,547
Provision for loan losses	106,904	(21,745)		85,159
Net income	343,940	68,345		412,285
Assets	145,046,584	1,598,610	(1,976,776)	144,668,418

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The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company s reportable segments are strategic business units that offer different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technology and marketing strategies.

The Bank derives a majority of its revenue from interest income and relies primarily on net interest income to assess the performance of the segments and make decisions about resources to be allocated to the segment. Therefore, the segments are reported using net interest income for the period ended March 31, 2005. The Bank does allocate income taxes to the segments. Other revenue represents noninterest income which is also allocated to the segments. The Bank includes an insurance and investment agency in its Bank segment above. The Bank does not have any single external customer from which is derives 10 percent or more of its revenues and operations in one geographical area.

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

Introduction

This discussion, analysis and related financial information are presented to explain the significant factors which affected Surrey Bancorp s financial condition and results of operations for the three months ending March 31, 2005 and 2004. This discussion should be read in conjunction with the financial statements and related notes contained within this report.

Surrey Bancorp (Company) is a North Carolina corporation, located in Mount Airy, North Carolina. The Company was incorporated on February 6, 2003 and began business on May 1, 2003.

Surrey Bank & Trust (Bank) is a North Carolina state Chartered Bank, located in Mount Airy, North Carolina. The Bank was chartered on July 15, 1996 and began operations on July 22, 1996.

Effective March 5, 1998 the Bank became a member of the Federal Home Loan Bank.

Highlights

Certain information contained in this discussion may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are generally identified by phrases such as the Company expects, the Company believes or words of similar import. Such forward-looking statements involve known and unknown risks including, but not limited to, changes in general economic and business conditions, interest rate fluctuations, competition within and from outside the banking industry, new products and services in the banking industry, risk inherent in making loans such as repayment risks and fluctuating collateral values, problems with technology utilized by the Company, changing trends in customer profiles and changes in laws and regulations applicable to the Company. Although the Company believes that its expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements

Net income available for common shareholders for the three months ended March 31, 2005, was $366,594 or $.27 per diluted share outstanding compared to a $382,633 or $.29 per diluted share outstanding for the same period in 2004. Earnings for the period ended March 31, 2005 are approximately 4.2% lower than for the same period in 2004. The decrease resulted from a reduction in the fee income earned from the mortgage lending operation and reduced incomes from the investment, insurance and sales finance subsidiaries. The mortgage fee reduction is due to a general slowdown in the refinancing market and the absence of servicing fee income for which the rights were sold to another bank in the second quarter of 2004. The reduced income from subsidiary operations primarily result from increased expenses incurred to strengthen the operations of those subsidiaries.

On March 31, 2005, Surrey Bancorp s assets totaled $166,925,476 compared to $157,292,940 on December 31, 2004. Net loans were $138,453,515 compared to $133,046,165 on December 31, 2004. This growth was primarily in the commercial loan area which increased 4.73% over December 2004 totals.

Total deposits on March 31, 2005, were $137,871,104 compared to $126,953,966 at the end of 2004. This increase is attributable to increases in demand deposit and time deposit accounts. Demand deposits increased 8.36% over 2004 totals. Certificates of deposit increased 13.65% over December 31, 2004 totals, while savings deposits decreased 9.00%.

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Common shareholders equity increased by $364,280 or 2.93% during the three months ended March 31, 2005 resulting in a common stock book value of $10.56 per share, up from $10.26 on December 31, 2004.

Financial Condition, Liquidity and Capital Resources

Investments

The Bank maintains a portfolio of securities as part of its asset/liability and liquidity management programs which emphasize effective yields and maturities to match its needs. The composition of the investment portfolio is examined periodically and appropriate realignments are initiated to meet liquidity and interest rate sensitivity needs for the Bank.

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted by premiums and discounts that are recognized in interest income using the interest method over the period to maturity or to call dates. The Bank had no Held to Maturity securities at March 31, 2005 or December 31, 2004.

Available for sale securities are reported at fair value and consist of bonds, notes, debentures, and certain equity securities not classified as trading securities or as held to maturity securities.

Unrealized holding gains and losses, net of tax, on available for sale securities are reported as a net amount in a separate component of shareholders equity. Realized gains and losses on the sale of available for sale securities are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity or to call dates.

Declines in the fair value of individual held to maturity and available for sale securities below cost that are other than temporary are reflected as write-downs of the individual securities to fair value. Related write-downs are included in earnings as realized losses.

Investments in available for sale securities of $3,162,465 consisted of U.S. Governmental Agency obligations with maturities ranging from one to fourteen months, and GNMA adjustable rate mortgage securities, which adjust annually.

Loans

Net loans outstanding on March 31, 2005, were $138,453,515 compared to $133,046,165 on December 31, 2004. The Bank maintains a loan portfolio dominated by real estate and commercial loans diversified among various industries. Approximately 38.9% of the Bank s loans as of March 31, 2005 are fixed rate loans with 61.1% floating with the Bank s prime rate or other appropriate internal or external indices.

Deposits

Deposits on March 31, 2005, were $137,871,104, compared to $126,953,966 on December 31, 2004.

The March total comes from a base of approximately 10,246 accounts compared to 9,845 accounts at December 31, 2004; a 4.07% increase. Interest-bearing accounts represented 84.29% of the 2005 period-end deposits versus 85.82% at December 31, 2004.

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Shareholders Equity

Surrey Bancorp and Surrey Bank & Trust are subject to various regulatory capital requirements administered by federal banking agencies. The Company and the Bank maintain strong capital positions which exceed all capital adequacy requirements of federal regulatory authorities.

The Company s and the Bank s capital ratios are presented in the following table.

	Ratio	Minimum Required For Capital Adequacy Purposes
March 31, 2005:		
Total Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	11.16%	8.0%
Surrey Bank & Trust	10.22%	8.0%
Tier I Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	9.91%	4.0%
Surrey Bank & Trust	8.96%	4.0%
Tier I Capital		
(to Average Assets)		
Surrey Bancorp (Consolidated)	9.08%	4.0%
Surrey Bank & Trust	8.21%	4.0%
December 31, 2004:		
Total Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	11.61%	8.0%
Surrey Bank & Trust	10.52%	8.0%
Tier I Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	10.36%	4.0%
Surrey Bank & Trust	9.26%	4.0%
Tier I Capital		
(to Average Assets)		
Surrey Bancorp (Consolidated)	8.98%	4.0%
Surrey Bank & Trust	8.08%	4.0%

Asset Quality

The notes to the financial statements contained within this report provide details of the activity in the allowance for possible loan losses.

The provision for loan losses charged to operations was $120,006 in the first three months of 2005 compared to $85,159 for the same period in 2004. The reserve for loan losses on March 31, 2005 was $2,342,023 or 1.66% of period end loans. This percentage is derived from total loans. Approximately $25,953,828 of loans at March 31, 2005 are government guaranteed loans which the Bank s exposure ranges from 10% to 49% of the outstanding balance. When the guaranteed portions of the loans are removed from the equation the loan loss reserve is approximately 1.85% of outstanding loans.

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The level of reserve is established based upon management s evaluation of portfolio composition, current and projected national and local economic conditions, and results of independent reviews of the loan portfolio by internal and external examination. Management recognizes the inherent risk associated with commercial and consumer lending, including whether or not a borrower s actual results of operations will correspond to those projected by the borrower when the loan was funded; economic factors such as the number of housing starts and increases in interest rates, etc.; depression of collateral values; and completion of projects within the original cost and time estimates. As a result, management continues to actively monitor the Bank s asset quality and lending policies. Management believes that its loan portfolio is diversified so that a downturn in a particular market or industry will not have a significant impact on the loan portfolio or the Bank s financial condition. Management believes that its provision and reserve offer an adequate allowance for loan losses and provide a sound reserve for the loan portfolio.

Unsecured loans that are past due more than 90 days are placed into nonaccrual status. Secured loans reach nonaccrual status when they surpass 120 days past due. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status.

At March 31, 2005, the Bank had loans totaling approximately $1,127,226 in nonaccrual status.

Interest Rate Sensitivity and Liquidity

One of the principal duties of the Bank s Asset/Liability Management Committee is management of interest rate risk. The Bank utilizes quarterly asset/liability reports prepared by a regional correspondent bank to project the impact on net interest income that might occur with hypothetical interest rate changes. The committee monitors and manages asset and liability strategies and pricing.

Another function of the Asset/Liability Committee is maintaining adequate liquidity and planning for future liquidity needs. Having adequate liquidity means the ability to meet current funding needs, including deposit withdrawals and commitments, in an orderly manner without sacrificing earnings. The Bank funds its investing activities, including making loans and purchasing investments, by attracting deposits and utilizing short-term borrowings when necessary.

At March 31, 2005 the liquidity position of the Company was good, with short-term liquid assets of $15,695,221. Deposit growth was approximately $5,462,000 greater than the growth in loans in the first three months of 2005 resulting in a slightly more liquid position compared to December 31, 2004. During the period the Bank invested in Bank Owned Life Insurance (BOLI) which reduced the net funds growth produced by deposits and loans. To provide supplemental liquidity, the Bank has six lines of credit with correspondent banks totaling $13,700,000. There were no outstanding advances against these lines at March 31, 2005. Additionally, the Bank has a secured borrowing arrangement with the Federal Home Loan Bank. The maximum credit available under this agreement approximates $20,241,000 at March 31, 2005. Advances taken down against the Federal Home Loan Bank line amounted to $12,250,000 at March 31, 2005. In addition, Freedom Finance, LLC has a secured revolving line of credit with another commercial bank in the amount of $1,200,000. At March 31, 2005 no balance was due on this line.

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ITEM 3. CONTROLS & PROCEDURES

As of the end of the period covered by the report, an evaluation was performed under the supervision and with the participation of the Company s management, including the 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-15e. Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. There have not been any changes in the Company s internal control over financial reporting that occurred during the Company s last quarter that has materially affected, or is reasonable likely to materially affect, internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

No significant changes in legal proceedings occurred during the quarter.

Item 2. Changes in Securities

None

Item 3. Defaults Upon Senior Securities

Not Applicable

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a.) Exhibits

31.1 Certification

31.2 Certification

32. Certification

(b.) Reports on 8-K

Incorporated by Reference to 8-Ks filed February 3, 2005

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SIGNATURES

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

	Surrey Bancorp
Date: May 12, 2005	/s/ Edward C. Ashby, III
	Edward C. Ashby, III President and Chief Executive Officer
Date: May 12, 2005	/s/ Mark H. Towe
	Mark H. Towe Sr. Vice President and Chief Financial Officer