SURREY BANCORP
Form 10-Q
August 09, 2013
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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 June 30, 2013

¨ **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 August 5, 2013 there were 3,542,984 common shares issued and outstanding.

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PART I FINANCIAL INFORMATION

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Consolidated Balance Sheets

June 30, 2013 (Unaudited) and December 31, 2012 (Audited)

	June 2013	December 2012
Assets		
Cash and due from banks	$ 5,499,080	$ 5,973,042
Interest-bearing deposits with banks	29,084,497	32,366,318
Federal funds sold	1,210,992	710,588
Investment securities available for sale	4,008,175	3,502,852
Restricted equity securities	676,709	738,324
Loans, net of allowance for loan losses of $3,431,373 at June 30, 2013 and $3,403,098 at December 31, 2012	180,450,435	173,577,565
Property and equipment, net	4,475,457	4,543,738
Foreclosed assets	79,261	491,424
Accrued income	999,403	979,098
Goodwill	120,000	120,000
Bank owned life insurance	5,379,120	5,298,354
Other assets	2,590,986	1,611,129
Total assets	$ 234,574,115	$ 229,912,432
Liabilities and Stockholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 44,029,296	$ 36,979,419
Interest-bearing	146,118,552	150,843,618
Total deposits	190,147,848	187,823,037
Long-term debt	7,750,000	7,750,000
Dividends payable	45,730	46,106
Accrued interest payable	185,379	135,801
Other liabilities	2,845,794	1,920,187
Total liabilities	200,974,751	197,675,131
Commitments and contingencies (Note 4)		
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 liquidation value 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 shares issued and outstanding at June 30, 2013 and December 31, 2012	12,061,153	12,061,153
Retained earnings	17,728,849	16,367,187

Accumulated other comprehensive loss	(59,445)	(59,846)
Total stockholders equity	33,599,364	32,237,301
Total liabilities and stockholders equity	$ 234,574,115	$ 229,912,432

See Notes to Consolidated Financial Statements

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Consolidated Statements of Income

Six months ended June 30, 2013 and 2012 (Unaudited)

	2013	2012
Interest income		
Loans and fees on loans	$ 5,220,767	$ 5,435,450
Federal funds sold	905	779
Investment securities, taxable	26,800	26,418
Investment securities, dividends	6,021	
Deposits with banks	38,703	23,806
Total interest income	5,293,196	5,486,453
Interest expense		
Deposits	599,132	719,681
Fed funds purchased	80	150
Short-term debt	38,543	
Long-term debt	144,518	151,854
Total interest expense	782,273	871,685
Net interest income	4,510,923	4,614,768
Provision for loan losses	135,796	738,988
Net interest income after provision for loan losses	4,375,127	3,875,780
Noninterest income		
Service charges on deposit accounts	437,060	461,730
Gain on sale of government guaranteed loans	229,130	
Realized gains on the sale of securities	5,297	
Fees on loans delivered to correspondents	35,320	70,234
Other service charges and fees	271,944	276,704
Other operating income	476,268	423,420
Total noninterest income	1,455,019	1,232,088
Noninterest expense		
Salaries and employee benefits	1,871,496	1,788,521
Occupancy expense	218,758	225,213
Equipment expense	120,635	117,612
Data processing	212,293	182,419
Foreclosed assets, net	24,305	32,294
Postage, printing and supplies	98,933	97,233
Professional fees	212,571	206,673
FDIC insurance premiums	46,868	84,505

Other expense	714,724	742,382
Total noninterest expense	3,520,583	3,476,852
Net income before income taxes	2,309,563	1,631,016
Income tax expense	856,944	599,378
Net income	1,452,619	1,031,638
Preferred stock dividends	(90,957)	(91,210)
Net income available to common stockholders	$ 1,361,662	$ 940,428
Basic earnings per common share	$ 0.38	$ 0.27
Diluted earnings per common share	$ 0.35	$ 0.25
Basic weighted average common shares outstanding	3,542,984	3,538,822
Diluted weighted average common shares outstanding	4,176,919	4,172,757

See Notes to Consolidated Financial Statements

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Consolidated Statements of Income

Three months ended June 30, 2013 and 2012 (Unaudited)

	2013	2012
Interest income		
Loans and fees on loans	$ 2,612,056	$ 2,690,474
Federal funds sold	560	387
Investment securities, taxable	13,160	12,215
Investment securities, dividends	3,403	
Deposits with banks	19,012	13,359
Total interest income	2,648,191	2,716,435
Interest expense		
Deposits	290,444	346,669
Fed funds purchased	80	150
Short-term debt	33,824	
Long-term debt	72,705	75,448
Total interest expense	397,053	422,267
Net interest income	2,251,138	2,294,168
Provision for loan losses	93,402	671,770
Net interest income after provision for loan losses	2,157,736	1,622,398
Noninterest income		
Service charges on deposit accounts	205,735	225,788
Gain on the sale of government guaranteed loans	229,130	
Realized gains on the sale of securities	3,339	
Fees on loans delivered to correspondents	14,025	29,413
Other service charges and fees	143,620	144,798
Other operating income	200,794	172,252
Total noninterest income	796,643	572,251
Noninterest expense		
Salaries and employee benefits	910,375	861,138
Occupancy expense	119,015	107,051
Equipment expense	57,937	54,399
Data processing	110,622	90,004
Foreclosed assets, net	(18,030)	(936)
Postage, printing and supplies	61,199	56,041
Professional fees	86,981	74,628
FDIC insurance premiums	13,693	35,650

Other expense	336,965	345,233
Total noninterest expense	1,678,757	1,623,208
Net income before income taxes	1,275,622	571,441
Income tax expense	474,779	203,860
Net income	800,843	367,581
Preferred stock dividends	(45,730)	(45,605)
Net income available to common stockholders	$ 755,113	$ 321,976
Basic earnings per common share	$ 0.21	$ 0.09
Diluted earnings per common share	$ 0.19	$ 0.09
Basic weighted average common shares outstanding	3,542,984	3,540,920
Diluted weighted average common shares outstanding	4,176,919	4,174,855

See Notes to Consolidated Financial Statements

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Consolidated Statements of Comprehensive Income

Six months ended June 30, 2013 and 2012 (Unaudited)

	2013	2012
Net income	$ 1,452,619	$ 1,031,638
Other comprehensive income (loss):		
Investment securities available for sale:		
Unrealized losses arising during the period	(42)	(7,360)
Tax benefit related to unrealized losses	443	2,838
Total other comprehensive income (loss)	401	(4,522)
Total comprehensive income	$ 1,453,020	$ 1,027,116

See Notes to Consolidated Financial Statements

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Consolidated Statements of Cash Flows

Six months ended June 30, 2013 and 2012 (Unaudited)

	2013	2012
Cash flows from operating activities		
Net income	$ 1,452,619	$ 1,031,638
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	123,958	115,562
Gain on sale of property and equipment	(100)	(650)
Gain on the sale of government guaranteed loans	(229,130)	
Gain on the sale of foreclosed assets	(33,520)	(63,705)
Stock-based compensation, net of tax benefit		11,504
Provision for loan losses	135,796	738,988
Deferred income taxes	2,853	3,895
Accretion of discount on securities, net of amortization of premiums	19	395
Increase in cash surrender value of life insurance	(80,766)	(74,163)
Changes in assets and liabilities:		
Accrued income	(20,305)	3,741
Other assets	(982,267)	(74,462)
Accrued interest payable	49,578	6,197
Other liabilities	1,154,737	632,341
Net cash provided by operating activities	1,573,472	2,331,281
Cash flows from investing activities		
Net decrease in interest-bearing deposits with banks	3,281,821	12,245,078
Net (increase) decrease in federal funds sold	(500,404)	633
Purchases of investment securities	(1,508,892)	(2,000,000)
Sales and maturities of investment securities	1,003,508	1,502,960
Purchase of Bank Owned Life Insurance		(1,750,000)
Redemption of restricted equity securities	61,800	45,000
Purchase of restricted equity securities	(185)	(2,150)
Net increase in loans	(7,038,966)	(617,530)
Proceeds from the sale of foreclosed assets	475,983	520,316
Purchases of property and equipment	(55,677)	(124,389)
Proceeds from the sale of property and equipment	100	650
Net cash provided by (used in) investing activities	(4,280,912)	9,820,568
Cash flows from financing activities		
Net increase in deposits	2,324,811	(5,297,996)
Repayments of long-term debt		(350,000)
Dividends paid	(91,333)	(622,346)
Common stock options exercised		30,111
Net cash provided by (used in) financing activities	2,233,478	(6,240,231)

Net increase (decrease) in cash and cash equivalents		(473,962)		5,911,618
Cash and due from banks, beginning		5,973,042		2,269,116
Cash and due from banks, ending	$	5,499,080	$	8,180,734
Supplemental disclosures of cash flow information				
Interest paid	$	732,695	$	865,488
Taxes paid	$	872,255	$	255,000
Supplemental disclosures of non-cash transactions				
Loans transferred to foreclosed properties	$	30,300	$	147,639
Proceeds from the sale of guaranteed loan previously recorded as short term debt	$	3,743,820	$	

See Notes to Consolidated Financial Statements

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Consolidated Statements of Changes in Stockholders Equity

Six months ended June 30, 2013 and 2012 (Unaudited)

	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, January 1, 2012	$ 3,868,807	3,536,724	$ 12,009,588	$ 14,405,467	$ (57,300)	$ 30,226,562
Net income				1,031,638		1,031,638
Other comprehensive loss					(4,522)	(4,522)
Common stock options exercised		6,260	30,111			30,111
Stock-based compensation, net of tax benefit			11,504			11,504
Dividends declared and accrued on convertible Series A preferred stock ($.31 per share)				(59,322)		(59,322)
Dividends declared and accrued on convertible Series D preferred stock ($.18 per share)				(31,888)		(31,888)
Balance, June 30, 2012	$ 3,868,807	3,542,984	$ 12,051,203	$ 15,345,895	$ (61,822)	$ 31,204,083
Balance, January 1, 2013	$ 3,868,807	3,542,984	$ 12,061,153	$ 16,367,187	$ (59,846)	$ 32,237,301
Net income				1,452,619		1,452,619
Other comprehensive income					401	401
Dividends declared and accrued on convertible Series A preferred stock ($.32 per share)				(59,157)		(59,157)
Dividends declared and accrued on convertible Series D preferred stock ($.18 per share)				(31,800)		(31,800)
Balance, June 30, 2013	$ 3,868,807	3,542,984	$ 12,061,153	$ 17,728,849	$ (59,445)	$ 33,599,364

See Notes to Consolidated Financial Statements

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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 June 30, 2013, the results of operations for the six and three months ended June 30, 2013 and 2012, and its changes in stockholders equity, comprehensive income and cash flows for the six months ended June 30, 2013 and 2012. These adjustments are of a normal and recurring nature. The results of operations for the six months ended June 30, 2013, 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, 2012, included in the Company s Form 10-K. The balance sheet at December 31, 2012, 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, 2012 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.

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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 June 30, 2013 and December 31, 2012, 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 June 30, 2013 and December 31, 2012.

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 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 were effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The amendments did not have a material effect on the Company s financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Recent Accounting Pronouncements, continued

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company 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 while the FASB redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments were effective for the Company on a prospective basis beginning January 1, 2013. These amendments did not have a material effect on the Company s financial statements.

On April 22, 2013, the FASB issued guidance addressing application of the liquidation basis of accounting. The guidance is intended to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments will be effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein and those requirements should be applied prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The Company does not expect these amendments to have any effect on its 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 June 30, 2013 and December 31, 2012 follow:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2013				
Government-sponsored enterprises	$ 3,000,000	$ 1,790	$ 11,800	$ 2,989,990
Mortgage-backed securities	38,132	1,270		39,402
Corporate bonds	550,000		101,750	448,250
Equities and mutual funds	517,728	22,008	9,203	530,533
	$ 4,105,860	$ 25,068	$ 122,753	$ 4,008,175
December 31, 2012				
Government-sponsored enterprises	$ 2,500,000	$ 4,875	$	$ 2,504,875
Mortgage-backed securities	41,659	1,316		42,975
Corporate bonds	550,000		107,250	442,750
Equities and mutual funds	508,836	3,416		512,252
	$ 3,600,495	$ 9,607	$ 107,250	$ 3,502,852

At June 30, 2013 and December 31, 2012, 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 June 30, 2013, were as follows:

	Amortized Cost	Fair Value
Due in one year or less	$ 517,728	$ 530,533
Due after one year through five years	3,250,000	3,193,740
Due after five years through ten years	326,468	271,761
Due after ten years	11,664	12,141
	$ 4,105,860	$ 4,008,175

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 June 30, 2013 and December 31, 2012. These unrealized losses on investment securities are a result of volatility in interest rates which relate to government-sponsored enterprises and corporate bonds issued by other banks and market volatility as it relates to equity and mutual fund investments at June 30, 2013 and December 31, 2012.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2013						
Government-sponsored enterprises	$ 1,988,200	$ 11,800	$	$	$ 1,988,200	$ 11,800
Corporate bonds			448,250	101,750	448,250	101,750
Equities and mutual funds	238,526	9,203			238,526	9,203
	$ 2,226,726	$ 21,003	$ 448,250	$ 101,750	$ 2,674,976	$ 122,753
December 31, 2012						
Corporate bonds	$	$	$ 442,750	$ 107,250	$ 442,750	$ 107,250
	$	$	$ 442,750	$ 107,250	$ 442,750	$ 107,250

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 at June 30, 2013, with unrealized losses for a period greater than 12 months. These securities also had unrealized losses for a period greater than 12 months at December 31, 2012. 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 realized gains of $5,297 from the sales of equity and mutual fund investment securities for the six month periods ended June 30, 2013. There were no such gains in 2012.

NOTE 3. EARNINGS PER SHARE

Basic earnings per share for the six and three months ended June 30, 2013 and 2012 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 June 30, 2013, the Company had commitments to extend credit, including unused lines of credit of approximately $35,076,000 and letters of credit outstanding of $1,673,838.

NOTE 5. LOANS

The major components of loans in the balance sheets at June 30, 2013 and December 31, 2012 are below.

	2013	2012
Commercial	$ 66,397,808	$ 75,914,072
Real estate:		
Construction and land development	5,524,198	4,873,512
Residential, 1-4 families	38,621,785	36,091,051
Residential, 5 or more families	1,603,611	1,676,449

Farmland	2,483,567	2,284,155
Nonfarm, nonresidential, net of discounts of $137,407 in 2013 and $22,001 in 2012	62,740,245	48,993,867
Agricultural	147,811	147,860
Consumer, net of discounts of $13,633 in 2013 and $17,764 in 2012	6,086,325	6,703,363
Other	2,251	3,000
	183,607,601	176,687,329
Deferred loan origination costs, net of (fees)	274,207	293,334
	183,881,808	176,980,663
Allowance for loan losses	(3,431,373)	(3,403,098)
	$ 180,450,435	$ 173,577,565

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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 $17,500,000 and $17,765,000 at June 30, 2013 and December 31, 2012, respectively.

NOTE 6. ALLOWANCE FOR LOAN LOSSES

The activity of the allowance for loan losses by loan components during the six months ended June 30, 2013 and 2012 was as follows:

	Construction & Development	1-4 Family Residential	Nonfarm, Nonresidential	Commercial & Industrial	Consumer	Other	Total
June 30, 2013							
Allowance for credit losses:							
Beginning balance	$ 86,300	$ 668,700	$ 801,999	$ 1,604,510	$ 198,789	$ 42,800	$ 3,403,098
Charge-offs		(8,122)	(79,609)	(6,150)	(54,118)		(147,999)
Recoveries	517	401	949	19,892	18,719		40,478
Provision	3,983	26,321	153,631	(69,156)	17,017	4,000	135,796
Ending balance	$ 90,800	$ 687,300	$ 876,970	$ 1,549,096	$ 180,407	$ 46,800	$ 3,431,373
Ending balance: individually evaluated for impairment	$	$	$ 254,670	$ 217,296	$	$	$ 471,966
Ending balance: collectively evaluated for impairment	$ 90,800	$ 687,300	$ 622,300	$ 1,331,800	$ 180,407	$ 46,800	$ 2,959,407
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
Loans Receivable:							
Ending balance	$ 5,524,198	$ 38,621,785	$ 62,740,245	$ 66,397,808	$ 6,086,325	$ 4,237,240	$ 183,607,601
Ending balance: individually evaluated for impairment	$ 86,589	$ 269,392	$ 3,345,220	$ 2,464,599	$	$	$ 6,165,800
Ending balance: collectively evaluated for impairment	$ 5,437,609	$ 38,352,393	$ 59,395,025	$ 63,933,209	$ 6,086,325	$ 4,237,240	$ 177,441,801
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$

June 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)	(268,006)	(21,831)	(579,503)	(128,611)		(1,005,237)
Recoveries	100	532	83,506	89,538	14,196		187,872
Provision	9,386	161,912	(87,540)	541,671	119,559	(6,000)	738,988
Ending balance	$ 105,400	$ 731,298	$ 839,989	$ 1,859,966	$ 215,951	$ 49,600	$ 3,802,204
Ending balance: individually evaluated for impairment	$	$ 23,598	$ 318,189	$ 383,366	$	$	$ 725,153
Ending balance: collectively evaluated for impairment	$ 105,400	$ 707,700	$ 521,800	$ 1,476,000	$ 215,951	$ 49,600	$ 3,077,051
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
Loans Receivable:							
Ending balance	$ 5,876,390	$ 36,568,561	$ 45,463,526	$ 79,246,988	$ 7,351,882	$ 4,450,720	$ 178,958,534
Ending balance: individually evaluated for impairment	$ 90,391	$ 336,705	$ 3,302,888	$ 3,199,855	$	$	$ 6,929,839
Ending balance: collectively evaluated for impairment	$ 5,786,466	$ 36,231,856	$ 42,160,638	$ 76,047,133	$ 7,351,882	$ 4,450,720	$ 172,028,695
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6. ALLOWANCE FOR LOAN LOSSES, CONTINUED

The following table presents impaired loans individually evaluated by class of loan as of June 30, 2013 and December 31, 2012 and the recognized interest income per the related period:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
June 30, 2013					
With no related allowance recorded:					
Construction and development	$ 86,589	$ 86,589	$	$ 87,038	$ 3,735
1-4 family residential	269,392	269,392		272,985	
Nonfarm, nonresidential	1,667,084	1,667,084		1,715,533	28,557
Commercial and industrial	1,292,535	1,292,535		1,226,791	14,463
Consumer					
Other loans					
	3,315,600	3,315,600		3,302,347	46,755
With an allowance recorded:					
Construction and development	$	$	$	$	$
1-4 family residential					
Nonfarm, nonresidential	1,678,136	1,779,577	254,670	1,692,293	7,351
Commercial and industrial	1,172,064	1,172,064	217,296	1,187,910	13,622
Consumer					
Other loans					
	2,850,200	2,951,641	471,966	2,880,203	20,973
Combined:					
Construction and development	$ 86,589	$ 86,589	$	$ 87,038	$ 3,735
1-4 family residential	269,392	269,392		272,985	
Nonfarm, nonresidential	3,345,220	3,446,661	254,670	3,407,826	35,908
Commercial and industrial	2,464,599	2,464,599	217,296	2,414,701	28,085
Consumer					
Other loans					
	$ 6,165,800	$ 6,267,241	$ 471,966	$ 6,182,550	$ 67,728