DYNATRONICS CORP
Form 8-K
May 16, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported):

May 14, 2007

DYNATRONICS CORPORATION

(Exact name of registrant as specified in its charter)

Commission File No. 0-12697

Utah	87-0398434
(State or other jurisdiction of incorporation)	(IRS Employer Identification Number)

7030 Park Centre Dr.
Salt Lake City, Utah 84121
(Address of principal executive offices, Zip Code)

Registrant's telephone number, including area code: (801) 568-7000

Former name or former address, if changed since last report: Not Applicable

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02 Results of Operations and Financial Condition

On May 14, 2007, Dynatronics Corporation issued a press release announcing its financial results for its third fiscal quarter ended March 31, 2007. The release also announced that executives of the company would discuss these results with investors on a telephone conference call and provided access information, date and time for the conference call. A copy of the press release is furnished herewith as Exhibit 99 to this Current Report on Form 8-K and is incorporated herein by reference.

The information in this Current Report is being furnished and shall not be deemed "filed" for the purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section. The information in this Current Report shall not be incorporated by reference into any registration statement or other document pursuant to the Securities Act of 1933, as amended. The furnishing of the information in this Current Report is not intended to, and does not, constitute a representation that such furnishing is required by Regulation FD or that the information this Current Report contains is material investor information that is not otherwise publicly available.

Item 9.01 Financial Statements and Exhibits (furnished herewith)

(d) Exhibits

Exhibit 99 Press release issued by Dynatronics Corporation dated May 14, 2007

SIGNATURES

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

DYNATRONICS CORPORATION

By: /s/ Terry M. Atkinson, CPA

Terry M. Atkinson, CPA
Chief Financial Officer

Date: May 16, 2007

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Federal Home Loan Bank stock	1,837	1,837	2,235	2,235
Loans receivable, net of allowance	330,393	332,925	331,837	334,762
Accrued interest receivable	1,602	1,602	1,916	1,916
Financial liabilities:				
Deposits	415,050	417,621	385,957	386,935
Borrowings	26,000	29,569	36,000	38,168
Junior subordinated debentures	12,887	6,233	12,887	8,647
Accrued interest payable	286	286	269	269
Off-balance financial instruments:				
Commitments to extend credit	-	-	-	-
Outstanding letters of credit	-	-	-	-

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Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT STRATEGY

We are a community-oriented financial institution serving the northern New Jersey, northeastern Pennsylvania and Orange County, New York marketplace. While offering traditional community bank loan and deposit products and services, we obtain non-interest income through our insurance brokerage operations, Tri-State Insurance Agency, Inc., (“Tri-State”) and the sale of non-deposit products. We report the operations of Tri-State as a separate segment from our commercial banking operations.

We continue to focus on strengthening our core operating performance by improving our net interest income and margin by closely monitoring our yield on earning assets and adjusting the rates offered on deposit products. The economic downturn continues to impact our level of nonperforming assets and in turn has increased our provision for loan losses. We have been focused on building for the future and strengthening our core operating results within a risk management framework.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with the accounting principles generally accepted in the United States of America (“U.S. GAAP”) and practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Actual results could differ from those estimates.

Critical accounting estimates are necessary in the application of certain accounting policies and procedures, and are particularly susceptible to significant change. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. For additional information on our critical accounting policies, please refer to the information contained in Note 1 of the accompanying unaudited consolidated financial statements and Note 1 of the consolidated financial statements included in our 2010 Annual Report on Form 10-K.

COMPARISION OF OPERATING RESULTS FOR THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

Overview - We realized net income of $534 thousand for the third quarter of 2011, a decrease of $97 thousand, or 15.4%, from net income of $631 thousand reported for the same period in 2010. Basic and diluted earnings per share for the three months ended September 30, 2011 were $0.16 compared to the basic and diluted earnings per share of $0.19 for the comparable period of 2010. The decrease in net income was largely due to an increase in non-interest expenses of $181 thousand. Third quarter results reflected an increase in non-interest expenses largely attributed to higher salaries and employee benefits expenses due in part to the expansion of our commercial lending group. Management continues to focus on strengthening the Company’s core operations as well as resolving and mitigating the Company’s credit exposures.

Net loss before taxes for our Tri-State segment improved to $4 thousand for the third quarter of 2011 compared to net loss before taxes of $46 thousand in the same period in 2010. This improvement was largely the result of a $60 thousand, or 12.4%, increase in revenues.

Comparative Average Balances and Average Interest Rates

The following table presents, on a fully taxable equivalent basis, a summary of our interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the three month period ended September 30, 2011 and 2010.

	Three Months Ended September 30,					
	2011			2010		
(Dollars in thousands)	Average Balance	Interest(1)	Average Rate(2)	Average Balance	Interest(1)	Average Rate(2)
Earning Assets:						
Securities:						
Tax exempt(3)	$30,059	$449	5.92 %	$30,669	$436	5.64 %
Taxable	48,890	313	2.54 %	49,501	412	3.30 %
Total securities	78,949	762	3.83 %	80,170	848	4.20 %
Total loans receivable(4)	338,393	4,687	5.49 %	329,294	4,765	5.74 %
Other interest-earning assets	35,530	20	0.22 %	39,071	23	0.23 %
Total earning assets	452,872	$5,468	4.79 %	448,535	$5,636	4.99 %
Non-interest earning assets	41,159			39,847		
Allowance for loan losses	(7,261)			(5,809)		
Total assets	$486,770			$482,573		
Sources of Funds:						
Interest bearing deposits:						
NOW	$77,676	$85	0.44 %	$67,306	$109	0.64 %
Money market	16,564	23	0.54 %	13,735	25	0.72 %
Savings	168,419	287	0.68 %	178,833	398	0.88 %
Time	102,725	411	1.59 %	100,517	411	1.62 %
Total interest bearing deposits	365,384	806	0.88 %	360,391	943	1.04 %
Borrowed funds	26,000	268	4.03 %	33,051	358	4.24 %
Junior subordinated debentures	12,887	55	1.65 %	12,887	62	1.88 %
Total interest bearing liabilities	404,271	$1,129	1.11 %	406,329	$1,363	1.33 %
Non-interest bearing liabilities:						
Demand deposits	41,012			38,721		
Other liabilities	2,613			1,266		
Total non-interest bearing liabilities	43,625			39,987		
Stockholders’ equity	38,874			36,257		
Total liabilities and stockholders’ equity	$486,770			$482,573		
Net interest income and margin(5)		$4,339	3.80 %		$4,273	3.78 %

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(1) Includes loan fee income

(2) Average rates on securities are calculated on amortized costs

(3) Fully taxable equivalent basis, using a 39% effective tax rate and adjusted for TEFRA (Tax and Equity Fiscal Responsibility Act) interest expense disallowance

(4) Loans outstanding include non-accrual loans

(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets

Net Interest Income - Net interest income is the difference between interest and fees on loans and other interest-earning assets and interest paid on interest-bearing liabilities. Net interest income is directly affected by changes in volume and mix of interest-earning assets and interest-bearing liabilities that support those assets, as well as changing interest rates when differences exist in repricing dates of assets and liabilities.

Net interest income, on a fully tax equivalent basis, increased $66 thousand, or 1.5%, to $4.3 million for the quarter ended September 30, 2011, as compared to the same period in 2010. The increase in net interest income was largely due to our net interest margin improving 2 basis points to 3.80% for the third quarter of 2011compared to the same period in 2010. The improvement was driven by a 22 basis point decrease in the average rate paid on interest bearing liabilities, offset by a decline in the average rate earned on total earning assets, which decreased 20 basis points to 4.79% for the third quarter of 2011 from 4.99% for the same period in 2010. Total earning assets increased $4.3 million while total interest bearing liabilities declined $2.1 million between the two third quarter periods ended September 30, 2011 and 2010.

Interest Income - Total interest income, on a fully taxable equivalent basis, decreased $168 thousand for the quarter ended September 30, 2011 as compared to the same period last year. The decline was due to lower taxable security yields and loan yields, which decreased 76 basis points and 25 basis points, respectively.

Total interest income on securities, on a fully taxable equivalent basis, decreased $86 thousand, to $762 thousand for the quarter ended September 30, 2011 from $848 thousand for the third quarter of 2010. This decline was largely due to a 37 basis point decrease in the yield on securities from 4.20% to 3.83% between the two third quarter periods. The decline in security yields was mostly attributed to the reinvestment of cash flows from maturities, calls and prepayments into lower market rate environment.

The interest earned on total loans receivable decreased $78 thousand for the third quarter of 2011 as compared to the third quarter in 2010. The decline was mostly driven by a 25 basis point decline in average yields due to lower market rates and a $5.0 million increase in non-accrual loans between the two third quarter periods. The average rate earned on loans for the quarter ended September 30, 2011 was 5.49% as compared to 5.74% for the same period in 2010.

Other interest-earning assets include federal funds sold and interest bearing deposits in other banks. The interest earned on total other interest-earning assets decreased $3 thousand for the third quarter of 2011 as compared to the third quarter in 2010 due to lower average balances. The average balances in other interest-earning assets decreased $3.5 million, or 9.1%, to $35.5 million in the third quarter of 2011 from $39.1 million during the third quarter a year earlier. The decreases in the average balance in interest bearing deposits were used to fund the growth in the loan portfolio.

Interest Expense - Our interest expense for the three months ended September 30, 2011 decreased $234 thousand, or 17.2%, to $1.1 million from $1.4 million for the same period in 2010. The improvement was principally due to lower average rates paid on total interest-bearing liabilities, which declined 22 basis points from 1.33% for the three months ended September 30, 2010 to 1.11% for the same period in 2011. The improvement in interest expense was partly due to a decline in average balances in interest-bearing liabilities, which decreased $2.1 million, or 0.5%, to $404.3 million for the third quarter in 2011 from $406.3 million for the same period in 2010.

Interest expense on deposits declined $137 thousand, or 14.5%, for the quarter ended September 30, 2011, as compared to the same period last year. The decline was largely attributed to lower rates on total interest bearing deposits, which decreased 16 basis points for the third quarter 2011 as compared to the same period in 2010. The decrease in rates on deposit products reflects managements' asset/liability strategies and a lower market rate environment between the two third quarter periods. During the third quarter of 2011, there was a favorable shift in deposit mix as savings deposits, on average, with a yield of 68 basis points declined $10.4 million, while NOW accounts, on average, with a yield of 44 basis points increased $10.4 million. The shift in mix had a positive effect on interest expense for the third quarter of 2011.

Interest expense on borrowings declined $90 thousand, or 25.1%, for the quarter ended September 30, 2011, as compared to the same period last year. The decrease was largely due to a decline in our average borrowed funds by $7.1 million to $26.0 million for the quarter ended September 30, 2011 as compared to the same period last year. The decline in interest expense on borrowings also benefited from lower average rates paid on borrowed funds, which declined 21 basis points to 4.03% for the quarter ended September 30, 2011 as compared to 4.24% for the same period last year.

We had an average balance of $12.9 million in junior subordinated debentures outstanding during the third quarters of 2011 and 2010. The $12.9 million junior subordinated debentures, issued on June 28, 2007 bear a floating rate of interest tied to the three month LIBOR. The average rate paid on the debentures declined 23 basis points to 1.65% for the third quarter for 2011 compared to 1.88% in the third quarter of 2010.

Provision for Loan Losses - The loan loss provision for the third quarter of 2011 increased $75 thousand, or 11.3%, to $737 thousand compared to a provision of $662 thousand in the third quarter of 2010. The provision for loan losses reflects management's judgment concerning the risks inherent in our existing loan portfolio and the size of the

allowance necessary to absorb the risks, as well as the activity in the allowance during the periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

Non-Interest Income - Our non-interest income increased $30 thousand, or 2.5%, to $1.2 million for the three months ended September 30, 2011 compared to the same period in 2010. The increase in non-interest income was largely due to a $60 thousand, or 12.4%, growth in insurance commissions and fees and a $12 thousand, or 9.4%, improvement in ATM and debit card fees for the third quarter of 2011 as compared to the same period in 2010. The aforementioned increases were partly offset by a $51 thousand, 13.6%, decline in service fees on deposits.

Non-Interest Expense – Total non-interest expense increased $181 thousand, or 4.7%, to $4.0 million for the quarter ended September 30, 2011. The increase for the third quarter of 2011 versus the same period in 2010 was largely due to a $334 thousand increase in salaries and employee benefits and higher loan collection costs of $170 thousand. The increase in salaries and employee benefits was mostly attributed to an increase in commercial lenders, an adjustment in 2010 to reduce incentive compensation and higher medical premium expenses for the third quarter of 2011 as compared to the same quarter in 2010. The aforementioned increase was partly offset by declines in write-downs on foreclosed real estate and FDIC assessments of $182 thousand and $79 thousand, respectively. Director fees declined $60 thousand in the third quarter of 2011 to $5 thousand, largely due to fluctuations in our stock price and its effect on the value of the Director's deferred stock compensation plan.

Income Taxes - our income tax expense, which includes both federal and state taxes, was $97 thousand for the three months ended September 30, 2011 compared to $168 thousand for the third quarter of 2010. The decrease of $71 thousand in income taxes in the third quarter of 2011, as compared to the same period in 2010, was largely the result of a decrease in pre-tax income. The 15.4% effective tax rate for the three months ended September 30, 2011 and 21.0% in the prior year period was due to the benefit from tax exempt income from securities and bank-owned life insurance policies.

COMPARISION OF OPERATING RESULTS FOR NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

Overview - For the nine months ended September 30, 2011, net income was $2.0 million, an increase of $376 thousand, or 23.8%, from $1.6 million reported for the same period in 2010. Diluted earnings per share were $0.59 for the nine month period ended September 30, 2011 and $0.48 for the same period last year. The increase in net income reflects a $761 thousand growth in net interest income and a $462 thousand improvement in non-interest income, which was partially offset by a $324 thousand increase in the provision for loan losses.

Net income before taxes for our Tri-State segment increased $158 thousand resulting in a net income before taxes of $154 thousand for the first nine months of 2011 compared to net loss before taxes of $4 thousand for the same period in 2010. This increase was the combination of insurance commission and fee income increasing $102 thousand and other expenses decreasing $56 thousand between the two periods.

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Comparative Average Balances and Average Interest Rates

The following table presents, on a fully taxable equivalent basis, a summary of our interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the nine month period ended September 30, 2011 and 2010.

	Nine Months Ended September 30,					
	2011			2010		
(Dollars in thousands)	Average Balance	Interest(1)	Average Rate(2)	Average Balance	Interest(1)	Average Rate(2)
Earning Assets:						
Securities:						
Tax exempt(3)	$29,962	$1,332	5.94 %	$28,432	$1,228	5.77 %
Taxable	52,398	989	2.52 %	49,820	1,378	3.70 %
Total securities	82,360	2,321	3.77 %	78,252	2,606	4.45 %
Total loans receivable(4)	341,123	14,210	5.57 %	330,340	14,194	5.74 %
Other interest-earning assets	23,318	35	0.20 %	34,914	50	0.19 %
Total earning assets	446,802	16,566	4.96 %	443,506	$16,850	5.08 %
Non-interest earning assets	38,020			38,058		
Allowance for loan losses	(7,227)			(5,991)		
Total assets	$477,595			$475,573		
Sources of Funds:						
Interest bearing deposits:						
NOW	$78,923	$305	0.52 %	$64,342	$386	0.80 %
Money market	14,838	61	0.55 %	12,857	74	0.77 %
Savings	169,360	881	0.70 %	174,285	1,398	1.07 %
Time	94,898	1,095	1.54 %	102,586	1,300	1.69 %
Total interest bearing deposits	358,019	2,342	0.87 %	354,070	3,158	1.19 %
Borrowed funds	26,859	797	3.91 %	33,065	1,065	4.25 %
Junior subordinated debentures	12,887	164	1.68 %	12,887	170	1.74 %
Total interest bearing liabilities	397,765	3,303	1.11 %	400,022	$4,393	1.47 %
Non-interest bearing liabilities:						
Demand deposits	39,423			38,474		
Other liabilities	2,427			1,436		
Total non-interest bearing liabilities	41,850			39,910		
Stockholders’ equity	37,980			35,641		
Total liabilities and stockholders’ equity	$477,595			$475,573		
Net interest income and margin(5)		$13,263	3.97 %		$12,457	3.76 %

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(1) Includes loan fee income

(2) Average rates on securities are calculated on amortized costs

(3) Fully taxable equivalent basis, using a 39% effective tax rate and adjusted for TEFRA (Tax and Equity Fiscal Responsibility Act) interest expense disallowance

(4) Loans outstanding include non-accrual loans

(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets

Net Interest Income - Net interest income, on a fully taxable equivalent basis, increased $806 thousand, or 6.5%, to $13.3 million for the nine months ended September 30, 2011, as compared to $12.5 million for same period in 2010. Our net interest margin improved 21 basis points to 3.97% for the first nine months of 2011, compared to 3.76% for the same period last year. The improvement was mostly attributed to a 36 basis point decline in the average rate paid on interest bearing liabilities to 1.11%, which was partly offset by an 12 basis point decrease in the average rate on earning assets to 4.96% for the nine month period ended September 30, 2011 as compared to the same period last year. The average balance of earning assets grew $3.3 million and as the balance sheet mix shifted to higher yielding loans and securities from lower yielding other interest-earning assets.

Interest Income - Total interest income, on a fully taxable equivalent basis, decreased $284 thousand for the nine months ended September 30, 2011 as compared to the same period last year. The decline was principally due to lower security yields, which decreased 68 basis points.

Total interest income on securities, on a fully taxable equivalent basis, decreased $285 thousand, to $2.3 million for the nine months ended September 30, 2011 from $2.6 million for the same period last year. This decline was driven by a 68 basis point decrease in the yield on securities from 4.45% for the nine months ended September 30, 2010 to 3.77% for the nine months ended September 30, 2011. The decline in interest income on securities was partly offset by a $4.1 million increase in average balances of total securities between the two periods. The decline in security yields was mostly attributed to the reinvestment of cash flows from maturities, calls and prepayments into a lower market rate environment.

The interest earned on total loans receivable increased $16 thousand for the first nine months of 2011 as compared to the same period in 2010, which was mostly driven by a $10.8 million growth in loans, on average. The increase in interest income was partly offset by a 17 basis point decline in average yields. The average rate earned on loans for the nine months ended September 30, 2011 was 5.57% as compared to 5.74% for the same period in 2010.

Interest Expense - Our interest expense for the nine months ended September 30, 2011 decreased $1.1 million, or 24.8%, to $3.3 million from $4.4 million for the same period in 2010. The improvement was principally due to lower average rates paid on total interest-bearing liabilities, which declined 36 basis points from 1.47% for the nine months ended September 30, 2010 to 1.11% for the same period in 2011.

Interest expense on deposits declined $816 thousand, or 25.8%, for the nine months ended September 30, 2011, as compared to the same period last year. The decline was largely attributed to lower rates on total interest bearing deposits, which decreased 32 basis points for the first nine months of 2011 as compared to the same period in 2010. The decrease in rates on deposit products reflects managements' asset/liability strategies and a lower market rate environment between the two periods. During the nine months of 2011, there was a favorable shift in deposit mix as time deposits, on average, declined $7.7 million, while NOW accounts, on average, increased $14.6 million. The shift in mix had a positive effect on interest expense for the first nine months of 2011.

Interest expense on borrowings declined $268 thousand, or 25.2%, for the nine months ended September 30, 2011, as compared to the same period last year. The decrease was largely due to a decline in our average borrowed funds by $6.2 million to $26.9 million for the nine months ended September 30, 2011 as compared to the same period last year. The decline in interest expense on borrowings also benefited from lower average rates paid on borrowed funds, which declined 34 basis points to 3.91% for the nine months ended September 30, 2011 as compared to 4.25% for the same period last year.

We had an average balance of $12.9 million in junior subordinated debentures outstanding during the first nine months of 2011 and 2010. The $12.9 million junior subordinated debentures, issued on June 28, 2007 bear a floating rate of interest tied to the three month LIBOR. The average rate paid on the debentures decreased 6 basis points to 1.68% for the nine months ended September 30, 2011 from 1.74% for the same period in 2010.

Provision for Loan Losses - The loan loss provision for the first nine months of 2011 increased $324 thousand, or 13.7%, to $2.7 million compared to a provision of $2.4 million for the same period in 2010. The provision for loan losses reflects management's judgment concerning the risks inherent in our existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as the activity in the allowance during the periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

Non-Interest Income - Our non-interest income increased income of $462 thousand, or 13.2%, to $4.0 million for the nine months ended September 30, 2011. The increase in non-interest income was largely due to a $216 thousand gain on sale of securities and a decrease in an impairment write-down on equity securities originally recorded in 2010. Contributing to the growth in non-interest income were increases in bank-owned life insurance income of $105 thousand, or 50.2%, and higher insurance commissions and fees of $102 thousand, or 6.3%, from Tri-State as compared to the same period last year.

Non-Interest Expense – Our non-interest expenses increased $376 thousand, or 3.4%, to $11.6 million for the nine months ended September 30, 2011. The increase for the first nine months of 2011 compared to the same period in 2010 was largely due to an increase in salaries and benefits and loan collection costs of $347 thousand, or 5.9%, and $299 thousand, or 97.4%, respectively. The increase was partly offset by a $146 thousand decline in FDIC assessment costs. The increase in salary and benefits expenses was largely due to higher medical benefits expenses

and 401k costs. Total salary expense, excluding benefits, increased 1.8% for the first nine months of 2011 compared to the same period in 2010.

Income Taxes – Our income tax expense, which includes both federal and state taxes, was $535 thousand for the nine months ended September 30, 2011 compared to $388 thousand for the same period in 2010. Our effective tax rate increased from 19.7% for the nine months period ended September 30, 2010 to 21.5% for the first nine months of 2011 and is below the statutory tax rate due to tax-exempt interest on securities and earnings on the investment in bank-owned life insurance.

COMPARISION OF FINANCIAL CONDITION AT SEPTEMBER 30, 2011 TO DECEMBER 31, 2010

At September 30, 2011, our total assets were $495.9 million, an increase of $21.9 million, or 4.6%, as compared to total assets of $474.0 million at December 31, 2010.

Cash and Cash Equivalents - Our cash and cash equivalents increased by $30.6 million at September 30, 2011 to $48.4 million, or 9.8% of total assets, from $17.7 million, or 3.7% of total assets, at December 31, 2010. The increase was largely due to and increase of $29.1 million in deposits.

Securities Portfolio - At September 30, 2011, total investment securities, which include available-for-sale and held-to-maturity securities, were $81.9 million compared to $90.4 million at December 31, 2010. Available-for-sale securities were $78.6 million at September 30, 2011 compared to $89.4 million at December 31, 2010. The available-for-sale securities are held primarily for liquidity, interest rate risk management and long-term yield enhancement. Accordingly, our investment policy is to invest in securities with low credit risk, such as U.S. Government agency obligations, state and political obligations and mortgage-backed securities. The decrease for the first nine months of 2011 in available-for-sale securities compared with the year ended December 31, 2010 is due to the maturities, calls and principal repayments of $23.7 million of securities in the first nine months of 2011. Held-to-maturity securities totaled $3.3 million at September 30, 2011 compared to $1.0 million at December 31, 2010 and consist principally of securities issued by state and political subdivisions.

Other investments totaled $1.8 million at September 30, 2011, compared to $2.2 million at December 31, 2010 and consisted primarily of FHLB stock. The decrease of $398 thousand, or 17.8%, from September 30, 2011 to December 31, 2010 was a result of the FHLB stock redemptions due to reductions in borrowings between the two periods. We also held $100 thousand in time deposits with other financial institutions at September 30, 2011 and $600 thousand at December 31, 2010.

Net unrealized gains were $1.4 million and $86 thousand at September 30, 2011 and December 31, 2010, respectively. The improvement in the fair value of the investment securities is driven by state and political subdivisions. Gross unrealized losses improved by $581 thousand to $486 thousand at September 30, 2011, as compared to $1.1 million at December 31, 2010. The improvement in gross unrealized losses was largely attributed to higher fair values of state and political subdivisions.

We conduct a regular assessment of its investment securities to determine whether any securities are other-than-temporarily impaired (“OTTI”). Further detail of the composition of the securities portfolio and discussion of the results of the most recent OTTI assessment are in Note 2 - Securities to the unaudited consolidated financial statements. Our securities in unrealized loss positions are mostly driven by changes in spreads and market interest rates. All of our debt and equity securities have been evaluated for other-than-temporary impairment as of September 30, 2011 and we do not consider any security OTTI. We evaluated the prospects of the issuers in relation to the severity and the duration of the unrealized losses. Based on that evaluation, we did not intend to the sell and it is more likely than not that we will not have to sell any of our securities before recovery of their cost basis.

Our equity portfolio, which amounted to a fair value of $1.3 million, is comprised primarily of investments in other banks, an equity fund and a tax exempt mutual fund. During the second quarter of 2010, we recognized $171 thousand pre-tax non-cash OTTI charge related to an equity portfolio fund of common stocks in bank holding companies that had an amortized cost of $250 thousand. We continue to closely monitor the performance of our equity securities that we own, as well as the impact from any further deterioration in the economy or in the banking industry that may adversely affect these securities. We will continue to evaluate them for OTTI, which could result in a future non-cash charge to earnings. We held no high-risk securities or derivatives at September 30, 2011 or December 31, 2010.

Loans - The loan portfolio comprises our largest class of earning assets. Total loans receivable, net of unearned income, at September 30, 2011 decreased $440 thousand to $337.8 million from $338.2 million at year-end 2010, as new loan originations were less than payments, charge-offs and maturities. The declines was largely in construction loans and commercial and industrial loans, which decreased $3.4 million and $1.5 million, respectively. The aforementioned decreases were mostly offset by an increase in residential real estate loans, which increased $4.7 million to $101.4 million at September 30, 2011 as compared to December 31, 2010. Approximately 95% of our loan portfolio is secured by real estate and less than 5% of the loan portfolio is commercial and industrial based loans. We do not originate sub-prime or unconventional one to four family real estate loans.

The following table summarizes the composition of our loan portfolio by type as of:

(Dollars in thousands)		September 30, 2011		December 31, 2010
Commercial and industrial	$	13,589	$	15,045
Construction		17,447		20,862
Commercial real estate		204,279		204,407
Residential real estate		101,386		96,659
Consumer and other loans		1,272		1,395
Total gross loans	$	337,973	$	338,368

Loan and Asset Quality - Total non-performing assets, which include non-accrual loans, performing troubled debt restructured loans and foreclosed real estate, increased by $7.0 million to $33.4 million at September 30, 2011 from $26.4 million at year end 2010. Our non-accrual loans increased $4.8 million to $27.5 million at September 30, 2011 from $22.7 million at December 31, 2010. Troubled debt restructured loans that were not on non-accrual were $1.3 million at September 30, 2011 and at December 31, 2010. Non-accrual loans at September 30, 2011 primarily consist of loans which are collateralized by real estate. During the first nine months of 2011, foreclosed real estate increased by a net of $2.1 million. We held 12 foreclosed real estate properties as of September 30, 2011 totaling $4.5 million. Six of the properties, which consist of three residential homes, a three lot residential subdivision, a single residential lot and a commercial property, had an average book balance of approximately $276 thousand for each property. The largest loan taken into inventory amounted to approximately $1.0 million and consisted of land and some partially completed condominiums. All foreclosed real estate properties were recorded at fair value less selling costs and are currently being marketed for sale.

Management continues to monitor our asset quality and believes that the non-performing assets are adequately collateralized and anticipated material losses have been adequately reserved for in the allowance for loan losses. However, given the uncertainty of the current real estate market, additional provisions for losses may be deemed necessary in future periods. The following table provides information regarding risk elements in the loan portfolio at each of the periods presented:

(Dollars in thousands)		September 30, 2011			December 31, 2010	
Non-accrual loans	$	27,493		$	22,682	
Non-accrual loans to total loans		8.14	%		6.71	%
Non-performing assets	$	33,351		$	26,397	
Non-performing assets to total assets		6.73	%		5.57	%
Allowance for loan losses as a % of non-performing loans		25.69	%		26.65	%
Allowance for loan losses to total loans		2.19	%		1.89	%

Loan balances past due 90 days or more and still accruing interest, but which management expects will eventually be paid in full are not included in total non-performing loans, were principally due to maturity and are current in payments and are well secured.. At September 30, 2011, we had $1.0 million in this category as compared to $49 thousand at December 31, 2010.

A loan is considered impaired, in accordance with the impairment accounting guidance (FASB ASC 310-10-35-16), when based on current information and events, it is probable that we will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Total impaired loans at September 30, 2011 were

$30.4 million and at December 31, 2010 were $23.5 million. Impaired loans measured at fair value increased to $14.2 million on September 30, 2011 from $13.4 million at December 31, 2010. The principal balances on loans measured at fair value were $16.7 million and $14.8 million, net of valuation allowance of $2.5 million at September 30, 2011 and $1.4 million at December 31, 2010. Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. Not all impaired loans and restructured loans are on non-accrual, and therefore not all are considered non-performing loans. Impaired and restructured loans that were still accruing totaled $1.3 million at September 30, 2011 and December 31, 2010.

In addition to non-performing loans we continue to monitor our portfolio for potential problem loans. Potential problem loans are defined as loans which causes management to have serious concerns as to the ability of such borrowers to comply with the present loan repayment terms and which may cause the loan to be placed on non-accrual status. As of September 30, 2011, we had 6 loan relationships totaling $1.7 million that it deemed potential problem loans. Management is actively monitoring these loans.

Further detail of the credit quality of the loan portfolio is in Note 3 - Loans to the unaudited consolidated financial statements.

Allowance for Loan Losses - The allowance consists of general and allocated components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical charge-off experience and expected losses derived from our internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

Management regularly assesses the appropriateness and adequacy of the loan loss reserve in relation to credit exposure associated with individual borrowers, overall trends in the loan portfolio and other relevant factors, and believes the reserve is reasonable and adequate for each of the periods presented.

At September 30, 2011, the total allowance for loan losses increased $1.0 million, or 15.7%, to $7.4 million, as compared to $6.4 million at December 31, 2010. The components of this increase were a provision for loan losses of $2.7 million, charge-offs totaling $2.2 million and recoveries of $546 thousand in the first nine months of 2011. The provision also reflects the continued decline in current real estate values in our market area and reduced cash flows to support the repayment of loans. The allowance for loan losses as a percentage of total loans was 2.19% at September 30, 2011 and 1.89% at December 31, 2010.

The table below presents information regarding our provision and allowance for loan losses at September 30, 2011 and September 30, 2010:

(Dollars in thousands)		September 30, 2011			September 30, 2010	
Balance, beginning of period	$	6,397		$	5,496	
Charge-offs		(2,230	)		(1,804	)
Recoveries		546			41	
Provision		2,688			2,364	
Balance, end of period	$	7,401		$	6,097	

The table below presents details concerning the allocation of the allowance for loan losses to the various categories for each of the periods presented. The allocation is made for analytical purposes and it is not necessarily indicative of the categories in which future credit losses may occur. The total allowance is available to absorb losses from any category of loans.

	Allowance for Loans Losses at September 30,					
	2011			2010		
(Dollars in thousands)	Amount	Percent of Loans In Each Category To Gross Loans		Amount	Percent of Loans In Each Category To Gross Loans	
Commercial and industrial	$487	4.01	%	$394	4.73	%

Construction	1,404	5.16	%	1,410	5.42	%
Commercial real estate	4,233	60.44	%	3,268	60.90	%
Residential real estate	1,003	30.01	%	608	28.58	%
Consumer and other loans	38	0.38	%	50	0.36	%
Unallocated	236	-		367	-	
Total	$7,401	100.00	%	$6,097	100.00	%

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Bank-Owned Life Insurance (BOLI) - Our BOLI carrying value amounted to $11.0 million at September 30, 2011 and $10.2 million at December 31, 2010.

Goodwill and Other Intangibles - Goodwill represents the excess of the purchase price over the fair market value of net assets acquired. At September 30, 2011 and December 31, 2010, we had recorded goodwill totaling $2.8 million, primarily as a result of the acquisition of an insurance agency in 2001. In accordance with U.S. GAAP, goodwill is not amortized, but evaluated at least annually for impairment. Any impairment of goodwill results in a charge to income. We periodically accesses whether events and changes in circumstances indicate that the carrying amounts of goodwill and intangible assets may be impaired. The estimated fair value of the reporting segment exceeded its book value; therefore, no write-down of goodwill was required. The goodwill related to the insurance agency is not deductible for tax purposes.

Deposits - Total deposits increased $29.1 million, or 7.5%, to $415.1 million at September 30, 2011 from $386.0 million at December 31, 2010. The increase was largely in total interest bearing deposits, which increased $24.8 million to $375.4 million at September 30, 2011 from $350.6 million at December 31, 2010. In addition, non-interest-bearing deposits increased $4.3 million, or 12.0% to $39.6 million at September 30, 2011 from $35.4 million at December 31, 2010.

Borrowings - Borrowings consist of long term advances from the Federal Home Loan Bank of New York ("FHLBNY"). The advances are secured under terms of a blanket collateral agreement by a pledge of qualifying mortgage loans. We had $26.0 million in borrowings, at a weighted average interest rate of 4.03%, at September 30, 2011 and $36.0 million in borrowings, at a weighted average interest rate of 4.25%, at December 31, 2010. The borrowings at September 30, 2011 consisted of advances with quarterly convertible options that allow the FHLBNY to change the note rate to a then current market rate.

Junior Subordinated Debentures - On June 28, 2007, we raised an additional $12.5 million in capital through the issuance of junior subordinated debentures to a non-consolidated statutory trust subsidiary. The subsidiary in turn issued $12.5 million in variable rate capital trust pass through securities to investors in a private placement. The interest rate is based on the three-month LIBOR plus 144 basis points and adjusts quarterly. The rate at September 30, 2011 was 1.79%. The capital securities are redeemable by us during the first five years at a redemption price of 103.5% of par for the first year and thereafter on a sliding scale down to 100% of par on or after June 15, 2012 in whole or in part or earlier if the regulatory capital or tax treatment of the securities is substantially changed. The proceeds of these trust preferred securities, which have been contributed to the Bank, are included in the Bank's capital ratio calculations and treated as Tier I capital.

In accordance with FASB issued ASC 810, Consolidations, our wholly-owned subsidiary, Sussex Capital Trust II, is not included in our consolidated financial statements.

Equity – Stockholders' equity, inclusive of accumulated other comprehensive income, net of income taxes, was $39.4 million at September 30, 2011 and $36.7 million at year-end 2010. In order to preserve capital, the Board of Directors elected not to declare any cash dividends in the first nine months of 2011. The Board will review our dividend policy based on a number of factors, including current economic and regulatory conditions, our earnings and asset quality and capital needs. On April 27, 2011, at our Annual Meeting of Stockholders, stockholders approved an increase in the number of authorized shares of common stock from 5 million to 10 million shares.

LIQUIDITY AND CAPITAL RESOURCES

A fundamental component of our business strategy is to manage liquidity to ensure the availability of sufficient resources to meet all financial obligations and to finance prospective business opportunities. Liquidity management is

critical to our stability. Our liquidity position over any given period of time is a product of our operating, financing and investing activities. The extent of such activities is often shaped by such external factors as competition for deposits and loan demand.

Traditionally, financing for our loans and investments is derived primarily from deposits, along with interest and principal payments on loans and investments. At September 30, 2011, total deposits amounted to $415.1 million, an increase of $29.1 million, or 7.5%, from December 31, 2010. At September 30, 2011, advances from FHLBNY and subordinated debentures totaled $38.9 million and represented 7.8% of total assets as compared to $48.9 million and 10.3% of total assets at December 31, 2010.

Loan production continued to be our principal investing activity. Net loans at September 30, 2011 amounted to $330.4 million, a decrease of $1.4 million, or 0.4%, compared to December 31, 2010.

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Our most liquid assets are cash and due from banks and federal funds sold. At September 30, 2011, the total of such assets amounted to $48.4 million, or 9.0%, of total assets, compared to $17.7 million, or 3.7%, of total assets at year-end 2010. Another significant liquidity source is our available-for-sale securities portfolio. At September 30, 2011, available-for-sale securities amounted to $78.6 million compared to $89.4 million at year-end 2010.

In addition to the aforementioned sources of liquidity, we have available various other sources of liquidity, including federal funds purchased from other banks and the Federal Reserve Bank discount window. The Bank also has the capacity to borrow an additional $30.4 million through its membership in the FHLBNY and $4.0 million at Atlantic Central Bankers Bank at September 30, 2011. Management believes that our sources of funds are sufficient to meet our present funding requirements.

The Bank's regulators have implemented risk based guidelines which require banks to maintain Tier I capital as a percent of risk-adjusted assets of 4.0% and Tier II capital as a percentage of risk-adjusted assets of 8.0% at a minimum. At September 30, 2011, the Bank's Tier I and Tier II capital ratios were 13.11% and 14.37%, respectively. In addition to the risk-based guidelines, the Bank's regulators require that banks which meet the regulators' highest performance and operational standards maintain a minimum leverage ratio (Tier I capital as a percent of tangible assets) of 4.0%. As of September 30, 2011, the Bank had a leverage ratio of 9.42%. The Bank’s risk based and leverage ratios are in excess of those required to be considered “well-capitalized” under FDIC regulations.

The Board of Governors of the Federal Reserve System also imposes similar capital requirements on bank holding companies with consolidated assets of $500 million or more. Since we do not currently have $500 million or more in consolidated assets, we are not currently subject to these requirements.

We have no investment or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources, except for the trust preferred securities of Sussex Capital Trust II. We are not aware of any known trends or any known demands, commitments, events or uncertainties, which would result in any material increase or decrease in liquidity. Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

Off-Balance Sheet Arrangements – Our consolidated financial statements do not reflect off-balance sheet arrangements that are made in the normal course of business. These off-balance sheet arrangements consist of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. These unused commitments, at September 30, 2011 totaled $43.6 million and consisted of $19.1 million in commitments to grant commercial real estate, construction and land development loans, $12.1 million in home equity lines of credit, $10.6 million in other unused commitments and $1.7 million in letters of credit. These instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to us. Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

Item 3 - Quantitative and Qualitative Disclosures about Market Risk

Not applicable

Item 4 - Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this report. Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective, to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely discussion regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during our last fiscal quarter that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1 - Legal Proceedings

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

Item 1A - Risk Factors

For a summary of risk factors relevant to our operations, see Part 1, Item 1A, "Risk Factors" in our 2010 Annual Report on Form 10-K. There are no material changes in the risk factors relevant to our operations.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

On April 16, 1999, we announced a stock repurchase plan whereby we may purchase up to 50,000 shares of outstanding stock. There is no expiration date to this plan. The plan has been amended several times to increase the number of shares which may be repurchased, and we currently have the authority to repurchase up to 400,000 shares of our common stock. As of September 30, 2011, 247,342 shares had been purchased as part of the plan and 152,658 shares were left to be purchased under the plan. No shares were purchased during the first nine months of 2011.

Item 3 - Defaults Upon Senior Securities

Not applicable

Item 4 - [Removed and Reserved]

Item 5 - Other Information

Not applicable

Item 6 - Exhibits

The exhibits required to be filed as part of this Quarterly Report on Form 10-Q are listed in the Exhibit Index attached hereto and are incorporated herein by reference.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SUSSEX BANCORP

By:	/s/ Steven M. Fusco
	STEVEN M. FUSCO
	Senior Vice President and
	Chief Financial Officer
	Date: November 14, 2011

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EXHIBIT INDEX

Number	Description
3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Quarterly Report on 10-Q filed with the SEC on August 15, 2011.)
3.2	Amended and Restated By-laws (incorporated by reference to Exhibit 3.II to the Current Report on Form 8-K filed with the SEC on April 28, 2010.)
10.1	Supplemental Executive Retirement Agreement, dated July 20, 2011, by and between Sussex Bancorp and Anthony J. Labozzetta (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed with the SEC on July 26, 2011.)
31.1*	Certification of Anthony Labozzetta pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Steven M. Fusco pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101**	Financial statements from the quarterly report on Form 10-Q of Sussex Bancorp for the quarter ended September 30, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) Notes to Consolidated Financial Statements.

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* Filed herewith

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.