PLATINUM GROUP METALS LTD
Form F-10/A
October 14, 2016

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As filed with the Securities and Exchange Commission on October 14, 2016.

Registration No. 333-213985

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Amendment No. 1
to

FORM F-10

REGISTRATION STATEMENT UNDER
THE SECURITIES ACT OF 1933

PLATINUM GROUP METALS LTD.

(Exact name of Registrant as specified in its charter)

British Columbia	**1099**	**Not Applicable**
(Province or other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number, if applicable)

Bentall Tower 5, 550 Burrard Street, Suite 788, Vancouver, British Columbia, Canada V6C 2B5, (604) 899-5450

(Address and telephone number of Registrant's principal executive offices)

DL Services Inc., 701 Fifth Avenue, Suite 6100, Seattle, WA 98104, (206) 903-8800

(Name, address (including zip code) and telephone number (including area code) of agent for service in the United States)

Copies to:

Christopher L. Doerksen
Dorsey & Whitney LLP
701 Fifth Avenue
Suite 6100
Seattle, WA 98104
USA
(206) 903-8800

Approximate date of commencement of proposed sale of the securities to the public:
From time to time after the effective date of this Registration Statement.

Province of British Columbia
(Principal jurisdiction regulating this offering)

It is proposed that this filing shall become effective (check appropriate box below):

A. o upon filing with the Commission, pursuant to Rule 467(a) (if in connection with an offering being made contemporaneously in the United States and Canada).

B. ý at some future date (check the appropriate box below)

1. o pursuant to Rule 467(b) on ( ) at ( ) (designate a time not sooner than 7 calendar days after filing).

2. o pursuant to Rule 467(b) on ( ) at ( ) (designate a time 7 calendar days or sooner after filing) because the securities regulatory authority in the review jurisdiction has issued a receipt or notification of clearance on ( ).

3. ý pursuant to Rule 467(b) as soon as practicable after notification of the Commission by the Registrant or the Canadian securities regulatory authority of the review jurisdiction that a receipt or notification of clearance has been issued with respect hereto.

4. o after the filing of the next amendment to this Form (if preliminary material is being filed).

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to the home jurisdiction's shelf prospectus offering procedures, check the following box. ý

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registration Statement shall become effective as provided in Rule 467 under the Securities Act of 1933 or on such date as the Commission, acting pursuant to Section 8(a) of the Act, may determine.

PART I

INFORMATION REQUIRED TO BE DELIVERED TO OFFEREES OR PURCHASERS

Information has been incorporated by reference in this short form base shelf prospectus from documents filed with securities commissions or similar authorities in Canada. Copies of the documents incorporated herein by reference may be obtained on request, without charge, from the Corporate Secretary of Platinum Group Metals Ltd. at Suite 788, 550 Burrard Street, Vancouver, British Columbia, Canada, V6C 2B5, telephone (604) 899-5450 and are also available electronically at www.sedar.com.

SHORT FORM BASE SHELF PROSPECTUS

NEW ISSUE **OCTOBER 14, 2016**

PLATINUM GROUP METALS LTD.

US$250,000,000

Common Shares
Debt Securities
Warrants
Subscription Receipts
Units

Platinum Group Metals Ltd. (the "**Company**") may offer and sell, from time to time (the "**Offerings**"), common shares of the Company ("**Common Shares**"), debt securities ("**Debt Securities**"), warrants to purchase Common Shares ("**Warrants**"), subscription receipts ("**Subscription Receipts**") or any combination of such securities ("**Units**") (all of the foregoing collectively, the "**Securities**") up to an aggregate initial offering price of US$250,000,000 (or its equivalent in Canadian dollars) during the 25-month period that this short form base shelf prospectus (this "**Prospectus**"), including any amendments hereto, remains effective. Securities may be offered in amounts, at prices and on terms to be determined based on market conditions at the time of sale and set forth in an accompanying prospectus supplement (a "**Prospectus Supplement**"). In addition, Securities may be offered and issued in consideration for the acquisition of other businesses, assets or securities by us or one of our subsidiaries. The consideration for any such acquisition may consist of any of the Securities separately, a combination of Securities or any combination of among other things, Securities, cash and assumption of liabilities.

Investing in the Securities involves significant risks. Prospective investors should carefully consider the risk factors described under the heading "Risk Factors" in this Prospectus, in the applicable Prospectus Supplement with respect to a particular Offering and in the documents incorporated by reference herein and therein.

The Offerings are made by a Canadian issuer that is permitted under a multijurisdictional disclosure system adopted by securities regulatory authorities in Canada and the United States (the "MJDS") to prepare this Prospectus in accordance with Canadian disclosure requirements. Prospective investors in the United States should be aware that such requirements are different from those applicable to issuers in the United States. Financial statements incorporated herein by reference have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board ("IFRS"), and may be subject to Canadian auditing and auditor independence standards, and thus may not be comparable to financial statements of United States companies.

Prospective investors should be aware that the acquisition of the Securities may have tax consequences both in the United States and in Canada. Such consequences for investors who are resident in, or citizens of, the United States or who are resident in Canada may not be described fully herein or in any applicable Prospectus Supplement. Prospective investors should read the tax discussion contained in the applicable Prospectus Supplement with respect to a particular Offering and consult their own tax advisors with respect to their own particular circumstances.

The enforcement by investors of civil liabilities under the U.S. federal securities laws may be affected adversely by the fact that the Company is incorporated or organized under the laws of British Columbia, Canada, that the majority of the Company's officers and directors and some or all of the experts named in this Prospectus are residents of a country other than the United States, and that a substantial portion of the assets of the Company and said persons are located outside the United States.

Neither the United States Securities and Exchange Commission (the "SEC") nor any state or Canadian securities regulator has approved or disapproved of the Securities, passed upon the accuracy or adequacy of this Prospectus or determined if this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

No underwriter has been involved in the preparation of this Prospectus or performed any review of the content of this Prospectus.

The specific terms of the Securities with respect to a particular Offering will be set out in the applicable Prospectus Supplement and may include, where applicable (i) in the case of Common Shares, the number of Common Shares offered, the offering price, whether the Common Shares are being offered for cash, and any other terms specific to the Common Shares being offered, (ii) in the case of Debt Securities, the specific designation, the aggregate principal amount, the currency or the currency unit for which the Debt Securities may be purchased, the maturity, the interest provisions, the authorized denominations, the offering price, whether the Debt Securities are being offered for cash, the covenants, the events of default, any terms for redemption or retraction, any exchange or conversion rights attached to the Debt Securities and any other terms specific to the Debt Securities being offered, (iii) in the case of Warrants, the offering price, whether the Warrants are being offered for cash, the designation, the number and the terms of the Common Shares or Debt Securities purchasable upon exercise of the Warrants, any procedures that will result in the adjustment of these numbers, the exercise price, the dates and periods of exercise, the currency in which the Warrants are issued and any other terms specific to the Warrants being offered, (iv) in the case of Subscription Receipts, the number of Subscription Receipts being offered, the offering price, whether the Subscription Receipts are being offered for cash, the procedures for the exchange of the Subscription Receipts for Common Shares, Debt Securities or Warrants, as the case may be, and any other terms specific to the Subscription Receipts being offered, and (v) in the case of Units, the designation, number and terms of the Common Shares, Warrants, Subscription Receipts or Debt Securities comprising the Units. Where required by statute, regulation or policy, and where Securities are offered in currencies other than Canadian dollars, appropriate disclosure of foreign exchange rates applicable to the Securities will be included in the Prospectus Supplement describing the Securities.

This Prospectus does not qualify for issuance debt securities in respect of which the payment of principal and/or interest may be determined, in whole or in part, by reference to one or more underlying interests, including, for example, an equity or debt security, or a statistical measure of economic or financial performance (including, but not limited to, any currency, consumer price or mortgage index, or the price or value of one or more commodities, indices or other items, or any other item or formula, or any combination or basket of the foregoing items). For greater certainty, this Prospectus may qualify for issuance debt securities, including Debt Securities convertible into other Securities, in respect of which the payment of principal and/or interest may be determined, in whole or in part, by reference to published rates of a central banking authority or one or more financial institutions, such as a prime rate or bankers' acceptance rate, or to recognized market benchmark interest rates such as LIBOR, EURIBOR or a U.S. federal funds rate.

All shelf information permitted under applicable laws to be omitted from this Prospectus will be contained in one or more Prospectus Supplements that will be delivered to purchasers together with this Prospectus. Each Prospectus Supplement will be incorporated by reference into this Prospectus for the purposes of securities legislation as of the date of the Prospectus Supplement and only for the purposes of the distribution of the Securities to which the Prospectus Supplement pertains.

This Prospectus constitutes a public offering of the Securities only in those jurisdictions where they may be lawfully offered for sale and only by persons permitted to sell the Securities in such jurisdictions. We may offer and sell Securities to, or through, underwriters or dealers, directly to one or more other purchasers, or through agents pursuant to exemptions from registration or qualification under applicable securities laws. A Prospectus Supplement relating to each issue of Securities will set forth the names of any underwriters, dealers or agents involved in the Offering and sale of the Securities and will set forth the terms of the Offering, the method of distribution of the Securities, including, to the extent applicable, the proceeds to us and any fees, discounts, concessions or other compensation payable to the underwriters, dealers or agents, and any other material terms of the plan of distribution.

In connection with any Offerings, the underwriters or agents may over-allot or effect transactions which stabilize or maintain the market price of the Securities offered at a higher level than that which might exist in the open market. Such transaction, if commenced, may be interrupted or discontinued at any time. See "Plan of Distribution".

Our outstanding Common Shares are listed and posted for trading on the Toronto Stock Exchange (the "**TSX**") under the symbol "PTM" and on the NYSE MKT, LLC (the "**NYSE MKT**") under the symbol "PLG". On October 13, 2016, the last trading day of the Common Shares prior to the date of this Prospectus, the closing price of the Common Shares on the TSX and NYSE MKT was CAN$2.71 and US$2.07, respectively. Unless otherwise specified in the applicable Prospectus Supplement, the Debt Securities, the Warrants, the Subscription Receipts and the Units will not be listed on any securities exchange. **There is no market through which these Securities may be sold and purchasers may not be able to resell these Securities purchased under this Prospectus. This may affect the pricing of these Securities in the secondary market, the transparency and availability of trading prices, the liquidity of these Securities, and the extent of issuer regulation. See "Risk Factors".**

Our head office is located at Suite 788, 550 Burrard Street, Vancouver, British Columbia, Canada, V6C 2B5. Our registered and records office is located at Suite 2300, 550 Burrard Street, Vancouver, British Columbia, Canada V6C 2B5.

Each of Diana Walters, a director of the Company, and Charles Muller, Gert Roets and Gordon Cunningham, each of whom is a named expert in this Prospectus, resides outside of Canada and has appointed Platinum Group Metals Ltd., Suite 788, 550 Burrard Street, Vancouver, British Columbia, Canada V6C 2B5 as their agent for service of process in Canada. Prospective investors are advised that it may not be possible for investors to enforce judgments obtained in Canada against Ms. Walters, Mr. Muller, Mr. Roets and Mr. Cunningham, even though they have appointed an agent for service of process.

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You should rely only on the information contained in or incorporated by reference in this Prospectus and any applicable Prospectus Supplement in connection with an investment in the Securities. We have not authorized anyone to provide you with different information. We are not making an offer of the Securities in any jurisdiction where such offer is not permitted. You should assume that the information appearing in this Prospectus or any Prospectus Supplement is accurate only as of the date on the front of those documents and that information contained in any document incorporated by reference herein or therein is accurate only as of the date of that document unless specified otherwise. Our business, financial condition, results of operations and prospects may have changed since those dates.

In this Prospectus and any Prospectus Supplement, unless the context otherwise requires, the terms "we", "our", "us" and the "Company" refer to Platinum Group Metals Ltd. and our direct and indirect subsidiaries.

CAUTIONARY NOTE TO UNITED STATES INVESTORS

We are permitted under the MJDS to prepare this Prospectus, any Prospectus Supplement, and the documents incorporated by reference herein and therein in accordance with the requirements of Canadian securities laws, which differ from the requirements of United States securities laws. All mineral resource and reserve estimates included in this Prospectus, any Prospectus Supplement and the documents incorporated by reference herein and therein, have been or will be prepared in accordance with National Instrument 43-101 *Standards of Disclosure for Mineral Projects* ("**NI 43-101**"). NI 43-101 is a rule developed by the Canadian Securities Administrators that establishes standards for all public disclosure an issuer makes of scientific and technical information concerning mineral projects. These standards differ significantly from the mineral reserve disclosure requirements of the SEC set out in Industry Guide 7. Consequently, mineral reserve and mineral resource information included and incorporated by reference in this Prospectus and any Prospectus Supplement is not comparable to similar information that would generally be disclosed by U.S. companies in accordance with the rules of the SEC.

In particular, Industry Guide 7 applies different standards in order to classify mineralization as a reserve. As a result, the definitions of proven and probable mineral reserves used in NI 43-101 differ from the definitions in Industry Guide 7. Under SEC standards, mineralization may not be classified as a "reserve" unless the determination has been made that the mineralization could be economically and legally produced or extracted at the time the reserve determination is made. Among other things, all necessary permits would be required to be in hand or issued imminently in order to classify mineralized material as reserves under the SEC standards. Accordingly, mineral reserve estimates included and incorporated by reference in this Prospectus and any Prospectus Supplement may not qualify as "reserves" under SEC standards.

In addition, the information included and incorporated by reference in this Prospectus and any Prospectus Supplement may use the terms "mineral resources", "measured mineral resources", "indicated mineral resources" and "inferred mineral resources" to comply with the reporting standards in Canada. Industry Guide 7 does not currently recognize mineral resources and U.S. companies are generally not permitted to disclose mineral resources in documents they file with the SEC. Investors are specifically cautioned not to assume that any part or all of the mineral deposits in these categories will ever be converted into mineral reserves under Industry Guide 7. Further, "inferred mineral resources" have a great amount of uncertainty as to their existence and as to whether they can be mined legally or economically. Therefore, investors are also cautioned not to assume that all or any part of an inferred mineral resource exists. In accordance with Canadian rules, estimates of "inferred mineral resources" cannot form the basis of feasibility or, except in limited circumstances, other economic studies. It cannot be assumed that all or any part of "measured mineral resources", "indicated mineral resources" or "inferred mineral resources" will ever be upgraded to a higher category or mineral resources or that mineral resources will be classified as mineral reserves. Investors are cautioned not to assume that any part of the reported "measured mineral resources", "indicated mineral resources" or "inferred mineral resources" included and incorporated by reference in this Prospectus and any Prospectus Supplement is economically or legally mineable. Disclosure of "contained ounces" in a resource is permitted under NI 43-101; however, the SEC normally only permits issuers to report mineralization that does not constitute "reserves" by SEC standards as in-place tonnage and grade without reference to unit measures. In addition, the documents included and incorporated by reference in this Prospectus and any prospectus Supplement may include information regarding adjacent or nearby properties on which we have no right to mine. The SEC does not normally allow U.S. companies to include such information in their filings with the SEC. For the above reasons, information included and incorporated by reference in this Prospectus and any Prospectus Supplement that describes our mineral reserve and resource estimates or that describes the results of pre-feasibility or other studies is not comparable to similar information made public by U.S. companies subject to the reporting and disclosure requirements of the SEC.

RESERVE AND RESOURCE DISCLOSURE

Due to the uncertainty that may be attached to inferred mineral resource estimates, it cannot be assumed that all or any part of an inferred mineral resource estimate will be upgraded to an indicated or measured mineral resource estimate as a result of continued exploration. Confidence in an inferred mineral resource estimate is insufficient to allow meaningful application of the technical and economic parameters to enable an evaluation of economic viability sufficient for public disclosure, except in certain limited circumstances set out in NI 43-101. Inferred mineral resource estimates are excluded from estimates forming the basis of a feasibility study. Mineral resources that are not mineral reserves do not have demonstrated economic viability.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Prospectus and the documents incorporated by reference herein contain "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995 and "forward-looking information" within the meaning of applicable Canadian securities legislation (collectively, "**Forward-Looking Statements**"). All statements, other than statements of historical fact, that address activities, events or developments that the Company believes, expects or anticipates will, may, could or might occur in the future are Forward-Looking Statements. The words "expect", "anticipate", "estimate", "may", "could", "might", "will", "would", "should", "intend", "believe", "target", "budget", "plan", "strategy", "goals", "objectives", "projection" or the negative of any of these words and similar expressions are intended to identify Forward-Looking Statements, although these words may not be present in all Forward-Looking Statements. Forward-Looking Statements included or incorporated by reference in this Prospectus include, without limitation, statements with respect to:

- production estimates and assumptions, including production rate, grade per tonne and smelter recovery;
- production timing;
- capital-raising activities, compliance with terms of indebtedness and the adequacy of capital;
- revenue, cash flow and cost estimates and assumptions;
- statements with respect to future events or future performance;
- anticipated exploration, development, construction, production, permitting and other activities on the Company's properties;
- the adequacy of capital, financing needs and the availability of and potential for receiving further commitments;
- project economics;
- future metal prices and exchange rates;
- mineral reserve and mineral resource estimates; and
- potential changes in the ownership structures of the Company's projects.

Forward-Looking Statements reflect the current expectations or beliefs of the Company based on information currently available to the Company. Forward-Looking Statements in respect of capital costs, operating costs, production rate, grade per tonne and smelter recovery are based upon the estimates in the technical reports referred to in this Prospectus and in the documents incorporated by reference herein and ongoing cost estimation work, and the Forward-Looking Statements in respect of metal prices and exchange rates are based upon the three year trailing average prices and the assumptions contained in such technical reports and ongoing estimates.

Forward-Looking Statements are subject to a number of risks and uncertainties that may cause the actual events or results to differ materially from those discussed in the Forward-Looking Statements, and even if events or results discussed in the Forward-Looking Statements are realized or substantially realized, there can be no assurance that they will have the expected consequences to, or effects on, the Company. Factors that could cause actual results or events to differ materially from current expectations include, among other things:

additional financing requirements;

the Company's history of losses;

the inability of the Company to generate sufficient cash flow to make payment on its indebtedness under the Project 1 Working Capital Facilities (as defined herein) and the restrictions imposed by such indebtedness;

the Project 1 Working Capital Facilities are secured and the Company has pledged its shares of Platinum Group Metals (RSA) Proprietary Limited ("**PTM RSA**") to the Lenders (as defined herein) under the Project 1 Working Capital Facilities, which potentially could result in the loss of the Company's interest in Project 1 (as defined herein), Project 3 (as defined herein), the Waterberg Project (as defined herein) and in PTM RSA in the event of a default under the Project 1 Working Capital Facilities;

the Company's negative cash flow;

the Company's ability to continue as a going concern;

delays in the production ramp-up of Project 1, which could result in a default under the Project 1 Working Capital Facilities;

there can be no assurance that underground development and production ramp-up at Project 1 will meet its production ramp-up timeline or that production at Project 1 will meet the Company's expectations;

delays in, or inability to achieve, planned commercial production;

discrepancies between actual and estimated mineral reserves and mineral resources, between actual and estimated development and operating costs, between actual and estimated metallurgical recoveries and between estimated and actual production;

fluctuations in the relative values of the U.S. dollar, the Rand and the Canadian dollar;

volatility in metals prices;

the failure of the Company or its joint venture partners to fund their pro-rata share of funding obligations for Project 1 or the Waterberg JV Project (as defined herein);

the inability of the Company to find an additional and suitable joint venture partner for Project 1 and Project 3 within such time frame as may be determined by the South African Department of Mineral Resources (the "**DMR**");

any disputes or disagreements with the Company's joint venture partners;

other than Project 1, no known mineral reserves on the Company's properties;

completion of a pre-feasibility study for the Waterberg Project is subject to economic analysis requirements;

the ability of the Company to retain its key management employees and skilled and experienced personnel;

conflicts of interest;

litigation or other legal or administrative proceedings brought against the Company;

actual or alleged breaches of governance processes or instances of fraud, bribery or corruption;

exploration, development and mining risks and the inherently dangerous nature of the mining industry, including environmental hazards, industrial accidents, unusual or unexpected formations, safety stoppages (whether voluntary or regulatory), pressures, mine collapses, cave-ins or flooding and the risk of inadequate insurance or inability to obtain insurance to cover these risks and other risks and uncertainties;

property and mineral title risks including defective title to mineral claims or property;

changes in national and local government legislation, taxation, controls, regulations and political or economic developments in Canada, South Africa or other countries in which the Company does or may carry out business in the future;

- equipment shortages and the ability of the Company to acquire the necessary access rights and infrastructure for its mineral properties;
- environmental regulations and the ability to obtain and maintain necessary permits, including environmental authorizations and water use licenses;
- extreme competition in the mineral exploration industry;
- delays in obtaining, or a failure to obtain, permits necessary for current or future operations or failures to comply with the terms of such permits;
- risks of doing business in South Africa, including but not limited to labour, economic and political instability and potential changes to and failures to comply with legislation;
- the failure to maintain or increase equity participation by HDSAs (as defined herein) in the Company's prospecting and mining operations and to otherwise comply with the Mining Charter (as defined herein); and
- the other risks disclosed under the heading "Risk Factors" in this Prospectus and in the documents incorporated by reference herein.

These factors should be considered carefully, and investors should not place undue reliance on the Forward-Looking Statements. In addition, although the Company has attempted to identify important factors that could cause actual actions or results to differ materially from those described in the Forward-Looking Statements, there may be other factors that cause actions or results not to be as anticipated, estimated or intended.

The mineral resource and mineral reserve figures referred to in this Prospectus and the documents incorporated herein by reference are estimates and no assurances can be given that the indicated levels of platinum, palladium, rhodium and gold will be produced. Such estimates are expressions of judgment based on knowledge, mining experience, analysis of drilling results and industry practices. Valid estimates made at a given time may significantly change when new information becomes available. By their nature, mineral resource and mineral reserve estimates are imprecise and depend, to a certain extent, upon statistical inferences which may ultimately prove unreliable. Any inaccuracy or future reduction in such estimates could have a material adverse impact on the Company.

Any Forward-Looking Statement speaks only as of the date on which it is made and, except as may be required by applicable securities laws, the Company disclaims any intent or obligation to update any Forward-Looking Statement, whether as a result of new information, future events or results or otherwise.

CURRENCY PRESENTATION AND EXCHANGE RATE INFORMATION

Unless stated otherwise or the context otherwise requires, all references to dollar amounts in this Prospectus are references to Canadian dollars. All references to "CAN$" are to Canadian dollars, references to "US$" are to United States dollars and references to "R" or "Rand" are to South African Rand.

The audited consolidated financial statements of the Company as at and for the financial years ended August 31, 2015 and 2014, together with the notes thereto and the auditor's reports thereon (the "**Annual Financial Statements**") are presented in Canadian dollars. Effective September 1, 2015, the Company changed its presentation currency from the Canadian dollar to the United States dollar. Accordingly, the Company's unaudited interim condensed consolidated financial statements for the three months ended November 30, 2015 and the three and nine months ended May 31, 2016 (together, the "**Interim Financial Statements**", and together with the Annual Financial Statements, the "**Financial Statements**"), each incorporated by reference in this Prospectus, are presented in United States dollars. The change in presentation currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the mining industry. The United States dollar is also the currency used for quoting prices in the Company's products. There has been no change to the Company's functional currency, being the Canadian dollar, or its subsidiaries' functional currencies, being the Rand.

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For further information regarding the Company's change in its presentation currency to the United States dollar, including the translation of certain information from Canadian dollars to United States dollars, see the Interim Financial Statements and the management's discussion and analysis of the Company related thereto, incorporated by reference in this Prospectus.

The following table sets forth the rate of exchange for the United States dollar expressed in Canadian dollars in effect at the end of each of the periods indicated, the average of the exchange rates in effect on the last day of each month during each of the periods indicated, and the high and low exchange rates during each of the periods indicated in each case based on the noon rate of exchange as reported by the Bank of Canada for the conversion of United States dollars into Canadian dollars.

	Twelve Months Ended August 31,	
	2015	**2014**
Average rate for period	CAN$1.2102	CAN$1.0776
Rate at end of period	CAN$1.3223	CAN$1.0858
High for period	CAN$1.3303	CAN$1.1251
Low for period	CAN$1.0863	CAN$1.0237

	Nine Months Ended May 31,	
	2016	**2015**
Average rate for period	CAN$1.3363	CAN$1.1868
Rate at end of period	CAN$1.3100	CAN$1.2465
High for period	CAN$1.4589	CAN$1.2803
Low for period	CAN$1.2544	CAN$1.1236

The noon rate of exchange on October 13, 2016 as reported by the Bank of Canada for the conversion of United States dollars into Canadian dollars was US$1.00 equals CAN$1.3219.

The following table sets forth the rate of exchange for the Rand expressed in Canadian dollars in effect at the end of each of the periods indicated, the average of the exchange rates in effect on the last day of each month during each of the periods indicated, and the high and low exchange rates during each of the periods indicated in each case based on the noon rate of exchange as reported by the Bank of Canada for conversion of Rand into Canadian dollars.

	Twelve Months Ended August 31,	
	2015	**2014**
Average rate for period	CAN$ 0.1026	CAN$0.1026
Rate at end of period	CAN$0.09979	CAN$0.1019
High for period	CAN$ 0.1102	CAN$0.1067
Low for period	CAN$0.09858	CAN$0.0984

	Nine Months Ended May 31,	
	2016	**2015**
Average rate for period	CAN$0.09023	CAN$ 0.1028
Rate at end of period	CAN$0.08333	CAN$ 0.1026
High for period	CAN$0.09927	CAN$ 0.1102
Low for period	CAN$0.08210	CAN$0.09858

The noon rate of exchange on October 13, 2016 as reported by the Bank of Canada for the conversion of Rand into Canadian dollars was one Rand equals CAN$0.09288.

NOTICE REGARDING NON-IFRS MEASURES

This Prospectus and the documents incorporated by reference herein include certain terms or performance measures that are not defined under International Financial Reporting Standards, as issued by the International Accounting Standards Board ("**IFRS**"), such as cash costs, all-in sustaining costs and total costs per payable ounce, realized price per ounce, adjusted net income (loss) before tax, adjusted net income (loss) and adjusted basic earnings (loss) per share. The Company believes that, in addition to conventional measures prepared in accordance with IFRS, certain investors use this information to evaluate the Company's performance. The data presented is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS. These non-IFRS measures should be read in conjunction with the Financial Statements.

DOCUMENTS INCORPORATED BY REFERENCE

Information has been incorporated by reference in this Prospectus from documents filed with securities commissions or similar authorities in Canada (the "Commissions") and filed with, or furnished to, the SEC. *Copies of the documents incorporated herein by reference may be obtained on request without charge from the Corporate Secretary of the Company at Suite 788, 550 Burrard Street, Vancouver, British Columbia, Canada, V6C 2B5, telephone (604) 899-5450. These documents are also available through the internet on SEDAR, which can be accessed online at www.sedar.com and on EDGAR, which can be accessed online at www.sec.gov.*

The following documents of the Company are specifically incorporated by reference into, and form an integral part of, this Prospectus:

(a) the annual information form of the Company dated November 24, 2015 for the financial year ended August 31, 2015 (the "**Annual Information Form**" or "**AIF**");

(b) the management information circular of the Company dated January 4, 2016 prepared for the purposes of the annual general meeting of the Company held on February 26, 2016 at which each of the Company's directors was re-elected and the shareholders approved all other matters submitted to a shareholder vote;

(c) the Annual Financial Statements;

(d) the management's discussion and analysis of the Company for the financial year ended August 31, 2015;

(e) the unaudited interim condensed consolidated financial statements of the Company for the three months ended November 30, 2015, together with the notes thereto;

(f) the management's discussion and analysis of the Company for the three months ended November 30, 2015;

(g) the unaudited interim condensed consolidated financial statements of the Company for the three and nine months ended May 31, 2016, together with the notes thereto;

(h) the management's discussion and analysis of the Company for the nine months ended May 31, 2016;

(i) the NI 43-101 technical report entitled "Mineral Resource Update on the Waterberg Project Located in the Bushveld Igneous Complex, South Africa" dated April 29, 2016 (the "**April 2016 Waterberg Report**");

(j) the NI 43-101 technical report entitled "An Independent Technical Report on the Maseve Project (WBJV Project areas 1 and 1A) located on the Western Limb of the Bushveld Igneous Complex, South Africa" dated August 28, 2015 (the "**Project 1 Report**");

(k) the material change report of the Company filed November 3, 2015 announcing that it had entered into a second lien credit agreement with Liberty Metals & Mining Holdings, LLC ("**Liberty Holdings**"), a subsidiary of Liberty Mutual Insurance, for a US$40 million secured loan facility (as subsequently amended on May 3, 2016 and September 19, 2016, the "**Liberty Facility**");

(l) the material change report of the Company filed November 23, 2015 announcing that the Company had simultaneously drawn down, in full, US$40 million from the Liberty Facility and US$40 million (the "**Original Sprott Advance**") from the secured loan facility with Sprott Resource Lending Partnership, among other lenders (the lenders from time to time, the "**Sprott Lenders**") pursuant to a credit agreement dated February 13, 2015 (as subsequently amended on November 19, 2015, May 3, 2016 and September 19, 2016, the "**Sprott Facility**", and the Sprott Lenders, together with Liberty Holdings, the "**Lenders**");

(m) the material change report of the Company filed January 12, 2016 announcing that the budget funded by Japan Oil, Gas and Metals National Corporation ("**JOGMEC**"), the Company's joint venture partner, for the Waterberg Project had been expanded from US$8.0 million to US$8.5 million for the annual period ending March 31, 2016;

(n) the material change report of the Company filed January 26, 2016 announcing the consolidation of the Common Shares on the basis of one new Common Share for ten old Common Shares effective January 26, 2016 (the "**Share Consolidation**");

(o) the material change report of the Company filed February 9, 2016 announcing the successful completion of hot commissioning at Project 1;

(p) the material change report of the Company filed March 17, 2016 announcing that over 90% of recent infill drilling on the Waterberg Project had successfully intersected the "T" and "F" targeted layers;

(q) the material change report of the Company filed April 19, 2016 announcing an increase in the resource estimate for platinum, palladium, rhodium and gold at the Waterberg JV Project;

(r) the material change report of the Company filed May 5, 2016 announcing the modification agreements to the Sprott Facility and the Liberty Facility, each dated May 3, 2016 (together, the "**May Credit Facility Amendments**");

(s) the material change report of the Company filed May 5, 2016 announcing that the Company had entered into an agreement with a syndicate of underwriters to buy, on a bought deal basis, 11,000,000 Common Shares, at a price of US$3.00 per Common Share (the "**May Offering**");

(t) the material change report of the Company filed May 26, 2016 announcing the closing of the May Offering;

(u) the material change report of the Company filed June 1, 2016 announcing new platinum, palladium and gold assay results for recent drill intercepts completed on the Waterberg Project;

(v) the material change report of the Company filed July 14, 2016 announcing financial results and highlights for the nine months ended May 31, 2016;

(w) the material change report of the Company filed September 20, 2016 announcing updates on Project 1 and the Waterberg Project and the modification agreements to the Sprott Facility and the Liberty Facility, each dated September 19, 2016 (together, the "**September Credit Facility Amendments**"); and

(x) the material change report of the Company filed October 12, 2016 announcing that the Sprott Lenders have provided a US$5 million second advance (the "**Second Sprott Advance**") to the Company pursuant to an amended and restated credit agreement dated October 11, 2016 (the "**Amended & Restated Sprott Credit Agreement**" and the Sprott Facility, as amended and restated, the "**Amended & Restated Sprott Facility**", and together with the Liberty Facility, the "**Project 1 Working Capital Facilities**").

Any document of the types referred to in the preceding paragraph (excluding press releases and confidential material change reports) or of any other type required to be incorporated by reference into a short form prospectus pursuant to National Instrument 44-101 *Short Form Prospectus Distributions* that are filed by us with a Commission after the date of this Prospectus and prior to the termination of an Offering under any Prospectus Supplement shall be deemed to be incorporated by reference in this Prospectus. In addition, any document filed by us with the SEC or furnished to the SEC on Form 6-K or otherwise after the date of this

Prospectus (and prior to the termination of an Offering) shall be deemed to be incorporated by reference into this Prospectus and the registration statement on Form F-10 of which this Prospectus forms a part (the "**Registration Statement**") (in the case of a Report on Form 6-K, if and to the extent expressly provided for therein).

Any statement contained in this Prospectus or in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this Prospectus to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document it modifies or supersedes. The making of a modifying or superseding statement shall not be deemed an admission for any purposes that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. Any statement so modified or superseded shall not constitute a part of this Prospectus, except as so modified or superseded.

A Prospectus Supplement containing the specific terms of an Offering will be delivered to purchasers of such Securities together with this Prospectus and will be deemed to be incorporated by reference into this Prospectus as of the date of such Prospectus Supplement, but only for the purposes of the Offering covered by that Prospectus Supplement.

Upon a new annual information form and related annual financial statements being filed by us with, and where required, accepted by, the applicable securities regulatory authority during the currency of this Prospectus, the previous annual information form, the previous annual financial statements and all interim financial statements, material change reports and information circulars and all Prospectus Supplements filed prior to the commencement of our financial year in which a new annual information form is filed shall be deemed no longer to be incorporated into this Prospectus for purposes of future offers and sales of Securities hereunder.

Without limiting the foregoing, on April 29, 2016, the Company filed the April 2016 Waterberg Report with an effective date of April 18, 2016. The April 2016 Waterberg Report supersedes and replaces the technical report titled "An Independent Technical Report on the Waterberg Project Located in the Bushveld Igneous Complex, South Africa" dated September 4, 2015 on the Waterberg Project and any earlier reports or estimates of resources for the Waterberg Project.

Reference to the Company's website in any documents that are incorporated by reference into this Prospectus do not incorporate by reference the information on such website into this Prospectus, and the Company disclaims any such incorporation by reference.

ADDITIONAL INFORMATION

We have filed with the SEC the Registration Statement. This Prospectus, which constitutes a part of the Registration Statement, does not contain all of the information contained in the Registration Statement, certain items of which are contained in the exhibits to the Registration Statement as permitted by the rules and regulations of the SEC. Statements included or incorporated by reference in this Prospectus about the contents of any contract, agreement or other documents referred to are not necessarily complete, and in each instance you should refer to the exhibits to the Registration Statement for a more complete description of the matter involved. Each such statement is qualified in its entirety by such reference.

We are subject to the information requirements of the *United States Securities Exchange Act of 1934*, as amended (the "**Exchange Act**"), and applicable Canadian securities legislation, and in accordance therewith file and furnish reports and other information with the SEC and with the securities regulators in Canada. Under the MJDS, documents and other information that we file and furnish with the SEC may be prepared in accordance with the disclosure requirements of Canada, which are different from those of the United States. As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and short

-swing profit recovery provisions contained in Section 16 of the Exchange Act. In addition, we are not required to publish financial statements as promptly as U.S. companies.

You may read any document that we have filed with or furnished to the SEC at the SEC's public reference room in Washington, D.C. You may also obtain copies of those documents from the public reference room of the SEC at 100 F Street, N.E., Washington, D.C. 20549 by paying a fee. You should call the SEC at 1-800-SEC-0330 or access its website at www.sec.gov for further information about the public reference rooms. You may read and download the documents we have filed with the SEC under our corporate profile at www.sec.gov. You may read and download any public document that we have filed with the Canadian securities regulatory authorities under our corporate profile on the SEDAR website at www.sedar.com.

DOCUMENTS FILED AS PART OF THE REGISTRATION STATEMENT

The following documents have been or will be filed with the SEC as part of the Registration Statement: (i) the documents referred to under the heading "Documents Incorporated by Reference"; (ii) consents of PricewaterhouseCoopers LLP and the persons named under "Interest of Experts" herein; (iii) powers of attorney from certain directors and officers of the Company; and (iv) the form of Indenture (as defined below). A copy of the form of warrant indenture, subscription receipt agreement or statement of eligibility of trustee on Form T-1, as applicable, will be filed by post-effective amendment or by incorporation by reference to documents filed or furnished with the SEC under the Exchange Act.

BUSINESS OF THE COMPANY

The Company is a platinum-focused exploration and development company conducting work primarily on mineral properties it has staked or acquired by way of option agreements or applications in the Republic of South Africa.

The Company's material subsidiaries are one wholly-owned company, one majority-owned company and a 49.9% holding in a third company, all of which are incorporated under the company laws of the Republic of South Africa.

The Company conducts its South African exploration and development work through its wholly-owned direct subsidiary, PTM RSA. PTM RSA holds the Company's interests in the Project 1 (also known as the Maseve Mine) and Project 3 platinum mines of what was formerly the Western Bushveld Joint Venture ("**Project 1**" and "**Project 3**", respectively) through its 82.9% holdings in Maseve Investments 11 Proprietary Limited ("**Maseve**"). Wesizwe Platinum Ltd. ("**Wesizwe**"), through its subsidiary Africa Wide Mineral Prospecting and Exploration Proprietary Limited ("**Africa Wide**") has a 17.1% ownership interest in Maseve. See "Mineral Property Interests Projects 1 and 3 of the Western Bushveld Complex" in the AIF.

On August 20, 2014, an arbitrator ruled that Africa Wide's shareholding in Maseve would be reduced to 21.2766% as a result of its failure to fund its US$21.8 million share of an initial project budget and cash call for Project 1 that had been unanimously approved by the Maseve board of directors. On March 3, 2014, Africa Wide informed the Company that it would not be funding its US$21.52 million share of a second cash call. As a result, Africa Wide's ownership of Maseve has been further diluted to approximately 17.1% based on the dilution formula in the Maseve Shareholders Agreement (defined below), as confirmed by the arbitration. Correspondingly, the Company's ownership in Maseve has increased to approximately 82.9%. See "General Developments of the Business Africa Wide Dilution" in the AIF and the risk factor in this Prospectus captioned "*The dilution of Africa Wide may have a material adverse effect on the Company's business and results of operations"*.

The Company also owns 49.9% of Mnombo Wethu Consultants Proprietary Limited ("**Mnombo**"), a black economic empowerment ("**BEE**") company, which holds a 26% participating interest in both the Waterberg joint venture project (the "**Waterberg JV Project**") and the Waterberg extension project (the "**Waterberg Extension Project**" and together with the Waterberg JV Project, the "**Waterberg Project**").

Subsequent to the end of the Company's third fiscal quarter in 2016, the DMR requested an update regarding the Company's efforts to increase the HDSA (as defined herein) equity ownership percentage in Maseve from 17.1% to 26% following the dilution of Africa Wide's interest in Maseve. The Company remains open to considering commercial and strategic alternatives with regard to possible BEE transactions for Maseve. The Company met with the DMR in early June 2016 and the DMR requested a further update by August 7, 2016, while reminding the Company of the risk of potential action under Sections 47 and 93 of the *Mineral and Petroleum Resources Development Act*, No. 28 of 2002 (the "**MPRDA**") if the Company were not to increase the HDSA ownership percentage. The Company believes that any action in this regard is premature given that the court proceedings between the Chamber of Mines and the DMR in regard to the "once empowered, always empowered" principle and the introduction of the New Draft Charter (as defined herein) both remain pending.

The Company has made several attempts to schedule a meeting with the DMR to further discuss this issue. To date, while the Company has been advised by the DMR that the matter will be discussed at a later date, no such meeting has taken place and the DMR has not issued a notice of non-compliance with the MPRDA. See the risk factors in this Prospectus captioned "*The dilution of Africa Wide may have a material adverse effect on the Company's business and results of operations*" and "*The failure to maintain or increase equity participation by HDSAs in the Company's prospecting and mining operations could adversely affect the Company's ability to maintain its prospecting and mining rights*."

Project 1 and Project 3

Project 1 and Project 3 are located on the Western Limb of the Bushveld Complex, 110 km west northwest of Pretoria and 120 km from Johannesburg. The approximately 47 km^2 of mining rights comprising Project 1 and Project 3 are owned by Maseve, the project operating company in which the Company has an 82.9% interest and Wesizwe, through its subsidiary, Africa Wide, which has a 17.1% ownership interest. Maseve is governed by a shareholders' agreement among PTM RSA, Africa Wide and Maseve (the "**Maseve Shareholders Agreement**"). See "General Developments of the Business Africa Wide Dilution" in the AIF. In April 2012, Maseve was granted a mining right over Project 1 and Project 3 (the "**Mining Right**") by the DMR.

Delays in underground development, stoping rates and planned tonnages have resulted in delays in achieving full commercial production at Project 1. Production guidance provided for September 2016 was not achieved principally as a result of the inability to mine from higher grade and better thickness reef in Block 11 of Project 1. The infrastructure required for mining in September 2016, including water pumping and ventilation, was also completed later than scheduled, which delayed production. Planned production from Block 11 is now expected in October 2016. The Company currently expects commercial production to be achieved by early 2017.

The current Project 1 mine plan calls for an aggregate of approximately 91,500 ounces platinum, palladium, rhodium and gold ("**4E**") (100% project basis) in concentrate to be produced from first production at the mine in early 2016 through the end of April 2017. Prior production guidance should not be relied upon.

Project 1 Working Capital Facilities

The Company announced that it had drawn down under the Sprott Facility and the Liberty Facility in November 2015 and under the Amended & Restated Sprott Facility in October 2016. The Company pays interest under the Liberty Facility at 9.5% over LIBOR and interest under the Amended & Restated Sprott Facility at 8.5% over LIBOR. Under the Liberty Facility, a production payment of 1.5% of revenues from Project 1 is payable to Liberty Holdings. Payment and performance of the Company's obligations under the Project 1 Working Capital Facilities are guaranteed by PTM RSA and secured by a first and second priority security interest in favor of the Lenders in all of the Company's personal property, including a pledge over all of the issued shares in the capital of PTM RSA. The Project 1 Working Capital Facilities contain covenants that include certain limits on, among other things, the ability of the Company and PTM RSA to create indebtedness, create liens, enter into related party transactions, dispose of assets, amend or alter their corporate status or amalgamate, make acquisitions, amend or terminate material contracts, declare or provide dividends or distributions, make investments, materially change their businesses, or enter into agreements restricting the ability of their subsidiaries to pay dividends, make any other distributions, deliver minerals or perform other obligations under their material agreements. Further, pursuant to the Liberty Facility, the Company is obligated to notify Liberty Holdings if the Company or PTM RSA, or any of their subsidiaries (including without limitation Maseve and Mnombo) wishes to undertake any financings (other than a financing that is entirely an equity financing) and must provide Liberty Holdings with a summary of the terms of such financing. Subject to the terms and conditions in the Liberty Facility, Liberty Holdings shall have a right of first offer to provide such financing to the applicable entity on the terms contained in the notice provided. Also, pursuant to that certain intercreditor agreement entered into among the Lenders, the Company and PTM RSA in connection with the Project 1 Working Capital Facilities (the "**Intercreditor Agreement**"), and under certain circumstances described therein, Liberty Holdings has a right to purchase all of the outstanding obligations under the Amended & Restated Sprott Facility, in which case the Amended & Restated Sprott Facility will be assigned to Liberty Holdings, as Lender.

Under the May Credit Facility Amendments, the September Credit Facility Amendments and the Amended & Restated Sprott Credit Agreement, the Company and the Lenders have agreed to extend the maturity dates of the Project 1 Working Capital Facilities, amend certain prepayment and repayment terms and amend certain events of default relating to production targets at Project 1. Under the terms of the September Credit Facility Amendments and the Amended & Restated Sprott Credit Agreement, the Company and the Lenders also agreed that the Company must pay, in partial prepayment of the Project 1 Working Capital Facilities, 50% of the net proceeds of any equity or debt financings (excluding intercompany financings) of the Company having a value exceeding US$1 million in the aggregate that close after January 31, 2017, in the case of the Amended & Restated Sprott Facility (the "**Amended & Restated Sprott Facility Repayment Requirement**"), and December 31, 2017, in the case of the Liberty Facility, subject to the terms of the Intercreditor Agreement (instead of after June 30, 2016 as was stipulated in the May Credit Facility Amendments).

On October 12, 2016, the Company announced that the Sprott Lenders provided the Second Sprott Advance to the Company pursuant to the Amended & Restated Sprott Credit Agreement, which increased the Amended & Restated Sprott Facility to US$45 million. The material terms of the Amended & Restated Sprott Credit Agreement include:

- interest shall accrue and become payable to the Sprott Lenders monthly on the Second Sprott Advance at a rate of LIBOR plus 8.5%, the same rate applied to the Original Sprott Advance;

- the Second Sprott Advance may be repaid in six equal, monthly installments commencing on July 31, 2017, unless the Sprott Lenders elect for earlier repayment from the proceeds of an equity or debt financing (excluding an intercompany financing) prior to December 31, 2017, in which case all such net proceeds shall be paid to the Sprott Lenders in repayment of the Second Sprott Advance, notwithstanding the Amended & Restated Sprott Facility Repayment Requirement;

- the Company must obtain certain regulatory approvals as a post-closing requirement of the Second Sprott Advance; and

- the Company must complete equity financings raising gross proceeds of US$20 million by December 31, 2016 (the "**Equity Financings**").

Other terms, conditions and covenants related to the Second Sprott Advance are substantially the same as for the Original Sprott Advance, as amended.

As consideration for the accommodations provided by the Lenders in the May Credit Facility Amendments, the Company issued to the Lenders an aggregate of 263,308 Common Shares, representing 1% of the original principal amount payable under the Project 1 Working Capital Facilities. As consideration for the accommodations provided by the Lenders in the September Credit Facility Amendments, the Company issued to the Lenders an aggregate of 1,602,628 Common Shares, representing 5% of the original principal amount payable under the Project 1 Working Capital Facilities. As consideration for the Second Sprott Advance, the Company has agreed to issue 113,963 Common Shares by October 31, 2016, representing 5% of the value of the Second Sprott Advance (using the Bank of Canada noon exchange rate on October 7, 2016). The Common Shares were valued at CAN$2.9185, which represented the 10-day volume weighted average price of the Common Shares on the TSX of CAN$3.2428, less a 10% discount. See "Prior Sales".

Events of default under the Project 1 Working Capital Facilities include:

- failure to complete the Equity Financings;

- the failure to pay principal when due and payable or interest, fees or other amounts payable;

- the breach by the Company of any financial covenant;

- a default under any other indebtedness of the Company;

a change in control of the Company;

failure to maintain planned production targets, as required by the September Credit Facility Amendments and the Amended & Restated Sprott Credit Agreement;

failure to obtain all required consents, authorizations or approvals of the South African Reserve Bank (the "**SARB**") in connection with the Amended & Restated Sprott Credit Agreement by April 5, 2017;

the occurrence of any event that could have a material adverse effect; and

various events relating to the bankruptcy or insolvency or winding-up, liquidation or dissolution or cessation of business of the Company.

Waterberg Project

PTM RSA is the operator of the Waterberg Project with JOGMEC and Mnombo. The Waterberg Project is comprised of the Waterberg JV Project, a contiguous granted prospecting right area of approximately 255 km^2, and the Waterberg Extension Project, an 864 km^2 area of granted and applied-for prospecting rights located adjacent and to the north of the Waterberg JV Project, located on the Northern Limb of the Bushveld Complex, approximately 85 km north of the town of Mokopane (formerly Potgietersrus).

On September 28, 2009, PTM RSA, Mnombo and JOGMEC entered into an agreement, as later amended on May 20, 2013 (the "**JOGMEC Agreement**"), whereby JOGMEC could earn up to a 37% participating interest in the Waterberg JV Project for an optional work commitment of US$3.2 million over four years. At the same time, Mnombo could earn a 26% participating interest in exchange for matching JOGMEC's expenditures on a $^{26}/_{74}$ basis (US$1.12 million). In April 2012, JOGMEC completed its US$3.2 million earn-in requirement to earn a 37% interest in the Waterberg JV Project. Following JOGMEC's earn-in, PTM RSA funded Mnombo's 26% share of costs for US$1.12 million until the earn-in phase of the joint venture ended in May 2012. PTM RSA holds the prospecting rights granted by the DMR for the Waterberg JV Project, and Mnombo is identified as the Company's BEE partner.

On January 20, 2015, PTM RSA and Mnombo entered into a written joint venture agreement effective February 1, 2012 relating to the Waterberg Extension Project, in which PTM RSA has a 74% interest and Mnombo has a 26% interest (the "**Waterberg Extension JV Agreement**"). PTM RSA holds the prospecting rights filed with the DMR for the Waterberg Extension Project, and Mnombo is identified as the Company's BEE partner.

On May 26, 2015, the Company announced a second amendment to the JOGMEC Agreement (the "**JOGMEC 2nd Amendment**"). Pursuant to the terms of the JOGMEC 2nd Amendment, the Waterberg JV Project and the Waterberg Extension Project are to be consolidated and contributed into a newly created operating company named Waterberg JV Resources Proprietary Limited ("**Waterberg JV Co.**"). The Company is to hold 45.65% of Waterberg JV Co. while JOGMEC is to own 28.35% and Mnombo will hold 26%. Through its 49.9% share of Mnombo, the Company will hold an effective 58.62% of Waterberg JV Co., post-closing. Once Waterberg JV Co. is fully organized and the transactions contemplated in the JOGMEC 2nd Amendment are completed, the Waterberg Extension JV Agreement will be dissolved. Based on the June 2014 Waterberg Project resource estimate, the number of ounces owned by each entity did not change with the revised ownership percentages. Under the JOGMEC 2nd Amendment, JOGMEC has committed to fund US$20 million in expenditures over a three-year period ending March 31, 2018, of which US$8 million has been funded by JOGMEC to March 31, 2016 and the first US$6 million to be spent in each of the following two 12-month periods will also be funded by JOGMEC. Waterberg Project expenditures in excess of US$6 million in either of the following 12-month periods are to be funded by PTM RSA, Mnombo and JOGMEC pro-rata to their interests in Waterberg JV Co. The Company remains the Waterberg Project operator under the JOGMEC 2nd Amendment. Under the terms of the JOGMEC 2nd Amendment, closing of this transaction will take place on a date to be agreed between the parties, as soon as reasonably possible after the grant of approval by the DMR under Section 11 of the MPRDA to transfer title of the prospecting rights. As a matter of law, the closing will also be dependent upon the approval of the competition authorities under the *South African Competition Act*, 89 of 1998. If closing of this transaction does not occur, the JOGMEC 2nd Agreement will terminate and the parties will default to the JOGMEC Agreement arrangement, with such portion of the US$20 million in expenditures funding already paid by JOGMEC being deemed to be an advance by JOGMEC towards its future spending commitments on the Waterberg JV Project. The Company and Mnombo will be required to make corresponding cash payments in respect of the Waterberg JV Project to pro rata match the advance payments made by JOGMEC, within 120 days of the termination of the JOGMEC 2nd Amendment, failing which they shall suffer equity dilutions under the JOGMEC Agreement as if such equivalent pro rata amounts were approved program funding in which they elected not to participate.

The Company carried Mnombo's 26% share of expenses in the Waterberg Project until March 31, 2015. JOGMEC has been funding expenses since March 31, 2015 under the terms of the JOGMEC 2nd Amendment.

April 2016 Waterberg Report

The following is the extracted summary section from the April 2016 Waterberg Report prepared for the Company by Mr. Charles Muller of CJM Consulting, South Africa, (Pty) Ltd. ("**CJM**"). The April 2016 Waterberg Report is incorporated by reference herein and, for full technical details, reference should be made to the complete text of the April 2016 Waterberg Report.

The following summary does not purport to be a complete summary of the Waterberg Project and is subject to all the assumptions, qualifications and procedures set out in the April 2016 Waterberg Report and is qualified in its entirety with reference to the full text of the April 2016 Waterberg Report. Readers should read this summary in conjunction with the April 2016 Waterberg Report. Readers are directed to review the full text of the report, available for review under the Company's profile on SEDAR at *www.sedar.com* and on the SEC's EDGAR website at *www.sec.gov*, for additional information.

1.1 Introduction

CJM was requested by PTM RSA, on behalf of the Company, the issuer, to complete the April 2016 Waterberg Report for the Waterberg Project. The Waterberg Project covers a buried portion of the Northern Limb of the Bushveld Complex where a deposit containing platinum group metals ("**PGMs**"), gold and base metals ("**Cu**", "**Ni**") has been discovered through drilling. The objective of the April 2016 Waterberg Report is to provide an update to the mineral resources on the Waterberg Project, to comply with disclosure and reporting requirements set forth in the Toronto Stock Exchange Manual, NI 43-101, Companion Policy 43-101CP to NI 43-101, and Form 43-101F1 of NI 43-101.

The April 2016 Waterberg Report reviews the geology, the exploration activities and states the most recent mineral resource estimation on the Waterberg Project (Effective Date: 18 April-2016). The report provides an update of the exploration activities completed subsequent to the last filed technical report on the resource estimate dated 20 July-2015 up to the effective date of 04 September-2016 to correspond to the public disclosure up to that date.

1.2 Waterberg Project Area and Location

The Waterberg Project is some 85 km north of the town of Mokopane (formerly Potgietersrus), within Limpopo Province, South Africa and covers an area along the strike length of the previously unknown northward extension of the Bushveld Complex. The Waterberg Project can be accessed *via* dirt roads exiting off sealed highway N11.

The Waterberg Project is comprised of several prospecting rights covering an area of 111,882 ha. The Waterberg Project is owned by a joint venture consisting of the Company, Mnombo, and JOGMEC. Conversion of the prospecting right into a mining right within the renewal period of three years is allowed. The area of the prospecting rights extends some 42 km from north to south and 42 km from east to west.

The Waterberg Project area is an extension of the trend at the northern tip of the Bushveld Complex and is the result of some detailed geophysical, geochemical and geological work that indicated potential for a package of Bushveld Complex rocks under the Waterberg group sedimentary cover rocks (the "**Waterberg Group**").

1.3 Geological Setting, Deposit Type and Mineralization

The Bushveld and Molopo Complexes in the Kaapvaal Craton are two of the most well-known mafic/ultramafic layered intrusions in the world. The Bushveld Complex was intruded about 2,060 million years ago into rocks of the Transvaal Supergroup, largely along an unconformity between the Magaliesberg quartzite of the Pretoria Group and the overlying Rooiberg felsites. It is estimated to exceed 66,000 km^2 in extent, of which about 55% is covered by younger formations. The Bushveld Complex hosts several layers rich in PGMs, chromium and vanadium, and constitutes the world's largest known resource of these metals.

The Waterberg Project is situated off the northern end of the previously known Northern Limb, where the mafic rocks have a different sequence to those of the Eastern and Western Limbs.

PGM mineralisation within the Bushveld package underlying the Waterberg Project is hosted in two main layers: the T Zone and the F Zone.

The T Zone occurs within the Main Zone just beneath the contact of the overlaying Upper Zone. Although the T Zone consists of numerous mineralised layers, three potential economical layers were identified, T1, T2HW and T2 Layers. They are composed mainly of anorthosite, pegmatoidal gabbros, pyroxenite, troctolite, harzburgite, gabbronorite and norite.

The F Zone is hosted in a cyclic unit of olivine rich lithologies towards the base of the Main Zone towards the bottom of the Bushveld Complex. This zone consists of alternating units of harzburgite, troctolite and pyroxenites. The F Zone was divided into the FH and FP layers. The FH layer has significantly higher volumes of olivine in contrast with the lower lying FP layer, which is predominately pyroxenite. The FH layer is further subdivided into six cyclic units chemically identified by their geochemical signature, especially chrome. The base of these units can also be lithologically identified by a pyroxenite layer.

1.4 Local Geology

The Waterberg Project is located along the strike extension of the Northern Limb of the Bushveld Complex. The geology consists predominantly of the Bushveld Main Zone gabbros, gabbronorites, norites, pyroxenites and anorthositic rock types with more mafic rock material such as harzburgite and troctolites that partially grade into dunites towards the base of the package. In the southern part of the project area, Bushveld Upper Zone lithologies such as magnetite gabbros and gabbronorites do occur as intersected in drillhole WB001 and WB002. The Lower Magnetite Layer of the Upper Zone was intersected on the south of the project property (Disseldorp) where drillhole WB001 was drilled and intersected a 2.5 m thick magnetite band.

On the property, the Bushveld package strikes south-west to north east with a general dip of 34º 38º towards the west is observed from drillhole core for the layered units intersected on Waterberg property within the Bushveld Package (Figure 1). However, some structural blocks may be tilted at different angles depending on structural and /or tectonic controls.

The Bushveld Upper Zone is overlain by a 120 m to 760 m thick Waterberg Group which is a sedimentary package predominantly made up of sandstones, and within the project area the two sedimentary formations known as the Setlaole and Makgabeng Formations constitute the Waterberg Group. The Waterberg package is flat lying with dip angles ranging from to 2º to 5º. Figure 1 gives an overview of interpreted geology for the Waterberg Project.

Figure 1:
Drillhole location and Interpreted Geology of the Waterberg Project

1.5 Exploration Status

The Waterberg Project is an advanced project that has undergone preliminary economic evaluations which have warranted further work. Drilling to date has given the confidence to classify mineral resources as Inferred and Indicated.

1.6 Sample Preparation

The sampling methodology concurs with the Company's protocol based on industry best practice. The quality of the sampling is monitored and supervised by a qualified geologist. The sampling is done in a manner that includes the entire potentially economic unit, with sufficient shoulder sampling to ensure the entire economic zones are assayed.

1.7 Analysis

For the present database, field samples have been analysed by two different laboratories: the primary laboratory is currently Set Point laboratories (South Africa). Genalysis (Australia) is used for referee test work to confirm the accuracy of the primary laboratory.

Samples are received, sorted, verified and checked for moisture and dried if necessary. Each sample is weighed and the results are recorded. Rocks, rock chips or lumps are crushed using a jaw crusher to less than 10 mm. The samples are then milled for 5 minutes to achieve a fineness of 90% less than 106 µm, which is the minimum requirement to ensure the best accuracy and precision during analysis.

Samples are analysed for Pt (ppm), Pd (ppm) Rh (ppm) and Au (ppm) by standard 25 g lead fire-assay using a silver collector. Rh (ppm) is assayed using the same method but with a palladium collector and only for selected samples. After pre-concentration by fire assay the resulting solutions are analysed using ICP-OES (Inductively Coupled Plasma Optical Emission Spectrometry).

The base metals (copper, nickel, cobalt and chromium) are analysed using ICP-OES (Inductively Coupled Plasma Optical Emission Spectrometry) after a multi-acid digestion. This technique results in "almost" total digestion.

The drilling, sampling and analytical aspects of the project are considered to have been undertaken to industry standards. The data is considered to be reliable and suitable for mineral resource estimation.

1.8 Drilling

The data from which the structure of the mineralised horizons was modelled and grade values estimated were derived from a total of 293,538 meters of diamond drilling. This report updates the mineral resource estimate using this dataset. The drillhole dataset consists of 294 drillholes and 459 deflections, at the date of data cut-off (April 1, 2016).

The management of the drilling programmes, logging and sampling have been undertaken from two facilities: one at the town of Marken in Limpopo Province, South Africa and the other on the farm Goedetrouw 366LR within the prospecting right area.

Drilled core is cleaned, de-greased and packed into metal core boxes by the drilling company. The core is collected from the drilling site on a daily basis by PTM personnel and transported to the coreyard. Before the core is taken off the drilling site, core recovery and the depths are checked. Core logging is done by hand on a pro-forma sheet by qualified geologists under supervision of the Waterberg Project geologist.

1.9 Quality Control and Quality Assurance

The Company has instituted a complete QA/QC programme including the insertion of blanks and certified reference materials as well as referee analyses. The programme is being followed and is considered to be to industry standard. The data is as a result, considered reliable in the opinion of the Qualified Person.

1.10 Mineral Resources

This report documents the mineral resource estimate Effective Date: April 18, 2016. The mineral resources are reported in the table below. Infill drilling over portions of the Waterberg Project area and new estimation methodology has made it possible to estimate a new mineral resource estimate and upgrade portions of the mineral resource to the Indicated category. The Mineral Resource Statement is summarised in Table 1.

Table 1
F Zone
Mineral Resource Details

Cut-off	**Tonnage**	**Grade**					**Metal**	
3PGE+Au		**Pt**	**Pd**	**Au**	**Rh**	**3PGE+Au**	**3PGE+Au**	
g/t	**Mt**	**g/t**	**g/t**	**g/t**	**g/t**	**g/t**	**Kg**	**Moz**
Indicated								
2	281.184	0.9	1.9	0.2	0	3.03	851 988	27.39
2.5	**179.325**	**1.1**	**2.2**	**0.2**	**0**	**3.49**	**625 844**	**20.12**
3	110.863	1.2	2.5	0.2	0	3.95	437 909	14.08
Inferred								
2	177.961	0.8	1.8	0.1	0	2.76	491 183	15.79
2.5	**84.722**	**1**	**2.1**	**0.2**	**0**	**3.35**	**283 819**	**9.125**
3	43.153	1.2	2.5	0.2	0	3.96	170 886	5.494

T Zone

Cut-off	Tonnage			Grade			Metal	
2PGE+Au		Pt	Pd	Au	Rh	2PGE+Au	2PGE+Au	
g/t	Mt	g/t	g/t	g/t	g/t	g/t	Kg	Moz
Indicated								
2	36.308	1.1	1.8	0.7		3.61	131 162	4.217
2.5	**30.234**	**1.2**	**1.9**	**0.8**		**3.88**	**117 363**	**3.773**
3	22.33	1.3	2.1	0.9		4.28	95 640	3.075
Inferred								
2	23.314	1.1	1.8	0.7		3.66	85 240	2.741
2.5	**21.196**	**1.1**	**1.9**	**0.8**		**3.79**	**80 394**	**2.585**
3	14.497	1.3	2.1	0.9		4.28	62 082	1.996

Waterberg Total

Cut-off	Tonnage			Grade			Metal	
3PGE+Au		Pt	Pd	Au	Rh	3PGE+Au	3PGE+Au	
g/t	Mt	g/t	g/t	g/t	g/t	g/t	Kg	Moz
Indicated								
2	317.492	0.9	1.9	0.2	0	3.1	983 150	31.61
2.5	**209.559**	**1.1**	**2.2**	**0.3**	**0**	**3.55**	**743 207**	**23.89**
3	133.193	1.2	2.5	0.3	0	4.01	533 549	17.15
Inferred								
2	201.275	0.9	1.8	0.2	0	2.86	576 423	18.53
2.5	**105.918**	**1**	**2.1**	**0.3**	**0**	**3.44**	**364 213**	**11.71**
3	57.65	1.2	2.4	0.4	0	4.04	232 968	7.49

Notes to Table 1:

1. Mineral resources are classified in accordance with the SAMREC standards. There are certain differences with the "CIM Standards on Mineral Resources and Reserves"; however, in this case the Company and the QP believe the differences are not material and the standards may be considered the same. Mineral resources do not have demonstrated economic viability and inferred resources have a high degree of uncertainty. Mineral resources might never be upgraded or converted to reserves.

2. Mineral resources are provided on a 100% project basis. Inferred and indicated categories are separate. The estimates have an effective date of April 18th 2016. Tables may not add perfectly due to rounding. For the purposes of inclusion of this table from the April 2016 Waterberg Report in this Prospectus, the figures have been subject to further rounding.

3. A cut-off grade of 2.5 g/t 3E (platinum, palladium and gold) for the T zone and 2.5 g/t 4E for the F zone is applied to the selected base case mineral resources. Prior to July 20, 2015, a 2 g/t cut-off was applied to resource estimates. For comparison with earlier resources a 2 g/t cut-off on the updated resource model is presented above. Cut-off grades of 3.0 g/t 4E are also presented as certain mining plans in early years may apply higher cut-offs for the Pre-Feasibility Study.

4. Cut off for the T and the F zones considered costs, smelter discounts, concentrator recoveries from the previous and ongoing engineering work completed on the property by the Company and its independent engineers. Spot and three-year trailing average prices and exchange rates are considered for the cut-off considerations. Metallurgical work indicates that an economically attractive concentrate can be produced from standard flotation methods.

5. Mineral resources were completed by Charles Muller of CJM and are reported in an NI 43-101 technical report for the mineral resources reported herein, effective April 18, 2016.

6. Mineral resources were estimated using Kriging methods for geological domains created in Datamine Studio3 from 262 mother holes and 322 deflections in mineralization. A process of geological modelling and creation of grade shells using indicating kriging was completed in the estimation process.

7.

The estimation of mineral resources have taken into account environmental, permitting, legal, title, taxation, socio-economic, marketing and political factors. The mineral resources may be materially affected by metals prices, exchange rates, labour costs, electricity supply issues or many other factors detailed in the Company's Annual Information Form.

8. The following United States dollar prices based on an approximate recent 3-year trailing average in accordance with the SEC guidance were used for the assessment of Resources; Pt 1,243/oz, Pd 720/oz, Au 1,238/oz, Rh 1,015/oz see "Cautionary Note to United States Investors".

9. Estimated grades and quantities for by-products will be included in recoverable metals and estimates in the on-going pre-feasibility work. Copper and Nickel are the main value by-products recoverable by flotation and for indicated resources are estimated at 0.18% copper and 0.10% nickel in the T zone 0.07% copper and 0.16% nickel in the F zone.

Previous Waterberg Project Resource dated July 20, 2015:

Indicated: 121 million tonnes grading 3.24 g/t 3E (0.97 g/t Pt, 2.11 g/t Pd, 0.16 g/t Au, 2.5 g/t cut-off)

Inferred: 246 million tonnes grading 3.25 g/t 3E, (0.94 g/t Pt, 2.09 g/t Pd, 0.16 g/t Au, 2.5 g/t cutoff)

The data that formed the basis of the estimate are the drillholes drilled by PTM which consist of geological logs, the drillhole collars, the downhole surveys and the assay data, all of which were validated by the QP. The area where each layer was present was delineated after examination of the intersections in the various drillholes.

There is no guarantee that all or any part of the Mineral Resource will be converted to a Mineral Reserve.

1.11 Interpretation and Conclusions

Exploration drilling by PTM has intersected layered magmatic PGM mineralisation in what is interpreted to be the northern extension of the Northern Limb of the Bushveld Complex under the Waterberg Group rocks. This has confirmed the existence of mineralised zones with potentially economic concentrations of PGM's. Improved understanding of the geology allowed improved Resource estimations which provided increases in the Resources reported.

The Estimation was undertaken using best practises in terms of geostatistics.

The objectives in terms of adherence to the Scope of this Study were met in that an updated resource model was produced.

The delineation of the F Zone and T Zone units has been advanced due to better understanding of the geology. As with the previous resource estimate, this mineral resource estimate used mineralised layers identified within this Waterberg Project area. The database used for this estimate consisted of 294 drillholes and 459 deflections. The mineralisation is considered open down-dip and along strike. The Waterberg Project represents one of the largest discoveries of PGE mineralization in recent history. Metallurgical work completed at Mintek along with previously published PEA adds to the confidence in this discovery.

1.12 Recommendations

It is recommended that exploration drilling continues in order to advance the geological confidence in the deposit through infill drilling. This will provide more data for detailed logging and refined modelling. This is expected to confirm the geological continuity and allow the declaration of further Indicated Mineral Resources.

Given the results of the diamond drilling on the northern area and the extent of target areas generated by geophysical surveys, the completion of the planned exploration drilling is recommended north of the location of the current exploration programme. The objective of the exploration drilling would be to find the limit of the current deposit, confirm the understanding of the F Zone and allow appropriate selection of the potential mining cut. This will improve geoscientific confidence in order to upgrade mineral resources to the Indicated category.

Metallurgical and other engineering work completed and underway indicates that a Pre-feasibility study is warranted and recommended to proceed on the Waterberg Project. The deposit should be studied for mechanised mining methods such as room and pillar and long hole mining as a result of the thickness of both the T and F Zones.

Other Projects

The Company also holds interests in various other early stage exploration projects located in Canada and in South Africa. The Company continues to evaluate exploration opportunities both on currently owned properties and on new prospects.

Recent Developments

Effective July 1, 2016, we set the salary of R. Michael Jones, our Chief Executive Officer, at CAN$525,000, Frank Hallam, our Chief Financial Officer, at $475,000 and Peter Busse, our Chief Operating Officer, at CAN$350,000. We also established the maximum discretionary cash bonus eligibility with respect to the calendar year ended December 31, 2016 at up to 70% of such salaries for Messrs. Jones and Hallam and up to 60% of such salary for Mr. Busse, based on milestones and deliverables established by the compensation committee of the Company.

Further details concerning the Company, including information with respect to the Company's assets, operations and history, are provided in the AIF and other documents incorporated by reference into this Prospectus. Readers are encouraged to thoroughly review these documents as they contain important information about the Company.

RISK FACTORS

An investment in the Securities involves a high degree of risk and must be considered a highly speculative investment due to the nature of the Company's business and the present stage of exploration and development of its mineral properties. Resource exploration and development is a speculative business, characterized by a number of significant risks including, among other things, unprofitable efforts resulting not only from the failure to discover mineral deposits but also from finding mineral deposits, which, though present, are insufficient in quantity or quality to return a profit from production.

Prospective purchasers of the Securities should carefully consider the risk factors set out below, as well as the information included in any Prospectus Supplement and in documents incorporated by reference in this Prospectus and any applicable Prospectus Supplement, before making an investment decision to purchase the Securities. Specific reference is made to the section entitled "Risk Factors" in the AIF. See "Documents Incorporated by Reference". Without limiting the foregoing, the following risk factors should be given special consideration when evaluating an investment in the Securities. Each of the risks described herein and in these sections and documents could materially and adversely affect our business, financial condition, results of operations and prospects, cause actual events to differ materially from those described in the Forward-Looking Statements and information relating to the Company and could result in a loss of your investment. Additional risks not currently known to the Company, or that the Company currently deems immaterial, may also have a material adverse effect on the Company.

Risks Relating to the Company

The Company will require additional financing, which may not be available on acceptable terms, if at all.

The Amended & Restated Sprott Facility requires the Company to complete the Equity Financings by December 31, 2016. Even if the Equity Financings and any Offerings are successfully completed, the Company may be required to source additional financing by way of private or public offerings of equity or debt or the sale of project or property interests in order to have sufficient working capital for the development and operation of Project 1 and the continued exploration on the Waterberg Project, as well as for general working capital purposes. The Project 1 Working Capital Facilities provide, however, that the Sprott Lenders can require repayment of the Second Sprott Advance from the proceeds of an equity or debt financing (excluding intercompany financings) prior to December 31, 2017. In addition, 50% of the proceeds from any equity or debt financings (excluding intercompany financings) with a value exceeding US$1 million that close after January 31, 2017, in the case of the Amended & Restated Sprott Facility (not including financings where the proceeds are used to repay the Second Sprott Advance, at the election of the Sprott Lenders) and December 31, 2017, in the case of the Liberty Facility, are to be paid to the Lenders in partial repayment of the Project 1 Working Capital Facilities, subject to terms and conditions of the Intercreditor Agreement.

The success and the pricing of any such capital raising and/or debt financing will be dependent upon the prevailing market conditions at that time. There can be no assurance that financing will be available to the Company or, if it is available, that it will be offered on acceptable terms. If additional financing is raised through the issuance of the Securities, this may have a depressive effect on the price of the Common Shares and the interests of shareholders in the net assets of the Company may be diluted.

Any failure by the Company to obtain required financing on acceptable terms or on a timely basis could cause the Company to delay development of its material projects or could result in the Company being forced to sell some of its assets on an untimely or unfavorable basis. Any such delay or sale could have a material adverse effect on the Company's financial condition, results of operations and liquidity. Failure to complete the Equity Financings by December 31, 2016 would constitute an event of default under the Project 1 Working Capital Facilities. Any default under the Project 1 Working Capital Facilities could result in the loss of the Company's entire interest in PTM RSA, and therefore its interests in Project 1, Project 3 and the Waterberg Project.

The Company has a history of losses and it anticipates continuing to incur losses.

The Company has a history of losses. The Company anticipates continued losses until it can successfully place one or more of its properties into commercial production on a profitable basis. It could be years before the Company receives any profits from any production of metals, if ever. If the Company is unable to generate significant revenues with respect to its properties, the Company will not be able to earn profits or continue operations.

The Company may be unable to generate sufficient cash to service its debt, the terms of the agreements governing the Company's debt may restrict its current or future operations and the indebtedness may adversely affect the Company's financial condition and results of operations.

The Company's ability to make scheduled payments on the Project 1 Working Capital Facilities will depend on its ability to successfully ramp-up production at Project 1, and on the Company's financial condition and operating performance, which are subject to prevailing economic and competitive conditions and to certain financial, business, legislative, regulatory and other factors beyond its control. If the Company's cash flows and capital resources are insufficient to fund its debt service obligations, the Company could face substantial liquidity problems and could be forced to reduce or delay investments and capital expenditures or to dispose of material assets or operations, seek additional debt or equity capital or restructure or refinance the Company's indebtedness, including indebtedness under the Project 1 Working Capital Facilities. The Company may not be able to effect any such alternative measures on commercially reasonable terms or at all and, even if successful, those alternatives may not allow the Company to meet its scheduled debt service obligations.

In addition, a breach of the covenants under the Project 1 Working Capital Facilities or the Company's other debt instruments from time to time could result in an event of default under the applicable indebtedness. Such a default may allow the creditors to accelerate the related debt, may result in the imposition of default interest, and may result in the acceleration of any other debt to which a cross acceleration or cross default provision applies. In particular, a cross default provision applies to the Amended & Restated Sprott Facility and the Liberty Facility. In the event a Lender accelerates the repayment of the Company's borrowings, the Company may not have sufficient assets to repay its indebtedness.

The Project 1 Working Capital Facilities contain a number of covenants that impose operating and financial restrictions on the Company and may limit the Company's ability to engage in acts that may be in its long term best interest. In particular, the Project 1 Working Capital Facilities restrict the Company's ability to modify material contracts, to dispose of assets, to use the proceeds from permitted dispositions, to incur additional indebtedness, to enter into transactions with affiliates, and to grant security interests or encumbrances and to use proceeds from future debt or equity financings. In addition, the Company must obtain the consent of the agent under each Project 1 Working Capital Facility to consolidate and contribute the Waterberg JV Project and the Waterberg Extension Project to Waterberg JV Co. Such consents may not be unreasonably withheld by the agents. As a result of these restrictions, the Company may be limited in how it conducts its business, may be unable to raise additional debt or equity financing, may be unable to compete effectively or to take advantage of new business opportunities or may become in breach of its obligations to joint venture partners and others, each of which may affect the Company's ability to grow in accordance with its strategy or may otherwise adversely affect its business and financial condition.

Further, the Company's maintenance of substantial levels of debt could adversely affect its financial condition and results of operations and could adversely affect its flexibility to take advantage of corporate opportunities. Substantial levels of indebtedness could have important consequences to the Company, including:

- limiting the Company's ability to obtain additional financing to fund future working capital, capital expenditures, acquisitions or other general corporate requirements, or requiring the Company to make non-strategic divestitures;

- requiring a substantial portion of the Company's cash flows to be dedicated to debt service payments instead of other purposes, thereby reducing the amount of cash flows available for working capital, capital expenditures, acquisitions and other general corporate purposes;

- increasing the Company's vulnerability to general adverse economic and industry conditions;

- exposing the Company to the risk of increased interest rates for any borrowings at variable rates of interest;

limiting the Company's flexibility in planning for and reacting to changes in the industry in which it competes;

placing the Company at a disadvantage compared to other, less leveraged competitors; and

increasing the Company's cost of borrowing.

The Company has granted first and second ranking security interests in favour of the Lenders over all of its personal property, subject to certain exceptions, and the Company has pledged its shares of PTM RSA to the Lenders under the Project 1 Working Capital Facilities, which may have a material adverse effect on the Company.

To secure its obligations under the Project 1 Working Capital Facilities (and in the case of the Liberty Facility, the production payment agreement between the Company, PTM RSA and Liberty Holdings, dated November 19, 2015, as amended, with respect to Project 1 and Project 3 (the "**Production Payment Agreement**")), the Company has entered into a general security agreement under which the Company has granted first and second ranking security interests in favour of the Lenders over all of its present and after-acquired personal property, subject to certain exceptions, and a share pledge agreement pursuant to which the Company has granted a first and second priority security interest in favour of the Lenders over all of the issued shares in the capital of PTM RSA. PTM RSA has also guaranteed the Company's obligations to the Lenders. These security interests and guarantee may impact the Company's ability to obtain project financing for the Waterberg Project or its ability to secure other types of financing. The Project 1 Working Capital Facilities have various covenants and provisions, including target production provisions, payment covenants and financial tests that must be satisfied and complied with during the term of the Project 1 Working Capital Facilities. There is no assurance that such covenants will be satisfied. Any default under Project 1 Working Capital Facilities, including any covenants thereunder, could result in the loss of the Company's entire interest in PTM RSA, and therefore its interests in Project 1, Project 3 and the Waterberg Project.

The Company has a history of negative operating cash flow, and may continue to experience negative operating cash flow.

The Company has had negative operating cash flow in recent financial years. The Company's ability to achieve and sustain positive operating cash flow will depend on a number of factors, including the Company's ability to produce at Project 1 on a profitable basis and advance the Waterberg Project into production. To the extent that the Company has negative cash flow in future periods, the Company may need to deploy a portion of its cash reserves to fund such negative cash flow. The Project 1 Working Capital Facilities require that the Company maintain consolidated cash and cash equivalents of at least US$5 million and working capital in excess of US$5 million. The Liberty Facility requires that the Company maintain a debt service coverage ratio of at least 1.20 to 1. The Company may be required to raise additional funds through the issuance of additional equity or debt securities to satisfy the minimum cash balance requirements under the Project 1 Working Capital Facilities. The Project 1 Working Capital Facilities provide, however, that a portion of the proceeds from any equity or debt financings (excluding intercompany financings) are required to be paid to mputed by the interest-method over their contractual lives. At June 30, 2012 and December 31, 2011, the Bank had no investments classified as held to maturity.

Loans Held for Sale

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

Loans Receivable

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

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

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

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Allowance for Loan Losses

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

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

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

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

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

Recent Accounting Pronouncements

The following is a summary of recent authoritative pronouncements:

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

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

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION, CONTINUED

Recent Accounting Pronouncements, continued

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

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

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.

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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, 2012 and December 31, 2011 follow:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
June 30, 2012				
Government-sponsored enterprises	$ 2,500,000	$ 1,045	$ (1,435)	$ 2,499,610
Mortgage-backed securities	46,317	1,534		47,851
Corporate bonds	550,000		(101,750)	448,250
	$ 3,096,317	$ 2,579	$ (103,185)	$ 2,995,711
December 31, 2011				
Government-sponsored enterprises	$ 2,000,374	$ 4,311	$	$ 2,004,685
Mortgage-backed securities	49,298	1,443		50,741
Corporate bonds	550,000		99,000	451,000
	$ 2,599,672	$ 5,754	$ 99,000	$ 2,506,426

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

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

	Amortized Cost	Fair Value
Due in one year or less	$	$
Due after one year through five years	2,500,000	2,499,610
Due after five years through ten years	582,812	482,145
Due after ten years	13,505	13,956
	$ 3,096,317	$ 2,995,711

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, 2012 and December 31, 2011. These unrealized losses on investment securities are a result of volatility in interest rates and primarily relate to corporate bonds issued by other banks at June 30, 2012 and December 31, 2011.

Less Than 12 Months	12 Months or More	Total

	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2012						
Government-sponsored enterprises	$ 1,498,565	$ 1,435	$	$	$ 1,498,565	$ 1,435
Corporate bonds			448,250	101,750	448,250	101,750
	$ 1,498,565	$ 1,435	$ 448,250	$ 101,750	$ 1,946,815	$ 103,185
December 31, 2011						
Corporate bonds	$	$	$ 451,000	$ 99,000	$ 451,000	$ 99,000
	$	$	$ 451,000	$ 99,000	$ 451,000	$ 99,000

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SECURITIES, CONTINUED

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

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

NOTE 3. EARNINGS PER SHARE

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

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

NOTE 4. COMMITMENTS AND LETTERS OF CREDIT

At June 30, 2012, the Company had commitments to extend credit, including unused lines of credit of approximately $38,676,000. Letters of credit totaling $1,232,886 were outstanding.

NOTE 5. LOANS

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

	2012	2011
Commercial	$ 79,246,988	$ 73,756,422
Real estate:		
Construction and land development	5,876,857	6,213,443
Residential, 1-4 families	36,568,561	39,499,189
Residential, 5 or more families	1,985,429	2,214,365
Farmland	2,439,577	2,722,872
Nonfarm, nonresidential	45,463,526	47,867,333
Agricultural	25,714	29,493
Consumer, net of discounts of $21,443 in 2012 and $21,742 in 2011	7,351,882	7,041,846

	178,958,534	179,344,963
Deferred loan origination costs, net of (fees)	20,779	(18,176)
	178,979,313	179,326,787
Allowance for loan losses	(3,802,204)	(3,880,581)
	$ 175,177,109	$ 175,446,206

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. LOANS, CONTINUED

Residential, 1-4 family loans pledged as collateral against FHLB advances approximated $18,272,000 and $19,112,000 at June 30, 2012 and December 31, 2011, respectively.

NOTE 6. ALLOWANCE FOR LOAN LOSSES

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

	Construction & Development	1-4 Family Residential	Nonfarm, Nonresidential	Commercial & Industrial	Consumer	Other	Total
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	$ 1,476,600	$ 215,951	$ 49,600	$ 3,077,051
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
Loans Receivable:							
Ending balance	$ 5,876,857	$ 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	$	$	$	$	$	$	$

June 30, 2011

Allowance for credit losses:							
Beginning balance	$ 118,797	$ 1,696,068	$ 1,199,292	$ 3,411,403	$ 205,662	$ 52,700	$ 6,683,922
Charge-offs	(27,468)	(1,105,516)	(203,418)	(959,152)	(27,387)		(2,322,941)
Recoveries	996	54,285	83,772	71,500	17,869		228,422
Provision	6,720	77,596	(204,924)	(537)	(3,383)	3,600	(120,928)
Ending balance	$ 99,045	$ 722,433	$ 874,722	$ 2,523,214	$ 192,761	$ 56,300	$ 4,468,475
Ending balance: individually evaluated for impairment	$ 645	$ 42,233	$ 301,922	$ 1,468,614	$	$	$ 1,813,414
Ending balance: collectively evaluated for impairment	$ 98,400	$ 680,200	$ 572,800	$ 1,054,600	$ 192,761	$ 56,300	$ 2,655,061
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$
Loans Receivable:							
Ending balance	$ 5,544,068	$ 42,991,762	$ 48,365,786	$ 67,791,434	$ 6,697,606	$ 5,042,967	$ 176,433,623
Ending balance: individually evaluated for impairment	$ 95,121	$ 1,052,398	$ 4,094,870	$ 6,998,129	$ 16,896	$	$ 12,257,414
Ending balance: collectively evaluated for impairment	$ 5,448,947	$ 41,939,364	$ 44,270,916	$ 60,793,305	$ 6,680,710	$ 5,042,967	$ 164,176,209
Ending balance: loans acquired with deteriorated credit quality	$	$	$	$	$	$	$

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SURREY BANCORP

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, 2012 and December 31, 2011:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
June 30, 2012					
With no related allowance recorded:					
Construction and development	$ 90,391	$ 90,391	$	$ 92,033	$ 500
1-4 family residential	153,334	153,334		160,318	
Nonfarm, nonresidential	1,212,440	1,212,440		1,231,396	34,681
Commercial and industrial	1,786,213	2,055,278		1,841,485	48,137
Consumer					
Other loans					
	3,242,378	3,511,443		3,325,232	83,318
With an allowance recorded:					
Construction and development	$	$	$	$	$
1-4 family residential	183,371	216,455	23,598	190,739	
Nonfarm, nonresidential	2,090,447	2,112,279	318,189	2,134,088	
Commercial and industrial	1,413,643	1,473,718	383,366	1,521,241	9,723
Consumer					
Other loans					
	3,687,461	3,802,452	725,153	3,846,068	9,723
Combined:					
Construction and development	$ 90,391	$ 90,391	$	$ 92,033	$ 500
1-4 family residential	336,705	369,789	23,598	351,057	
Nonfarm, nonresidential	3,302,887	3,324,719	318,189	3,365,484	34,681
Commercial and industrial	3,199,856	3,528,996	383,366	3,362,726	57,860
Consumer					
Other loans					
	$ 6,929,839	$ 7,313,895	$ 725,153	$ 7,171,300	$ 93,041
December 31, 2011					
With no related allowance recorded:					
Construction and development	$ 92,504	$ 92,504	$	$ 92,504	$ 4,398
1-4 family residential	469,514	502,598		504,456	20,970
Nonfarm, nonresidential	1,548,288	1,711,019		1,720,582	90,633
Commercial and industrial	1,526,985	1,701,473		1,679,148	99,979
Consumer	10,452	10,452		6,753	6,738
Other loans					

	3,647,743	4,018,046		4,003,443	222,718
With an allowance recorded:					
Construction and development	$	$	$	$	$
1-4 family residential	235,812	235,812	83,460	236,822	13,693
Nonfarm, nonresidential	2,079,602	2,079,602	280,454	2,079,917	109,936
Commercial and industrial	1,633,189	1,633,189	449,260	1,843,975	97,007
Consumer					
Other loans					
	3,948,603	3,948,603	813,174	4,160,714	220,636
Combined:					
Construction and development	$ 92,504	$ 92,504	$	$ 92,504	$ 4,398
1-4 family residential	705,326	738,410	83,460	741,278	34,663
Nonfarm, nonresidential	3,627,890	3,790,621	280,454	3,800,499	200,569
Commercial and industrial	3,160,174	3,334,662	449,260	3,523,123	196,986
Consumer	10,452	10,452		6,753	6,738
Other loans					
	$ 7,596,346	$ 7,966,649	$ 813,174	$ 8,164,157	$ 443,354

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6. ALLOWANCE FOR LOAN LOSSES, CONTINUED

The following presents by class, an aging analysis of the recorded investment in loans.

	30-59 Days Past Due	60-89 Days Past Due	90 Days Plus Past Due	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
June 30, 2012							
Construction and development	$ 14,721	$	$	$ 14,721	$ 5,862,136	$ 5,876,857	$
1-4 family residential	497,072	149,147	227,799	874,018	35,694,543	36,568,561	49,668
Nonfarm, nonresidential	314,706	35,631	201,227	551,564	44,911,962	45,463,526	79,500
Commercial and industrial	533,614	260,768	751,276	1,545,658	77,701,330	79,246,988	582,291
Consumer	261,805	19,450	20,735	301,990	7,049,892	7,351,882	16,019
Other loans		212,293		212,293	4,238,427	4,450,720	
Total	$ 1,621,918	$ 677,289	$ 1,201,037	$ 3,500,224	$ 175,458,290	$ 178,958,534	$ 727,478
Percentage of total loans	0.91%	0.38%	0.67%	1.96%	98.04%	100.00%	
Non-accruals included above							
Construction and development	$	$	$	$	$ 90,391	$ 90,391	
1-4 family residential	37,647	128,262	178,131	344,040	241,752	585,792	
Nonfarm, nonresidential	22,147		121,727	143,874	2,091,685	2,235,559	
Commercial and industrial			168,985	168,985	936,033	1,015,018	
Consumer		4,748	4,716	9,464		9,464	
Other loans							
	$ 59,794	$ 133,010	$ 473,559	$ 666,363	$ 3,359,861	$ 4,026,224	
December 31, 2011							
Construction and development	$ 273,412	$ 23,727	$	$ 297,139	$ 5,916,304	$ 6,213,443	$
1-4 family residential	621,656	77,631	72,774	772,061	38,727,128	39,499,189	
Nonfarm, nonresidential	98,922	119,046		217,968	47,649,365	47,867,333	
Commercial and industrial	764,276	56,117	218,516	1,038,909	72,717,513	73,756,422	44,543
Consumer	170,447	229,368	15,790	415,605	6,626,241	7,041,846	5,338
Other loans					4,966,730	4,966,730	
Total	$ 1,928,713	$ 505,889	$ 307,080	$ 2,741,682	$ 176,603,281	$ 179,344,963	$ 49,881
Percentage of total loans	1.08%	0.28%	0.17%	1.53%	98.47%	100.00%	

Non-accruals included above						
Construction and development	$	$	$	$	$ 92,504	$ 92,504
1-4 family residential	92,736	217,814	72,774	383,324	322,003	705,327
Nonfarm, nonresidential					2,517,311	2,517,311
Commercial and industrial			173,973	173,973	895,643	1,069,616
Consumer			10,452	10,452		10,452
Other loans						
	$ 92,736	$ 217,814	$ 257,199	$ 567,749	$ 3,827,461	$ 4,395,210

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. Loans classified as substandard or special mention are reviewed quarterly by the Company for further impairment or improvement to determine if appropriately classified. All other loans greater than $500,000, commercial lines greater than $250,000 and personal lines of credit greater than $100,000, and unsecured loans greater than $100,000 are specifically reviewed at least annually to determine the appropriate loan grading. In addition, during the renewal process of any loan, as well as when a loan becomes past due, the Company will evaluate the loan grade.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6. ALLOWANCE FOR LOAN LOSSES, CONTINUED

Loans excluded from the scope of the annual review process above are generally classified as pass credits until: (a) they become past due; (b) management becomes aware of deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Company for a modification. In these circumstances, the loan is specifically evaluated for potential classification as to special mention, substandard or even charged off. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution s credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and payment capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans by credit quality indicator are provided in the following table.

	Total	Pass Credits	Special Mention	Substandard	Doubtful
June 30, 2012					
Construction and development	$ 5,876,857	$ 5,786,466	$ 90,391	$	$
1-4 family residential	36,568,561	36,045,220	523,341		
Nonfarm, nonresidential	45,463,526	44,028,351	1,178,320	256,855	
Commercial and industrial	79,246,988	77,596,227	1,650,761		
Consumer	7,351,882	7,341,460	8,911	1,511	
Other loans	4,450,720	4,449,606	1,114		
	$ 178,958,534	$ 175,247,330	$ 3,452,838	$ 258,366	$
	100.0%	97.9%	1.9%	0.2%	0.0%
Guaranteed portion of loans	$ 40,294,597	$ 39,239,354	$ 1,055,243	$	$

	Total	Pass Credits	Special Mention	Substandard	Doubtful
December 31, 2011					
Construction and development	$ 6,213,443	$ 6,120,939	$ 92,504	$	$
1-4 family residential	39,499,189	38,839,069	660,120		
Nonfarm, nonresidential	47,867,333	46,159,505	1,071,939	635,889	

Commercial and industrial	73,756,422	72,268,150	1,488,272		
Consumer	7,041,846	7,039,155	411	2,280	
Other loans	4,966,730	4,966,730			
	$ 179,344,963	$ 175,393,548	$ 3,313,246	$ 638,169	$
	100.0%	97.8%	1.8%	0.4%	0.0%
Guaranteed portion of loans	$ 38,917,951	$ 38,077,329	$ 840,622	$	$

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. TROUBLED DEBT RESTRUCTURINGS

For the quarters ended June 30, 2012 and 2011, the following table presents loans modified during the period that were considered to be troubled debt restructurings.

	For the three months ended June 30, 2012			For the six months ended June 30, 2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings						
Construction and development	0	$ 0	$ 0	1	$ 237,883	$ 237,883
1-4 Family residential	0	0	0	1	113,743	116,438
Nonfarm, nonresidential	0	0	0	1	96,028	96,028
Commercial and industrial	1	76,358	76,358	2	343,060	343,060

	For the three months ended June 30, 2011			For the six months ended June 30, 2011		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings						
Construction and development	1	$ 63,711	$ 30,627	1	$ 63,711	$ 30,627
1-4 Family residential	0	0	0	1	15,928	15,928
Nonfarm, nonresidential	1	347,455	347,455	6	1,841,718	1,678,987
Commercial and industrial	1	63,105	63,105	6	544,812	370,324

During the six months ended June 30, 2012, the Bank modified five loans that were considered to be troubled debt restructurings. The terms for these loans were extended. The interest rate was lowered on one loan.

During the six months ended June 30, 2012, no loans that had previously been restructured were in default.

In the determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings by adjusting the loan grades of such loans, which figure into the environmental factors associated with the allowance. Defaults resulting in charge-offs affect the historical loss experience ratios which are a component of the allowance calculation. Additionally, specific reserves may be established on restructured loans evaluated individually.

SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. FAIR VALUE

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale, trading securities and derivatives, if present, are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Fair Value Hierarchy

Under the Fair Value Measurements and Disclosures Topic of the FASB ASC, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1	Valuation is based upon quoted prices for identical instruments traded in active markets.
Level 2	Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
Level 3	Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with the Receivables Topic of the FASB ASC. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2012, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with the Fair Value and Measurement Topic of the FASB ASC, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the

Company records the impaired loan as nonrecurring Level 3.

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. FAIR VALUE, CONTINUED

Servicing Assets

A valuation of loan servicing rights is performed on an individual basis due to the small number of loans serviced. Loans are evaluated on a discounted earnings basis to determine the present value of future earnings. The present value of the future earnings is the estimated market value for the loan, calculated using consensus assumptions that a first party purchaser would utilize in evaluating a potential acquisition of the servicing. As such, the Company classifies loan servicing rights as Level 3.

Foreclosed Assets

Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

(in thousands) **June 30, 2012**	**Total**	**Level 1**	**Level 2**	**Level 3**
Government-sponsored enterprises	$ 2,500	$	$ 2,500	$
Mortgage-backed securities	48		48	
Corporate bonds	448		448	
Servicing assets	90			90
Total assets at fair value	$ 3,086	$	$ 2,996	$ 90
Total liabilities at fair value	$	$	$	$

(in thousands) **December 31, 2011**	**Total**	**Level 1**	**Level 2**	**Level 3**
Government-sponsored enterprises	$ 2,004	$	$ 2,004	$
Mortgage-backed securities	51		51	
Corporate bonds	451		451	
Servicing assets	93			93
Total assets at fair value	$ 2,599	$	$ 2,506	$ 93

Total liabilities at fair value	$	$	$	$

For the six months ended June 30, 2012 and 2011, the changes in Level 3 assets and liabilities measured at fair value on a recurring basis were as follows:

	Level 3	
	2012	**2011**
	Fair Value	**Fair Value**
Balance, January 1	$ 92,682	$ 94,878
Capitalized		
Amortization included in other income	(2,293)	(1,427)
Balance, June 30	$ 90,389	$ 93,451

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. FAIR VALUE, CONTINUED

Changes in Level 3 assets and liabilities measured at fair value on a recurring basis for the three month period ended June 30, 2012 and 2011, was $781 and $695, respectively, which was amortized to other income.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets or liabilities at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets and liabilities that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets and liabilities measured at fair value on a nonrecurring basis are included in the table below.

(in thousands) **June 30, 2012**	**Total**	**Level 1**	**Level 2**	**Level 3**
Loans-commercial and industrial	$ 1,030	$	$	$ 1,030
Loans-nonfarm, non-residential	1,772			1,772
Loans-other	160			160
Foreclosed assets	251			251
Total assets at fair value	$ 3,213	$	$	$ 3,213
Total liabilities at fair value	$	$	$	$

(in thousands) **December 31, 2011**	**Total**	**Level 1**	**Level 2**	**Level 3**
Loans-commercial and industrial	$ 1,184	$	$	$ 1,184
Loans-nonfarm, non-residential	1,799			1,799
Loans- 1- 4 family residential	152			152
Loans-other				
Foreclosed assets	560			560
Total assets at fair value	$ 3,695	$	$	$ 3,695
Total liabilities at fair value	$	$	$	$

Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and due from banks: The carrying amounts reported in the balance sheet for cash and due from banks approximate their fair values.

Interest-bearing deposits with banks: Fair values for time deposits are estimated using a discounted cash flow analysis that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

Federal funds sold: Due to the short-term nature of these assets, the carrying value approximates fair value.

Securities: Fair values for securities, excluding restricted equity securities, are based on quoted market prices, where available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security s credit rating, prepayment assumptions and other factors such as credit loss assumptions. The carrying values of restricted equity securities approximate fair values.

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SURREY BANCORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. FAIR VALUE, CONTINUED

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows.

Bank owned life insurance: The carrying amount reported in the balance sheet approximates the fair value as it represents the cash surrender value of the life insurance.

Deposit liabilities: The fair values disclosed for demand and savings deposits are, by definition, equal to the amount payable on demand at the reporting date. The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

Federal funds purchased, securities sold under agreements to repurchase and short-term debt: The carrying amounts of federal funds purchased, securities sold under agreements to repurchase and short-term debt approximate their fair values.

Long-term debt: The fair value of long-term debt is estimated using a discounted cash flow calculation that applies interest rates currently available on similar instruments.

Other liabilities: For fixed-rate loan commitments, fair value considers the difference between current levels of interest rates and the committed rates. The carrying amounts of other liabilities approximate fair value.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company s financial instruments as of June 30, 2012 and December 31, 2011. This table excludes financial instruments for which the carrying amount approximates fair value.

			Fair Value Measurements		
(dollars in thousands)	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2012					
Financial Instruments - Assets					
Loans	$ 175,177	$ 180,229	$	$	$ 180,229
Financial Instruments Liabilities					
Deposits	178,640	171,259		171,259	
Long-Term Debt	7,750	8,257		8,257	
December 31, 2011					

Financial Instruments - Assets					
Loans	$ 175,446	$ 163,835	$	$	$ 163,835
Financial Instruments Liabilities					
Deposits	183,938	174,610		174,610	
Long-Term Debt	8,100	8,704		8,704	

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

Introduction

This discussion, analysis and related financial information are presented to explain the significant factors which affected Surrey Bancorp s financial condition and results of operations for the six months ending June 30, 2012 and 2011. This discussion should be read in conjunction with the financial statements and related notes contained within this report.

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

Surrey Bank & Trust (Bank) is a North Carolina state chartered bank, located in Mount Airy, North Carolina. The Bank was chartered on July 15, 1996, and began operations on July 22, 1996. The Bank has two operating subsidiaries: Surrey Investment Services, Inc. and Freedom Finance, LLC.

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

Highlights

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

Net income available for common stockholders for the three months ended June 30, 2012, was $321,976 or $0.09 per diluted share outstanding, compared to a $665,448 or $0.19 per diluted share outstanding, for the same period in 2011. Earnings for the three months ended June 30, 2012, are approximately 51.6% lower than for the same period in 2011. The decrease results from an increase in the provision for loan losses. The provision for loan losses increased from a recapture of $279,825 in the second quarter of 2011 to a provision of $671,770 in 2012. This increase is due to an increase in net loan charge offs during the second quarter of 2012 compared to the second quarter of 2011. Net loan charge offs in the second quarter of 2012 amounted to $771,324 compared to net recoveries of $99,278 in 2011, a difference of $870,602. The majority of the net charge offs were commercial and revolving 1-4 family loans. Charge off of these problem assets resulted in an overall increase in the credit quality of the loan portfolio. At June 30, 2012, the percentage of loans receiving pass credit risk grades was 97.9%, compared to 96.3% at June 30, 2011. Credit quality was further enhanced by an increase in loans carrying government guarantees. At June 30, 2012, the guaranteed portion of loans equaled 22.5% of total loans compared to 20.2% at June 30, 2011. Net interest income increased from $2,118,802 in the second quarter of 2011 to $2,294,168 in 2012. A reduction in the cost of deposits from the second quarter of 2011 to 2012 contributed to the margin improvement. Asset yields increased from 4.97% to 5.27% from 2011 to 2012 due to the change in earning asset mix from lower yielding deposits in other banks to higher yielding loans. The cost of funds continued to decrease from 1.14% in the second quarter of 2011 to 0.89% in the second quarter of 2012. Noninterest income remained relatively flat decreasing 0.7% in 2012. Noninterest expenses decreased 9.9% from $1,802,453 in the second quarter of 2011, to $1,623,208 in 2012. This decrease is primarily attributable to decreased costs associated with foreclosed assets. Net expenses associated from foreclosed asset activity decreased from $120,908 in 2011 to a net income of $936 in 2012. Salaries and employee benefits decreased from $883,412 in 2011 to $861,138 in 2012 primarily due to in increase in salary cost deferred for loan production. FDIC insurance premiums dropped due to shrinkage in deposits. The remaining noninterest expenses did not materially change from quarter to quarter.

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

Net income available for common stockholders for the six months ended June 30, 2012, was $940,428 or $0.25 per diluted share outstanding compared to $1,172,411 or $0.33 per diluted share outstanding for the same period in 2011. This represents a 19.8% decrease in earnings for the first six months of 2012 compared to the same period in 2011. This decrease is attributable to an increase in the provision for loan losses. The provision increased from a recapture of $120,928 in the first six months of 2011 to a provision of $738,988 during the same period in 2012. The charge off of nonperforming loans and their effect on the historical loss component of the loan loss reserve resulted in the provision increase. Loan charge offs were greater for the first six months of 2011 than in 2012 but most of the loans charged off in 2011 had specific reserves already established. When these loans were charged off it had minimal effect on the loan loss provision in 2011 since both the loan and the corresponding reserve were removed. However, the historical loss component was enhanced. This increase coupled with second quarter losses required the current provision to be increased. Net interest income increased from $4,295,430 in the first six months of 2011 to $4,614,768 in 2012. This increase is due to an increase in average loans as a percentage of total earning assets for the six month period ended June 30, 2012 versus the same period in 2011. Overall assets yields have increased as a result of this increase in higher yielding average loans. Additionally, corresponding reductions in the cost of funds further increased the margin. The cost of funds decreased from 1.19% in 2011 to 0.92% in 2012. Noninterest income increased 5.4% in 2012 primarily due to an increase in revenues from the Bank s insurance subsidiary. Noninterest expenses decreased 1.6% from $3,532,825 in the six months ended June 30, 2011, to $3,476,852 for the same period in 2012. Most of the decrease is associated with gains on the sales and reduced expenses associated with foreclosed assets. Foreclosed asset expense decreased from $140,332 in first six months of 2011 to $32,294 in 2011.

On June 30, 2012, Surrey Bancorp s assets totaled $220,164,691 compared to $224,727,764 on December 31, 2011. Net loans were $175,177,109 compared to $175,446,206 on December 31, 2011. This decrease was primarily attributable to a decrease in gross loans of approximately $347,000. Commercial loans increased 7.4% during the six month period ended June 30, 2012; however real estate loans decreased over 5.4% leading to an overall decrease in gross loans of 0.2%. Interest-bearing deposits with banks decreased from $30,757,636 at December 31, 2011 to $18,512,558 at June 30, 2012, due to an increase in deposits due from banks of approximately $5,912,000 and a decrease in total deposits of $5,298,000. The increase in deposits with other banks resulted from changing our correspondent banking relationship for deposit clearings to a correspondent that does not automatically sweep the account to overnight funds. In addition, deposit clearings at the end of June were above the bank s normal average.

Total deposits on June 30, 2012, were $178,640,380 compared to $183,938,376 at the end of 2011. This decrease is attributable to decreases in all primary deposit categories except demand deposits and savings deposits. Demand deposits increased 9.4% from 2011 totals, while savings deposits, including money market accounts, increased 5.7%. Certificates of deposit decreased 12.8% from December 31, 2011 totals.

Common stockholders equity increased by $977,521, or 3.71%, during the six months ended June 30, 2012. The increase is comprised of net income of $1,031,638, exercised common stock options of $30,111 and other stock based compensation of $11,504. Decreases included the payment and accrual of preferred dividends of $91,210 and adjustments to Accumulated Other Comprehensive Income of $4,522. The net increase resulted in a common stock book value of $7.72 per share, up from $7.45 on December 31, 2011.

The book value per common share is calculated by taking total stockholders equity, subtracting all preferred equity, and then dividing by the total number of common shares outstanding at the end of the reporting period.

Preferred stockholders equity remained the same during the period ended June 30, 2012. Combined preferred and common stockholders equity increased $977,521, or 3.23%, for the six months ended June 30, 2012.

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

Financial Condition, Liquidity and Capital Resources

Investments

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

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

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

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

Investments in available for sale securities of $2,995,711 consisted of U.S. Governmental Agency obligations with maturities ranging from 20 to 33 months, corporate bonds with maturities of 6.0 years to 6.25 years, that reprice quarterly, and GNMA adjustable rate mortgage securities, which adjust annually.

Loans

Net loans outstanding on June 30, 2012, were $175,177,109 compared to $175,446,206 on December 31, 2011. The Bank maintains a loan portfolio dominated by real estate and commercial loans diversified among various industries. Approximately 73.1% of the Bank s loans as of June 30, 2012, are fixed rate loans with 26.9% floating with the Bank s prime rate or other appropriate internal or external indices.

Deposits

Deposits on June 30, 2012, were $178,640,380, compared to $183,938,376 on December 31, 2011. The June total consists of a base of approximately 12,292 accounts compared to 12,126 accounts at December 31, 2011. Interest-bearing accounts represent 79.2% of June 30, 2012 period end deposits versus 83.3% at December 31, 2011.

Federal Funds Purchased

The Company had no federal funds purchased at June 30, 2012 or December 31, 2011. Federal funds purchased were not utilized due to the adequate liquidity resulting from the increase in deposits.

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

Stockholders Equity

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

	Ratio	Minimum Required For Capital Adequacy Purposes
June 30, 2012:		
Total Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	19.52%	8.0%
Surrey Bank & Trust	19.50%	8.0%
Tier I Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	18.26%	4.0%
Surrey Bank & Trust	18.23%	4.0%
Tier I Capital		
(to Average Assets)		
Surrey Bancorp (Consolidated)	13.35%	4.0%
Surrey Bank & Trust	13.33%	4.0%
December 31, 2011:		
Total Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	18.54%	8.0%
Surrey Bank & Trust	18.53%	8.0%
Tier I Capital		
(to Risk-Weighted Assets)		
Surrey Bancorp (Consolidated)	17.28%	4.0%
Surrey Bank & Trust	17.26%	4.0%
Tier I Capital		
(to Average Assets)		
Surrey Bancorp (Consolidated)	12.67%	4.0%
Surrey Bank & Trust	12.65%	4.0%

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

Asset Quality

The Company actively monitors delinquencies, nonperforming assets and potential problem loans. Unsecured loans past due more than 90 days are placed into nonaccrual status. Secured loans reach nonaccrual status when they surpass 120 days past due. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status.

Management reviews all criticized loans on a periodic basis for possible charge offs. Any unsecured loans that are 90 plus days past due must be charged off in full. If secured, a reserve equal to the potential loss will be established. Any charge off must be reported to the Board of Directors within 30 days. On a monthly basis, a management report of recovery actions is provided to the Board of Directors.

Nonperforming assets are detailed below.

	June 30, 2012	December 31, 2011
Nonaccrual loans	$ 4,026,224	$ 4,395,210
Loans past due 90 days and still accruing	727,478	49,881
Foreclosed assets	251,046	560,018
Total	$ 5,004,748	$ 5,005,109
Total assets	$ 220,164,691	$ 224,727,764
Ratio of nonperforming assets to total assets	2.27%	2.23%

At June 30, 2012, the Bank had loans totaling $4,026,224 in nonaccrual status. Approximately $3,360,000 of the nonaccrual loans were current at the end of June. Approximately $662,000 of loans past due 90 days and still accruing are less than 120 days past due. These loans are government guaranteed loans that are not moved to nonaccrual status until they are 120 days past due. The guaranteed portion of these loans is $538,300. Foreclosed assets at June 30, 2012 primarily include 1-4 family dwellings. Loans that were considered impaired but were still accruing interest at June 30, 2012, including troubled debt restructurings, totaled $3,162,167. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due under the contractual terms of the loan agreement. Specific reserves on nonaccrual and impaired loans totaled $804,797 at quarter end, or 10.8% of the balances outstanding.

Nonaccrual and impaired loans still accruing are summarized below:

	June 30, 2012	December 31, 2011
Construction and development	$ 90,391	$ 92,504
1-4 family residential	585,792	705,326
Nonfarm, nonresidential	3,302,888	3,627,890
Commercial and industrial	3,199,856	3,160,174
Consumer	9,464	10,452
Total impaired and nonaccrual	$ 7,188,391	$ 7,596,346

At June 30, 2012, consumer loans totaling $255,431 are included above that were not individually evaluated for impairment in the determination of the allowance for loan loss reserve (See Note 6). These loans are primarily home equity loans collateralized by 1-4 family properties which are considered consumer loans. These loans are on nonaccrual status at the end of the quarter and therefore considered impaired.

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

The loan portfolio is dominated by real estate and commercial loans. The general composition of the loan portfolio is as follows:

	June 30, 2012		December 31, 2011	
Construction and development	$ 5,876,857	3.28%	$ 6,213,443	3.46%
1-4 family residential	36,568,561	20.43%	39,499,189	22.02%
Multi-family	1,985,429	1.11%	2,214,365	1.23%
Farmland	2,439,577	1.36%	2,722,872	1.52%
Nonfarm, non-residential	45,463,526	25.41%	47,867,333	26.69%
Total real estate	92,333,950	51.59%	98,517,202	54.92%
Agricultural	25,714	0.01%	29,493	0.02%
Commercial and industrial	79,246,988	44.29%	73,756,422	41.13%
Consumer	7,351,882	4.11%	7,041,846	3.93%
Total loans	$ 178,958,534	100.00%	$ 179,344,963	100.00%

The concentrations represented above do not, based on managements assessment, expose the Bank to any unusual concentration risk. Based on the Bank s asset size, the only concentration that is above area peer group analysis is commercial and industrial loans. Management recognizes the inherent risk associated with commercial lending, including a borrower s actual results of operations not corresponding to those projected by the borrower when the loan was funded; economic factors such as the number of housing starts and increases in interest rates, etc.; depression of collateral values; and completion of projects within the original cost and time estimates. The Bank mitigates some of that risk by actively seeking government guarantees on these loans. Collectively, the Bank has approximately $50,185,372 in loans that carry government guarantees. The guaranteed portion of these loans amounts to $40,294,597 at June 30, 2012. Loan guarantees by loan class are below:

	June 30, 2012	Guaranteed Portion Amount	Percentage
Construction and development	$ 5,876,857	$	%
1-4 family residential	36,568,561	865,117	2.37%
Multi-family	1,985,429	20,095	1.01%
Farmland	2,439,577	453,455	18.59%
Nonfarm, non-residential	45,463,526	14,503,236	31.90%
Total real estate	92,333,950	15,841,903	17.16%
Agricultural	25,714		%
Commercial and industrial	79,246,988	24,452,694	30.86%
Consumer	7,351,882		%
Total loans	$ 178,958,534	$ 40,294,597	22.52%

Loans in higher risk categories, such as non-owner occupied nonfarm, non-residential property and commercial real estate construction represent a small segment of our loan portfolio. Commercial construction loans included in construction and development loans amounted to $3,015,896 at June 30, 2012. Non-owner occupied nonfarm, non-residential properties included in nonfarm, non-residential loans above amounted to $9,228,209 at June 30, 2012.

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

The consolidated provision for loan losses was $738,988 for the first six months of 2012 compared to a recapture of $120,928 for the same period in 2011. The charge off of nonperforming loans and their effect on the historical loss component of the loan reserve resulted in the provision increase. Loan charge offs were greater for the first six months of 2011 than in 2012 but most of the loans charged off in 2011 had specific reserves already established. When these loans were charged off it had minimal effect on the loan loss provision in 2011 since both the loan and the corresponding reserve were removed. However, the historical loss component was enhanced. This increase coupled with second quarter losses required the current provision to be increased. Reserves for nonaccrual and impaired loans at June 30, 2012 amounted to $725,153, compared to $813,174 at December 31, 2011.

The reserve for loan losses on June 30, 2012, was $3,802,204 or 2.12% of period end loans. This percentage is derived from total loans. Approximately $50,185,000 of total loans outstanding at June 30, 2012, are government guaranteed loans which carry guarantees ranging from 49% to 100% of the outstanding loan balance. When the guaranteed portion of the loans, for which the Bank has no credit exposure, is removed from the equation the loan loss reserve is approximately 2.74% of outstanding loans. At December 31, 2011 the loan loss reserve percentage was 2.16% of total loans and 2.76% of loans net of government guarantees.

The level of reserve is established based upon management s evaluation of historical loss data and the effects of certain environmental factors on the loan portfolio. The historical loss portion of the reserve is computed using the average loss data from the past applied to its corresponding category of loans. However, historical losses only reflect a small portion of the Bank s loan loss reserve, although that portion did increase during the first six months of 2012 due to the effect of charged off loans. The environmental factors represent risk from external economic influences on the credit quality of the loan portfolio. These factors include the movement of interest rates, unemployment rates, past due and charge off trends, loan grading migrations, movement in collateral values and the Bank s exposure to certain loan concentrations. Positive or negative movements in any of these factors have an effect on the credit quality of the loan portfolio. As a result, management continues to actively monitor the Bank s asset quality affected by these environmental factors. The following table is a summary of loans past due at June 30, 2012 and December 31, 2011.

	June 30, 2012		December 31, 2011	
	30-89 Days	90 Days Plus	30-89 Days	90 Days Plus
Construction and development	$ 14,721	$	$ 297,139	$
1-4 family residential	646,219	227,799	699,287	72,774
Nonfarm, non-residential	350,337	201,227	217,968	
Commercial and industrial	794,382	751,276	820,393	218,516
Consumer	281,255	20,735	399,815	15,790
Other loans	212,293			
	$ 2,299,207	$ 1,201,037	$ 2,434,602	$ 307,080
Non-accrual loans included above	$ 192,804	$ 473,559	$ 310,550	$ 257,199
Guaranteed portion	$ 371,815	$ 676,151	$ 422,069	$ 33,407
Ratio to total loans	1.17%	0.41%	1.36%	0.17%
Ratio to total loans, net of guarantees	1.39%	0.38%	1.44%	0.19%

Past due loans are reviewed weekly and collection efforts assessed to determine potential problems arising in the loan portfolio. Proactive monitoring of past due accounts allows management to anticipate trends within the portfolio and make appropriate adjustments to collection efforts and to the allowance for loan losses. Collectively, past dues increased from December 31, 2011 to June 30, 2012. All of the increase is in the 90 days plus time frame. Since many of these loans carry government guarantees they are not put on nonaccrual status until the loans are 120 days past due. The largest increases were in 1-4 family loans, nonfarm, non-residential loans and commercial loans. The increase in 1-4 family loans is attributable to one loan (home equity) that was not past due at December 31, 2011. The non-farm, non-residential loans past due at June 30, 2012 consist of two customers that carry government guarantees of $131,045. Commercial loans over 90 days past due consist of loans due from five customers. Two of these loans are past due less than 95 days. The guaranteed portion of commercial loans past due over 90 days is $545,106. Overall past dues increased approximately 27.7% from the end of 2011 to June 30, 2012. At June 30, 2012, the guaranteed portion of total past due loans equals 30% compared to 17% at December 31, 2011.

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

Management believes that its loan portfolio is sufficiently diversified such that a downturn in a particular market or industry will not have a significant impact on the loan portfolio or the Bank s financial condition. Management believes that its provision and reserve offer an adequate allowance for loan losses and provide an appropriate reserve for the loan portfolio. The Bank lends primarily in Surry County, North Carolina and Patrick Country, Virginia and surrounding counties.

Interest Rate Sensitivity and Liquidity

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

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

At June 30, 2012, the liquidity position of the Company was good, in management s opinion, with short-term liquid assets of $27,402,495 compared to $33,736,588 at December 31, 2011. Deposit decreases of $5,297,996 account for most of the decrease in liquidity. The Bank also increased its investment in Bank Owned Life Insurance (BOLI) by $1,750,000. To provide supplemental liquidity, the Bank has six unsecured lines of credit with correspondent banks totaling $25,500,000. At June 30, 2012, there were no advances against these lines. Additionally, the Bank has a secured borrowing arrangement with the Federal Home Loan Bank (FHLB). The maximum credit available under this agreement approximates $13,037,000 of which $7,750,000 of advances had been taken down at June 30, 2012.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable as a Smaller Reporting Company .

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ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by the report, an evaluation was performed under the supervision and with the participation of the Company s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to Exchange Act Rule 13a-15e. Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. There have not been any changes in the Company s internal control over financial reporting that occurred during the Company s last quarter that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

None

Item 1A. Risk Factors

Not Applicable as a Smaller Reporting Company

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

None

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Item 6. Exhibits

31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act
32.1	Certification of PEO/PFO Pursuant to Section 906 of the Sarbanes Oxley Act
101	Interactive Data File

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SIGNATURES

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

Surrey Bancorp

Date: August 10, 2012

/s/ Edward C. Ashby, III
Edward C. Ashby, III
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 10, 2012

/s/ Mark H. Towe
Mark H. Towe
Sr. Vice President and Chief Financial Officer
(Principal Financial Officer)