

SOUTHEASTERN BANKING CORP  
Form 10-Q  
May 20, 2005  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**For the Quarterly Period Ended March 31, 2005**

**Commission File Number 2-83157**

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**SOUTHEASTERN BANKING CORPORATION**

(Exact name of registrant as specified in its charter)

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**Georgia**  
(State or other jurisdiction of  
incorporation or organization)

**58-1423423**  
(IRS Employer  
Identification No.)

**P. O. Box 455, 1010 Northway, Darien, Georgia 31305**

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(Address of principal executive offices) (Zip Code)

(912) 437-4141

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of April 30, 2005, 3,304,149 shares of the registrant's common stock, par value \$1.25 per share, were outstanding.

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**Table of Contents****Part I - Financial Information****Southeastern Banking Corporation****Consolidated Balance Sheets**

	(Unaudited) March 31, 2005	December 31, 2004
	<u>2005</u>	<u>2004</u>
<b>Assets</b>		
Cash and due from banks	\$ 19,705,272	\$ 17,923,519
Federal funds sold	27,708,000	31,118,000
	<u>47,413,272</u>	<u>49,041,519</u>
Cash and cash equivalents		
Investment securities		
Held-to-maturity (market value of approximately \$37,989,000 and \$38,769,000 at March 31, 2005 and December 31, 2004)	36,731,917	36,988,268
Available-for-sale, at market value	85,778,462	80,895,767
	<u>122,510,379</u>	<u>117,884,035</u>
Total investment securities		
Loans, gross	218,464,038	218,708,809
Unearned income	(195,780)	(204,306)
Allowance for loan losses	(4,127,009)	(4,134,048)
	<u>214,141,249</u>	<u>214,370,455</u>
Loans, net		
Premises and equipment, net	9,273,644	9,254,380
Intangible assets	608,365	622,918
Other assets	5,429,399	9,581,911
	<u>399,376,308</u>	<u>400,755,218</u>
<b>Total Assets</b>		
<b>Liabilities and Shareholders Equity</b>		
<b>Liabilities</b>		
Deposits		
Noninterest-bearing deposits	\$ 75,528,708	\$ 70,186,636
Interest-bearing deposits	266,182,501	269,123,254
	<u>341,711,209</u>	<u>339,309,890</u>
Total deposits		
U. S. Treasury demand note	962,850	1,431,211
Federal Home Loan Bank advances	5,000,000	5,000,000
Other liabilities	2,164,987	5,772,356
	<u>349,839,046</u>	<u>351,513,457</u>
Total liabilities		

<b>Shareholders Equity</b>		
Common stock (\$1.25 par value; 10,000,000 shares authorized; 3,580,797 shares issued; 3,304,149 shares outstanding)	<b>4,475,996</b>	4,475,996
Additional paid-in-capital	<b>1,391,723</b>	1,391,723
Retained earnings	<b>48,778,015</b>	47,828,636
Treasury stock, at cost (276,648 shares)	<b>(4,815,629)</b>	(4,815,629)
Realized shareholders equity	<b>49,830,105</b>	48,880,726
Accumulated other comprehensive income - unrealized (losses) gains on available-for-sale securities, net of tax	<b>(292,843)</b>	361,035
Total shareholders equity	<b>49,537,262</b>	49,241,761
<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 399,376,308</b>	\$ 400,755,218

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Southeastern Banking Corporation****Consolidated Statements of Income****(Unaudited)**

<i>Three Months Ended March 31,</i>	<b>2005</b>	<b>2004</b>
<b>Interest income</b>		
Loans, including fees	<b>\$ 3,947,403</b>	\$ 3,582,597
Federal funds sold	<b>145,065</b>	22,098
Investment securities		
Taxable	<b>908,445</b>	1,050,258
Tax-exempt	<b>372,871</b>	378,294
Other assets	<b>11,013</b>	9,109
Total interest income	<b>5,384,797</b>	5,042,356
<b>Interest expense</b>		
Deposits	<b>902,750</b>	803,068
Federal funds purchased		39
U. S. Treasury demand note	<b>3,388</b>	955
Federal Home Loan Bank advances	<b>74,000</b>	74,822
Total interest expense	<b>980,138</b>	878,884
Net interest income	<b>4,404,659</b>	4,163,472
<b>Provision for loan losses</b>	<b>93,333</b>	203,583
Net interest income after provision for loan losses	<b>4,311,326</b>	3,959,889
<b>Noninterest income</b>		
Service charges on deposit accounts	<b>544,187</b>	610,863
Investment securities losses, net		(3,306)
Other operating income	<b>304,404</b>	314,998
Total noninterest income	<b>848,591</b>	922,555
<b>Noninterest expense</b>		
Salaries and employee benefits	<b>1,910,351</b>	1,698,357
Occupancy and equipment, net	<b>642,401</b>	597,202
Other operating expense	<b>624,924</b>	668,697
Total noninterest expense	<b>3,177,676</b>	2,964,256
Income before income tax expense	<b>1,982,241</b>	1,918,188
<b>Income tax expense</b>	<b>603,322</b>	578,707

<b>Net income</b>	<b>\$ 1,378,919</b>	\$ 1,339,481
<b>Basic earnings per common share</b>	<b>\$ 0.42</b>	\$ 0.40
Weighted average common shares outstanding	<b>3,304,149</b>	3,312,539

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Southeastern Banking Corporation****Consolidated Statements of Shareholders' Equity****(Unaudited)**

	<i>Common Stock</i>	<i>Additional Paid-In Capital</i>	<i>Retained Earnings</i>	<i>Treasury Stock</i>	<i>Accumulated Other Comprehensive Income</i>	<i>Total</i>
<b>Balance, December 31, 2003</b>	\$ 4,475,996	\$ 1,391,723	\$ 45,330,975	\$ (4,600,167)	\$ 1,166,730	\$ 47,765,257
Comprehensive income:						
Net income			1,339,481			1,339,481
Other comprehensive income, net of tax effect of \$263,932:						
Change in unrealized gains on available-for-sale securities					512,339	512,339
<b>Total comprehensive income</b>						<b>1,851,820</b>
Cash dividends declared (\$0.12 1/2 per share)			(414,068)			(414,068)
<b>Balance, March 31, 2004</b>	<b>\$ 4,475,996</b>	<b>\$ 1,391,723</b>	<b>\$ 46,256,388</b>	<b>\$ (4,600,167)</b>	<b>\$ 1,679,069</b>	<b>\$ 49,203,009</b>
<b>Balance, December 31, 2004</b>	<b>\$ 4,475,996</b>	<b>\$ 1,391,723</b>	<b>\$ 47,828,636</b>	<b>\$ (4,815,629)</b>	<b>\$ 361,035</b>	<b>\$ 49,241,761</b>
Comprehensive income:						
Net income			<b>1,378,919</b>			<b>1,378,919</b>
Other comprehensive income, net of tax effect of \$336,846:						
Change in unrealized gains (losses) on available-for-sale securities					<b>(653,878)</b>	<b>(653,878)</b>
<b>Total comprehensive income</b>						<b>725,041</b>
Cash dividends declared (\$0.13 per share)			<b>(429,540)</b>			<b>(429,540)</b>
<b>Balance, March 31, 2005</b>	<b>\$ 4,475,996</b>	<b>\$ 1,391,723</b>	<b>\$ 48,778,015</b>	<b>\$ (4,815,629)</b>	<b>\$ (292,843)</b>	<b>\$ 49,537,262</b>

See accompanying notes to consolidated financial statements.



**Table of Contents****Southeastern Banking Corporation****Consolidated Statements of Cash Flows****(Unaudited)**

<i>Three Months Ended March 31,</i>	<b>2005</b>	<b>2004</b>
<b>Operating activities</b>		
Net income	\$ 1,378,919	\$ 1,339,481
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	93,333	203,583
Depreciation	215,593	198,492
Amortization and accretion, net	80,520	192,261
Investment securities losses, net		3,306
Net (gains) losses on other real estate	(24,018)	14,178
Changes in assets and liabilities:		
(Increase) decrease in other assets	(38,961)	129,752
Increase (decrease) in other liabilities	9,865	(310,434)
Net cash provided by operating activities	<u>1,715,251</u>	<u>1,770,619</u>
<b>Investing activities</b>		
Principal collections and maturities of investment securities:		
Held-to-maturity	682,000	1,305,500
Available-for-sale	32,993,122	12,552,940
Proceeds from sales of investment securities available-for-sale	4,373,125	1,659,084
Purchases of investment securities held-to-maturity	(456,602)	(788,166)
Purchases of investment securities available-for-sale	(40,877,984)	(20,796,056)
Net decrease in loans	175,457	5,469,139
Proceeds from sales of other real estate	134,377	37,065
Capital expenditures, net	(234,857)	(75,657)
Net cash used in investing activities	<u>(3,211,362)</u>	<u>(636,151)</u>
<b>Financing activities</b>		
Net increase in deposits	2,401,319	9,075,444
Net (decrease) increase in U. S. Treasury demand note	(468,361)	136,516
Dividends paid	(2,065,094)	(2,120,025)
Net cash (used in) provided by financing activities	<u>(132,136)</u>	<u>7,091,935</u>
Net (decrease) increase in cash and cash equivalents	<u>(1,628,247)</u>	<u>8,226,403</u>
Cash and cash equivalents at beginning of period	49,041,519	26,405,941
Cash and cash equivalents at end of period	<u>\$ 47,413,272</u>	<u>\$ 34,632,344</u>

**Supplemental disclosure**

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**Cash paid during the period**

Interest	\$ 1,016,261	\$ 979,564
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**Noncash investing and financing activities**

Broker receivable for security sales	\$ (4,373,125)	\$
Broker payable for security purchases	(1,981,680)	
Real estate acquired through foreclosure	196,799	63,585
Loans made in connection with sales of foreclosed real estate	221,758	

*See accompanying notes to consolidated financial statements.*

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**Southeastern Banking Corporation**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

**1. Accounting and Reporting Policy for Interim Periods**

The accompanying unaudited consolidated financial statements of Southeastern Banking Corporation (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. These statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statement presentation. In the opinion of management, all adjustments necessary for a fair presentation have been made. These adjustments, consisting of normal, recurring accruals, include estimates for various fringe benefits and other transactions normally determined or settled at year-end. Operating results for the three months ended March 31, 2005 are not necessarily indicative of trends or results to be expected for the full year 2005. For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004. There have been no significant changes to the Company's Accounting Policies as disclosed in the 2004 Form 10-K.

**2. Recent Accounting Standards**

*The Meaning of Other-Than-Temporary Impairment & Its Application to Certain Investments*

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue NO. 03-1, *The Meaning of Other-Than-Temporary Impairment & Its Application to Certain Investments*. The Issue provides guidance for evaluating whether securities are other-than-temporarily impaired and requires certain disclosures. The Company adopted the current provisions of this Issue effective December 31, 2004.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*This Analysis should be read in conjunction with the 2004 Annual Report on Form 10-K and the consolidated financial statements & related notes on pages 3 - 7 of this quarterly filing. The Company's accounting policies, which are described in detail in Form 10-K, are integral to understanding the results reported. The Company's accounting policies require management's judgment in valuing assets, liabilities, commitments, and contingencies. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset, or relieving a liability. This Analysis contains forward-looking statements with respect to business and financial matters. Actual results may vary significantly from those contained in these forward-looking statements. See the section entitled Forward-Looking Statements within this Analysis.*

#### **Description of Business**

Southeastern Banking Corporation (the Company), with assets exceeding \$399,376,000, is a financial services company with operations in southeast Georgia and northeast Florida. Southeastern Bank (SEB), the Company's principal subsidiary, offers a full line of commercial and retail services to meet the financial needs of its customer base through its sixteen branch locations and ATM network. Services offered include traditional deposit and credit services, long-term mortgage originations, and credit cards. SEB also offers 24-hour delivery channels, including internet and telephone banking, and through an affiliation with Raymond James Financial Services, provides insurance agent and investment brokerage services.

#### **Financial Condition**

Consolidated assets totaled \$399,376,308 at March 31, 2005, down \$1,378,910 or 0.34% from year-end 2004 but up \$16,375,253 or 4.28% from March 31, 2004. Asset growth was concentrated in the securities portfolio. Specifically, investment securities grew \$4,626,344 or 3.92%; federal funds sold declined \$3,410,000, and loans, \$229,206. Loans comprised approximately 59%, investment securities, 34%, and federal funds sold, 7%, of earning assets at March 31, 2005 versus 59%, 32%, and 9% at December 31, 2004. Overall, earning assets approximated 92% of total assets at March 31, 2005. During the year-earlier period, total assets grew \$8,633,321 or 2.31%. Growth in the investment portfolio and federal funds sold were the primary factors in the 2004 results. Refer to the Liquidity section of this Analysis for details on deposits and other funding sources.

#### **Investment Securities**

On a carrying value basis, investment securities grew \$4,626,344 or 3.92% since December 31, 2004. Purchases of securities during the three-month period, including short-term securities with original maturities of 90 days or less, approximated \$39,350,000, and redemptions, \$33,675,000. The effective repricing of redeemed securities impacts current and future earnings results; refer to the Interest Rate and Market Risk/Interest Rate Sensitivity and Operations sections of this Analysis for more details. In conjunction with asset/liability management, the Company continues to increase its proportionate holdings of mortgage-backed securities, corporates, and municipals when feasible to reduce its exposure to Agency securities with call features. At March 31, 2005, mortgage-backed securities, corporates, and municipals comprised 28%, 10%, and 30% of the portfolio. Overall, securities comprised 34% of earning assets at March 31, 2005, up 200 basis points from year-end 2004 levels. The portfolio yield approximated 4.75% in 2005 year-to-date.

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Management believes the credit quality of the investment portfolio remains sound, with 59.80% of the carrying value of debt securities being backed by the U.S. Treasury or other U.S. Government-sponsored agencies at March 31, 2005. All of the Company's corporate bonds were rated A or higher by at least

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one nationally recognized rating agency at March 31, 2005. The weighted average life of the portfolio remained less than 4.0 years at March 31, 2005. The amortized cost and estimated fair value of investment securities are delineated in the table below:

*Investment Securities by Category*

<i>March 31, 2005</i>	<i>Amortized Cost</i>	<i>Unrealized Gains</i>	<i>Unrealized Losses</i>	<i>Fair Value</i>
<i>(In thousands)</i>				
Available-for-sale:				
U. S. Government agencies	\$ 39,828	\$ 10	\$ 496	\$ 39,342
Mortgage-backed securities	34,401	136	612	33,925
Corporates	11,993	547	29	12,511
	<b>86,222</b>	693	1,137	<b>85,778</b>
Held-to-maturity:				
States and political subdivisions	36,732	1,347	90	37,989
<b>Total investment securities</b>	<b>\$ 122,954</b>	<b>\$ 2,040</b>	<b>\$ 1,227</b>	<b>\$ 123,767</b>

As shown, the carrying value of the investment portfolio reflected \$813,429 in net unrealized gains at March 31, 2005; refer to the Capital Adequacy section of this Analysis for more details on investment securities and related fair value. The Company does not have a concentration in the obligations of any issuer other than the U.S. Government and its agencies.

## Loans

Loans, net of unearned income, declined a negligible \$236,245 since year-end 2004. The net loans to deposits ratio aggregated 63.88% at March 31, 2005 versus 64.40% at December 31, 2004, and 61.35% a year ago. The decline in loans outstanding resulted primarily from pay-downs on large commercial loans in the normal course of business. Overall, the commercial portfolio fell \$3,780,789 at March 31, 2005 compared to December 31, 2004. Basically all sectors of the commercial portfolio registered declines: Nonfarm real estate, agricultural, and governmental loans within the portfolio fell \$3,214,370, \$706,908, and \$257,165 during the three-month period; other commercial/industrial loans grew \$397,654. Balances in the consumer portfolio also declined \$1,775,013 or 10.14% at March 31, 2005 compared to year-end 2004; real estate mortgage loans fell \$626,454 or 1.10%. Reduced demand was the chief element in the 2005 results. Although balances in the commercial, consumer, and real estate - mortgage portfolios declined, real estate - construction loans grew 10.51% or \$5,937,485 during 2005 year-to-date. The majority of the growth within the construction portfolio was residential in nature. Most of the loans in the real estate-construction portfolio are preparatory to customers' attainment of permanent financing or developer's sale and are, by nature, short-term and somewhat cyclical; swings in these account balances are normal and to be expected. Although the Company, like peer institutions of similar size, originates permanent mortgages for new construction, it traditionally does not hold or service long-term mortgage loans for its own portfolio. Rather, permanent mortgages are typically brokered through a mortgage underwriter or government agency. The Company receives mortgage origination fees for its participation in these origination transactions; refer to the disclosures provided under Results of Operations for more details.

Despite economic uncertainties within the Company's markets, management is optimistic that loan volumes will trend higher in 2005 than 2004. Managerial strategies to increase loan production include continuing competitive pricing on loan products, development of additional loan relationships, and purchase of loan participations from correspondent banks, all without compromising portfolio quality. During the same period last year, net loans fell 2.75% or \$5,648,020. A decline in the commercial portfolio was the predominant factor in the 2004 results. Loans outstanding are presented by type in the table on the next page.



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<i>Loans by Category</i>	March 31, 2005	December 31, 2004	March 31, 2004
<i>(In thousands)</i>			
Commercial, financial, and agricultural <sup>1</sup>	\$ 84,004	\$ 87,784	\$ 79,820
Real estate construction	62,408	56,471	47,321
Real estate residential mortgage <sup>2</sup>	56,317	56,944	53,013
Consumer, including credit cards	15,735	17,510	20,081
Loans, gross	218,464	218,709	200,235
Unearned income	196	204	203
Loans, net	\$ 218,268	\$ 218,505	\$ 200,032

<sup>1</sup> Includes obligations of states and political subdivisions.

<sup>2</sup> Typically have final maturities of 15 years or less.

The Company had no concentration of loans to borrowers engaged in any single industry that exceeded 10% of total loans for any of the periods presented. Although the Company's loan portfolio is diversified, significant portions of its loans are collateralized by real estate. At March 31, 2005, the Company had approximately \$170,001,000 in real estate loans, and an additional \$18,754,000 commitment to extend credit on such loans. As required by policy, real estate loans are collateralized based on certain loan-to-appraised value ratios. A geographic concentration in loans arises given the Company's operations within a regional area of southeast Georgia and northeast Florida. On an aggregate basis, commitments to extend credit and standby letters of credit approximated \$36,259,000 at March 31, 2005; because a substantial amount of these contracts expire without being drawn upon, total contractual amounts do not represent future credit exposure or liquidity requirements. The Company has not funded or incurred any losses on letters of credit in 2005 year-to-date.

*Nonperforming Assets*

Nonperforming assets consist of nonaccrual loans, restructured loans, and foreclosed real estate and other assets. Overall, nonperforming assets approximated \$1,259,000 at March 31, 2005, down \$246,000 or 16.35% from year-end 2004 and 18.88% from March 31, 2004. As a percent of total assets, nonperforming assets totaled 0.32% at March 31, 2005 versus 0.38% at year-end 2004 and 0.41% a year ago. No material credits have been transferred or removed from nonaccrual status during 2005 year-to-date. Industry or individual concentrations within nonaccrual balances at March 31, 2005 included:

- a) Industry concentrations: Approximately 32% or \$305,000 of nonaccrual balances at March 31, 2005 pertained to the shrimping industry; charge-offs on these particular loans approximated \$39,000 during 2005 year-to-date. Collateral held varies but includes real estate and commercial fishing vessels. Management considers the allowance sufficient to absorb any additional losses that may result from these loans.
- b) Individual concentrations: At March 31, 2005, nonaccrual balances also included loans to one other borrower totaling \$73,000. Due to the underlying collateral coverage, no significant losses, if any, are expected on this balance.

Refer to the subsection entitled Policy Note for criteria used by management in classifying loans as nonaccrual. The allowance for loan losses approximated 4.36X the nonperforming loans balance at March 31, 2005 versus 3.87X at year-end 2004 and 2.94X a year ago. Significant activity within foreclosed real estate balances included foreclosure of one borrower's residential real estate valued at \$94,000 and sale of an



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unrelated \$150,000 parcel. Management is unaware of any other material developments in nonperforming assets at March 31, 2005 that should be presented or otherwise discussed.

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Loans past due 90 days or more approximated \$797,000, or less than 1% of net loans, at March 31, 2005. Management is unaware of any material concentrations within these past due balances. The table below provides further information about nonperforming assets and loans past due 90 plus days:

<i>Nonperforming Assets</i>	March 31, 2005	December 31, 2004	March 31, 2004
<i>(In thousands)</i>			
Nonaccrual loans:			
Commercial, financial, and agricultural	\$ 212	\$ 312	\$ 657
Real estate construction	60	33	55
Real estate mortgage	557	556	530
Consumer, including credit cards	117	168	90
Total nonaccrual loans	946	\$ 1,069	1,332
Restructured loans <sup>1</sup>			
Total nonperforming loans	946	\$ 1,069	1,332
Foreclosed real estate <sup>2</sup>	259	409	213
Other repossessed assets	54	27	7
Total nonperforming assets	\$ 1,259	\$ 1,505	\$ 1,552
Accruing loans past due 90 days or more	\$ 797	\$ 876	\$ 655
Ratios:			
Nonperforming loans to net loans	0.43%	0.49%	0.67%
Nonperforming assets to net loans plus foreclosed/repossessed assets	0.58%	0.69%	0.78%

<sup>1</sup> Does not include restructured loans that yield a market rate.

<sup>2</sup> Includes only other real estate acquired through foreclosure or in settlement of debts previously contracted.

*Policy Note.* Loans classified as nonaccrual have been placed in nonperforming, or impaired, status because the borrower's ability to make future principal and/or interest payments has become uncertain. The Company considers a loan to be nonaccrual with the occurrence of any one of the following events: a) interest or principal has been in default 90 days or more, unless the loan is well-collateralized and in the process of collection; b) collection of recorded interest or principal is not anticipated; or c) income on the loan is recognized on a cash basis due to deterioration in the financial condition of the borrower. Smaller balance consumer loans are generally not subject to the above-referenced guidelines and are normally placed on nonaccrual status or else charged-off when payments have been in default 90 days or more. Nonaccrual loans are reduced to the lower of the principal balance of the loan or the market value of the underlying real estate or other collateral net of selling costs. Any impairment in the principal balance is charged against the allowance for loan losses. Accrued interest on any loan placed on nonaccrual status is reversed. Interest income on nonaccrual loans, if subsequently recognized, is recorded on a cash basis. No interest is subsequently recognized on nonaccrual (or former nonaccrual) loans until all principal has been collected. Loans are classified as restructured when either interest or principal has been reduced or deferred because of deterioration in the borrower's financial position. Foreclosed real estate represents real property acquired by foreclosure or directly by title or deed transfer in settlement of debt. Provisions for subsequent devaluations of foreclosed real estate are charged to operations, while costs associated with improving the properties are generally capitalized.

*Allowance for Loan Losses*

The Company continuously reviews its loan portfolio and maintains an allowance for loan losses available to absorb losses inherent in the portfolio. The three-month provision for loan losses at March 31, 2005 totaled \$93,333 and net charge-offs, \$100,372. The comparable provision and charge-off amounts at March 31, 2004 were \$203,583 and \$115,295. Net charge-offs represented 0.18% of average

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loans at March 31, 2005 compared to 0.23% at March 31, 2004 and 0.54% in 2003. No single charge-off exceeded \$39,000 at March 31, 2005. The Company is committed to the early recognition of problem loans and to an appropriate and adequate level of allowance. The adequacy of the allowance is further discussed in the next subsection of this Analysis. Activity in the allowance is presented in the table below:

*Allowance for Loan Losses*

<i>Three Months Ended March 31,</i>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>(Dollars in thousands)</i>			
Allowance for loan losses at beginning of year	\$ 4,134	\$ 3,833	\$ 3,601
Provision for loan losses	93	204	234
Charge-offs:			
Commercial, financial, and agricultural	71	40	123
Real estate construction		12	3
Real estate mortgage	15	24	56
Consumer, including credit cards	75	98	105
Total charge-offs	161	174	287
Recoveries:			
Commercial, financial, and agricultural	10	2	5
Real estate construction			
Real estate mortgage	3	15	4
Consumer, including credit cards	48	41	40
Total recoveries	61	58	49
Net charge-offs	100	116	238
Allowance for loan losses at end of period	\$ 4,127	\$ 3,921	\$ 3,597
Net loans outstanding <sup>1</sup> at end of period	\$ 218,268	\$ 200,032	\$ 177,387
Average net loans outstanding <sup>1</sup> at end of period	\$ 216,733	\$ 203,256	\$ 175,880
Ratios:			
Allowance to net loans	1.89%	1.96%	2.03%
Net charge-offs to average loans	0.18%	0.23%	0.54%
Provision to average loans	0.17%	0.40%	0.53%
Recoveries to total charge-offs	37.89%	33.33%	17.07%

<sup>1</sup> Net of unearned income

The Company prepares a comprehensive analysis of the allowance for loan losses at least quarterly. SEB's Board of Directors is responsible for affirming the allowance methodology and assessing the general and specific allowance factors in relation to estimated and actual net charge-off trends. The allowance for loan losses consists of three elements: a) specific allowances for individual loans; b) general allowances for loan pools

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based on historical loan loss experience and current trends; and c) allowances based on economic conditions and other risk factors in the Company's markets. The specific allowance is based on a regular analysis of classified loans where the internal risk ratings are below a predetermined classification. The specific allowance established for these classified loans is based on a careful analysis of probable and potential sources of repayment, including cash flow, collateral value, and guarantor capacity. The general allowance is determined by the mix of loan products within the portfolio, an internal loan grading process, and associated allowance factors. These general allowance factors are updated at least annually and are based on a statistical loss analysis and current loan charge-off trends. The loss analysis examines loss experience for loan portfolio segments in relation to internal loan grades. Charge-off trends are analyzed for homogeneous loan categories (e.g., residential real estate, consumer loans, etc.). While formal loss and charge-off trend analyses are conducted annually,

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the Company continually monitors credit quality in all portfolio segments and revises the general allowance factors whenever necessary in order to address improving or deteriorating credit quality trends or specific risks associated with a given loan category. The third element, comprised of economic conditions, concentrations, and other risk factors, is based on marketplace conditions and/or events that may affect loan repayment in the near-term. This element requires a high degree of managerial judgment to anticipate the impact that economic trends, legislative or governmental actions, or other unique market and/or portfolio issues will have on credit losses. Consideration of other risk factors typically includes such issues as recent loss experience in specific portfolio segments, trends in loan quality, changes in market focus, and concentrations of credit. These factors are based on the influence of current external variables on portfolio risk, so there will typically be some movement between this element and the specific allowance component during various stages of the economic cycle. Because of their subjective nature, these risk factors are carefully reviewed by management and revised as conditions indicate. Based on its analyses, management believes the allowance was adequate at March 31, 2005.

### **Other Commitments**

Other than construction of a permanent branch building to replace the temporary facility in Brunswick, Georgia, renovation of other SEB offices, and the purchase of new core banking software, the Company had no material plans or commitments for capital expenditures as of March 31, 2005. Planning for the permanent branch building and the software purchase have not been finalized, and potential capital expenditures cannot yet be estimated.

### **Liquidity**

Liquidity is managed to ensure sufficient cash flow to satisfy demands for credit, deposit withdrawals, and other corporate needs. The Company's sources of funds include a large, stable deposit base and secured advances from the Federal Home Loan Bank. Additional liquidity is provided by payments and maturities, including both principal and interest, of the loan and investment securities portfolios. At March 31, 2005, loans<sup>1</sup> and investment securities with carrying values exceeding \$101,230,000 and \$8,146,000 were scheduled to mature in one year or less. The investment portfolio has also been structured to meet liquidity needs prior to asset maturity when necessary. The Company's liquidity position is further strengthened by its access, on both a short- and long-term basis, to other local and regional funding sources.

Funding sources primarily comprise customer-based core deposits but also include borrowed funds and cash flows from operations. Customer-based core deposits, the Company's largest and most cost-effective source of funding, comprised 91% of the funding base at March 31, 2005, virtually unchanged from 2004 levels. Borrowed funds, which variously encompass U.S. Treasury demand notes, federal funds purchased, and FHLB advances, totaled \$5,962,850 at March 31, 2005 versus \$6,431,211 at year-end 2004. More specifically, the maximum amount of U.S. Treasury demand notes available to the Company at March 31, 2005 totaled \$3,000,000, of which \$962,850 was outstanding. Unused borrowings under unsecured federal funds lines of credit from other banks, each with varying terms and expiration dates, totaled \$22,000,000. Additionally, under a credit facility with the FHLB, the Company can borrow up to 16% of SEB's total assets; at March 31, 2005, unused borrowings approximated \$58,888,000. Refer to the subsection entitled FHLB Advances for details on the Company's outstanding balance with the FHLB. Cash flows from operations also constitute a significant source of liquidity. Net cash from operations derives primarily from net income adjusted for noncash items such as depreciation and amortization, accretion, and the provision for loan losses.

Management believes the Company has the funding capacity, from operating activities or otherwise, to meet its financial commitments in 2005. Refer to the Capital Adequacy section of this Analysis for details on treasury stock purchases and intercompany dividend policy and the Financial Condition section for details on unfunded loan commitments.

<sup>1</sup> No cash flow assumptions other than final contractual maturities have been made for installment loans. Nonaccrual loans are excluded.

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## Deposits

Deposits grew a modest \$2,401,319 or 0.70% since year-end 2004. Noninterest-bearing deposits increased \$5,342,072 or 7.61%, while interest-bearing deposits fell \$2,940,753 or 1.09%. Virtually the entire decline in interest-bearing balances was due to seasonal variation in local government balances, particularly NOW accounts. Notably, customers continue to utilize savings as an alternative to time certificates in the current low-rate environment; savings balances exceeded 36% of interest-bearing balances at March 31, 2005. Overall, interest-bearing deposits comprised 77.90%, and noninterest-bearing deposits, 22.10%, of total deposits at March 31, 2005. The distribution of interest-bearing balances at March 31, 2005 and certain comparable quarter-end dates is shown in the table below:

<i>Deposits</i>	<u>March 31, 2005</u>		<u>December 31, 2004</u>		<u>March 31, 2004</u>	
	<i>Balances</i>	<i>Percent of Total</i>	<i>Balances</i>	<i>Percent of Total</i>	<i>Balances</i>	<i>Percent of Total</i>
<i>(Dollars in thousands)</i>						
Interest-bearing demand deposits <sup>1</sup>	\$ 91,825	34.50%	\$ 98,352	36.55%	\$ 85,111	32.89%
Savings	97,977	36.81%	95,414	35.45%	97,034	37.50%
Time certificates < \$100,000	45,015	16.91%	45,256	16.82%	48,471	18.73%
Time certificates >= \$100,000	31,366	11.78%	30,101	11.18%	28,162	10.88%
<b>Total interest-bearing deposits</b>	<b>\$ 266,183</b>	<b>100.00%</b>	<b>\$ 269,123</b>	<b>100.00%</b>	<b>\$ 258,778</b>	<b>100.00%</b>

<sup>1</sup> NOW and money market accounts.

Deposits of one local governmental body comprised approximately \$33,244,000 and \$36,468,000 of the overall deposit base at March 31, 2005 and December 31, 2004. Brokered deposits totaled \$594,000 at both March 31, 2005 and year-end 2004.

Approximately 83% of time certificates at March 31, 2005 were scheduled to mature within the next twelve months. The composition of average deposits and the fluctuations therein at March 31 for the last two years is shown in the Average Balances table included in the Operations section of this Analysis.

## FHLB Advances

Advances outstanding with the FHLB totaled \$5,000,000 at March 31, 2005, unchanged from year-end 2004. The outstanding advance, which matures March 17, 2010, accrues interest at an effective rate of 6.00%, payable quarterly. The advance is convertible into a three-month Libor-based floating rate anytime at the option of the FHLB. Year-to-date, interest expense on the advance approximated \$74,000. Mortgage-backed securities were pledged to collateralize advances under this line of credit.

**Interest Rate and Market Risk/Interest Rate Sensitivity**



The normal course of business activity exposes the Company to interest rate risk. Fluctuations in interest rates may result in changes in the fair market value of the Company's financial instruments, cash flows, and net interest income. The asset/liability committee regularly reviews the Company's exposure to interest rate risk and formulates strategy based on acceptable levels of interest rate risk. The overall objective of this process is to optimize the Company's financial position, liquidity, and net interest income, while limiting volatility to net interest income from changes in interest rates. The Company uses gap analysis and simulation modeling to measure and manage interest rate sensitivity.

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An indicator of interest rate sensitivity is the difference between interest rate sensitive assets and interest rate sensitive liabilities; this difference is known as the interest rate sensitivity gap. In an asset sensitive, or positive, gap position, the amount of interest-earning assets maturing or repricing within a given period exceeds the amount of interest-bearing liabilities maturing or repricing within that same period. Conversely, in a liability sensitive, or negative, gap position, the amount of interest-bearing liabilities maturing or repricing within a given period exceeds the amount of interest-earning assets maturing or repricing within that time period. During a period of rising rates, a negative gap would tend to affect net interest income adversely, while a positive gap would theoretically result in increased net interest income. In a falling rate environment, a negative gap would tend to result in increased net interest income, while a positive gap would affect net interest income adversely. The gap analysis below provides a snapshot of the Company's interest rate sensitivity position at March 31, 2005:

<i>Interest Rate Sensitivity</i>	<i>Repricing Within</i>				<i>Total</i>
	<i>0 - 3 Months</i>	<i>4 - 12 Months</i>	<i>One - Five Years</i>	<i>More Than Five Years</i>	
<i>March 31, 2005</i>					
<i>(Dollars in thousands)</i>					
<b>Interest Rate Sensitive Assets</b>					
Federal funds sold	\$ 27,708				\$ 27,708
Securities <sup>1</sup>	2,582	\$ 5,930	\$ 77,294	\$ 37,148	122,954
Loans, gross <sup>2</sup>	118,320	21,678	72,399	5,121	217,518
Other assets	1,247				1,247
<b>Total interest rate sensitive assets</b>	<b>149,857</b>	<b>27,608</b>	<b>149,693</b>	<b>42,269</b>	<b>369,427</b>
<b>Interest Rate Sensitive Liabilities</b>					
Deposits <sup>3</sup>	\$ 207,063	46,367	12,693	60	266,183
U.S. Treasury demand note	963				963
Federal Home Loan Bank advances			5,000		5,000
<b>Total interest rate sensitive liabilities</b>	<b>208,026</b>	<b>46,367</b>	<b>17,693</b>	<b>60</b>	<b>272,146</b>
<b>Interest rate sensitivity gap</b>	<b>\$ (58,169)</b>	<b>\$ (18,759)</b>	<b>\$ 132,000</b>	<b>\$ 42,209</b>	<b>\$ 97,281</b>
<b>Cumulative gap</b>	<b>\$ (58,169)</b>	<b>\$ (76,928)</b>	<b>\$ 55,072</b>	<b>\$ 97,281</b>	
<b>Ratio of cumulative gap to total rate sensitive assets</b>	<b>(15.75)%</b>	<b>(20.82)%</b>	<b>14.91%</b>	<b>26.33%</b>	
<b>Ratio of cumulative rate sensitive assets to rate sensitive liabilities</b>	<b>72.04%</b>	<b>69.76%</b>	<b>120.24%</b>	<b>135.75%</b>	
Cumulative gap at December 31, 2004	\$ (59,503)	\$ (71,138)	\$ 54,244	\$ 91,758	
Cumulative gap at March 31, 2004	\$ (94,465)	\$ (107,551)	\$ 34,082	\$ 87,454	

<sup>1</sup> Distribution of maturities for available-for sale-securities is based on amortized cost. Additionally, distribution of maturities for mortgage-backed securities is based on expected average lives which may be different from the contractual terms. Equity securities, if any, are excluded.

<sup>2</sup> No cash flow assumptions other than final contractual maturities have been made for installment loans with fixed rates. Nonaccrual loans are excluded.

<sup>3</sup> NOW, money market, and savings account balances are included in the 0-3 months repricing category.

As shown in the table above, the Company's gap position remained negative through the short-term repricing intervals at March 31, 2005, totaling \$(58,169) at three months and \$(76,928) through one-year. Excluding traditionally nonvolatile NOW and premium savings balances from the gap calculation, the

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cumulative gap at March 31, 2005 totaled \$101,580 at three months and \$82,821 at twelve months. The widening of the short-term gap position at March 31, 2005 versus year-end 2004 was primarily attributable to the purchase of investment securities with contractual maturities exceeding one year. The gap position is expected to widen further during 2005 as federal funds sold are reallocated to other earning assets and as seasonal deposits decline. Shortcomings are inherent in any gap analysis since certain assets and liabilities may not move proportionally as rates change. For example, the gap analysis presumes that all loans<sup>2</sup> and securities<sup>1</sup> will perform according to their contractual maturities when, in many cases, actual loan terms are much shorter than the original terms and securities are subject to early redemption.

In addition to gap analysis, the Company uses simulation modeling to test the interest rate sensitivity of net interest income and the balance sheet. Contractual maturity and repricing characteristics of loans are incorporated into the model, as are prepayment assumptions, maturity data, and call options within the investment portfolio. Non-maturity deposit accounts are modeled based on past experience. Simulation results quantify interest rate risks under various interest rate scenarios. In estimating the impact of these rate movements on the Company's net interest income, the following general assumptions were made: a) Spreads on all loans, investment securities, and deposit products remain constant; b) Interest rate movements occur gradually over an extended period versus rapidly; and c) Loans and deposits are projected to grow at constant speeds. Limitations inherent with these assumptions include: a) Certain deposit accounts, in particular, interest-bearing demand deposits, infrequently reprice and historically, have had limited impact on net interest income from a rate perspective; b) In a down rate environment, competitive and other factors constrain timing of rate cuts on other deposit products whereas loans tied to prime and other variable indexes reprice instantaneously and, as amply demonstrated the last few years, securities with call or other prepayment features are likely to be redeemed prior to stated maturity and replaced at lower rates (lag effect); c) Changes in balance sheet mix, for example, unscheduled pay-offs of large commercial loans, are oftentimes difficult to forecast; and d) Rapid and aggressive rate movements by the Federal Reserve can materially impact estimated results. Management is optimistic that initiatives taken to increase loan production and diversify the securities portfolio have reduced the interest rate sensitivity of net interest income and the balance sheet, and such actions will continue.

The Company has not in the past, but may in the future, utilize interest rate swaps, financial options, financial futures contracts, or other rate protection instruments to reduce interest rate and market risks.

## **Impact of Inflation**

The effects of inflation on the local economy and the Company's operating results have been relatively modest the last several years. Because substantially all the Company's assets and liabilities, including cash, securities, loans, and deposits, are monetary in nature, their values are less sensitive to the effects of inflation than to changing interest rates. As discussed in the preceding section, the Company attempts to control the impact of interest rate fluctuations by managing the relationship between its interest sensitive assets and liabilities.

## **Capital Adequacy**

Federal banking regulators have established certain capital adequacy standards required to be maintained by banks and bank holding companies. These regulations define capital as either Tier 1 (primarily shareholders' equity) or Tier 2 (certain debt instruments and a portion of the allowance for loan losses). The Company and SEB are subject to a minimum Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) of 4%, total capital ratio (Tier 1 plus Tier 2 to risk-weighted assets) of 8%, and Tier 1 leverage ratio (Tier 1 to average quarterly assets) of 4%. To be considered a well-capitalized institution, the

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Tier 1 capital, total capital, and Tier 1 leverage ratios must equal or exceed 6%, 10%, and 5%, respectively. Banks and bank holding companies are prohibited from including unrealized gains and losses on debt securities in the calculation of risk-based capital but are permitted to include up to 45 percent of net unrealized pre-tax holding gains on equity securities in Tier 2 capital. The Company did not have any unrealized gains on equity securities includible in the risk-based capital calculations for any of the periods presented. The Company is committed to maintaining its well-capitalized status.

The Company's capital ratios for the most recent periods are presented in the table below:

<u>Capital Ratios</u>	<u>March 31, 2005</u>	<u>December 31, 2004</u>	<u>March 31, 2004</u>
<i>(Dollars in thousands)</i>			
Tier 1 capital:			
Realized shareholders' equity	\$ 49,830	\$ 48,881	\$ 47,524
Intangible assets and other adjustments	(608)	(623)	(671)
Total Tier 1 capital	<u>49,222</u>	<u>48,258</u>	<u>46,853</u>
Tier 2 capital:			
Portion of allowance for loan losses	3,101	3,201	2,970
Allowable long-term debt			
Total Tier 2 capital	<u>3,101</u>	<u>3,201</u>	<u>2,970</u>
Total risk-based capital	<u>\$ 52,323</u>	<u>\$ 51,459</u>	<u>\$ 49,823</u>