

SOUTHEASTERN BANKING CORP  
Form 10-K  
April 03, 2006  
Table of Contents

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

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**Annual Report Pursuant to Section 13 or 15(d)**

**of the Securities Exchange Act of 1934**

**For the Fiscal Year Ended December 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

**58-1423423**  
(IRS Employer

incorporation or organization)

Identification No.)

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

(Address of principal executive offices) (Zip Code)

**(912) 437-4141**

(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$1.25 per share**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of common stock held by non-affiliates on June 30, 2005 was approximately \$58,729,000 (based on a per share price of \$26.50 on over-the-counter trades executed by principal market-makers).

As of March 15, 2006, the Registrant had 3,235,002 shares of common stock outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Annual Report on Form 10-K for the year ended December 31, 1990 and Quarterly Report on Form 10-Q for the quarter ended March 31, 2003 are incorporated by reference in Part IV, Item 15.

Portions of the Registrant's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 10, 2006 are incorporated by reference in Part III.

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**Table of Contents**

**Table of Contents**

**Part I**

|  | <b>Page</b> |
|--|-------------|
| Item 1. <u>Business</u>  | 3           |
| Item 1A. <u>Risk Factors</u>                                       | 3           |
| Item 1B. <u>Unresolved Staff Comments</u>                          | 6           |
| Item 2. <u>Properties</u>  | 8           |
| Item 3. <u>Legal Proceedings</u>                                   | 9           |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | 9           |

**Part II**

|  |    |
|--|----|
| Item 5. <u>Market for the Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities</u> | 9  |
| Item 6. <u>Selected Consolidated Financial Data</u>  | 11 |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                             | 12 |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 31 |
| Item 8. <u>Financial Statements and Supplementary Data</u>   | 31 |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                              | 51 |
| Item 9A. <u>Controls and Procedures</u>  | 51 |
| Item 9B. <u>Other Information</u>  | 51 |

**Part III**

|  |    |
|--|----|
| Item 10. <u>Directors and Executive Officers of the Registrant</u>   | 51 |
| Item 11. <u>Executive Compensation</u>   | 51 |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u> | 52 |
| Item 13. <u>Certain Relationships and Related Transactions</u>   | 52 |
| Item 14. <u>Principal Accountant Fees and Services</u>   | 52 |

**Part IV**

|   |    |
|---|----|
| Item 15. <u>Exhibits, Financial Statement Schedules</u> | 53 |
|---|----|

|                          |           |
|--------------------------|-----------|
| <b><u>Signatures</u></b> | <b>54</b> |
|--------------------------|-----------|

---

**Table of Contents**

**PART I**

**Item 1. Business.**

**1. History and Organization.** Southeastern Banking Corporation (the Company) and its wholly-owned subsidiary, Southeastern Bank (SEB), provide a full line of commercial and retail services to meet the financial needs of individual, corporate, and government customers in southeast Georgia and northeast Florida. The Company's corporate offices are located at 1010 Northway Street, Darien, Georgia.

The Company was formed in 1980 to serve as the parent holding company of its then sole subsidiary bank, The Citizens Bank, Folkston, Georgia, which later changed its name to Southeastern Bank. In 1983, the Company acquired The Darien Bank, Darien, Georgia. Since 1983, the Company has acquired three additional financial institutions in the southeast Georgia market. These acquisitions were consummated by merging the acquired bank with SEB; the acquired banks were subsequently converted to branches of SEB. In this manner, the Company acquired The Camden County State Bank, Woodbine, Georgia, in 1984; the Jeff Davis Bank, Hazlehurst, Georgia, in 1986; and the Nicholls State Bank, Nicholls, Georgia, in 1988. In 1990, SEB merged with and into The Darien Bank, with The Darien Bank being the surviving bank in the merger operating under its 1888 Charter. Immediately, The Darien Bank changed its name to Southeastern Bank. SEB is a state banking association incorporated under the laws of the State of Georgia.

In 1991, the Company acquired the Folkston, St. Marys, and Douglas, Georgia, offices of First Georgia Savings Bank, a savings bank in Brunswick, Georgia. Offices located in St. Marys and Douglas are now operating as branches of SEB, but the First Georgia office in Folkston was closed and merged into the existing Folkston branch. In 1993, the Company acquired the Folkston and St. Marys offices of Bank South, N.A., Atlanta, Georgia. Both of the acquired offices were closed and merged into existing offices of the Company.

In 1996, the Company acquired the Callahan, Hilliard, and Yulee offices of Compass Bank in northeast Florida's Nassau County. Geographically, Nassau County borders Camden and Charlton Counties in southeast Georgia where the Company has other offices. In 2002, the Company acquired the Richmond Hill office of Valdosta, Georgia-based Park Avenue Bank. Richmond Hill is located approximately ten miles outside the greater Savannah area. All of these facilities are operated as branches of SEB.

In February 2003, the Company opened a loan production office in Brunswick, Georgia. In November 2004, a full service banking facility was opened in Brunswick, and the loan production office closed.

SBC Financial Services, the Company's subsidiary which formerly offered insurance agent and investment brokerage services, is now inactive. Insurance and investment services are now being offered directly by SEB.

**Item 1A. Risk Factors**

Our business is subject to certain risks, including those described below. The risks below do not describe all risks applicable to our business and are intended only as a summary of certain material factors that affect our operations in our industry and markets. New risks may emerge at any time, and we cannot predict such risks or estimate the extent to which they may affect our financial performance in which we operate. More detailed information concerning these and other risks is contained in other sections of this Annual Report on Form 10-K.

*We face strong competition from other financial services providers.*

We operate in a highly competitive market for the products and services we offer. The competition among financial services providers to attract and retain customers is strong. Customer loyalty can be easily influenced by a competitor's new products, especially offerings that could provide cost savings or a higher return to the customer. Some of our competitors may be better able to provide a wider range of products and services over a greater geographic area. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other mutual funds, as well as other super-regional, national and international financial institutions that operate offices in our market areas and elsewhere. Moreover, this highly competitive industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Many of our competitors have fewer regulatory constraints and some have lower cost structures. While we believe we can and do successfully compete with these other financial institutions in our market areas, we may face a competitive disadvantage as a result of our smaller size, lack of geographic diversification and inability to spread our marketing costs across a broader market.

*Our business is subject to the success of the economic conditions of the United States and the markets in which we operate.*

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The success of our business and earnings is affected by general business and economic conditions in the United States and our market areas, particularly Southeast Georgia and Northeast Florida. If the communities in which we operate do not grow as anticipated or

## Table of Contents

if prevailing economic conditions locally or nationally are unfavorable, our business may be negatively impacted. An economic downturn, an increase in unemployment, or other events that affect household and/or corporate incomes either nationally or locally could decrease the demand for loans and our other products and services and increase the number of customers who fail to pay interest or principal on their loans. Moreover, we cannot give any assurance that we will benefit from any market growth or favorable economic conditions in our market areas if they do occur.

In addition, the market value of the real estate securing loans as collateral could be adversely affected by unfavorable changes in market and economic conditions. As of December 31, 2005, approximately 78% of our total loans were secured by real estate. Any sustained period of increased payment delinquencies, foreclosures or losses caused by adverse market or economic conditions in our market areas could adversely affect the value of our assets, our revenues, results of operations and financial condition.

*Our recent operating results may not be indicative of our future operating results.*

We may not be able to sustain our historical rate of growth or may not even be able to grow our business at all. In the future, we may not have the benefit of a favorable interest rate environment or a strong real estate market. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

*Risks associated with unpredictable economic and political conditions may be amplified as a result of our limited market areas.*

Conditions such as inflation, recession, unemployment, high interest rates, short money supply, scarce natural resources, international disorders, terrorism and other factors beyond our control may adversely affect our profitability. Because the majority of our borrowers are individuals and businesses located and doing business in Southeast Georgia and Northeast Florida our success will depend significantly upon the economic conditions in those areas. Due to our limited market areas, these negative conditions may have a more noticeable effect on us than would be experienced by a larger institution more able to spread these risks of unfavorable local economic conditions across a large number of diversified economies.

*If our allowance for loan losses is not sufficient to cover actual loan losses, or if credit delinquencies increase, our earnings could decrease.*

Like other financial institutions, we face the risk that our customers will not repay their loans, that the collateral securing the payment of those loans may be insufficient to assure repayment, and that we may be unsuccessful in recovering the remaining loan balances. Management makes various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. Based in part on those assumptions and judgments, we maintain an allowance for loan losses in an attempt to cover any loan losses which may occur. In determining the size of the allowance, we also rely on an analysis of our loan portfolio based on historical loss experience, volume and types of loans, trends in classification, volume, delinquencies and non-accruals, national and local economic conditions and other pertinent information. However, those established loan loss reserves may prove insufficient. If we are unable to raise revenue to compensate for these losses, such losses could have a material adverse effect on our operating results.

In addition, federal and state regulators periodically review our allowance for loan losses and may require us to increase our allowance for loan losses or recognize further loan charge-offs, based on judgments different than those of our management. Higher charge-off rates and an increase in our allowance for loan losses may hurt our overall financial performance may increase our cost of funds.

*Departures of our key personnel may harm our ability to operate successfully.*

Our success has been and continues to be largely dependent upon the services of our senior management team, including our senior loan officers, and our board of directors, many of whom have significant relationships with our customers. Our continued success will depend, to a significant extent, on the continued service of these key personnel. The prolonged unavailability or the unexpected loss of any of them could have an adverse effect on our financial condition and results of operations. We cannot be assured of the continued service of our senior management team or our board of directors with us.

*We may face risks with respect to the future expansion of our business.*

As we expand our business in the future into new and emerging markets, we may also consider and enter into new lines of business or offer new products or services. Such expansion involves risks, including:

entry into new markets where we lack experience;

the introduction of new products or services into our business with which we lack experience;

## Table of Contents

the time and cost associated with identifying and evaluating potential markets, products and services, hiring experienced local management and opening new offices;

potential time lags between preparatory activities and the generation of sufficient assets and deposits to support the costs of expansion; and

the estimates and judgments used to evaluate market risks with respect to new markets, products and services may not be accurate. *Future growth may require us to raise additional capital, but that capital may not be available when it is needed.*

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our capital resources will continue to satisfy our capital requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time and on our financial performance. Accordingly, we cannot ensure our ability to raise additional capital if needed on favorable terms. If we cannot raise additional capital when needed, our ability to expand our operations through internal growth and acquisitions could be materially impaired.

*We are subject to extensive regulation that could limit or restrict our activities and adversely affect our earnings.*

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various federal and state agencies. Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. Many of these regulations are intended to protect depositors, the public and the FDIC rather than shareholders. The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability. In addition, the Sarbanes-Oxley Act of 2002, and the related rules and regulations promulgated by the Securities and Exchange Commission and Nasdaq, that are now applicable to us, have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices, including the costs of completing our audit and maintaining our internal controls.

*The monetary policies and laws of the United States, including interest rate policies of the Federal Reserve Board, could affect our earnings.*

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its policies determine in large part our cost of funds for lending and investing and our return on those loans and investments, both of which affect our net interest margin. They can also materially affect the value of financial instruments we hold. Changes in interest rates by the Federal Reserve may affect our level of interest income and interest expense. In a period of rising interest rates, our interest expense could increase in different amounts and at different rates while the interest that we earn on our assets may not change in the same amounts or at the same rates. Accordingly, increases in interest rates could decrease our net interest income. In addition, an increase in interest rates may decrease the demand for consumer and commercial credit, including real estate loans, which are a major component of our loan portfolio.

Changes in the level of interest rates also may negatively affect our ability to originate real estate loans, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately affect our earnings. A decline in the market value of our assets may limit our ability to borrow additional funds or result in our lenders requiring additional collateral from us under our loan agreements. As a result, we could be required to sell some of our loans and investments under adverse market conditions, upon terms that are not favorable to us, in order to maintain our liquidity. If those sales are made at prices lower than the amortized costs of the investments, we will incur losses. Changes in Federal Reserve Board policies and laws are beyond our control and hard to predict.

*Fluctuations in our expenses and other costs may hurt our financial results.*

Our expenses and other costs, such as operating and marketing expenses, directly affect our earnings results. In light of the extremely competitive environment in which we operate, and because the size and scale of many of our competitors provides them with increased operational efficiencies, we must successfully manage such expenses. As our business develops, changes or expands, additional expenses can arise.

*We must respond to rapid technological changes and these changes may be more difficult or expensive than anticipated.*



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If competitors introduce new products and services embodying new technologies, or if new industry standards and practices emerge, our existing product and service offerings, technology and systems may become obsolete. Further, if we fail to adopt or develop new technologies or to adapt our products and services to emerging industry standards, we may lose current and future customers, which could have a material adverse effect on our business, financial condition and results of operations. The financial services industry is changing rapidly and in order to remain competitive, we must continue to enhance and improve the functionality and features of our products, services and technologies. These changes may be more difficult or expensive than we anticipate.

## **Table of Contents**

*Changes in accounting policies and practices, as may be adopted by the regulatory agencies, the Financial Accounting Standards Board, or other authoritative bodies, could materially impact our financial statements.*

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the regulatory agencies, the Financial Accounting Standards Board, and other authoritative bodies change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations.

*The costs and effects of litigation, investigations or similar matters, or adverse facts and developments related thereto, could materially affect our business, operating results and financial condition.*

We may be involved from time to time in a variety of litigation, investigations or similar matters arising out of our business. Our insurance may not cover all claims that may be asserted against it, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. Should the ultimate judgments or settlements in any litigation or investigation significantly exceed our insurance coverage, they could have a material adverse effect on our business, financial condition and results of operations. In addition, we may not be able to obtain appropriate types or levels of insurance in the future, nor may we be able to obtain adequate replacement policies with acceptable terms, if at all.

*Various domestic or international military or terrorist activities or conflicts could affect our business and financial condition.*

Acts or threats of war or terrorism, actions taken by the United States or other governments in response to such acts or threats could negatively affect business and economic conditions in the United States. If terrorist activity, acts of war or other international hostilities cause an overall economic decline, our financial condition and results of operations could be adversely affected. The potential for future terrorist attacks, the national and international responses to terrorist attacks or perceived threats to national security and other actual or potential conflicts or acts of war, including war in the Middle East, have created many economic and political uncertainties that could seriously harm our business and results of operations in ways that we cannot predict.

*Our directors and executive officers own a significant portion of our common stock.*

Our directors and executive officers, as a group, beneficially owned approximately 27% of our outstanding common stock as of December 31, 2005. As a result of their ownership, the directors and executive officers will have the ability, by voting their shares in concert, to significantly influence the outcome of all matters submitted to our shareholders for approval, including the election of directors.

*The trading volume in our common stock has been low, and the sale of substantial amounts of our common stock in the public market could depress the price of our common stock.*

The trading volume in our common stock has been relatively low. We cannot say with any certainty that a more active and liquid trading market for our common stock will develop. Because of this, it may be more difficult for you to sell a substantial number of shares for the same price at which you could sell a smaller number of shares.

We cannot predict the effect, if any, that future sales of our common stock in the market, or the availability of shares of common stock for sale in the market, will have on the market price of our common stock. We, therefore, can give no assurance that sales of substantial amounts of common stock in the market, or the potential for large amounts of sales in the market, would not cause the price of our common stock to decline or impair our future ability to raise capital through sales of our common stock.

*Our ability to pay dividends is limited and we may be unable to pay future dividends.*

Our ability to pay dividends is limited by regulatory restrictions and the need to maintain sufficient consolidated capital. The ability of our Bank subsidiaries to pay dividends to the Company is limited by its obligation to maintain sufficient capital and by other general restrictions on their dividends that are applicable to Georgia banks and banks that are regulated by the FDIC. If we do not satisfy these regulatory requirements, we will be unable to pay dividends on our common stock.

## **Item 1B. Unresolved Staff Comments**

None

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**2. Business.** SEB, the Company's commercial bank subsidiary, offers a wide range of services to meet the financial needs of its customer base through its branch and ATM network in southeast Georgia and northeast Florida. SEB's primary business comprises traditional deposit and credit services as well as official check services, wire transfers, and safe deposit box rentals. Deposit services offered include time certificates plus NOW, money market, savings, and individual retirement accounts. Credit services include commercial and installment loans, long-term mortgage originations, credit cards, and standby letters of credit. Commercial loans are made primarily to fund real estate construction and to meet the needs of customers engaged in the agriculture, timber, seafood, and other industries. Installment loans are made for both consumer and non-consumer purposes. Through an affiliation with Raymond James Financial Services, SEB also provides insurance agent and investment brokerage services. At December 31, 2005, SEB operated sixteen full-service banking offices with total assets exceeding \$389,000,000. A list of SEB offices is provided in Part I, Item 2.

## Table of Contents

The Federal Reserve Bank of Atlanta is the principal correspondent of SEB; virtually all checks and electronic payments are processed through the Federal Reserve. SEB also maintains accounts with other correspondent banks in Georgia, Florida, and Alabama.

At December 31, 2005, the Company and its subsidiaries had 157 full-time employees and 15 part-time employees.

**3. Competition.** The Company has direct competition with other commercial banks, savings and loan associations, and credit unions in each market area. Since mid-1998, intrastate branching restrictions in all of the Company's market areas have been lifted. The removal of intrastate branching restrictions has given the Company opportunities for growth but has also intensified competition as other banks branch into the Company's markets.

The Company faces increasingly aggressive competition from other domestic lending institutions and from numerous other providers of financial services. The ability of nonbanking financial institutions to provide services previously reserved for commercial banks has intensified competition. Because nonbanking financial institutions are not subject to the same regulatory restrictions as banks and bank holding companies, they can often operate with greater flexibility and lower cost structures. Recent abolishment of certain restrictions between banks, securities firms, and insurance companies will further intensify competition; refer to the Supervision and Regulation section of this Item for more details.

**4. Supervision and Regulation.** As a bank holding company, the Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (Federal Reserve). SEB, an insured state non-member bank chartered by the Georgia Department of Banking and Finance (GDBF), is subject to supervision and regulation by the GDBF and the Federal Deposit Insurance Corporation (FDIC). SEB is subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types and amounts of loans that may be made and the interest that may be charged thereon, and limitations on the types of investments that may be made and the types of services that may be offered. Numerous consumer laws and regulations also affect the operations of SEB. In addition to the impact of regulation, the Company is also significantly affected by the actions of the Federal Reserve as it attempts to control the money supply and credit availability in order to influence the economy. The Company's nonbank subsidiary, although currently inactive, is regulated and supervised by applicable bank, insurance, and various other regulatory agencies.

Pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, bank holding companies from any state may acquire banks located in any other state, subject to certain conditions, including concentration limits. In addition, a bank may establish branches across state lines by merging with a bank in another state, subject to certain restrictions.

A number of obligations and restrictions imposed on bank holding companies and their bank subsidiaries by federal law and regulatory policy are designed to reduce potential loss exposure to bank depositors and to the FDIC insurance fund in the event of actual or possible default. For example, under Federal Reserve policy with respect to bank holding company operations, the Company is expected to serve as a source of financial strength to, and commit resources to support, SEB where it might refuse absent such policy. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the applicable institution is well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized, as those terms are defined under regulations issued by each of the federal banking agencies. The Company and SEB are considered well-capitalized by their respective federal banking regulators. The Company's capital position is delineated in Note 15 to the consolidated financial statements and in the Capital Adequacy section of Part II, Item 7.

There are various legal and regulatory limits on the amount of dividends and other funds SEB may pay or otherwise supply the Company. Additionally, federal and state regulatory agencies have the authority to prevent a bank or bank holding company from engaging in any activity that, in the opinion of the agency, would constitute an unsafe or unsound practice.

**Table of Contents**

On November 12, 1999, financial modernization legislation known as the Gramm-Leach-Bliley Act (the Act) was signed into law. Under the Act, a bank holding company which elects to become a financial holding company may engage in expanded financial activities, including insurance and securities underwriting, and may also acquire securities and insurance companies, subject in each case to certain conditions. Securities firms and insurance companies may also choose to establish or become financial holding companies and thereby acquire banks, also subject to certain conditions. The abolishment of certain restrictions between banks, securities firms, and insurance companies provides both challenges and opportunities to the Company. The Company has no present intention to change its status from a bank holding company to a financial holding company.

The Sarbanes-Oxley Act of 2002 and its impact on the Company is discussed in the Corporate Governance section of Part II, Item 7.

There have been a number of legislative and regulatory proposals that would have an impact on the operation of bank holding companies and their subsidiaries. It is impossible to predict whether or in what form these proposals may be adopted in the future and, if adopted, what their effect will be on the Company.

**5. Securities Exchange Act Reports.** Through its Internet website at [www.southeasternbank.com](http://www.southeasternbank.com), the Company provides a direct link to its Securities and Exchange Act filings. Reports accessible from this link include annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K.

**Item 2. Properties.**

**Company Property.** The Company's executive offices are located in SEB's main banking office at 1010 Northway Street, Darien, Georgia.

**Banking Facilities.** Besides its main office in Darien, SEB has fifteen other banking offices in northeast Florida and southeast Georgia as shown in the table below:

**Banking Offices**

|                |                                 |                                 |
|----------------|---------------------------------|---------------------------------|
| <b>Florida</b> | 542238 US Highway 1             | 463128 State Road 200           |
|                | Nassau County                   | Nassau County                   |
|                | <b>Callahan, Florida 32011</b>  | <b>Yulee, Florida 32097</b>     |
|                | 7964 W. County Road 108         |                                 |
|                | Nassau County                   |                                 |
|                | <b>Hilliard, Florida 32046</b>  |                                 |
| <b>Georgia</b> | 755 Scranton Road               | 1501 GA Highway 40 East         |
|                | Glynn County                    | Camden County                   |
|                | <b>Brunswick, Georgia 31525</b> | <b>Kingsland, Georgia 31548</b> |
|                | 620 S. Peterson Street          | 110 Bacon Street                |
|                | Coffee County                   | Brantley County                 |
|                | <b>Douglas, Georgia 31533</b>   | <b>Nahunta, Georgia 31553</b>   |

Highway 17

910 Van Streat Highway

McIntosh County

Coffee County

**Eulonia, Georgia 31331**

**Nicholls, Georgia 31554**

**Table of Contents**

**Banking Offices, continued:**

|                |                                  |                                     |
|----------------|----------------------------------|-------------------------------------|
| <b>Georgia</b> | 101 Love Street                  | 2004 Highway 17                     |
|                | Charlton County                  | Bryan County                        |
|                | <b>Folkston, Georgia 31537</b>   | <b>Richmond Hill, Georgia 31324</b> |
|                | 14 Hinson Street                 | 2512 Osborne Road                   |
|                | Jeff Davis County                | Camden County                       |
|                | <b>Hazlehurst, Georgia 31539</b> | <b>St. Marys, Georgia 31558</b>     |
|                | 107 E. Main Street               | 414 Bedell Avenue                   |
|                | Brantley County                  | Camden County                       |
|                | <b>Hoboken, Georgia 31542</b>    | <b>Woodbine, Georgia 31569</b>      |

The Company owns all of its main office and branch facilities except its Brunswick facility. The Brunswick facility is a temporary branch building leased from a third party. Additionally, general office space is leased in Brunswick from another third party. The annual lease expense for the Brunswick office space and branch facility approximates \$77,000; the remaining term of the leases is less than one year. See Note 5 to the consolidated financial statements for further property information.

**Item 3. Legal Proceedings.**

The Company and its subsidiaries are parties to claims and lawsuits arising in the course of their normal business activities. Although the ultimate outcome of these suits cannot be ascertained at this time, it is the opinion of management and counsel that none of these matters, when resolved, will have a material effect on the Company's consolidated results of operations or financial position.

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

None

**PART II**

**Item 5. Market for the Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities.**

The Company's stock trades publicly over-the-counter under the symbol SEBC. The high and low sales prices shown below are based on information being posted to electronic bulletin boards by market-makers in the Company's stock. These market prices may include dealer mark-up, markdown, and/or commission. Prices paid on treasury stock purchases are excluded from these results.

The table on the next page sets forth the high and low sales prices and the cash dividends declared on the Company's common stock during the periods indicated.

**Table of Contents**

| Market Sales Price & Dividends Declared | Quarter         | Sales Price |          | Dividends |
|---|-----------------|-------------|----------|-----------|
|   |                 | High        | Low      | Declared  |
| 2005                                    | 4 <sup>th</sup> | \$ 28.25    | \$ 27.50 | \$ 0.63   |
|   | 3 <sup>rd</sup> | 28.50       | 26.50    | 0.13      |
|   | 2 <sup>nd</sup> | 28.00       | 25.00    | 0.13      |
|   | 1 <sup>st</sup> | 28.00       | 25.00    | 0.13      |
| 2004                                    | 4 <sup>th</sup> | 26.25       | 25.10    | 0.625     |
|   | 3 <sup>rd</sup> | 27.25       | 25.00    | 0.125     |
|   | 2 <sup>nd</sup> | 27.45       | 24.75    | 0.125     |
| 2003                                    | 1 <sup>st</sup> | 26.00       | 24.00    | 0.125     |
|   | 4 <sup>th</sup> | 25.90       | 22.00    | 0.64      |
|   | 3 <sup>rd</sup> | 22.00       | 20.50    | 0.12      |
|   | 2 <sup>nd</sup> | 24.50       | 19.00    | 0.12      |
|   | 1 <sup>st</sup> | 20.50       | 17.76    | 0.12      |

The Company had approximately 500 shareholders of record at December 31, 2005.

The Company has paid regular cash dividends on a quarterly basis every year since its inception. Additionally, in recent years, the Company has declared a special dividend in the fourth quarter of each year. Management anticipates that the Company will continue to pay regular and special cash dividends. See the Capital Adequacy section of Part II, Item 7 for more details.

The Company is a legal entity separate and distinct from its subsidiaries, and its revenues depend primarily on the payment of dividends from its subsidiaries. State banking regulations limit the amount of dividends SEB may pay without prior approval of the regulatory agencies. The amount of cash dividends available from SEB for payment in 2006 without such prior approval is approximately \$3,246,000.

The Company manages capital through dividends and share repurchases authorized by the Board of Directors. Capital needs are assessed based on expected growth and the current economic climate. In 2005, the Company repurchased 69,147 shares at an aggregate price of \$1,941,444 and in 2004, 8,390 shares at an aggregate price of \$215,462. As of December 31, 2005, the Company was authorized to purchase treasury shares valued at \$3,242,927 under current Board resolutions. There is no expiration date for the treasury authorization.

Treasury purchases made during 2005 are summarized in the table below:

| Share Repurchases - 2005 | Total Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>per<br>Share | Number of Shares<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs | Maximum Dollar Value of   |
|--------------------------|--|---------------------------------------|---|---|
|                          |  |                                       |   | Shares that May Yet<br>be<br>Purchased under the Plans<br>or Programs |
| January - July           |  |                                       |   | \$ 5,184,371  |
| August                   | 5,947                                  | \$ 27.09                              | 5,947   | 5,023,296   |
| September                | 4,800                                  | 27.20                                 | 4,800   | 4,892,730   |
| October                  | 58,400                                 | 28.25                                 | 58,400  | 3,242,927   |
| November - December      |  |                                       |   | 3,242,927   |
| Total                    | 69,147                                 | \$ 28.08                              | 69,147  |   |



**Table of Contents****Item 6. Selected Consolidated Financial Data.**

Selected financial data for the last five years is provided in the table below:

| <b>Financial Data</b>                               | <b>2005</b> | <b>2004</b> | <b>2003</b> | <b>2002</b> | <b>2001</b> |
|---|-------------|-------------|-------------|-------------|-------------|
| <i>(Dollars in thousands except per share data)</i> |             |             |             |             |             |
| <b>At December 31:</b>                              |             |             |             |             |             |
| Total assets  | \$ 388,691  | \$ 400,755  | \$ 374,368  | \$ 378,140  | \$ 355,215  |
| Loans, net of unearned income                       | 223,791     | 218,505     | 205,680     | 174,981     | 163,348     |
| Allowance for loan losses                           | 4,311       | 4,134       | 3,833       | 3,601       | 3,135       |
| Investment securities                               | 117,376     | 117,884     | 131,759     | 153,323     | 157,620     |
| Deposits  | 328,801     | 339,310     | 316,963     | 317,848     | 298,707     |
| Long-term debt                                      | 5,000       | 5,000       | 5,000       | 5,000       | 5,000       |
| Treasury stock                                      | 6,757       | 4,816       | 4,600       | 4,124       | 3,248       |
| Realized stockholders equity                        | 50,089      | 48,881      | 46,599      | 45,193      | 44,656      |
| <b>For the Year:</b>                                |             |             |             |             |             |
| Net interest income                                 | \$ 18,610   | \$ 17,275   | \$ 16,385   | \$ 15,333   | \$ 14,616   |
| Provision for loan losses                           | 340         | 807         | 968         | 1,074       | 1,200       |
| Net income  | 6,475       | 5,803       | 5,201       | 4,759       | 4,097       |
| Common dividends paid                               | 3,352       | 3,361       | 3,383       | 3,430       | 1,842       |
| <b>Per Common Share:</b>                            |             |             |             |             |             |
| Basic earnings                                      | \$ 1.97     | \$ 1.75     | \$ 1.56     | \$ 1.42     | \$ 1.21     |
| Dividends declared                                  | 1.02        | 1.00        | 1.00        | 1.00        | 1.00        |
| Book value  | 15.48       | 14.79       | 14.07       | 13.56       | 13.19       |
| <b>Financial Ratios:</b>                            |             |             |             |             |             |
| Return on average assets                            | 1.67%       | 1.53%       | 1.42%       | 1.30%       | 1.15%       |
| Return on beginning equity                          | 13.25       | 12.45       | 11.51       | 10.66       | 9.16        |
| Tier 1 capital ratio                                | 19.73       | 18.92       | 19.06       | 20.76       | 23.45       |
| Total capital ratio                                 | 20.98       | 20.17       | 20.32       | 22.01       | 24.71       |
| Tier 1 leverage ratio                               | 13.10       | 12.34       | 12.56       | 12.14       | 12.32       |

The book value per share and equity ratios exclude the effects of mark-to-market accounting for investment securities. In accordance with generally accepted accounting principles, prior period amounts have not been restated to reflect the treasury stock purchases made from 2001 - 2005.

**Business Combinations and Divestitures/New Offices**

The financial data in the table above reflects the following developments:

In November 2004, the Company opened a full service branch facility in Brunswick, Georgia and closed its loan production office that was opened in 2003. In 2004, approximately \$12,000,000 of new loan production was attributable to the Brunswick market and in 2003, approximately \$16,000,000.

On January 31, 2002, the Company acquired the Richmond Hill office of Valdosta, Georgia-based Park Avenue Bank. The Company received certain loans, property and equipment, and other assets with fair values of approximately \$12,201,000, while assuming deposits and other liabilities totaling approximately \$4,270,000. Cash balances applied towards the purchase approximated \$8,000,000. A deposit premium of \$100,000 was recorded in conjunction with the transaction.



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**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*This Analysis should be read in conjunction with the consolidated financial statements and related notes. The Company's accounting policies, which are described in Note 1 to the financial statements and in the Critical Accounting Policies section of this Analysis, 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, with assets exceeding \$388,600,000, is a financial services company with operations in southeast Georgia and northeast Florida. Southeastern Bank, 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 \$388,691,172 at year-end 2005, down \$12,064,046 or 3.01% from December 31, 2004. The asset decline in 2005 ensued primarily from reductions in federal funds sold balances. Specifically, federal funds sold declined \$16,115,000 and investment securities, \$508,000; loans grew \$5,110,172 or 2.38%. Loans comprised approximately 63%, securities, 33%, and federal funds sold, 4%, of earning assets at December 31, 2005 versus 59%, 32%, and 9% at December 31, 2004. Overall, earning assets approximated 91% of total assets at both December 31, 2005 and 2004. During the year-earlier period, total assets grew \$26,387,484 or 7.05%. Growth in federal funds sold and the loan portfolio, particularly real estate construction balances, was the chief factor 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 declined \$508,000 or 0.43% at December 31, 2005 compared to 2004. Purchases of securities during 2005 approximated \$57,257,000 and sales and other redemptions, \$53,891,000. The Company recognized a loss of \$76,750 on the sale of Agency securities approximating \$3,000,000 in 2005; these securities were sold to improve the overall yield of the portfolio. In 2004, the Company recognized a net gain of \$124,094 on the sale of securities approximating \$10,075,000; the sale of these securities, primarily corporates and Agencies, was prompted by then-favorable market conditions. The remaining redemptions were attributable to various issuers exercise of call options and other prepayments as a result of the interest rate environment as well as maturities in the normal course of business. The effective repricing of 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 December 31, 2005, mortgage-backed securities, corporates, and municipals comprised 24%, 7%, and 29% of the portfolio and at December 31, 2004, 29%, 11%, and 31%. Overall, securities comprised 33% of earning assets at December 31, 2005, virtually unchanged from 32% at December 31, 2004. The portfolio yield approximated 4.83% in 2005, down 4 basis points from 2004.

**Table of Contents**

Management believes the credit quality of the investment portfolio remains sound, with 63.24% of the carrying value of debt securities being backed by the U.S. Treasury or other U.S. Government-sponsored agencies at December 31, 2005. All of the Company's corporate bonds were rated A or higher by at least one nationally recognized rating agency at December 31, 2005. The weighted average life of the portfolio was less than 3.25 years at year-end 2005. The amortized cost and estimated fair value of investment securities are delineated in the table below:

**Investment Securities by Category**

| <i>December 31,<br/>(In thousands)</i> | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
|--|---------------------------|-----------------------------|------------------------------|-----------------------|
| <b>Available-for-sale:</b>             |                           |                             |                              |                       |
| U. S. Government agencies              |                           |                             |                              |                       |
| <b>2005</b>                            | <b>\$ 46,668</b>          | <b>\$</b>                   | <b>\$ 722</b>                | <b>\$ 45,946</b>      |
| 2004                                   | 34,381                    | 54                          | 72                           | 34,363                |
| 2003                                   | 42,406                    | 548                         | 93                           | 42,861                |
| Mortgage-backed securities             |                           |                             |                              |                       |
| <b>2005</b>                            | <b>29,014</b>             | <b>67</b>                   | <b>796</b>                   | <b>28,285</b>         |
| 2004                                   | 33,940                    | 231                         | 305                          | 33,866                |
| 2003                                   | 33,996                    | 388                         | 139                          | 34,245                |
| Corporate bonds                        |                           |                             |                              |                       |
| <b>2005</b>                            | <b>8,152</b>              | <b>436</b>                  | <b>27</b>                    | <b>8,561</b>          |
| 2004                                   | 12,027                    | 643                         | 3                            | 12,667                |
| 2003                                   | 16,173                    | 1,064                       |                              | 17,237                |
| Total available-for-sale               |                           |                             |                              |                       |
| <b>2005</b>                            | <b>83,834</b>             | <b>503</b>                  | <b>1,545</b>                 | <b>82,792</b>         |
| 2004                                   | 80,348                    | 928                         | 380                          | 80,896                |
| 2003                                   | 92,575                    | 2,000                       | 232                          | 94,343                |
| <b>Held-to-maturity:</b>               |                           |                             |                              |                       |
| State and municipal securities         |                           |                             |                              |                       |
| <b>2005</b>                            | <b>34,585</b>             | <b>953</b>                  | <b>157</b>                   | <b>35,381</b>         |
| 2004                                   | 36,989                    | 1,823                       | 42                           | 38,770                |
| 2003                                   | 37,416                    | 2,296                       | 35                           | 39,677                |
| Total investment securities:           |                           |                             |                              |                       |
| <b>2005</b>                            | <b>\$ 118,419</b>         | <b>\$ 1,456</b>             | <b>\$ 1,702</b>              | <b>\$ 118,173</b>     |
| 2004                                   | 117,337                   | 2,751                       | 422                          | 119,666               |
| 2003                                   | 129,991                   | 4,296                       | 267                          | 134,020               |

As shown, the carrying value of the investment portfolio reflected \$246,034 in net unrealized losses at December 31, 2005; refer to Note 2 of the consolidated financial statements and 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.

The distribution of maturities and the weighted average yields of investment securities at December 31, 2005 are shown in the table on the next page. Actual maturities may differ from contractual maturities because borrowers may, in many instances, have the right to call or prepay obligations.

**Table of Contents**

| <b>Maturity Distribution of Investment Securities</b>     | <b>1 Year<br/>or Less</b> | <b>1 5<br/>Years</b> | <b>5 10<br/>Years</b> | <b>After 10<br/>Years</b> | <b>Total</b>      |
|---|---------------------------|----------------------|-----------------------|---------------------------|-------------------|
| <i>December 31, 2005</i><br><i>(Dollars in thousands)</i> |                           |                      |                       |                           |                   |
| <b>Distribution of maturities</b>                         |                           |                      |                       |                           |                   |
| <b>Amortized cost:</b>                                    |                           |                      |                       |                           |                   |
| U.S. Government agencies                                  | \$ 5,743                  | \$ 38,072            | \$ 2,853              | \$                        | \$ 46,668         |
| Mortgage-backed securities <sup>1</sup>                   | 516                       | 27,220               | 1,278                 |                           | 29,014            |
| Corporate bonds   |                           | 8,152                |                       |                           | 8,152             |
| States and municipal securities                           | 1,507                     | 9,702                | 14,471                | 8,905                     | 34,585            |
| <b>Total investment securities</b>                        | <b>\$ 7,766</b>           | <b>\$ 83,146</b>     | <b>\$ 18,602</b>      | <b>\$ 8,905</b>           | <b>\$ 118,419</b> |
| <b>Fair value:</b>  |                           |                      |                       |                           |                   |
| U.S. Government agencies                                  | \$ 5,706                  | \$ 37,438            | \$ 2,802              | \$                        | \$ 45,946         |
| Mortgage-backed securities <sup>1</sup>                   | 512                       | 26,552               | 1,221                 |                           | 28,285            |
| Corporate bonds   |                           | 8,561                |                       |                           | 8,561             |
| States and municipal securities                           | 1,504                     | 9,938                | 14,866                | \$ 9,073                  | 35,381            |
| <b>Total investment securities</b>                        | <b>\$ 7,722</b>           | <b>\$ 82,489</b>     | <b>\$ 18,889</b>      | <b>\$ 9,073</b>           | <b>\$ 118,173</b> |
| <b>Weighted average yield:</b>                            |                           |                      |                       |                           |                   |
| U.S. Government agencies                                  | 3.57%                     | 3.95%                | 4.52%                 |                           | 3.94%             |
| Mortgage-backed securities <sup>1</sup>                   | 3.91%                     | 4.09%                | 4.59%                 |                           | 4.11%             |
| Corporate bonds   |                           | 6.04%                |                       |                           | 6.04%             |
| States and municipal securities <sup>2</sup>              | 6.28%                     | 6.69%                | 6.80%                 | 6.26%                     | 6.61%             |
| <b>Total investment securities</b>                        | <b>4.12%</b>              | <b>4.52%</b>         | <b>6.30%</b>          | <b>6.26%</b>              | <b>4.91%</b>      |

<sup>1</sup> Distribution of maturities for mortgage-backed securities is based on expected average lives which may differ from the contractual terms.

<sup>2</sup> The weighted average yields for tax-exempt securities have been calculated on a taxable-equivalent basis, using a federal income tax rate of 34%. No adjustments have been made for any state tax benefits or the nondeductible portion of interest expense pertaining to tax-exempt income.

**Loans**

Loans, net of unearned income, grew 2.42% or \$5,287,131 since year-end 2004. The net loans to deposits ratio aggregated 68.06% at December 31, 2005 versus 64.40% and 64.89% at December 31, 2004 and 2003. Offsetting declines of \$4,111,793 within other sectors of the portfolio, the real estate construction and real estate mortgage portfolios grew \$8,078,588 and \$1,271,761 in 2005. The majority of the growth within the construction portfolio was residential in nature and concentrated in the Company's coastal markets. 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. Continuing 2004 gains, real estate mortgage loans grew 2.24% at December 31, 2005 compared to 2004; these loans comprised 26% of the total portfolio at December 31, 2005. Overall, the commercial portfolio fell \$1,528,399 or 1.74% at year-end 2005 compared to 2004. The decline in loans outstanding resulted primarily from pay-downs on large commercial loans in the normal course of business. Agricultural and governmental loans within the commercial portfolio fell \$7,300,883 and \$331,545; nonfarm real estate and other commercial/industrial loans grew \$2,601,078 and \$3,502,951. Balances in the consumer portfolio declined \$2,583,394 or 14.75%; reduced demand was the chief element in the 2005 results.

Despite economic uncertainties within the Company's markets, management is optimistic that loan volumes will continue to grow in 2006. Managerial strategies to increase loan production include continuing competitive pricing



**Table of Contents**

on loan products, development of additional loan relationships, and purchase of loan participations from correspondent banks, all without compromising portfolio quality. Additionally, strong origination volume in the Company's coastal markets is expected to continue. During 2004, net loans grew 6.23% or \$12,824,124. A \$12,700,380 or 29.02% increase in real estate construction loans was the primary factor in the 2004 results. Loans outstanding are presented by type in the table below:

**Loans by Category**

| <i>December 31,</i><br><i>(In thousands)</i>         | 2005       | 2004       | 2003       | 2002       | 2001       |
|--|------------|------------|------------|------------|------------|
| Commercial, financial, and agricultural <sup>1</sup> | \$ 86,256  | \$ 87,784  | \$ 86,078  | \$ 77,680  | \$ 56,065  |
| Real estate construction                             | 64,549     | 56,471     | 43,770     | 17,371     | 6,959      |
| Real estate residential mortgage <sup>2</sup>        | 58,215     | 56,944     | 54,782     | 55,614     | 70,361     |
| Consumer, including credit cards                     | 14,927     | 17,510     | 21,266     | 24,649     | 30,420     |
| Loans, gross   | 223,947    | 218,709    | 205,896    | 175,314    | 163,805    |
| Unearned income                                      | 156        | 204        | 216        | 333        | 457        |
| Loans, net   | \$ 223,791 | \$ 218,505 | \$ 205,680 | \$ 174,981 | \$ 163,348 |

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

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

<sup>3</sup> To comply with recent regulatory guidelines, certain loans that formerly would have been classified as real estate - mortgage are now being coded as real estate - construction. Comparable loans from 2001 have not been reclassified to reflect this change. The majority of real estate - construction loans are residential in nature.

The amount of commercial/financial/agricultural and real estate - construction loans outstanding at December 31, 2005, based on remaining contractual repayments of principal, are shown by maturity and interest rate sensitivity in the table below. The maturities shown are not necessarily indicative of future principal reductions or cash flow since each loan is evaluated at maturity and, in many instances, is renewed in part or total.

| <b>Loan Maturity and Interest Rate Sensitivity</b> Selected Loans |            | Within    | One-Five  | After Five |
|---|------------|-----------|-----------|------------|
| <i>December 31, 2005</i><br><i>(In thousands)</i>                 | Total      | One Year  | Years     | Years      |
| <b>Loan maturity:</b>   |            |           |           |            |
| Commercial, financial, and agricultural <sup>1</sup>              | \$ 85,929  | \$ 40,782 | \$ 42,460 | \$ 2,687   |
| Real estate construction  | 64,516     | 43,852    | 18,799    | 1,865      |
| Total   | \$ 150,445 | \$ 84,634 | \$ 61,259 | \$ 4,552   |
| <b>Interest rate sensitivity:</b>                                 |            |           |           |            |
| Selected loans with:  |            |           |           |            |
| Predetermined interest rates                                      |            |           | \$ 34,581 | \$ 567     |
| Floating or adjustable interest rates                             |            |           | 26,678    | 3,985      |
| Total   |            |           | \$ 61,259 | \$ 4,552   |

<sup>1</sup> Excludes nonaccrual loans totaling approximately \$327 and \$33.

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Although the Company's loan portfolio is diversified, significant portions of its loans are collateralized by real estate. At December 31, 2005, approximately 78% of the loan portfolio was comprised of loans with real estate as the primary collateral. 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 \$40,142,000 at year-end 2005; because a substantial amount of these contracts expire without being drawn upon, total contractual amounts do not necessarily represent future credit exposure or liquidity requirements. The Company did not fund or incur any losses on letters of credit in 2005 and 2004.



**Table of Contents****Nonperforming Assets**

Nonperforming assets consist of nonaccrual loans, restructured loans, and foreclosed real estate and other assets. Overall, nonperforming assets approximated \$1,494,000 at year-end 2005, down \$11,407 or 0.76% from year-end 2004 and 6.39% from December 31, 2003. As a percent of total assets, nonperforming assets totaled 0.38% at both December 31, 2005 and 2004 and 0.63% at December 31, 2003. No material credits were transferred or removed from nonaccrual status during 2005. Industry or individual fluctuations within nonaccrual balances at December 31, 2005 included:

- a) Industry concentrations: Approximately 23% or \$297,000 of nonaccrual balances at December 31, 2005 pertained to the commercial shrimping industry; charge-offs on these particular loans approximated \$64,000 during 2005. 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 December 31, 2005, nonaccrual balances also included loans to one other borrower totaling \$89,000. 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 3.35X the nonperforming loans balance at December 31, 2005 versus 3.87X at year-end 2004 and 2.76X at year-end 2003. Significant activity within foreclosed real estate balances included foreclosure of one borrower's residential real estate valued at \$94,000 and sale of an unrelated \$150,000 parcel. Management is unaware of any other material developments in nonperforming assets at December 31, 2005 that should be presented or otherwise discussed.

Loans past due 90 days or more approximated \$579,000, or less than 1% of net loans, at year-end 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:

**Nonperforming Assets**

| <i>December 31,</i><br><i>(Dollars in thousands)</i> | <b>2005</b> | <b>2004</b> | <b>2003</b> | <b>2002</b> | <b>2001</b> |
|--|-------------|-------------|-------------|-------------|-------------|
| Nonaccrual loans:                                    |             |             |             |             |             |
| Commercial, financial, and agricultural              | \$ 327      | \$ 312      | \$ 691      | \$ 1,417    | \$ 1,275    |
| Real estate construction                             | 33          | 33          | 60          |             |             |
| Real estate residential mortgage                     | 818         | 556         | 560         | 517         | 588         |
| Consumer, including credit cards                     | 107         | 168         | 77          | 96          | 18          |
| Total nonaccrual loans                               | \$ 1,285    | \$ 1,069    | \$ 1,388    | \$ 2,030    | \$ 1,881    |
| Restructured loans <sup>1</sup>                      |             |             |             |             |             |
| Total nonperforming loans                            | \$ 1,285    | \$ 1,069    | \$ 1,388    | \$ 2,030    | \$ 1,881    |
| Foreclosed real estate <sup>2</sup>                  | 187         | 409         | 197         | 273         | 317         |
| Other repossessed assets                             | 22          | 27          | 11          | 91          | 14          |
| Total nonperforming assets                           | \$ 1,494    | \$ 1,505    | \$ 1,596    | \$ 2,394    | \$ 2,212    |
| Accruing loans past due 90 days or more              | \$ 579      | \$ 876      | \$ 961      | \$ 1,448    | \$ 1,528    |
| Ratios:  |             |             |             |             |             |
| Nonperforming loans to net loans                     | 0.57%       | 0.49%       | 0.67%       | 1.16%       | 1.15%       |

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|  |              |       |       |       |       |
|--|--------------|-------|-------|-------|-------|
| Nonperforming assets to net loans plus foreclosed/repossessed assets | <b>0.67%</b> | 0.69% | 0.78% | 1.37% | 1.35% |
|--|--------------|-------|-------|-------|-------|

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<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.

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**Table of Contents**

*Nonperforming Assets 2004 compared to 2003.* Nonaccrual activity in 2004 included a \$191,000 reduction in a large loan due to borrower sale of underlying collateral and an \$86,000 charge-off on a separate commercial real estate loan. Notable activity within foreclosed real estate balances included foreclosure of a commercial parcel valued at \$170,000 and sale of an unrelated \$98,000 parcel at a book gain of \$117,000.

*Nonperforming Assets 2003 compared to 2002 and 2001.* The fluctuation in nonperforming asset balances at year-end 2003 versus 2002 resulted predominantly from agricultural-based loans. Specifically, nonaccrual balances in 2002 and 2001 included approximately \$600,000 pertaining to an impaired agricultural loan collateralized by timber and farmlands. In March 2003, this loan was paid off; interest income recognized upon settlement totaled \$112,000. Conversely, due to the decline in the shrimping industry, multiple loans to commercial fishermen totaling approximately \$334,000 were converted to nonaccrual status during 2003. Although not reflected in period-end 2001 balances, an impaired real estate loan was reduced by a \$300,000 charge to the allowance prior to foreclosure in February 2001. Impairment of the loan was based on the fair value of the underlying collateral, less estimated selling expenses, as determined by a third party appraisal. This property was sold to a third party in August 2001.

*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. The gross amount of interest income that would have been recorded in 2005, 2004, and 2003, if such loans had been accruing interest at their contractual rates, was \$99,000, \$154,000, and \$168,000; interest income actually recognized totaled \$65,000, \$155,000, and \$142,000. 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. Refer to the footnotes accompanying the consolidated financial statements for more details on the Company's accounting and reporting policies on impaired loans and other real estate.

**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 2005 provision for loan losses totaled \$339,833, which exceeded net charge-offs of \$162,874 by \$176,959. The comparable provision and charge-off amounts for 2004 were \$807,483 and \$506,086 and in 2003, \$967,500 and \$735,682. Net charge-offs represented 0.07% of average loans in 2005 compared to 0.24% in 2004 and 0.39% in 2003. Refer to the Nonperforming Assets section of this Analysis for details on specific charge-offs recognized the last few years. 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 on the next page.

**Table of Contents****Allowance for Loan Losses**

| <i>Years Ended December 31,</i><br><i>(Dollars in thousands)</i> | 2005       | 2004       | 2003       | 2002       | 2001       |
|--|------------|------------|------------|------------|------------|
| Allowance for loan losses at beginning of year                   | \$ 4,134   | \$ 3,833   | \$ 3,601   | \$ 3,135   | \$ 3,160   |
| Provision for loan losses  | 340        | 807        | 968        | 1,074      | 1,200      |
| Charge-offs:   |            |            |            |            |            |
| Commercial, financial, and agricultural                          | 126        | 339        | 391        | 146        | 698        |
| Real estate construction   | 28         | 12         | 29         | 2          |            |
| Real estate residential mortgage                                 | 35         | 71         | 106        | 198        | 132        |
| Consumer, including credit cards                                 | 227        | 335        | 450        | 528        | 720        |
| Total charge-offs  | 416        | 757        | 976        | 874        | 1,550      |
| Recoveries:  |            |            |            |            |            |
| Commercial, financial, and agricultural                          | 76         | 11         | 31         | 21         | 38         |
| Real estate construction   |            |            | 1          |            |            |
| Real estate residential mortgage                                 | 19         | 47         | 20         | 5          | 13         |
| Consumer, including credit cards                                 | 158        | 193        | 188        | 240        | 274        |
| Total recoveries   | 253        | 251        | 240        | 266        | 325        |
| Net charge-offs  | 163        | 506        | 736        | 608        | 1,225      |
| Allowance for loan losses at end of period                       | \$ 4,311   | \$ 4,134   | \$ 3,833   | \$ 3,601   | \$ 3,135   |
| Net loans outstanding <sup>1</sup> at end of period              | \$ 223,791 | \$ 218,505 | \$ 205,680 | \$ 174,981 | \$ 163,348 |
| Average net loans outstanding <sup>1</sup> at end of period      | \$ 218,211 | \$ 210,477 | \$ 187,789 | \$ 173,663 | \$ 164,402 |
| Ratios:  |            |            |            |            |            |
| Allowance to net loans   | 1.93%      | 1.89%      | 1.86%      | 2.06%      | 1.92%      |
| Net charge-offs to average loans                                 | 0.07%      | 0.24%      | 0.39%      | 0.35%      | 0.75%      |
| Provision to average loans                                       | 0.16%      | 0.38%      | 0.52%      | 0.62%      | 0.73%      |
| Recoveries to total charge-offs                                  | 60.82%     | 33.16%     | 24.59%     | 30.43%     | 20.97%     |

<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 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, 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

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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.

**Table of Contents**

Because of their subjective nature, these risk factors are carefully reviewed by management and revised as conditions indicate. The unallocated component of the allowance reflects the margin for imprecisions in data and analytics inherent in most estimation processes. Based on its analyses, management believes the allowance was adequate at December 31, 2005.

The allowance is summarized by loan categories in the table below:

**Allocation of Allowance for Loan Losses**

| <i>December 31,</i><br><i>(Dollars in thousands)</i> | <b>2005</b>     | <b>2004</b> | <b>2003</b> | <b>2002</b> | <b>2001</b> |
|--|-----------------|-------------|-------------|-------------|-------------|
| <b>Allocation of allowance by loan category:</b>     |                 |             |             |             |             |
| Commercial, financial, and agricultural              | <b>\$ 1,621</b> | \$ 1,764    | \$ 1,581    | \$ 1,843    | \$ 909      |
| Real estate construction                             | <b>666</b>      | 1,055       | 906         | 144         | 140         |
| Real estate residential mortgage                     | <b>866</b>      | 973         | 918         | 893         | 931         |
| Consumer, including credit cards                     | <b>687</b>      | 323         | 385         | 449         | 841         |
| Unallocated  | <b>471</b>      | 19          | 43          | 272         | 314         |
| <b>Total</b>   | <b>\$ 4,311</b> | \$ 4,134    | \$ 3,833    | \$ 3,601    | \$ 3,135    |

**Allocation of allowance as a percent of total allowance:**

|   |             |      |      |      |      |
|---|-------------|------|------|------|------|
| Commercial, financial, and agricultural | <b>38%</b>  | 43%  | 41%  | 51%  | 29%  |
| Real estate construction                | <b>15%</b>  | 26%  | 24%  | 4%   | 4%   |
| Real estate residential mortgage        | <b>20%</b>  | 23%  | 24%  | 25%  | 30%  |
| Consumer, including credit cards        | <b>16%</b>  | 8%   | 10%  | 12%  | 27%  |
| Unallocated                             | <b>11%</b>  | %    | 1%   | 8%   | 10%  |
| <b>Total</b>                            | <b>100%</b> | 100% | 100% | 100% | 100% |

**Year-end loan categories as a percent of total loans:**

|   |             |      |      |      |      |
|---|-------------|------|------|------|------|
| Commercial, financial, and agricultural | <b>38%</b>  | 41%  | 42%  | 44%  | 34%  |
| Real estate construction                | <b>29%</b>  | 25%  | 21%  | 10%  | 4%   |
| Real estate residential mortgage        | <b>26%</b>  | 26%  | 27%  | 32%  | 43%  |
| Consumer, including credit cards        | <b>7%</b>   | 8%   | 10%  | 14%  | 19%  |
| <b>Total</b>                            | <b>100%</b> | 100% | 100% | 100% | 100% |

As shown in the table above, growth in the allowance allocated to real estate construction loans was primarily attributable to volume increases within that portfolio.

**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 December 31, 2005. Estimated remaining costs associated with new construction and renovations in progress at December 31, 2005 were \$1,800,000; costs associated with the new operating system, which will include both teller and deposit platforms, approximate \$550,000.

**LIQUIDITY**

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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

**Table of Contents**

and interest, of the loan and investment securities portfolios. At December 31, 2005, loans<sup>1</sup> and investment securities with carrying values exceeding \$112,812,000 and \$7,725,000 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 92% of the funding base at December 31, 2005, virtually unchanged from 2004 levels. Borrowed funds, which variously encompass U.S. Treasury demand notes, federal funds purchased, and FHLB advances, totaled \$6,355,559 at year-end 2005 versus \$6,431,211 at December 31, 2004. More specifically, the maximum amount of U.S. Treasury demand notes available to the Company at year-end 2005 totaled \$3,000,000, of which 45% was outstanding. Unused borrowings under unsecured federal funds lines of credit from other banks, each with varying terms and expiration dates, totaled \$23,000,000. Additionally, under a credit facility with the FHLB, the Company can borrow up to 16% of SEB's total assets; at year-end 2005, unused borrowings approximated \$57,145,000. 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 2006. Refer to the Capital Adequacy section of this Analysis for details on treasury stock purchases and intercompany dividend policy and the Financial Condition section of this Analysis 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.

**Deposits**

Deposits declined \$10,508,802 or 3.10% since year-end 2004. Interest-bearing deposits fell \$20,072,789 or 7.46%, while noninterest-bearing deposits grew \$9,563,987 or 13.63%. Declines in SmartSaver and local government balances were the primary factors in the 2005 results. Savings declined \$13,306,257, comprising 32.97% of interest-bearing balances at December 31, 2005 versus 35.45% at December 31, 2004; the current rising rate environment prompted the movement of funds from savings. The variation in local government balances, largely seasonal, was concentrated in NOW accounts. Overall, interest-bearing deposits comprised 75.75%, and noninterest-bearing deposits, 24.25%, of total deposits at December 31, 2005. The distribution of interest-bearing balances at December 31, 2005, 2004, and 2003 is shown in the table below:

|   | 2005       |                  | 2004       |                  | 2003       |                  |
|---|------------|------------------|------------|------------------|------------|------------------|
|   | Balances   | Percent of Total | Balances   | Percent of Total | Balances   | Percent of Total |
| <b>Deposits</b>                               |            |                  |            |                  |            |                  |
| <b>December 31,</b>                           |            |                  |            |                  |            |                  |
| <i>(Dollars in thousands)</i>                 |            |                  |            |                  |            |                  |
| Interest-bearing demand deposits <sup>1</sup> | \$ 93,954  | 37.72%           | \$ 98,352  | 36.55%           | \$ 85,797  | 33.25%           |
| Savings                                       | 82,107     | 32.97%           | 95,414     | 35.45%           | 94,189     | 36.51%           |
| Time certificates < \$100,000                 | 46,891     | 18.83%           | 45,256     | 16.82%           | 49,300     | 19.11%           |
| Time certificates >= \$100,000                | 26,098     | 10.48%           | 30,101     | 11.18%           | 28,724     | 11.13%           |
| Total interest-bearing deposits               | \$ 249,050 | 100.00%          | \$ 269,123 | 100.00%          | \$ 258,010 | 100.00%          |

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

Deposits of one local governmental body comprised approximately \$31,527,000 and \$36,468,000 of the overall deposit base at December 31, 2005 and 2004. Brokered deposits totaled \$594,000 at both December 31, 2005 and 2004.



**Table of Contents**

As shown in the table below, approximately 76% of time certificates at December 31, 2005 were scheduled to mature within the next twelve months.

| <b>Maturities of Certificates of Deposit</b> | <b>Balances</b>       |                    |                  |
|--|-----------------------|--------------------|------------------|
|  | <b>&lt; \$100,000</b> | <b>≥ \$100,000</b> | <b>Total</b>     |
| <b>December 31, 2005</b>                     |                       |                    |                  |
| <i>(In thousands)</i>                        |                       |                    |                  |
| Months to maturity:                          |                       |                    |                  |
| 3 or less                                    | \$ 10,430             | \$ 9,833           | \$ 20,263        |
| Over 3 through 6                             | 9,294                 | 1,981              | 11,275           |
| Over 6 through 12                            | 16,408                | 7,172              | 23,580           |
| Over 12                                      | 10,759                | 7,112              | 17,871           |
| <b>Total</b>                                 | <b>\$ 46,891</b>      | <b>\$ 26,098</b>   | <b>\$ 72,989</b> |

The average balances table included in the Operations section of this Analysis provides detailed information about income/expense and rates paid on deposits for the last three years. The composition of average deposits for these same periods is shown below:

| <b>Composition of Average Deposits</b>        | <b>2005</b>       |                         | <b>2004</b>       |                         | <b>2003</b>       |                         |
|---|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
|   | <b>Balances</b>   | <b>Percent of Total</b> | <b>Balances</b>   | <b>Percent of Total</b> | <b>Balances</b>   | <b>Percent of Total</b> |
| <b>Years Ended December 31,</b>               |                   |                         |                   |                         |                   |                         |
| <i>(Dollars in thousands)</i>                 |                   |                         |                   |                         |                   |                         |
| Noninterest-bearing deposits                  | \$ 76,832         | 23.30%                  | \$ 67,526         | 20.89%                  | \$ 61,018         | 19.66%                  |
| Interest-bearing demand deposits <sup>1</sup> | 86,489            | 26.23%                  | 82,001            | 25.37%                  | 71,315            | 22.98%                  |
| Savings                                       | 91,412            | 27.72%                  | 96,303            | 29.80%                  | 98,103            | 31.61%                  |
| Time certificates                             | 75,029            | 22.75%                  | 77,378            | 23.94%                  | 79,917            | 25.75%                  |
| <b>Total</b>                                  | <b>\$ 329,762</b> | <b>100.00%</b>          | <b>\$ 323,208</b> | <b>100.00%</b>          | <b>\$ 310,353</b> | <b>100.00%</b>          |

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

**FHLB Advances**

Advances outstanding with the FHLB totaled \$5,000,000 at year-end 2005, unchanged from 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. Interest expense on the advance approximated \$300,000 in 2005 and 2004. Mortgage-backed securities with an aggregate carrying value of \$5,310,124 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.

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



**Table of Contents**

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 December 31, 2005.

| Interest Rate Sensitivity   | Repricing Within   |                    |                     |                     | Total             |
|---|--------------------|--------------------|---------------------|---------------------|-------------------|
|   | 0 - 3<br>Months    | 4 - 12<br>Months   | One - Five<br>Years | After Five<br>Years |                   |
| <i>December 31, 2005</i><br><i>(Dollars in thousands)</i>               |                    |                    |                     |                     |                   |
| <b>Interest Rate Sensitive Assets</b>                                   |                    |                    |                     |                     |                   |
| Federal funds sold  | \$ 15,003          |                    |                     |                     | \$ 15,003         |
| Securities <sup>1</sup>   | 1,155              | \$ 6,657           | \$ 83,100           | \$ 27,507           | 118,419           |
| Loans, gross <sup>2</sup>   | 130,012            | 19,564             | 70,170              | 2,916               | 222,662           |
| Other assets  | 1,101              |                    |                     |                     | 1,101             |
| <b>Total interest rate sensitive assets</b>                             | <b>147,271</b>     | <b>26,221</b>      | <b>153,270</b>      | <b>30,423</b>       | <b>357,185</b>    |
| <b>Interest Rate Sensitive Liabilities</b>                              |                    |                    |                     |                     |                   |
| Deposits <sup>3</sup>   | 196,324            | 34,855             | 17,861              | 10                  | 249,050           |
| U.S. Treasury demand note   | 1,356              |                    |                     |                     | 1,356             |
| Federal Home Loan Bank advances   |                    |                    | 5,000               |                     | 5,000             |
| <b>Total interest rate sensitive liabilities</b>                        | <b>197,680</b>     | <b>34,855</b>      | <b>22,861</b>       | <b>10</b>           | <b>255,406</b>    |
| <b>Interest rate sensitivity gap</b>                                    | <b>\$ (50,409)</b> | <b>\$ (8,634)</b>  | <b>\$ 130,409</b>   | <b>\$ 30,413</b>    | <b>\$ 101,779</b> |
| <b>Cumulative gap</b>   | <b>\$ (50,409)</b> | <b>\$ (59,043)</b> | <b>\$ 71,366</b>    | <b>\$ 101,779</b>   |                   |
| Ratio of cumulative gap to total rate sensitive assets                  | (14.11)%           | (16.53)%           | 19.98%              | 28.49%              |                   |
| Ratio of cumulative rate sensitive assets to rate sensitive liabilities | 74.50%             | 74.61%             | 127.94%             | 139.85%             |                   |
| Cumulative gap at December 31, 2004                                     | \$ (59,503)        | \$ (71,138)        | \$ 54,244           | \$ 91,758           |                   |
| Cumulative gap at December 31, 2003                                     | \$ (73,160)        | \$ (89,804)        | \$ 36,027           | \$ 82,296           |                   |

<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.

<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 (\$ in thousands) remained negative through the short-term repricing intervals at year-end 2005, totaling \$(50,409) at three months and \$(59,043) through one-year. Excluding traditionally nonvolatile NOW from the gap calculation, the cumulative gap at December 31, 2005 totaled \$32,687 at three months and \$24,053 at twelve months. Compared to 2004, the short-term gap position narrowed 17.00% at December 31, 2005. The narrowing of the short-term gap position at December 31, 2005 was primarily attributable to declines in savings and interest-bearing demand deposits. Other than seasonal variations, primarily in deposit balances, no significant changes are anticipated in the gap position during 2006. 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.

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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

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## **Table of Contents**

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 realized 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 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. At December 31, 2005, the Company's Tier 1, total capital, and Tier 1 leverage ratios totaled 19.73%, 20.98%, and 13.10%. 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 on the next page.

**Table of Contents****Capital Ratios**

| <i>December 31,</i><br><i>(Dollars in thousands)</i> | 2005             | 2004       | 2003       | 2002       | 2001       |
|--|------------------|------------|------------|------------|------------|
| <b>Tier 1 capital:</b>                               |                  |            |            |            |            |
| Realized shareholders' equity                        | \$ 50,089        | \$ 48,881  | \$ 46,599  | \$ 45,193  | \$ 44,656  |
| Intangible assets and other adjustments              | (565)            | (623)      | (703)      | (853)      | (905)      |
| <b>Total Tier 1 capital</b>                          | <b>49,524</b>    | 48,258     | 45,896     | 44,340     | 43,751     |
| <b>Tier 2 capital:</b>                               |                  |            |            |            |            |
| Portion of allowance for loan losses                 | 3,152            | 3,201      | 3,020      | 2,681      | 2,342      |
| Allowable long-term debt                             |                  |            |            |            |            |
| <b>Total Tier 2 capital</b>                          | <b>3,152</b>     | 3,201      | 3,020      | 2,681      | 2,342      |
| <b>Total risk-based capital</b>                      | <b>\$ 52,676</b> | \$ 51,459  | \$ 48,916  | \$ 47,021  | \$ 46,093  |
| Risk-weighted assets                                 | \$ 251,024       | \$ 255,110 | \$ 240,749 | \$ 213,596 | \$ 186,565 |
| <b>Risk-based ratios:</b>                            |                  |            |            |            |            |
| Tier 1 capital                                       | 19.73%           | 18.92%     | 19.06%     | 20.76%     | 23.45%     |
| <b>Total risk-based capital</b>                      | <b>20.98%</b>    | 20.17%     | 20.32%     | 22.01%     | 24.71%     |
| Tier 1 leverage ratio                                | 13.10%           | 12.34%     | 12.56%     | 12.14%     | 12.32%     |
| Realized shareholders' equity to assets              | 12.86%           | 12.21%     | 12.49%     | 12.06%     | 12.60%     |

Book value per share grew 4.67% or \$0.69 during 2005 to \$15.48 at year-end. Dividends declared totaled \$1.02, up a mere 2% or \$0.02 from 2004 to 2001, but up 96% or \$0.49 from 2000. The most significant factor affecting comparative results was an extraordinary dividend declared in the fourth quarters of 2005 to 2001; these dividends averaged \$0.52. Although the Company's continuing strong capital position enabled the payment of these dividends the last five years, management does not anticipate payment of extraordinary dividends on a permanent basis. For more specifics on the Company's dividend policy, refer to the subsection immediately following. Accumulated other comprehensive income, which measures net fluctuations in the fair values of investment securities, declined \$1,048,779 at year-end 2005 compared to 2004. Movement in interest rates remained a dominant factor in the fair value results. Further details on investment securities and associated fair values are contained in the Financial Condition section of this Analysis.

Under existing authorization, the Company can purchase up to \$10,000,000 in treasury stock. In 2004, the Company purchased 8,390 shares on the open market and through private transactions at an average price of \$25.68 per share, and in 2005, an additional 69,147 shares at an average price of \$28.08. Since inception in 2000, the treasury stock program has reduced the Company's outstanding stock from 3,580,797 shares to 3,235,002 shares. The maximum consideration available for additional purchases, at prices to be determined in the future, is \$3,242,927. Any acquisition of additional shares will be dictated by market conditions. In accordance with generally accepted accounting principles, no prior period amounts have been restated to reflect the treasury stock purchases.

Refer to the Financial Condition and Liquidity sections of this Analysis for details on planned capital expenditures.

**Dividend Policy**

The Parent Company is a legal entity separate and distinct from its subsidiaries, and its revenues and liquidity position depend primarily on the payment of dividends from its subsidiaries. State banking regulations limit the amount of dividends SEB may pay without prior approval of the regulatory agencies. In 2005, SEB paid \$4,912,640 in dividends to the Company. A \$2,000,000 special dividend approved by the regulators enabled the Company, in turn, to pay the extraordinary dividend described in the preceding section. Cash dividends available from SEB for payment in 2006 without similar approval approximate \$3,246,000. The Company uses regular dividends paid by SEB in order to pay quarterly dividends to its own shareholders. Management anticipates that the Company will continue to pay cash dividends on a recurring basis.



**Table of Contents****RESULTS OF OPERATIONS**

Net income totaled \$6,474,634 in 2005, up \$671,170 or 11.56% from 2004. On a per share basis, net income grew \$0.22 to \$1.97 in 2005 from \$1.75 in 2004. The return on beginning equity improved 80 basis points to 13.25% in 2005 from 12.45% in 2004. Similarly, the return on average assets totaled 1.67% in 2005 versus 1.53% in 2004. A 7.73% increase in net interest income was the overriding factor in the 2005 results. Earnings increased \$602,443 or 11.58% in 2004 compared to 2003. An \$889,681 or 5.43% increase in net interest income was the predominant factor in the 2004 results. Variations in net interest income and noninterest income/expense are further discussed in the next two subsections of this Analysis; the provision for loan losses is separately discussed within the Financial Condition section.

Selected ratios for the measurement of net income and equity are presented below:

**Return on Equity and Assets**

| <i>Years Ended December 31,<sup>1</sup></i> | <b>2005</b>   | <b>2004</b> | <b>2003</b> | <b>2002</b> | <b>2001</b> |
|---|---------------|-------------|-------------|-------------|-------------|
| Return on average assets                    | <b>1.67%</b>  | 1.53%       | 1.42%       | 1.30%       | 1.15%       |
| Return on average equity                    | <b>12.72%</b> | 11.89%      | 11.05%      | 10.37%      | 9.01%       |
| Dividend payout ratio <sup>2</sup>          | <b>51.36%</b> | 56.96%      | 63.83%      | 70.29%      | 82.71%      |
| Average equity to average assets ratio      | <b>13.10%</b> | 12.87%      | 12.90%      | 12.54%      | 12.76%      |

<sup>1</sup> These ratios exclude the effects of mark-to-market accounting for investment securities.

<sup>2</sup> Refer to the Capital Adequacy section of this Analysis for particulars on the Company's dividend policy and the 2001-2005 dividend payouts.

**Net Interest Income**

Net interest income increased \$1,335,584 or 7.73% in 2005 compared to 2004. The net interest margin approximated 5.40% in 2005 versus 5.13% in 2004; the interest rate spread, 4.94% versus 4.78%. Interest earnings on loans, federal funds sold, and other earning assets improved \$2,045,551, \$277,609, and \$13,444 from 2004 while earnings on investment securities fell 4.17% or \$230,827. Overall improvements in asset yields and, to a lesser extent, shifts in earning assets precipitated the 2005 results. On average, asset yields totaled 6.59% in 2005, up 47 basis points from 2004; see the interest differential table on page 24 for more details on changes in interest income attributable to volume and rates in 2005 versus 2004. Interest expense on deposits and other borrowed funds increased \$770,193 or 22.02% in 2005 versus 2004. Cost of funds increased 31 basis points from 2004 levels, totaling 1.65% in 2005 versus 1.34% in 2004. The jump in cost of funds resulted primarily from higher deposit rates, particularly on NOW and time deposits, in 2005 compared to 2004. Given the rising rate environment currently propelled by the Federal Reserve, management expects costs of funds and corresponding interest expense to continue increasing as deposits and other funds reprice at higher levels. Anticipated loan growth in Brunswick and other markets is expected to alleviate declines in margins and spreads. Additionally, because most of the loans in the variable portfolio are tied to prime and similar indexes, the portfolio is positioned to take advantage of rate hikes promulgated by the Federal Reserve in 2006; variable loans comprised approximately 54% of total loans at December 31, 2005. Net interest income increased \$889,681 or 5.43% in 2004 compared to 2003. Reductions in interest expense fueled the 2004 results.

The intense competition for loans and deposits continued in 2005 and shows no sign of abating. The high number of new and existing financial institutions in the Company's market areas essentially guarantees downward pressure on net interest spreads and margins as all participants struggle to amass and grow market share. Volume of assets and deposits will become even more important as margins decline. Strategies implemented by management to increase average loans outstanding emphasize competitive pricing on loan products and development of additional loan relationships, all without compromising portfolio quality. Management's strategy for deposits is to closely manage anticipated market increases and maintain a competitive position with respect to pricing and products. Comparative details about average balances, income/expense, and average yields earned and rates paid on interest-earning assets and liabilities for the last three years are provided in the table on the next page.



**Table of Contents**

| <b>Average Balances<sup>6</sup></b>                                 | <b>Average</b>    | <b>2005</b>      | <b>Yields/</b> | <b>Average</b>    | <b>2004</b>      | <b>Yields/</b> | <b>Average</b>    | <b>2003</b>      | <b>Yields/</b> |
|---|-------------------|------------------|----------------|-------------------|------------------|----------------|-------------------|------------------|----------------|
| <i>Years Ended December 31,</i>                                     | <b>Balances</b>   | <b>Income/</b>   | <b>Rates</b>   | <b>Balances</b>   | <b>Expense</b>   | <b>Rates</b>   | <b>Balances</b>   | <b>Expense</b>   | <b>Rates</b>   |
| <i>(Dollars in thousands)</i>                                       |                   | <b>Expense</b>   |                |                   |                  |                |                   |                  |                |
| <b>Assets</b>   |                   |                  |                |                   |                  |                |                   |                  |                |
| Cash and due from banks   | \$ 19,316         |                  |                | \$ 17,806         |                  |                | \$ 15,256         |                  |                |
| Interest-earning assets:  |                   |                  |                |                   |                  |                |                   |                  |                |
| Loans, net <sup>1,2,4</sup>   | 218,211           | \$ 17,158        | 7.86%          | 210,477           | \$ 15,048        | 7.15%          | 187,789           | \$ 14,653        | 7.80%          |
| Federal funds sold  | 14,710            | 424              | 2.88%          | 10,947            | 147              | 1.34%          | 10,483            | 116              | 1.11%          |
| Taxable investment securities <sup>3</sup>                          | 92,249            | 3,831            | 4.15%          | 95,493            | 4,016            | 4.21%          | 106,814           | 4,519            | 4.23%          |
| Tax-exempt investment securities <sup>3,4</sup>                     | 33,423            | 2,234            | 6.68%          | 34,451            | 2,310            | 6.71%          | 34,616            | 2,364            | 6.83%          |
| Other interest-earning assets                                       | 1,150             | 51               | 4.43%          | 1,005             | 38               | 3.78%          | 1,035             | 42               | 4.06%          |
| <b>Total interest-earning assets</b>                                | <b>359,743</b>    | <b>23,698</b>    | <b>6.59%</b>   | <b>352,373</b>    | <b>21,559</b>    | <b>6.12%</b>   | <b>340,737</b>    | <b>21,694</b>    | <b>6.37%</b>   |
| Allowance for loan losses   | (4,228)           |                  |                | (4,017)           |                  |                | (3,700)           |                  |                |
| Premises and equipment, net   | 9,086             |                  |                | 8,969             |                  |                | 8,513             |                  |                |
| Intangible and other assets   | 4,696             |                  |                | 4,083             |                  |                | 3,996             |                  |                |
| Unrealized (losses) gains on investment securities                  | (97)              |                  |                | 1,197             |                  |                | 2,615             |                  |                |
| <b>Total Assets</b>   | <b>\$ 388,516</b> |                  |                | <b>\$ 380,411</b> |                  |                | <b>\$ 367,417</b> |                  |                |
| <b>Liabilities and Shareholders Equity</b>                          |                   |                  |                |                   |                  |                |                   |                  |                |
| Noninterest-bearing deposits  | \$ 76,832         |                  |                | \$ 67,526         |                  |                | \$ 61,018         |                  |                |
| Interest-bearing liabilities:                                       |                   |                  |                |                   |                  |                |                   |                  |                |
| Interest-bearing demand deposits <sup>5</sup>                       | 86,489            | \$ 1,251         | 1.45%          | 82,001            | \$ 789           | 0.96%          | 71,315            | \$ 874           | 1.23%          |
| Savings   | 91,412            | 825              | 0.90%          | 96,303            | 857              | 0.89%          | 98,103            | 1,195            | 1.22%          |
| Time deposits   | 75,029            | 1,868            | 2.49%          | 77,378            | 1,542            | 1.99%          | 79,917            | 2,082            | 2.61%          |
| Federal funds purchased   | 187               | 8                | 4.01%          | 99                | 2                | 2.12%          | 327               | 5                | 1.53%          |
| U.S. Treasury demand note   | 560               | 17               | 2.96%          | 632               | 8                | 1.22%          | 787               | 8                | 0.96%          |
| Federal Home Loan Bank advances                                     | 5,000             | 300              | 6.00%          | 5,000             | 300              | 6.00%          | 5,000             | 300              | 6.00%          |
| <b>Total interest-bearing liabilities</b>                           | <b>258,677</b>    | <b>4,269</b>     | <b>1.65%</b>   | <b>261,413</b>    | <b>3,498</b>     | <b>1.34%</b>   | <b>255,449</b>    | <b>4,464</b>     | <b>1.75%</b>   |
| Other liabilities   | 2,156             |                  |                | 1,882             |                  |                | 2,160             |                  |                |
| Realized shareholders equity  | 50,912            |                  |                | 48,800            |                  |                | 47,064            |                  |                |
| Accumulated other comprehensive income (loss)                       | (61)              |                  |                | 790               |                  |                | 1,726             |                  |                |
| <b>Total Liabilities and Shareholders Equity</b>                    | <b>\$ 388,516</b> |                  |                | <b>\$ 380,411</b> |                  |                | <b>\$ 367,417</b> |                  |                |
| Excess of interest-earning assets over interest-bearing liabilities | \$ 101,066        |                  |                | \$ 90,960         |                  |                | \$ 85,288         |                  |                |
| <b>Interest rate spread</b>   |                   |                  | <b>4.94%</b>   |                   |                  | <b>4.78%</b>   |                   |                  | <b>4.62%</b>   |
| <b>Net interest income</b>  |                   | <b>\$ 19,429</b> |                |                   | <b>\$ 18,061</b> |                |                   | <b>\$ 17,230</b> |                |
| <b>Net interest margin</b>  |                   |                  | <b>5.40%</b>   |                   |                  | <b>5.13%</b>   |                   |                  | <b>5.06%</b>   |

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- <sup>1</sup> Average loans are shown net of unearned income. Nonperforming loans are included. Income on nonaccrual loans, if recognized, is recorded on a cash basis.
- <sup>2</sup> Interest income includes loan fees and late charges of approximately \$1,262,000, \$1,426,000, and \$1,449,000 in 2005, 2004, and 2003.
- <sup>3</sup> Securities are presented on an amortized cost basis. Investment securities with original maturities of three months or less are included, as applicable.
- <sup>4</sup> Interest income on tax-exempt loans and securities is presented on a taxable-equivalent basis, using a federal income tax rate of 34%. The taxable-equivalent amounts included in the above table aggregated approximately \$819,000, \$786,000, and \$845,000 in 2005, 2004, and 2003. No adjustments have been made for any state tax benefits or the nondeductible portion of interest expense.
- <sup>5</sup> Now and money market accounts.
- <sup>6</sup> Averages presented generally represent average daily balances.

**Table of Contents****Analysis of Changes in Net Interest Income**

The average balance table on the previous page provides detailed information about average balances, income/expense, and average yields earned and rates paid on interest-earning assets and interest-bearing liabilities for each of the last three years. The table below summarizes the changes in interest income and interest expense attributable to volume and rates in 2005 and 2004.

| Interest Differential <sup>1</sup>            | 2005 Compared to 2004      |               |                 | 2004 Compared to 2003      |                 |               |
|---|----------------------------|---------------|-----------------|----------------------------|-----------------|---------------|
|   | Increase (Decrease) Due to |               |                 | Increase (Decrease) Due to |                 |               |
| Years Ended December 31,<br>(In thousands)    | Volume                     | Rate          | Net             | Volume                     | Rate            | Net           |
| <b>Interest income</b>                        |                            |               |                 |                            |                 |               |
| Loans <sup>2,3</sup>                          | \$ 568                     | \$ 1,542      | \$ 2,110        | \$ 1,709                   | \$ (1,314)      | \$ 395        |
| Federal funds sold                            | 64                         | 213           | 277             | 6                          | 25              | 31            |
| Taxable investment securities                 | (135)                      | (50)          | (185)           | (479)                      | (24)            | (503)         |
| Tax-exempt investment securities <sup>3</sup> | (69)                       | (7)           | (76)            | (11)                       | (43)            | (54)          |
| Other interest-earning assets                 | 6                          | 7             | 13              | (1)                        | (3)             | (4)           |
| <b>Total interest income</b>                  | <b>434</b>                 | <b>1,705</b>  | <b>2,139</b>    | <b>1,224</b>               | <b>(1,359)</b>  | <b>(135)</b>  |
| <b>Interest expense</b>                       |                            |               |                 |                            |                 |               |
| Interest-bearing demand deposits <sup>4</sup> | 45                         | 417           | 462             | 113                        | (198)           | (85)          |
| Savings                                       | (44)                       | 12            | (32)            | (16)                       | (322)           | (338)         |
| Time deposits                                 | (48)                       | 374           | 326             | (52)                       | (488)           | (540)         |
| Federal funds purchased <sup>5</sup>          | 3                          | 3             | 6               | (3)                        |                 | (3)           |
| U.S. Treasury demand note                     | (1)                        | 10            | 9               | (2)                        | 2               |               |
| Federal Home Loan Bank advances               |                            |               |                 |                            |                 |               |
| <b>Total interest expense</b>                 | <b>(45)</b>                | <b>816</b>    | <b>771</b>      | <b>40</b>                  | <b>(1,006)</b>  | <b>(966)</b>  |
| <b>Net change in net interest income</b>      | <b>\$ 479</b>              | <b>\$ 889</b> | <b>\$ 1,368</b> | <b>\$ 1,184</b>            | <b>\$ (353)</b> | <b>\$ 831</b> |

<sup>1</sup> Changes in net interest income are attributed to either changes in average balances (volume change) or changes in average rates (rate change) for earning assets and sources of funds on which interest is received or paid. Volume change is calculated as change in volume times the previous rate while rate change is change in rate times the previous volume. The rate/volume change, change in rate times change in volume, is allocated between volume change and rate change at the ratio each component bears to the absolute value of their total.

<sup>2</sup> Includes loan fees. See the average balances table on the previous page for more details.

<sup>3</sup> Interest income on tax-exempt loans and securities is presented on a taxable-equivalent basis, using a federal income tax rate of 34%. No adjustments have been made for any state tax benefits or the nondeductible portion of interest expense.

<sup>4</sup> Now and money market accounts.

<sup>5</sup> The entire change in net interest income attributable to the Company's initial borrowings under these credit facilities has been allocated to the change in volume. Similarly, when these facilities are unutilized in subsequent years, the change in net interest income is allocated to the change in volume.

**Noninterest Income and Expense**

Noninterest income declined \$331,431 or 8.58% in 2005 compared to 2004. A \$200,844 decline in net gains/losses on investment securities and a \$172,018 drop in service charges on deposit accounts were the major factors in the 2005 results. As discussed in the Financial Condition section of this Analysis, the Company recognized a \$76,750 net loss on the sale of securities in 2005 versus a \$124,094 net gain in 2004. Securities were sold during 2005 to improve the overall yield of the portfolio and in 2004, to capitalize on then-favorable market conditions. The service charge decline was attributable approximately 50-50 to reduced volume of NSF fees and recurring charges on noninterest-bearing deposits, including club accounts. The other operating portion of noninterest income grew \$41,431 in 2005 compared to 2004; mortgage origination fees led the 3.40% improvement. By type and amount, the chief components of other operating income in 2005 were mortgage origination fees, \$497,348; commissions on the sale of credit life insurance, \$105,062; surcharge fees - ATM, \$157,728; income on sale of check

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products, \$152,083; and safe deposit box rentals, \$73,327. Together, these five income items comprised 78.31% of other operating income in 2005. In 2004, these same five income components comprised 77.02% of other operating income. Overall, noninterest expense increased \$464,468 or 3.87% in 2005. Personnel costs accounted for virtually

## **Table of Contents**

the entire increase. The 2005 increase ensued largely from additional staff in various administrative and other managerial positions. The vast majority, or 84%, of employee expenses remained concentrated in salaries and other direct compensation, including related payroll taxes, in 2005. Profit-sharing accruals and other fringe benefits constituted the remaining 6% and 10% of employee expenses. The division of employee expenses between compensation, profit-sharing, and other fringe benefits remained consistent with historical norms in 2005. Net occupancy and equipment expense declined 3.22% or \$82,208 in 2005 after increasing 4.42% in 2004. The variation both years resulted largely from costs associated with technology programs. The 2005 decline was specifically attributable to reductions in amortization and other overhead on check imaging and similar programs; this reduction was partially offset by operational costs associated with the Company's new branch facility in Brunswick, Georgia, operational since November 2004. Other operating expenses fell \$135,777 or 5.29% in 2005 and 4.00% in 2004. Declines in legal and other professional expenses was the key element in the 2005 - 2004 fluctuation. Refer to Note 17 of the consolidated financial statements for more details on noninterest income and expense.

## **CRITICAL ACCOUNTING POLICIES**

Following is a description of the accounting policies applied by the Company that are deemed critical. Critical accounting policies are defined as policies that are crucial to the presentation of the Company's financial condition and results of operations and that require management's most difficult, subjective, or complex judgments. Financial results could vary significantly if different judgments or estimates are applied in the application of these policies.

### **Allowance for Loan Losses**

The allowance for loan losses represents management's estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged-off, net of recoveries. The allowance for loan losses is determined based on management's assessment of several factors: reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on segments of the loan portfolio, historical loan loss experiences, and the level of classified and nonperforming loans.

Loans are considered impaired if, based on current information and events, it is probable the Company will be unable to collect scheduled payments of principal and interest according to the contractual terms of the loan. The measurement of impaired loans is based on either the fair value of the underlying collateral, the present value of the future cash flows discounted at the historical effective interest rate stipulated in the loan agreement, or the estimated market value of the loan. In measuring the fair value of the collateral, management uses assumptions (e.g. discount rate) and methodologies (e.g. comparison to the recent selling price of similar assets) consistent with those that would be utilized by unrelated third parties.

Changes in the financial condition of individual borrowers, economic conditions, historical loan loss experience, or the condition of the various markets in which collateral may be sold may affect the required level of the allowance for loan losses. Should cash flow assumptions or market conditions change, a different amount may be reported for the allowance and associated provision for loan losses. See the Financial Condition section of this Analysis for further details on the allowance for loan losses.

### **Income Taxes**

The preparation of financial statements requires management to estimate its income taxes in each of the jurisdictions in which it operates. This process involves estimating actual current tax exposure and assessing temporary differences resulting from differing treatment of certain items, such as the provision for loan losses, for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities that are included in the consolidated balance sheet.

## **Table of Contents**

The Company must assess the likelihood that deferred tax assets will not be recovered from future taxable income, and to the extent recovery is deemed unlikely, establish a valuation allowance. Significant managerial judgment is necessarily required in determining the provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recorded against net deferred tax assets. To the extent a valuation allowance is established or adjusted in a particular period, an expense must be included within the tax provision in the statement of income. See Note 11 to the consolidated financial statements for additional details on income taxes.

### **Estimates of Fair Value**

The estimation of fair value is significant to a number of the Company's assets, including, but not limited to, investment securities, other real estate, other repossessed assets, as well as intangibles and other long-lived assets. These assets are all recorded at either fair value or at the lower of cost or fair value. Fair values are volatile and may be influenced by a number of factors. Circumstances that could cause estimates of fair values of certain assets and liabilities to change include modifications in prepayment speeds, discount rates, or other market interest rates.

Fair values for most investment securities are based on quoted market prices. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments. The fair values of other real estate are typically determined based on appraisals by third parties, less estimated costs to sell.

Estimates of fair value are also required in performing impairment analyses of goodwill and other intangible assets. The Company reviews intangible assets for impairment at least annually and whenever events or circumstances indicate the carrying value of the assets may not be recoverable. An impairment would be recognized if the carrying value of the asset exceeds its fair value.

Other long-lived assets, including fixed assets, are evaluated regularly for other than temporary impairment. Factors that could trigger impairment include significant underperformance relative to historical or projected future operating results, changes in the use of the acquired assets, and negative industry or economic trends. The review of factors present and the resulting appropriate carrying value of other long-lived assets are subject to managerial judgments and estimates. Future events could cause the Company to conclude that an asset is impaired and a write-down would be appropriate.

### **RECENT ACCOUNTING DEVELOPMENTS**

The provisions of recent pronouncements and the related impact on the Company's consolidated financial statements, if any, are discussed in the Recent Accounting Standards section of Note 1.

Various other accounting proposals affecting the banking industry are pending with the Financial Accounting Standards Board. Given the inherent uncertainty of the proposal process, the Company cannot assess the impact of any such proposals on its financial condition or results of operations.

### **CORPORATE GOVERNANCE**

Pursuant to The Sarbanes-Oxley Act of 2002 (the Act), the Chief Executive Officer (the CEO) and Chief Financial Officer (the treasurer), or persons acting in those capacities, are required to certify the Company's financial statements. The legislation also requires public companies to report certain off-balance sheet transactions, as well as present any pro-forma disclosures in a straightforward manner. The new legislation also accelerates the required reporting of insider stock transactions, which now generally must be reported by the end of the second business day following a covered transaction; requires that annual reports filed with the SEC include a statement by management asserting that it is responsible for creating and maintaining adequate internal controls and assessing the effectiveness of those controls; and requires companies to disclose whether they have adopted an ethics code for senior financial officers, and if not, why not, and whether the audit committee includes at least one audit committee financial expert. The Company believes that it has complied with each of the foregoing requirements except the last.

## **Table of Contents**

Although the audit committee includes directors presiding over their own businesses and actively engaged in financial matters, the Company does not believe that any of its current committee members qualify as a financial expert; however, a local certified public accountant well versed in financial matters serves on the audit committee of the Bank, and because all committee meetings are joint and the Bank is the predominant asset of the Company, the Company believes that it complies with the spirit of the Act.

The Code of Ethical Conduct for Senior Financial Officers (the Code) adopted by the Company applies to the Company's treasurer as well as other financial officers. The Company's CEO has executed an affirmation whereby he has agreed to abide by all provisions and requirements stated in the Code. A full text of the Code is available without charge upon written request to Southeastern Banking Corporation, Attention: Corporate Secretary, P.O. Box 455, 1010 Northway, Darien, Georgia 31305.

## **FORWARD-LOOKING STATEMENTS**

The Private Securities Litigation Reform Act of 1995 (the Act) provides a safe harbor for forward-looking statements made by or on behalf of the Company. The Company and its representatives have made, and may continue to make, various written or oral forward-looking statements with respect to business and financial matters, including statements contained in this report, filings with the Securities and Exchange Commission, and press releases. Generally, the words believe, expect, intend, estimate, anticipate, project, will, should, and similar identify forward-looking statements. All statements which address operating performance, events or developments that we expect or anticipate will occur in the future, including statements related to loan growth, deposit growth, per share growth, and statements expressing general sentiment about future operating results and non-historical information, are forward-looking statements within the meaning of the Act. The forward-looking statements are and will be based on management's then current views and assumptions regarding future events and operating performance. The Company undertakes no obligation to publicly update or revise any forward-looking statements in light of new information or future events.

Forward-looking statements involve inherent risks and uncertainties. Certain factors that could cause actual results to differ materially from estimates contained in or underlying forward-looking statements include:

Competitive pressures between depository and other financial institutions may increase significantly.

Changes in the interest rate environment may reduce margins and impact funding sources.

General economic or business conditions in the geographic regions and industry in which the Company operates may lead to a deterioration in credit quality or a reduced demand for credit.

Legislative or regulatory changes, including changes in accounting standards, monetary policies, and taxation requirements, may adversely affect the Company's business.

Other factors include:

Changes in consumer spending and saving habits as well as real estate markets.

Management of costs associated with expansion of existing and development of new distribution channels, and ability to realize increased revenues from these distribution channels.

The outcome of litigation which depends on judicial interpretations of law and findings of juries.

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The effect of mergers, acquisitions, and/or dispositions and their integration into the Company.

Other risks and uncertainties as detailed from time to time in Company filings with the Securities and Exchange Commission. The foregoing list of factors is not exclusive. Many of the factors that will determine actual financial performance and values are beyond the Company's ability to predict or control. This Analysis should be read in conjunction with the consolidated financial statements and related notes.



**Table of Contents****Item 7A. Quantitative and Qualitative Disclosures about Market Risk.**

The discussion on market risk is included in the Interest Rate and Market Risk/Interest Rate Sensitivity section of Part II, Item 7.

**Item 8. Financial Statements and Supplementary Data.**

The response to this item commences on page 30. Selected Statistical Information is included within the management discussion in Part II, Item 7. Both the financial information and statistical information presented should be read in conjunction with the accompanying management discussion of Southeastern Banking Corporation and subsidiaries.

**Quarterly Results (Unaudited)**

The following tables set forth certain consolidated quarterly financial information. This information is derived from unaudited consolidated financial statements which include, in the opinion of management, all normal recurring adjustments necessary for a fair presentation. The results for any quarter are not necessarily indicative of trends or results for any future period.

**Selected Quarterly Financial Data**

| <i>2005 Quarter Ended</i>                           | December 31 | September 30 | June 30  | March 31 |
|---|-------------|--------------|----------|----------|
| <i>(Dollars in thousands except per share data)</i> |             |              |          |          |
| Interest income                                     | \$ 5,929    | \$ 5,837     | \$ 5,728 | \$ 5,385 |
| Interest expense                                    | 1,173       | 1,076        | 1,040    | 980      |
| Net interest income                                 | 4,756       | 4,761        | 4,688    | 4,405    |
| Provision for loan losses                           | 81          | 33           | 133      | 93       |
| Investment securities losses, net                   | (77)        |              |          |          |
| Income before income tax expense                    | 2,598       | 2,494        | 2,257    | 1,982    |
| Net income  | 1,832       | 1,701        | 1,563    | 1,379    |
| Basic earnings per common share                     | \$ 0.56     | \$ 0.52      | \$ 0.47  | \$ 0.42  |

**Selected Quarterly Financial Data**

| <i>2004 Quarter Ended</i>                           | December 31 | September 30 | June 30  | March 31 |
|---|-------------|--------------|----------|----------|
| <i>(Dollars in thousands except per share data)</i> |             |              |          |          |
| Interest income                                     | \$ 5,349    | \$ 5,226     | \$ 5,156 | \$ 5,042 |
| Interest expense                                    | 911         | 851          | 857      | 879      |
| Net interest income                                 | 4,438       | 4,375        | 4,229    | 4,163    |
| Provision for loan losses                           | 194         | 189          | 220      | 204      |
| Investment securities gains (losses), net           | 127         |              |          | (3)      |
| Income before income tax expense                    | 2,195       | 2,131        | 2,080    | 1,918    |
| Net income  | 1,536       | 1,479        | 1,449    | 1,339    |
| Basic earnings per common share                     | \$ 0.46     | \$ 0.45      | \$ 0.44  | \$ 0.40  |

**Table of Contents**

CERTIFIED PUBLIC ACCOUNTANTS, LLC  
**REPORT OF INDEPENDENT REGISTERED**

**PUBLIC ACCOUNTING FIRM**

**To the Board of Directors**

**Southeastern Banking Corporation**

**Darien, Georgia**

We have audited the consolidated balance sheets of **Southeastern Banking Corporation and Subsidiary** as of December 31, 2005 and 2004, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southeastern Banking Corporation and Subsidiary, as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

/s/ Mauldin & Jenkins, LLC

Albany, Georgia

March 10, 2006

**Table of Contents****Item 7A. Quantitative and Qualitative Disclosures about Market Risk.**

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**Quarterly Results (Unaudited)**

The following tables set forth certain consolidated quarterly financial information. This information is derived from unaudited consolidated financial statements which include, in the opinion of management, all normal recurring adjustments necessary for a fair presentation. The results for any quarter are not necessarily indicative of trends or results for any future period.

**Selected Quarterly Financial Data**

| <i>2005 Quarter Ended</i>                           | December 31 | September 30 | June 30  | March 31 |
|---|-------------|--------------|----------|----------|
| <i>(Dollars in thousands except per share data)</i> |             |              |          |          |
| Interest income                                     | \$ 5,929    | \$ 5,837     | \$ 5,728 | \$ 5,385 |
| Interest expense                                    | 1,173       | 1,076        | 1,040    | 980      |
| Net interest income                                 | 4,756       | 4,761        | 4,688    | 4,405    |
| Provision for loan losses                           | 81          | 33           | 133      | 93       |
| Investment securities losses, net                   | (77)        |              |          |          |
| Income before income tax expense                    | 2,598       | 2,494        | 2,257    | 1,982    |
| Net income  | 1,832       | 1,701        | 1,563    | 1,379    |
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**Selected Quarterly Financial Data**

| <i>2004 Quarter Ended</i>                           | December 31 | September 30 | June 30  | March 31 |
|---|-------------|--------------|----------|----------|
| <i>(Dollars in thousands except per share data)</i> |             |              |          |          |
| Interest income                                     | \$ 5,349    | \$ 5,226     | \$ 5,156 | \$ 5,042 |
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| Net interest income                                 | 4,438       | 4,375        | 4,229    | 4,163    |
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| Investment securities gains (losses), net           | 127         |              |          | (3)      |
| Income before income tax expense                    | 2,195       | 2,131        | 2,080    | 1,918    |
| Net income  | 1,536       | 1,479        | 1,449    | 1,339    |
| Basic earnings per common share                     | \$ 0.46     | \$ 0.45      | \$ 0.44  | \$ 0.40  |

**Table of Contents****Consolidated Balance Sheets**

| <i>December 31,</i>  | <b>2005</b>           | <b>2004</b>           |
|--|-----------------------|-----------------------|
| <b>Assets</b>  |                       |                       |
| Cash and due from banks  | \$ 21,587,266         | \$ 17,923,519         |
| Federal funds sold   | 15,003,000            | 31,118,000            |
| Cash and cash equivalents  | 36,590,266            | 49,041,519            |
| <b>Investment securities</b>   |                       |                       |
| Available-for-sale, at market value  | 82,791,294            | 80,895,767            |
| Held-to-maturity (market value of approximately \$35,381,000 and \$38,769,000 at December 31, 2005 and 2004)   | 34,584,741            | 36,988,268            |
| Total investment securities  | 117,376,035           | 117,884,035           |
| Loans, gross   | 223,947,365           | 218,708,809           |
| Unearned income  | (155,731)             | (204,306)             |
| Allowance for loan losses  | (4,311,007)           | (4,134,048)           |
| Loans, net   | 219,480,627           | 214,370,455           |
| Premises and equipment, net  | 8,817,550             | 9,254,380             |
| Intangible assets  | 564,704               | 622,918               |
| Other assets   | 5,861,990             | 9,581,911             |
| <b>Total Assets</b>  | <b>\$ 388,691,172</b> | <b>\$ 400,755,218</b> |
| <b>Liabilities and Shareholders Equity</b>   |                       |                       |
| <b>Liabilities</b>   |                       |                       |
| <b>Deposits</b>  |                       |                       |
| Noninterest-bearing deposits   | \$ 79,750,623         | \$ 70,186,636         |
| Interest-bearing deposits  | 249,050,465           | 269,123,254           |
| Total deposits   | 328,801,088           | 339,309,890           |
| U.S. Treasury demand note  | 1,355,559             | 1,431,211             |
| Federal Home Loan Bank advances  | 5,000,000             | 5,000,000             |
| Other liabilities  | 4,133,625             | 5,772,356             |
| Total liabilities  | 339,290,272           | 351,513,457           |
| <b>Commitments and Contingencies (Notes 13 and 18)</b>   |                       |                       |
| <b>Shareholders Equity</b>   |                       |                       |
| Common stock (\$1.25 par value; 10,000,000 shares authorized; 3,580,797 shares issued; 3,235,002 and 3,304,149 shares outstanding at December 31, 2005 and 2004) | 4,475,996             | 4,475,996             |
| Additional paid-in capital   | 1,391,723             | 1,391,723             |
| Retained earnings  | 50,977,998            | 47,828,636            |
| Treasury stock, at cost (345,795 and 276,648 shares at December 31, 2005 and 2004)   | (6,757,073)           | (4,815,629)           |
| Realized shareholders equity   | 50,088,644            | 48,880,726            |
| Accumulated other comprehensive income (loss)  | (687,744)             | 361,035               |

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|   |                       |                |
|---|-----------------------|----------------|
| Total shareholders' equity                        | <b>49,400,900</b>     | 49,241,761     |
| <b>Total Liabilities and Shareholders' Equity</b> | <b>\$ 388,691,172</b> | \$ 400,755,218 |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Consolidated Statements of Income**

| <i>Years Ended December 31,</i>                     | <b>2005</b>         | <b>2004</b>         | <b>2003</b>         |
|---|---------------------|---------------------|---------------------|
| <b>Interest income</b>                              |                     |                     |                     |
| Loans, including fees                               | \$ 17,093,379       | \$ 15,047,828       | \$ 14,611,237       |
| Federal funds sold                                  | 424,485             | 146,876             | 115,875             |
| Investment securities                               |                     |                     |                     |
| Taxable   | 3,830,722           | 4,015,885           | 4,518,526           |
| Tax-exempt  | 1,479,049           | 1,524,713           | 1,562,345           |
| Other assets  | 51,251              | 37,807              | 41,501              |
| Total interest income                               | 22,878,886          | 20,773,109          | 20,849,484          |
| <b>Interest expense</b>                             |                     |                     |                     |
| Deposits  | 3,944,385           | 3,187,705           | 4,150,995           |
| Federal funds purchased                             | 7,503               | 2,102               | 5,859               |
| U.S. Treasury demand note                           | 16,631              | 7,697               | 7,528               |
| Federal Home Loan Bank advances                     | 300,111             | 300,933             | 300,111             |
| Total interest expense                              | 4,268,630           | 3,498,437           | 4,464,493           |
| Net interest income                                 | 18,610,256          | 17,274,672          | 16,384,991          |
| <b>Provision for loan losses</b>                    | <b>339,833</b>      | <b>807,483</b>      | <b>967,500</b>      |
| Net interest income after provision for loan losses | 18,270,423          | 16,467,189          | 15,417,491          |
| <b>Noninterest income</b>                           |                     |                     |                     |
| Service charges on deposit accounts                 | 2,347,417           | 2,519,435           | 2,653,296           |
| Investment securities (losses) gains, net           | (76,750)            | 124,094             | 12,921              |
| Other operating income                              | 1,258,525           | 1,217,094           | 1,274,596           |
| Total noninterest income                            | 3,529,192           | 3,860,623           | 3,940,813           |
| <b>Noninterest expense</b>                          |                     |                     |                     |
| Salaries and employee benefits                      | 7,563,746           | 6,881,293           | 6,838,733           |
| Occupancy and equipment, net                        | 2,473,512           | 2,555,720           | 2,447,645           |
| Other operating expense                             | 2,430,788           | 2,566,565           | 2,673,580           |
| Total noninterest expense                           | 12,468,046          | 12,003,578          | 11,959,958          |
| Income before income tax expense                    | 9,331,569           | 8,324,234           | 7,398,346           |
| <b>Income tax expense</b>                           | <b>2,856,935</b>    | <b>2,520,770</b>    | <b>2,197,325</b>    |
| <b>Net income</b>                                   | <b>\$ 6,474,634</b> | <b>\$ 5,803,464</b> | <b>\$ 5,201,021</b> |
| <b>Basic earnings per common share</b>              | <b>\$ 1.97</b>      | <b>\$ 1.75</b>      | <b>\$ 1.56</b>      |

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Weighted average common shares outstanding

**3,286,428**

3,308,807

3,329,178

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Consolidated Statements of Shareholders Equity**

|  | Additional   |              |               |                | Accumulated   | Total         |
|--|--------------|--------------|---------------|----------------|---------------|---------------|
|  | Common       | Paid-In      | Retained      | Treasury       | Other         |               |
|  |              |              |               |                | Comprehensive |               |
|  | Stock        | Capital      | Earnings      | Stock          | Income (Loss) |               |
| <b>Balance, December 31, 2002</b>                                    | \$ 4,475,996 | \$ 1,391,723 | \$ 43,449,597 | \$ (4,124,263) | \$ 2,336,117  | \$ 47,529,170 |
| Comprehensive income:  |              |              |               |                |               |               |
| Net income   |              |              | 5,201,021     |                |               | 5,201,021     |
| Other comprehensive loss, net of tax effect of \$602,412:            |              |              |               |                |               |               |
| Change in unrealized gains on available-for-sale securities          |              |              |               |                | (1,169,387)   | (1,169,387)   |
| Total comprehensive income   |              |              |               |                |               | 4,031,634     |
| Cash dividends declared (\$1.00 per share)                           |              |              | (3,319,643)   |                |               | (3,319,643)   |
| Purchase of treasury stock   |              |              |               | (475,904)      |               | (475,904)     |
| <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   |              |              | 5,803,464     |                |               | 5,803,464     |
| Other comprehensive loss, net of tax effect of \$415,055:            |              |              |               |                |               |               |
| Change in unrealized gains on available-for-sale securities          |              |              |               |                | (805,695)     | (805,695)     |
| Total comprehensive income   |              |              |               |                |               | 4,997,769     |
| Cash dividends declared (\$1.00 per share)                           |              |              | (3,305,803)   |                |               | (3,305,803)   |
| Purchase of treasury stock   |              |              |               | (215,462)      |               | (215,462)     |
| <b>Balance, December 31, 2004</b>                                    | 4,475,996    | 1,391,723    | 47,828,636    | (4,815,629)    | 361,035       | 49,241,761    |
| Comprehensive income:  |              |              |               |                |               |               |
| Net income   |              |              | 6,474,634     |                |               | 6,474,634     |
| Other comprehensive loss, net of tax effect of \$540,279:            |              |              |               |                |               |               |
| Change in unrealized gains (losses) on available-for-sale securities |              |              |               |                | (1,048,779)   | (1,048,779)   |
| Total comprehensive income   |              |              |               |                |               | 5,425,855     |
| Cash dividends declared (\$1.02 per share)                           |              |              | (3,325,272)   |                |               | (3,325,272)   |
| Purchase of treasury stock   |              |              |               | (1,941,444)    |               | (1,941,444)   |
| <b>Balance, December 31, 2005</b>                                    | \$ 4,475,996 | \$ 1,391,723 | \$ 50,977,998 | \$ (6,757,073) | \$ (687,744)  | \$ 49,400,900 |



*See accompanying notes to consolidated financial statements.*

**Table of Contents****Consolidated Statements of Cash Flows**

| <i>Years Ended December 31,</i>   | <b>2005</b>          | <b>2004</b>   | <b>2003</b>   |
|---|----------------------|---------------|---------------|
| <b>Operating activities</b>   |                      |               |               |
| Net income  | \$ 6,474,634         | \$ 5,803,464  | \$ 5,201,021  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                      |               |               |
| Provision for loan losses   | 339,833              | 807,483       | 967,500       |
| Depreciation  | 761,269              | 794,704       | 830,148       |
| Amortization and accretion, net   | 381,799              | 693,041       | 1,156,225     |
| Deferred income tax benefit   | (69,674)             | (134,139)     | (87,593)      |
| Investment securities losses (gains), net   | 76,750               | (124,094)     | (12,921)      |
| Net gains on sales of other real estate   | (94,323)             | (103,114)     | (30,077)      |
| Changes in assets and liabilities:  |                      |               |               |
| (Increase) decrease in other assets   | (286,221)            | 241,664       | 254,359       |
| Increase (decrease) in other liabilities  | 369,992              | (59,442)      | (341,557)     |
| Net cash provided by operating activities   | <b>7,954,059</b>     | 7,919,567     | 7,937,105     |
| <b>Investing activities</b>   |                      |               |               |
| Principal collections and maturities of investment securities:                    |                      |               |               |
| Available-for-sale  | 47,161,870           | 42,406,420    | 76,329,154    |
| Held-to-maturity  | 3,729,600            | 2,227,500     | 3,583,550     |
| Proceeds from sales of available-for-sale investment securities                   | 7,296,375            | 5,826,122     |               |
| Proceeds from sales of held-to-maturity investment securities                     |                      |               | 310,650       |
| Purchases of available-for-sale investment securities                             | (55,818,378)         | (38,738,847)  | (57,693,351)  |
| Purchases of held-to-maturity investment securities                               | (1,438,414)          | (1,926,441)   | (3,721,287)   |
| Net increase in loans   | (5,517,826)          | (13,516,845)  | (31,445,367)  |
| Proceeds from sales of other real estate  | 384,113              | 85,954        | 130,470       |
| Capital expenditures, net   | (324,439)            | (1,115,329)   | (1,623,018)   |
| Net cash used in investing activities   | <b>(4,527,099)</b>   | (4,751,466)   | (14,129,199)  |
| <b>Financing activities</b>   |                      |               |               |
| Net (decrease) increase in deposits   | (10,508,802)         | 22,346,398    | (884,535)     |
| Net (decrease) increase in U.S. Treasury demand note                              | (75,652)             | 697,275       | (2,294,251)   |
| Purchase of treasury stock  | (1,941,444)          | (215,462)     | (475,904)     |
| Dividends paid  | (3,352,315)          | (3,360,734)   | (3,382,825)   |
| Net cash (used in) provided by financing activities                               | <b>(15,878,213)</b>  | 19,467,477    | (7,037,515)   |
| <b>Net (decrease) increase in cash and cash equivalents</b>                       | <b>(12,451,253)</b>  | 22,635,578    | (13,229,609)  |
| <b>Cash and cash equivalents at beginning of year</b>                             | <b>49,041,519</b>    | 26,405,941    | 39,635,550    |
| <b>Cash and cash equivalents at end of year</b>                                   | <b>\$ 36,590,266</b> | \$ 49,041,519 | \$ 26,405,941 |
| <b>Supplemental disclosure</b>  |                      |               |               |
| <b>Cash paid during the year</b>  |                      |               |               |
| Interest  | \$ 4,146,341         | \$ 3,608,413  | \$ 5,062,352  |
| Income taxes  | 2,920,000            | 2,620,000     | 2,320,000     |
| <b>Noncash investing and financing activities</b>                                 |                      |               |               |
| Broker receivable for security sales  | \$ (4,373,125)       | \$ 4,373,125  | \$            |
| Broker payable for security purchases   | (1,981,680)          | 1,981,680     |               |

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|   |                |         |         |
|---|----------------|---------|---------|
| Real estate acquired through foreclosure                      | <b>318,027</b> | 494,215 | 335,400 |
| Loans made in connection with sales of foreclosed real estate | <b>224,668</b> | 307,579 | 325,150 |

*See accompanying notes to consolidated financial statements.*

## **Table of Contents**

### **Notes to Consolidated Financial Statements**

#### **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### **Nature of Operations**

Southeastern Banking Corporation (the Company) is a bank holding company whose principal activity is the ownership and management of its wholly-owned commercial bank subsidiary, Southeastern Bank (the Bank). Through its sixteen offices, the Bank provides a full range of banking services to individual, corporate, and government customers in southeast Georgia and northeast Florida. The Bank operates as one identifiable segment, that of commercial banking. The Company and its subsidiaries are headquartered in Darien, Georgia.

In February 2003, the Company opened a loan production office in Brunswick, Georgia as a division of the Bank. In November 2004, the Company opened a full service branch facility in Brunswick, Georgia, and closed its loan production office.

##### *Inactive Subsidiary*

SBC Financial Services, the Company's subsidiary which formerly offered insurance agent and investment brokerage services, is now inactive. Insurance and investment services are now being offered directly by the Bank.

##### **Basis of Presentation and Accounting Estimates**

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. Operating results of branches acquired are included from the date of acquisition. Assets and liabilities of branches acquired are stated at estimated fair values at the date of acquisition.

The preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could vary from these estimates. Material estimates that are particularly susceptible to significant change pertain to the determination of the allowance for loan losses, the valuation of other real estate, and the measurement of contingent assets and liabilities.

##### **Reclassifications**

Certain prior year amounts have been reclassified, with no effect on total assets or net income, to conform with the current year financial statement presentation.

##### **Cash, Due from Banks and Cash Flows**

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in other banks, and federal funds sold. Cash flows from loans, federal funds sold, federal funds purchased, and deposits are reported net.

The Company is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. Reserve balances totaled approximately \$10,391,000 and \$9,928,000 at December 31, 2005 and 2004.

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## **Table of Contents**

### **Notes to Consolidated Financial Statements**

#### **Investment Securities**

Debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as available-for-sale and recorded at fair value with unrealized gains and losses excluded from earnings and reported in accumulated other comprehensive income, net of any tax effect. Equity securities without readily determinable fair values are included in other assets and recorded at cost. The Company does not maintain a trading portfolio.

The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the lives of the securities. Realized gains and losses on the sale of securities, determined using the specific identification method, are included in earnings on the trade date. Other-than-temporary declines in the fair value of securities below cost are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, managements considers (1) the length of time and the extent to which fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the Company's ability to retain its investment for a period of time sufficient to allow for any fair value recovery.

#### **Loans**

Loans are reported at their principal balances outstanding, net of unearned income and the allowance for loan losses. Interest income accrued on unpaid principal balances is generally recognized on a level-yield basis. Interest accrual is discontinued when it appears that future collection of principal or interest according to contractual terms may be doubtful. The Company classifies a loan as nonaccrual with the occurrence of one of the following events: (i) interest or principal has been in default 90 days or more, unless the loan is well-collateralized and in the process of collection; (ii) collection of recorded interest or principal is not anticipated; or (iii) income for the loan is recognized on a cash basis due to deterioration in the financial condition of the borrower. Accrued interest on any loan placed on nonaccrual status is reversed. Cash receipts on nonaccrual loans are applied first to outstanding principal balances and secondly to interest. The loan is returned to accrual status only when all of the principal and interest amounts contractually due are brought current and the borrower has demonstrated the ability to make scheduled payments.

Management considers a loan to be impaired when it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan. Loans classified as nonaccrual generally meet the criteria to be considered impaired loans. The Company typically measures the impairment of a loan 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. The amount of impairment is considered in evaluating the overall adequacy of the allowance for loan losses. Personal uncollateralized loans are typically charged-off no later than 90 days past due and credit card loans no later than 120 days past due.

Accounting principles normally require loan origination fees and certain direct loan origination costs to be capitalized and recognized as an adjustment to the yields on the related loans. As the net amount of loan origination fees for the years ended December 31, 2005, 2004, and 2003 was not significant, no amounts have been capitalized or deferred.

#### **Allowance for Loan Losses**

The Company's allowance for loan losses is that amount considered adequate to absorb potential losses in the loan portfolio based on management's evaluation of the size and current risk characteristics of the portfolio. Such evaluations consider the level of problem loans and prior loan loss experience as well as the impact of current economic conditions, portfolio concentrations, and other risk factors. Specific allowances are established for impaired loans based on a comparison of the recorded carrying value of the loan to either the present value of the loan's expected cash flow, the loan's estimated market price, or the estimated fair value of the underlying collateral. General allowances are

## **Table of Contents**

### **Notes to Consolidated Financial Statements**

established for loans that can be grouped into pools based on similar characteristics. In this process, general allowance factors are based on the results of a statistical loss analysis and other analyses of recent and historical charge-off experience and are typically applied to the portfolio in terms of loan type and internal risk ratings. The general economic conditions and other risk elements are based on marketplace conditions that are impacting borrowers and could affect the collectibility of loans.

### **Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated primarily using the straight-line method over the assets' estimated useful lives. Maintenance and repairs are expensed as incurred, while improvements are capitalized.

Long-lived assets, including certain fixed assets, are evaluated regularly for other-than-temporary impairment. If circumstances suggest that the value of such assets may be impaired and a write-down would be material, an assessment of recoverability is performed prior to any write-down. Impairment, if any, is recognized through a valuation allowance with a corresponding charge recorded in the income statement. The Company did not consider any of its long-lived assets to be impaired at December 31, 2005 and 2004.

### **Other Real Estate**

Other real estate represents properties acquired through, or in lieu of, foreclosure and also includes any property owned that was formerly used as a branch facility. Other real estate is held for sale and is initially recorded at the lower of cost or fair value less estimated selling expenses. Any write-down to fair value at foreclosure is charged to the allowance for loan losses. Provisions for subsequent devaluation of other real estate are charged to operations, while costs associated with improving the property are capitalized. The carrying amount of other real estate was \$186,976 and \$408,947 at December 31, 2005 and 2004, respectively.

### **Intangible Assets**

Intangible assets comprise goodwill and core deposit intangibles. Goodwill represents the excess of purchase price over the fair value of identifiable net assets of acquired companies. Goodwill is required to be tested annually for impairment, or whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. If impaired, the excess of the carrying amount over fair value would be charged to earnings. Based on impairment tests performed, the Company determined its goodwill was not impaired as of December 31, 2005 or 2004.

Core deposit intangibles are being amortized over useful lives ranging from 10-15 years. Amortization periods are reviewed annually or more frequently as circumstances dictate.

### **Income Taxes**

The Company files consolidated income tax returns where permissible. Income tax expense (benefit) is allocated to each member of the consolidated group on the basis of their respective taxable income or loss included in the consolidated income tax return. Deferred income tax assets and liabilities result from temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years.

**Table of Contents****Notes to Consolidated Financial Statements****Earnings Per Share**

Basic earnings per share are based on the weighted average number of common shares outstanding during each period. The Company does not have any dilutive securities.

**Comprehensive Income**

Comprehensive income, which includes certain transactions and other economic events that bypass the income statements, consists of net income and unrealized gains and losses on available-for-sale securities, net of income taxes.

**Recent Accounting Standards**

In November 2002, the FASB issued Interpretation (FIN) No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. This interpretation clarifies that a guarantor is required to recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantee. The Company has identified standby letters of credit as guarantees under FIN 45 and adopted FIN 45, in entirety, effective January 1, 2003. Adoption of FIN 45 did not have a material impact on the Company's financial position or results of operations.

In December 2003, the American Institute of Certified Public Accountants issued Statement of Position (SOP) 03-3, Accounting for Loans or Certain Debt Securities Acquired in a Transfer. This statement addresses accounting for differences arising between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities acquired in a transfer, if those differences relate to credit quality. SOP 03-3 also prohibits the carryover or creation of a valuation allowance in the initial accounting for loans acquired in a transfer. The scope of SOP 03-3 includes loans acquired in purchase business combinations but not loans originated by the entity. The Company adopted SOP 03-3 effective January 1, 2004. Adoption of SOP 03-3 did not have a significant impact on the consolidated financial statements.

**2. INVESTMENT SECURITIES**

The amortized cost and estimated fair value of investment securities are summarized as follows:

|                                | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value  |
|--------------------------------|-------------------|------------------------------|-------------------------------|----------------|
| <i>December 31, 2005</i>       |                   |                              |                               |                |
| Available-for-sale:            |                   |                              |                               |                |
| U. S. Government agencies      | \$ 46,667,851     | \$                           | \$ 722,094                    | \$ 45,945,757  |
| Mortgage-backed securities     | 29,013,617        | 67,473                       | 796,323                       | 28,284,767     |
| Corporate bonds                | 8,151,862         | 436,201                      | 27,293                        | 8,560,770      |
|                                | 83,833,330        | 503,674                      | 1,545,710                     | 82,791,294     |
| Held-to-maturity:              |                   |                              |                               |                |
| State and municipal securities | 34,584,741        | 952,968                      | 156,966                       | 35,380,743     |
| Total investment securities    | \$ 118,418,071    | \$ 1,456,642                 | \$ 1,702,676                  | \$ 118,172,037 |

**Table of Contents****Notes to Consolidated Financial Statements**

|                                | Amortized      | Gross<br>Unrealized | Gross<br>Unrealized | Fair           |
|--------------------------------|----------------|---------------------|---------------------|----------------|
| <i>December 31, 2004</i>       | Cost           | Gains               | Losses              | Value          |
| <b>Available-for-sale:</b>     |                |                     |                     |                |
| U. S. Government agencies      | \$ 34,381,271  | \$ 54,159           | \$ 72,268           | \$ 34,363,161  |
| Mortgage-backed securities     | 33,940,050     | 231,174             | 304,953             | 33,866,271     |
| Corporate bonds                | 12,027,424     | 642,143             | 3,232               | 12,666,335     |
|                                | 80,348,745     | 927,476             | 380,453             | 80,895,767     |
| <b>Held-to-maturity:</b>       |                |                     |                     |                |
| State and municipal securities | 36,988,268     | 1,822,862           | 42,161              | 38,768,969     |
| Total investment securities    | \$ 117,337,013 | \$ 2,750,338        | \$ 422,614          | \$ 119,664,736 |

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2005 are shown in the table below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

|                            | Available-for-Sale |               | Held-to-Maturity  |               |
|----------------------------|--------------------|---------------|-------------------|---------------|
|                            | Amortized<br>Cost  | Fair Value    | Amortized<br>Cost | Fair<br>Value |
| <i>December 31, 2005</i>   |                    |               |                   |               |
| Due within one year        | \$ 5,743,387       | \$ 5,706,325  | \$ 1,506,797      | \$ 1,503,821  |
| Due from one to five years | 46,224,550         | 45,998,945    | 9,702,037         | 9,938,433     |
| Due from five to ten years | 2,851,776          | 2,801,257     | 14,471,108        | 14,865,667    |
| Due after ten years        |                    |               | 8,904,799         | 9,072,822     |
|                            | 54,819,713         | 54,506,527    | 34,584,741        | 35,380,743    |
| Mortgage-backed securities | 29,013,617         | 28,284,767    |                   |               |
|                            | \$ 83,833,330      | \$ 82,791,294 | \$ 34,584,741     | \$ 35,380,743 |

Securities with carrying values of \$77,387,910 and \$77,102,000 at December 31, 2005 and 2004, respectively, were pledged to secure public deposits and other funds, including advances from the Federal Home Loan Bank of Atlanta (Note 9).

Realized gains and losses on sales and other redemptions of securities comprised the following:

| <i>Years Ended December 31,</i> | 2005        | 2004       | 2003      |
|---------------------------------|-------------|------------|-----------|
| Gross gains                     | \$          | \$ 246,521 | \$ 12,921 |
| Gross losses                    | (76,750)    | (122,427)  |           |
| Net realized (losses) gains     | \$ (76,750) | \$ 124,094 | \$ 12,921 |

The tax provision applicable to these net realized (losses) gains approximated \$(30,700), \$49,600, and \$5,200 in 2005, 2004, and 2003.



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In 2003, realized gains included \$7,054 from the sale of securities held-to-maturity. The underlying securities, which had a carrying value of \$303,596, were sold due to substantial deterioration in the creditworthiness of the issuer. No securities held-to-maturity were sold in 2005 and 2004.

**Table of Contents****Notes to Consolidated Financial Statements**

Securities with unrealized losses at December 31 were as follows:

|                                       | Less than Twelve Months<br>Gross |               | Twelve Months or More<br>Gross |               |
|---------------------------------------|----------------------------------|---------------|--------------------------------|---------------|
|                                       | Unrealized<br>Losses             | Fair<br>Value | Unrealized<br>Losses           | Fair<br>Value |
| <i>December 31, 2005</i>              |                                  |               |                                |               |
| Available-for-sale:                   |                                  |               |                                |               |
| U. S. Government agencies             | \$ 450,255                       | \$ 32,381,500 | \$ 271,839                     | \$ 12,700,900 |
| Mortgage-backed securities            | 104,594                          | 7,521,831     | 691,729                        | 17,508,884    |
| Corporate bonds                       | 27,293                           | 1,107,700     |                                |               |
|                                       | 582,142                          | 41,011,031    | 963,568                        | 30,209,784    |
| Held-to-maturity:                     |                                  |               |                                |               |
| State and municipal securities        | 85,880                           | 4,004,897     | 71,086                         | 2,191,732     |
| Total temporarily impaired securities | \$ 668,022                       | \$ 45,015,928 | \$ 1,034,654                   | \$ 32,401,516 |

Market changes in interest rates will result in temporary unrealized losses as a normal fluctuation in the price of securities. Unrealized losses within the portfolio resulted primarily from increases in interest rates on securities purchased in prior years. At December 31, 2005, 121 of the Company's 288 debt securities had unrealized losses with aggregate depreciation of 2.15% from their amortized cost bases; at December 31, 2004, 68 of 293 debt securities had unrealized losses with aggregate depreciation of less than 1% from their amortized cost basis. At December 31, 2005, 51 or \$32,401,516 of the Company's debt securities had been in a continuous unrealized loss position for twelve months or more. Only 10 or 3.41% of the Company's debt securities had been in a continuous unrealized loss position for twelve months or more at December 31, 2004. Interest rate increases during 2005 rather than credit quality was the significant factor in these unrealized losses. Except for one non-rated Georgia municipal, these securities were all highly rated, investment grade securities. In analyzing non-rated municipals, management considers debt service coverage and whether the bonds support essential services such as water/sewer systems and education. The Company has determined that there were no other-than-temporary impairments associated with these securities at December 31, 2005 and 2004.

**3. LOANS**

The composition of the Company's loan portfolio is shown in the table below:

| <i>December 31,</i>                    | 2005           | 2004           |
|--|----------------|----------------|
| Commercial, financial and agricultural | \$ 86,255,524  | \$ 87,783,923  |
| Real estate - construction             | 64,549,524     | 56,470,936     |
| Real estate - residential mortgage     | 58,215,245     | 56,943,484     |
| Consumer, including credit cards       | 14,927,072     | 17,510,466     |
| Loans, gross                           | 223,947,365    | 218,708,809    |
| Unearned income                        | (155,731)      | (204,306)      |
| Allowance for loan losses              | (4,311,007)    | (4,134,048)    |
| Loans, net                             | \$ 219,480,627 | \$ 214,370,455 |

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Nonaccrual and restructured loans totaled approximately \$1,285,000 and \$1,069,000 at December 31, 2005 and 2004, respectively. Included in the allowance for loan losses was approximately \$43,000 and \$226,000 pertaining to such loans at December 31, 2005 and 2004. The gross amount of interest income that would have been recorded in 2005, 2004, and 2003, if such loans had been accruing interest at their contractual rates, was \$99,000, \$154,000, and \$168,000; interest income actually recognized totaled \$65,000, \$155,000, and \$142,000. Nonaccrual and restructured loans averaged approximately \$1,059,000, \$1,241,000, and \$1,804,000 in 2005, 2004, and 2003. Loans past due ninety days or more and still accruing interest approximated \$579,000 and \$876,000 at December 31, 2005 and 2004, respectively.

**Table of Contents****Notes to Consolidated Financial Statements**

In the normal course of business, the Bank has made loans at prevailing interest rates and terms to directors, executive officers, and principal shareholders of the Company and its subsidiaries, and to their affiliates. The aggregate dollar amount of these loans, as defined, approximated \$1,360,000 at December 31, 2005 and \$2,605,000 at December 31, 2004. During 2005, approximately \$1,891,000 of such loans were made and \$3,136,000 repaid.

**4. ALLOWANCE FOR LOAN LOSSES**

Activity in the allowance for loan losses is summarized below:

| <i>December 31,</i>        | <b>2005</b>         | <b>2004</b>  | <b>2003</b>  |
|----------------------------|---------------------|--------------|--------------|
| Balance, beginning of year | <b>\$ 4,134,048</b> | \$ 3,832,651 | \$ 3,600,833 |
| Provision for loan losses  | <b>339,833</b>      | 807,483      | 967,500      |
| Charge-offs                | <b>(415,862)</b>    | (756,804)    | (975,501)    |
| Recoveries                 | <b>252,988</b>      | 250,718      | 239,819      |
| <br>                       |                     |              |              |
| Balance, end of year       | <b>\$ 4,311,007</b> | \$ 4,134,048 | \$ 3,832,651 |

**5. PREMISES AND EQUIPMENT**

Premises and equipment are summarized as follows:

| <i>December 31,</i>                       | <b>2005</b>         | <b>2004</b>  |
|---|---------------------|--------------|
| Land                                      | <b>\$ 3,431,311</b> | \$ 3,648,278 |
| Buildings                                 | <b>8,148,077</b>    | 7,582,824    |
| Furniture and equipment                   | <b>5,989,171</b>    | 5,890,072    |
| Construction-in-progress                  | <b>43,470</b>       | 578,561      |
|   | <b>17,612,029</b>   | 17,699,735   |
| Accumulated depreciation and amortization | <b>(8,794,479)</b>  | (8,445,355)  |
| <br>                                      |                     |              |
| Premises and equipment, net               | <b>\$ 8,817,550</b> | \$ 9,254,380 |

The Company owned all its facilities and equipment at December 31, 2005 except for one branch facility, an office suite, and various ATM facilities and computer hardware that were leased short-term. Depreciation and amortization of premises and equipment totaled \$761,269, \$794,704, and \$830,148 in 2005, 2004, and 2003, respectively. Rent expense associated with operating leases on facilities and equipment approximated \$145,500, \$136,500, and \$95,000 in 2005, 2004, and 2003. The Company had no capital leases at December 31, 2005.

Construction-in-progress represents new construction and remodeling costs associated with various branch facilities. Estimated remaining construction costs at December 31, 2005 were \$1,800,000.

**6. INTANGIBLE ASSETS**

Intangible assets are tested for impairment on an annual basis or more frequently, as circumstances dictate. The Company completed its annual review as of October 1, 2005 and determined no intangible assets were impaired as of that date. A summary of information related to acquired intangible assets, including goodwill, is shown on the next page.



**Table of Contents****Notes to Consolidated Financial Statements**

|                                   | <b>Core</b>       |                    |
|-----------------------------------|-------------------|--------------------|
|                                   | <b>Deposit</b>    |                    |
|                                   | <b>Goodwill</b>   | <b>Intangibles</b> |
| Balance, December 31, 2002        | \$ 256,775        | \$ 597,459         |
| Amortization                      |                   | (151,436)          |
| Balance, December 31, 2003        | \$ 256,775        | \$ 446,023         |
| Amortization                      |                   | (79,880)           |
| Balance, December 31, 2004        | \$ 256,775        | \$ 366,143         |
| <b>Amortization</b>               |                   | <b>(58,214)</b>    |
| <b>Balance, December 31, 2005</b> | <b>\$ 256,775</b> | <b>\$ 307,929</b>  |

Estimated amortization expense for the next five years, all pertaining to core deposit intangibles, is as follows:

|              |                   |
|--------------|-------------------|
| 2006         | \$ 58,214         |
| 2007         | 58,214            |
| 2008         | 58,214            |
| 2009         | 58,214            |
| 2010         | 58,214            |
| Thereafter   | 16,859            |
| <b>Total</b> | <b>\$ 307,929</b> |

**7. INTEREST-BEARING DEPOSITS**

Interest-bearing deposits consisted of the following:

| <i>December 31,</i>                                     | <b>2005</b>           | <b>2004</b>    |
|---|-----------------------|----------------|
| Interest-bearing demand deposits (NOW and money market) | <b>\$ 93,954,129</b>  | \$ 98,352,926  |
| Savings   | <b>82,107,344</b>     | 95,413,601     |
| Time certificates under \$100,000                       | <b>46,891,068</b>     | 45,255,958     |
| Time certificates of \$100,000 or more                  | <b>26,097,924</b>     | 30,100,769     |
| <b>Total interest-bearing deposits</b>                  | <b>\$ 249,050,465</b> | \$ 269,123,254 |

Interest expense on time certificates of \$100,000 or more approximated \$758,000, \$562,000, and \$638,000 in 2005, 2004, and 2003, respectively.

Scheduled maturities of time certificates at December 31, 2005 were as follows:

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|              |                      |
|--------------|----------------------|
| 2006         | \$ 55,118,568        |
| 2007         | 11,278,037           |
| 2008         | 2,100,017            |
| 2009         | 1,996,921            |
| 2010         | 2,485,449            |
| Thereafter   | 10,000               |
| <b>Total</b> | <b>\$ 72,988,992</b> |

**Table of Contents****Notes to Consolidated Financial Statements**

The Company had brokered deposits totaling \$594,000 at both December 31, 2005 and 2004. At December 31, 2005 and 2004, deposits of one local governmental body comprised approximately \$31,527,000 and \$36,468,000 of the deposit base, respectively. Overdraft demand deposits reclassified to loans totaled \$177,753 and \$92,518 at December 31, 2005 and 2004, respectively.

**8. SHORT-TERM BORROWINGS**

Short-term borrowings at December 31 included:

| <i>December 31,</i>                | 2005                |       | 2004                |       |
|------------------------------------|---------------------|-------|---------------------|-------|
|                                    | Balance             | Rate  | Balance             | Rate  |
| U.S. Treasury demand notes         | \$ 1,355,559        | 4.02% | \$ 1,431,211        | 2.67% |
| Other                              |                     |       |                     |       |
| <b>Total short-term borrowings</b> | <b>\$ 1,355,559</b> |       | <b>\$ 1,431,211</b> |       |

At December 31, 2005, \$23,000,000 in unsecured lines of credit from non-affiliated banks was available to meet general liquidity needs. No amounts were drawn against these lines at December 31, 2005 and 2004. The average balances of short-term borrowings for the years ended December 31, 2005 and 2004 were \$747,000 and \$731,000 respectively, while the maximum amounts outstanding at any month-end during the years ended December 31, 2005 and 2004 were \$2,277,000 and \$2,186,000, respectively.

**9. OTHER BORROWINGS**

The Company has a line of credit from the Federal Home Loan Bank of Atlanta (FHLB) to meet general liquidity and other needs. Under this line, the Company can borrow, in total or increments, up to 16% of the Bank's total assets; at December 31, 2005, maximum borrowings available under this line approximated \$57,145,000. Advances outstanding with the FHLB totaled \$5,000,000 at December 31, 2005 and 2004. The outstanding advance, which matures March 17, 2010, accrues interest at an effective rate of 6.00%, payable quarterly. The \$5,000,000 advance is convertible into a three-month Libor-based floating rate anytime at the option of the FHLB. The advance was secured by mortgage-backed securities with an aggregate carrying value of \$5,310,124 at December 31, 2005.

**10. EMPLOYEE BENEFIT PLAN**

The Company maintains a profit-sharing plan which covers substantially all employees. Historically, employee contributions to the plan were not permitted. Effective January 1, 2005, the Company amended the plan to include a 401(k) component for eligible employees. Eligible employees can elect to participate in the plan through contributions of the lesser of deferral limits (\$15,000 in 2006 and \$14,000 in 2005) or 80% of their total compensation plus any allowed catch-up contribution. The Company will match the employee's contribution in an amount equal to a discretionary percentage of the employee's contribution as determined each year. Matching contributions vest to the employee when made by the Company. Any additional profit-sharing contributions are allocated to participants based on compensation and years of service; these contributions vest equally over a five-year period after the employee reaches three years of service. Total contributions expensed under this plan totaled \$450,000 in each of the last three years.



**Table of Contents****Notes to Consolidated Financial Statements****11. INCOME TAXES**

The components of income tax expense were as follows:

| <i>Years ended December 31,</i> | <b>2005</b>         | <b>2004</b>  | <b>2003</b>  |
|---------------------------------|---------------------|--------------|--------------|
| <b>Federal:</b>                 |                     |              |              |
| Current tax expense             | <b>\$ 2,649,834</b> | \$ 2,381,768 | \$ 2,022,310 |
| Deferred tax benefit            | <b>(69,674)</b>     | (134,139)    | (87,593)     |
|                                 | <b>2,580,160</b>    | 2,247,629    | 1,934,717    |
| <b>State:</b>                   |                     |              |              |
| Current tax expense             | <b>276,775</b>      | 273,141      | 262,608      |
| <b>Total income tax expense</b> | <b>\$ 2,856,935</b> | \$ 2,520,770 | \$ 2,197,325 |

The Company's income tax expense differs from the amounts computed by applying the statutory federal income tax rate of 34% to income before income taxes. A reconciliation of this difference follows:

| <i>Years ended December 31,</i>            | <b>2005</b>         | <b>2004</b>  | <b>2003</b>  |
|--|---------------------|--------------|--------------|
| Taxes at federal statutory rate            | <b>\$ 3,172,733</b> | \$ 2,830,240 | \$ 2,515,438 |
| (Decrease) increase resulting from:        |                     |              |              |
| Tax-exempt interest income, net            | <b>(516,075)</b>    | (513,764)    | (528,762)    |
| State income taxes, net of federal benefit | <b>182,672</b>      | 180,273      | 173,321      |
| Other, net                                 | <b>17,605</b>       | 24,021       | 37,328       |
| <b>Total income tax expense</b>            | <b>\$ 2,856,935</b> | \$ 2,520,770 | \$ 2,197,325 |

Temporary differences create deferred tax assets and liabilities that are detailed below:

| <i>December 31,</i>  | <b>2005</b>         | <b>2004</b> |
|--|---------------------|-------------|
| <b>Deferred tax assets (liabilities):</b>                                  |                     |             |
| Allowance for loan losses  | <b>\$ 1,109,695</b> | \$ 994,195  |
| Other real estate  | <b>6,027</b>        | 30,756      |
| Unrealized losses (gains) on available-for-sale investment securities, net | <b>354,291</b>      | (185,988)   |
| Accretion of discounts on investment securities                            | <b>(62,541)</b>     | (34,306)    |
| Other  | <b>17,255</b>       | 10,117      |
| <b>Net deferred tax asset</b>  | <b>\$ 1,424,727</b> | \$ 814,774  |

The Company has not recorded any valuation allowances for deferred tax assets.

**12. TREASURY STOCK**

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Under existing authorization, the Company can purchase up to \$10,000,000 in treasury stock. In 2004, the Company purchased 8,390 shares on the open market and through private transactions at an average price of \$25.68 per share. In 2005, the Company purchased an additional 69,147 shares at a purchase price of \$28.08. Since inception in 2000, the treasury stock program has reduced the Company's outstanding stock from 3,580,797 shares to 3,235,002 shares. The maximum consideration available for additional purchases, at prices to be determined in the future, is \$3,242,927. Any acquisition of additional shares will be dictated by market conditions. There is no expiration date for the treasury authorization.

**Table of Contents****Notes to Consolidated Financial Statements****13. COMMITMENTS AND OFF-BALANCE SHEET FINANCIAL INSTRUMENTS****Loan Commitments**

In the normal course of business, the Company originates financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit represent legally binding agreements to lend to a customer with fixed expiration dates or other termination clauses. The amount of collateral obtained is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, and property, plant and equipment. Standby letters of credit are conditional commitments issued by the Company guaranteeing the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral is obtained when deemed necessary. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. Since many commitments expire without being funded, total commitment amounts do not necessarily represent future credit exposure or liquidity requirements. The majority of all commitments are variable rate instruments. A summary of the Company's commitments follows:

| <i>December 31,</i>          | <b>2005</b>          | <b>2004</b>   |
|------------------------------|----------------------|---------------|
| Commitments to extend credit | <b>\$ 38,672,000</b> | \$ 33,618,000 |
| Standby letters of credit    | <b>1,470,000</b>     | 1,281,000     |
| <b>Total commitments</b>     | <b>\$ 40,142,000</b> | \$ 34,899,000 |

The Company did not fund or incur any losses on letters of credit in 2005 and 2004.

**Other Off-Balance Sheet Financial Instruments**

The Company does not invest in off-balance sheet derivative financial instruments such as swaps, options or forward contracts.

**14. CONCENTRATIONS OF CREDIT RISK**

Credit risk represents the maximum accounting loss that would be recognized at the reporting date if borrowers failed to perform as contracted and any collateral or security proved to be of no value. Concentrations of credit risk arising from financial instruments, whether on- or off-balance sheet, can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or market areas. Credit risk associated with these concentrations could arise when a significant amount of loans, related by similar characteristics, are simultaneously impacted by changes in economic or other conditions that cause their probability of repayment to be adversely affected. Within the investment portfolio, the Company does not have a concentration in the obligations of any issuer other than the U.S. Government and its agencies. The major concentrations of credit risk in loans and loan commitments arise by collateral type and market areas. The majority of the Company's loan portfolio is concentrated in loans collateralized by real estate. At December 31, 2005, the Company had approximately \$173,582,000 in real estate-collateralized loans, and an additional \$22,625,000 commitment to extend credit on such loans. Substantial portions of these loans are in the Company's primary market areas. In addition, a substantial portion of the Company's other real estate is located in those same markets. Accordingly, the ultimate collectibility of the Company's loan portfolio and recovery of the carrying amount of other real estate are susceptible to changes in market conditions in the Company's trade areas. The Company, as a matter of policy, generally does not extend credit to any single borrower or group of related borrowers in excess of 25% of the Bank's statutory capital.

**Table of Contents****Notes to Consolidated Financial Statements****15. REGULATORY MATTERS**

The Company is subject to various regulatory capital requirements which involve quantitative measures of the Company's assets, liabilities, and certain off-balance sheet items. The Company's capital requirements and classification are ultimately subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The Company and the Bank 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 Tier 1 capital ratio, the total capital ratio, and the Tier 1 leverage ratio must equal or exceed 6%, 10%, and 5%, respectively. The Company is committed to remaining well-capitalized. As of December 31, 2005, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. Management believes that the Company and the Bank met all applicable capital adequacy requirements as of December 31, 2005. No conditions or events have occurred since that notification that management believes would change this classification. Actual capital amounts and ratios are presented in the table below:

| <i>December 31,</i>                      | 2005          |        | 2004          |        |
|--|---------------|--------|---------------|--------|
|  | Amount        | Rate   | Amount        | Rate   |
| <b>Southeastern Banking Corporation:</b> |               |        |               |        |
| Tier 1 capital                           | \$ 49,524,000 | 19.73% | \$ 48,258,000 | 18.92% |
| Total capital                            | 52,676,000    | 20.98% | 51,459,000    | 20.17% |
| Tier 1 leverage                          | 49,524,000    | 13.10% | 48,258,000    | 12.34% |
| <b>Southeastern Bank:</b>                |               |        |               |        |
| Tier 1 capital                           | \$ 46,983,000 | 18.74% | \$ 45,346,000 | 17.79% |
| Total capital                            | 50,132,000    | 19.99% | 48,554,000    | 19.05% |
| Tier 1 leverage                          | 46,983,000    | 12.43% | 45,346,000    | 11.60% |

State banking regulations limit the amount of dividends the Bank may pay without prior approval. The amount of cash dividends available from the Bank for payment in 2006 without such prior approval is approximately \$3,246,000.

**16. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The fair value of a financial instrument is the current amount that would be exchanged between willing parties except in a forced liquidation. Fair value is best determined using quoted market prices. In cases where quoted market prices are not available, fair values are based on pricing models or other valuation techniques. Those techniques are significantly affected by the assumptions used, including discount rates and cash flow analyses. Accordingly, the fair value estimates may not be indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a material effect on estimated fair values.

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

Short-term financial instruments are valued at their carrying amounts reported in the balance sheet, which are reasonable estimates of fair value due to the relatively short period to maturity. This approach applies to cash and cash equivalents, short-term investments, short-term borrowings, and certain other assets and liabilities.

Investment securities are substantially valued at quoted market prices. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities.

**Table of Contents****Notes to Consolidated Financial Statements**

Fair values for variable-rate loans that reprice frequently and have no significant change in credit risk approximate carrying values. For other loans, fair values are based upon discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, as applicable.

Deposit liabilities with no defined maturity such as demand deposits, NOW/money market accounts, and savings accounts have a fair value equal to the amount payable on demand at the reporting date, i.e., their carrying amounts. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities. The intangible value of long-term relationships with depositors is not considered in estimating fair values.

Fair values for other borrowings are based on quoted market prices for similar instruments or estimated using the Company's current incremental borrowing rate for such instruments.

The carrying amount of accrued interest approximates its fair value.

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments:

| <i>December 31,</i>           | 2005           |                | 2004           |                |
|-------------------------------|----------------|----------------|----------------|----------------|
|                               | Carrying       | Fair           | Carrying       | Fair           |
|                               | Value          | Value          | Value          | Value          |
| <b>Financial assets:</b>      |                |                |                |                |
| Cash and cash equivalents     | \$ 36,590,266  | \$ 36,590,266  | \$ 49,041,519  | \$ 49,041,519  |
| Investment securities         | 117,376,035    | 118,172,037    | 117,884,035    | 119,664,736    |
| Loans, net                    | 219,480,627    | 217,467,319    | 214,370,455    | 212,893,646    |
| Accrued interest receivable   | 2,384,233      | 2,384,233      | 2,118,543      | 2,118,543      |
| Other financial assets        | 1,101,100      | 1,101,100      | 5,421,425      | 5,421,425      |
| <b>Financial liabilities:</b> |                |                |                |                |
| Deposits                      | \$ 328,801,088 | \$ 328,057,633 | \$ 339,309,890 | \$ 338,849,097 |
| U.S. Treasury demand note     | 1,355,559      | 1,355,559      | 1,431,211      | 1,431,211      |
| FHLB advances                 | 5,000,000      | 5,244,917      | 5,000,000      | 5,610,000      |
| Accrued interest payable      | 691,019        | 691,019        | 568,730        | 568,730        |
| Other financial liabilities   |                |                | 1,981,680      | 1,981,680      |

Because SFAS No. 107, Disclosures about Fair Value of Financial Instruments, excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements, the aggregate fair value amounts presented may not necessarily represent the underlying market value of the Company.

**17. SUPPLEMENTAL FINANCIAL DATA**

Components of other operating income and expense in excess of 1% of total revenue were as follows:

| <i>Years Ended December 31,</i> | 2005 | 2004 | 2003 |
|---------------------------------|------|------|------|
| <b>Other operating income:</b>  |      |      |      |

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|                                 |            |            |            |
|---------------------------------|------------|------------|------------|
| Mortgage origination fees       | \$ 497,348 | \$ 452,651 | \$ 529,332 |
| <b>Other operating expense:</b> |            |            |            |
| Advertising                     | \$ 243,284 | \$ 238,377 | \$ 263,834 |
| Stationery & supplies           | 268,559    | 241,508    | 223,746    |

**Table of Contents****Notes to Consolidated Financial Statements****18. CONTINGENCIES**

The Company and its subsidiaries are parties to claims and lawsuits arising in the course of their normal business activities. Although the ultimate outcome of these suits cannot be ascertained at this time, it is the opinion of management and counsel that none of these matters, when resolved, will have a material effect on the consolidated results of operations or financial position.

**19. PARENT COMPANY FINANCIAL INFORMATION**

Parent Company only financial information is presented below:

**Condensed Balance Sheets**

| <i>December 31,</i>                               | <b>2005</b>          | <b>2004</b>          |
|---|----------------------|----------------------|
| <b>Assets</b>                                     |                      |                      |
| Cash  | \$ 4,125,742         | \$ 4,498,134         |
| Investment in subsidiaries, at equity             | 46,905,367           | 46,374,697           |
| Other assets                                      | 407,842              | 434,024              |
| <b>Total Assets</b>                               | <b>\$ 51,438,951</b> | <b>\$ 51,306,855</b> |
| <b>Liabilities</b>                                |                      |                      |
| Dividends payable                                 | \$ 2,038,051         | \$ 2,065,094         |
| <b>Shareholders' Equity</b>                       |                      |                      |
| Common stock                                      | 4,475,996            | 4,475,996            |
| Additional paid-in capital                        | 1,391,723            | 1,391,723            |
| Retained earnings                                 | 50,977,998           | 47,828,636           |
| Treasury stock, at cost                           | (6,757,073)          | (4,815,629)          |
| Realized shareholders' equity                     | 50,088,644           | 48,880,726           |
| Accumulated other comprehensive income (loss)     | (687,744)            | 361,035              |
| <b>Total shareholders' equity</b>                 | <b>49,400,900</b>    | <b>49,241,761</b>    |
| <b>Total Liabilities and Shareholders' Equity</b> | <b>\$ 51,438,951</b> | <b>\$ 51,306,855</b> |

**Table of Contents****Notes to Consolidated Financial Statements****Condensed Statements of Income**

| <i>Years Ended December 31,</i>                | <b>2005</b>         | <b>2004</b>         | <b>2003</b>         |
|--|---------------------|---------------------|---------------------|
| <b>Income</b>                                  |                     |                     |                     |
| Dividends                                      | \$ 4,912,640        | \$ 4,611,000        | \$ 4,384,000        |
| Interest                                       | 28,605              | 19,785              | 20,862              |
| Equity in undistributed income of subsidiaries | 1,579,449           | 1,214,855           | 840,183             |
| <b>Total income</b>                            | <b>6,520,694</b>    | <b>5,845,640</b>    | <b>5,245,045</b>    |
| <b>Operating expenses</b>                      |                     |                     |                     |
| Occupancy and other expenses                   | 59,865              | 58,252              | 60,677              |
| Income before income tax benefit               | 6,460,829           | 5,787,388           | 5,184,368           |
| <b>Income tax benefit</b>                      | <b>(13,805)</b>     | <b>(16,076)</b>     | <b>(16,653)</b>     |
| <b>Net income</b>                              | <b>\$ 6,474,634</b> | <b>\$ 5,803,464</b> | <b>\$ 5,201,021</b> |

**Condensed Statements of Cash Flows**

| <i>Years Ended December 31,</i>   | <b>2005</b>         | <b>2004</b>         | <b>2003</b>         |
|---|---------------------|---------------------|---------------------|
| <b>Operating activities</b>   |                     |                     |                     |
| Net income  | \$ 6,474,634        | \$ 5,803,464        | \$ 5,201,021        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                     |                     |                     |
| Equity in undistributed income of subsidiaries                                    | (1,579,449)         | (1,214,855)         | (840,183)           |
| Changes in assets and liabilities:  |                     |                     |                     |
| Decrease (increase) in other assets   | 26,182              | (68,323)            | (17,685)            |
| <b>Net cash provided by operating activities</b>                                  | <b>4,921,367</b>    | <b>4,520,286</b>    | <b>4,343,153</b>    |
| <b>Financing activities</b>   |                     |                     |                     |
| Purchase of treasury stock  | (1,941,444)         | (215,462)           | (475,904)           |
| Dividends paid  | (3,352,315)         | (3,360,734)         | (3,382,825)         |
| <b>Net cash used in financing activities</b>                                      | <b>(5,293,759)</b>  | <b>(3,576,196)</b>  | <b>(3,858,729)</b>  |
| <b>Net (decrease) increase in cash and cash equivalents</b>                       | <b>(372,392)</b>    | <b>944,090</b>      | <b>484,424</b>      |
| <b>Cash and cash equivalents at beginning of year</b>                             | <b>4,498,134</b>    | <b>3,554,044</b>    | <b>3,069,620</b>    |
| <b>Cash and cash equivalents at end of year</b>                                   | <b>\$ 4,125,742</b> | <b>\$ 4,498,134</b> | <b>\$ 3,554,044</b> |



## **Table of Contents**

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures.**

None

### **Item 9A. Controls and Procedures.**

A review and evaluation was performed by the Company's management, including the Company's CEO and treasurer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) or 15(d)-15(e)) as of the end of the period covered by this report. Based on that review and evaluation, the CEO and treasurer have concluded that the Company's current disclosure controls and procedures, as designed and implemented, were effective.

### **Item 9B. Other Information.**

None

## **PART III**

### **Item 10. Directors and Executive Officers of the Registrant.**

The information required by this Item is incorporated by reference to the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held May 10, 2006 (Proxy Statement).

### **Item 11. Executive Compensation.**

The information required by this Item is incorporated by reference to the Company's Proxy Statement.

**Supplemental Disclosure/Compensation Pursuant to Plans.** The Company maintains an Employee Profit-Sharing Plan (the Plan). The purpose of the Plan is to provide employees with an opportunity to share in the profits generated by participating subsidiaries and save for retirement on a tax-deferred basis. A participating employee (the Participant) is eligible to participate once the age requirement specified in the Plan has been met. Historically, contributions by Participants were not permitted. Effective January 1, 2005, the Company amended the Plan to include a 401(k) component for eligible employees. Eligible employees can elect to participate in the Plan through contributions of the lesser of deferral limits (\$15,000 in 2006 and \$14,000 in 2005) or 80% of their total compensation plus any allowed catch-up contribution. The Company will match the employee's contribution in an amount equal to a discretionary percentage of the employee's contribution as determined each year. Matching contributions vest to the employee when made by the Company. Any additional profit-sharing contributions are allocated to participants based on compensation and years of service; these contributions normally vest equally over a five-year period after the employee reaches three years of service. Immediate vesting will apply when employment is terminated due to normal retirement at age 65 or later, disability, or death.

Contributions are placed in a trust account, and each Participant's balance is adjusted daily to reflect these contributions, income received from trust assets, and any forfeitures which become available. When employment is terminated, a Participant with a vested benefit in excess of \$1,000 may choose to receive his benefits in a lump sum or remain in the Plan. A Participant with a vested benefit of \$1,000 or less will receive a lump sum payment.

The Plan is administered by the Company. A trustee appointed by the Company has the sole responsibility to administer the trust assets. Both the Company and the trustee are considered fiduciaries of the Plan and have the corresponding duties, obligations, and responsibilities.

**Table of Contents**

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters.**

The information required by this Item is incorporated by reference to the Company's Proxy Statement.

**Item 13. Certain Relationships and Related Transactions.**

The information required by this Item is incorporated by reference to the Company's Proxy Statement.

**Item 14. Principal Accountant Fees and Services.**

The information required by this Item is incorporated by reference to the Company's Proxy Statement.

**Table of Contents**

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

- (a) 1. and 2. - Financial Statements and Schedules

**Index to Financial Statements & Schedules**

**Page Number in  
Annual Report**

**Audited Financial Statements**

Independent auditors' report

Consolidated balance sheets at December 31, 2005 and 2004

**32**

Consolidated statements of income for each of the three years in the period ended December 31, 2005

**33**

Consolidated statements of shareholders' equity for each of the three years in the period ended December 31, 2005

**34**

Consolidated statements of cash flows for each of the three years in the period ended December 31, 2005

**35**

Notes to consolidated financial statements

**36**

- (b) Reports on Form 8-K:

None

- (c) Index to Exhibits:

- Exhibit 3 Articles of Incorporation and By-Laws, incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 1990.
- Exhibit 10 Employment Contract of R. Lanier Miles, incorporated by reference to Exhibit 10 of the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003.
- Exhibit 21 Subsidiaries of the Company
- Exhibit 22 Registrant's Proxy Statement relating to the 2006 Annual Meeting of Shareholders, which will be filed in April 2006.
- Exhibit 31.1 CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 31.2 Treasurer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32 CEO/Treasurer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**Table of Contents**

**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**SOUTHEASTERN BANKING CORPORATION**  
*(Registrant)*

By: /s/ ALYSON G. BEASLEY  
**Alyson G. Beasley, Vice President & Treasurer**

Date: March 30, 2006

**Table of Contents**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <b>Directors</b>  | <b>Date</b>    |
|---|----------------|
| /s/ ALYSON G. BEASLEY<br><br><b>Alyson G. Beasley</b>                 | March 30, 2006 |
| /s/ LESLIE H. BLAIR<br><br><b>Leslie H. Blair</b>                     | March 30, 2006 |
| /s/ DAVID H. BLUESTEIN<br><br><b>David H. Bluestein</b>               | March 30, 2006 |
| /s/ CORNELIUS P. HOLLAND, III<br><br><b>Cornelius P. Holland, III</b> | March 30, 2006 |
| /s/ ALVA J. HOPKINS, III<br><br><b>Alva J. Hopkins, III</b>           | March 30, 2006 |
| /s/ G. NORRIS JOHNSON<br><br><b>G. Norris Johnson</b>                 | March 30, 2006 |
| /s/ A. W. STRICKLAND<br><br><b>A. W. Strickland</b>                   | March 30, 2006 |