SOUTHEASTERN BANKING CORP
Form 10-K
April 23, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2009

Commission File Number 000-32627

(Exact name of registrant as specified in its charter)

Georgia (State or other jurisdiction of incorporation or organization)	58-1423423 (IRS Employer Identification No.)

P. O. Box 455, 1010 North Way, 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

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

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 [X]

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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§232.405 of this chapter) 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, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ] Accelerated filer [ ]

Non-accelerated filer [ ] (Do not check if a smaller reporting company.) Smaller reporting company [X]

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

The aggregate market value of common stock held by non-affiliates on June 30, 2009 was approximately $25,332,000 (based on a per share price of $12.25 on over-the-counter trades executed by principal market-makers). For purposes of this calculation, the Registrant has assumed that its directors, principal shareholders, and executive officers are affiliates.

As of April 15, 2010, the Registrant had 3,129,388 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 are incorporated by reference into Part IV, Item 15.

The Registrant s Specimen Common Stock Certificate filed on April 30, 2001 on Form 8-A is incorporated by reference into Part IV, Item 15.

Portions of the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 are incorporated by reference into Part IV, Item 15.

Portions of the Registrant s definitive Proxy Statement for the 2010 Annual Meeting of Shareholders, which will be filed no later than April 30, 2010, are incorporated by reference into Part III, Items 10 - 14.

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PART I

Item 1. Business.

1. General. Southeastern Banking Corporation (the Company) and its wholly-owned subsidiary, Southeastern Bank (SEB or the Bank), offer a broad range of banking services to meet the financial needs of consumer and commercial customers in southeast Georgia and northeast Florida. The Company s corporate offices are located at 1010 North Way, 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. From 1983 - 1988, the Company acquired three additional financial institutions in the southeast Georgia market, which were converted to branches of SEB. 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. From 1991 2001, the Company acquired banking offices from other financial institutions, which were either consolidated with existing SEB offices or operated as stand-alone facilities. Six stand-alone facilities were acquired in this manner, most recently Richmond Hill. In February 2003, the Company opened a loan production office in Brunswick, Georgia. In November 2004, a full service banking facility was opened at 15 Trade Street in Brunswick, and the loan production office closed. In January 2007, the Company opened a new branch at 601 Palisade Drive in the Southport area of Brunswick. SEB is a state banking association incorporated under the laws of the State of Georgia.

Unless the context indicates otherwise, all references to the Company in this Report refer to Southeastern Banking Corporation and its consolidated bank subsidiary.

2. Markets. SEB, the Company s commercial bank subsidiary, offers traditional banking products and services to commercial and individual customers in its markets. The Bank s product line includes loans to small- and medium-sized businesses, residential and commercial construction and development loans, commercial real estate loans, agricultural production loans, long-term mortgage originations, home equity loans, consumer loans, and a variety of commercial and consumer demand, savings, and time deposit products. SEB also offers internet banking, on-line cash management, electronic bill payment services, safe deposit box rentals, telephone banking, credit and debit card services, and access to a network of ATMs. In addition, through an affiliation with a third party broker-dealer, SEB also provides securities brokerage and investment advisory services. SEB s banking facilities are predominantly located in rural communities on or near the Atlantic coast with populations less than 50,000. The Company operates these seventeen full-service banking offices within one business segment, community banking. At December 31, 2009, SEB s total assets approximated $420,000,000.

The following table provides basic information and summary demographic data on the Company s markets. Further discussion regarding local real estate market conditions is provided in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of this Report. A list of SEB offices is provided in Part I, Item 2.

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Market/ County *(Dollars in thousands)*	Number of Offices	Total Deposits[1]	Market Share[2]	Population[3]	Population Growth[4]	Employment Growth[5]	Unemployment Rate[6]
Florida:							
Nassau	3	$ 59,879	6.81%	70,576	22.4%	(4.8)%	11.3%
State of Florida					16.0	(4.0)	11.6
Georgia:							
McIntosh	2	$ 54,192	68.38%	11,378	4.9%	(3.6)%	9.7%
Brantley	2	55,271	68.29	15,643	6.9	(3.6)	10.9
Bryan	1	6,654	1.92	32,559	39.0	(3.7)	8.0
Camden	3	56,882	10.04	48,277	10.6	(4.0)	9.2
Charlton	1	58,270	56.44	10,725	4.3	(5.3)	10.7
Coffee	2	20,390	3.08	40,868	9.2	(10.4)	16.9
Glynn	2	16,787	0.69	76,820	13.7	(3.6)	8.4
Jeff Davis	1	23,446	14.14	13,659	7.7	(5.8)	14.4
	14	$ 291,892					
	17	$ 351,771					
State of Georgia					20.1%	(5.4)%	10.0%
National Total					9.1%	(3.6)%	9.7%

[1]Dollar amounts at December 31, 2009.

[2]Based on the FDIC Summary of Deposits market share report as of June 30, 2009.

[3]Estimated July 1, 2009 population provided by the U.S. Census Bureau.

[4]Estimated percentage population change from 2000 2009 provided by the U.S. Census Bureau.

[5]Percentage change in employment growth (not seasonally adjusted) for the period December 2008 December 2009 based on preliminary figures from the Bureau of Labor

Statistics.

[6]Unemployment rate (not seasonally adjusted) as of December 2009 provided by the Bureau of Labor Statistics.

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.

3. Competition. The Company operates in a highly competitive industry that could become even more competitive as a result of legislative, regulatory, economic, and technological changes, as well as continued consolidation. In its markets, the Company faces direct competition from both larger regional banks and smaller community banks, thrifts, and credit unions in attracting and retaining commercial and consumer accounts. Competition is amplified in some smaller markets as more financial service providers compete for fewer customers. The Company also faces increasingly aggressive competition from other domestic lending institutions and 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. Securities firms and insurance companies that elect to become financial holding companies may acquire banks and other financial institutions, potentially changing the competitive environment in which the Company conducts its business significantly. Certain of the Company s competitors have greater financial resources or face fewer regulatory constraints.

As a result of these various sources of competition, the Company could lose business to competitors or be forced to price products and services on less advantageous terms to retain or attract customers, either of which would adversely affect the Company s profitability. Key factors in competing for customer accounts include interest rates, fee structures, range of products and services offered, convenience of office and ATM locations, and technological innovations.

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Although competition is fierce and ever-changing, the Company believes that its experience and strong community ties result in a higher level of service to small and medium-sized businesses and consumers. By being smaller and less bureaucratic than regional and national competitors, the Company can oftentimes operate with greater flexibility and provide more timely responses in meeting customer needs.

The Company s ability to expand remains subject to various federal and state laws and other regulatory restrictions that may exist now or in the future. See Government Supervision and Regulation below for a more detailed discussion of these laws and restrictions.

4. Government 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), with branches in Georgia and Florida, 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 s financial position and results of operation are 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. Techniques used by the Federal Reserve include setting reserve requirements of financial institutions and establishing rates on borrowings.

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 bank holding company may not directly or indirectly acquire ownership or control of more than 5% of the voting shares or substantially all of the assets of any bank or merge or consolidate with another bank holding company without prior approval of the Federal Reserve.

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, Federal Reserve policy requires a bank holding company to serve as a source of financial strength to, and commit resources to support, its bank subsidiaries 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 largely 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 Federal Reserve and the FDIC have issued substantially similar risk-based and leverage capital guidelines applicable to United States banking organizations. In addition, these regulatory agencies may from time to time require that a banking organization maintain capital above the minimum levels, whether because of its financial condition or actual or anticipated growth. The Federal Reserve risk-based guidelines define a tier-based capital framework. Tier 1 capital includes common shareholders equity, minority interests, and qualifying preferred stock, less goodwill and other adjustments, as applicable. Tier 2 capital consists of preferred stock not qualifying as Tier 1 capital, mandatory convertible debt, limited amounts of subordinated debt, other qualifying term debt, the allowance for loan losses up to a certain amount, and a portion of any unrealized gain on equity securities, also as applicable. The sum of Tier 1 and Tier 2 capital represents the Company s qualifying total capital. Risk-based capital ratios are calculated by dividing Tier 1 and total capital by risk-weighted assets. Assets and off-balance sheet exposures are assigned to one of four categories of risk-weights, based primarily on relative credit risk. The leverage ratio is determined by dividing Tier 1 capital by adjusted average total assets.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), among other things, identifies five capital categories for insured depository institutions (well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized) and requires the respective federal regulatory agencies to implement systems for prompt corrective action for insured depository institutions that do not meet minimum capital requirements within such categories. FDICIA imposes progressively more restrictive constraints on operations, management, and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements. An undercapitalized bank must develop a capital restoration plan and its parent holding company must guarantee that bank s compliance with the plan. The liability of the parent holding company under any such guarantee is limited to the lesser of five percent of the bank s assets at the time it became undercapitalized or the amount needed to comply with the plan. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent s general unsecured creditors. In addition, FDICIA requires the various regulatory agencies to prescribe certain non-capital standards for safety and soundness relating generally to operations and management, asset quality, and executive compensation and permits regulatory action against a financial institution that does not meet such standards.

The various regulatory agencies have adopted substantially similar regulations that define the five capital categories identified by FDICIA, using the total risk-based capital, Tier 1 risk-based capital, and leverage capital ratios as the relevant capital measures. Such regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations, a well-capitalized institution must have a Tier 1 risk-based capital ratio of at least six percent, a total risk-based capital ratio of at least ten percent, and a leverage ratio of at least five percent and not be subject to a capital directive order. The Company and SEB are considered well-capitalized by their respective federal banking regulators. The Company s capital position is delineated in Note 14 to the Consolidated Financial Statements and in the Capital Adequacy section of Part II, Item 7.

Regulators also must take into consideration: (a) concentrations of credit risk; (b) interest rate risk (when the interest rate sensitivity of an institution s assets does not match the sensitivity of its liabilities or its off-balance-sheet position); and (c) risks from non-traditional activities, as well as an institution s ability to manage those risks, when determining the adequacy of an institution s capital. This evaluation is made as part of an institution s regular safety and soundness examination. In addition, regulators may choose to examine other factors in order to evaluate the safety and soundness of financial institutions. For example, regulators have begun to focus on Tier 1 common equity, which is the proportion of Tier 1 capital that is common equity. As the Company s Tier 1 capital is comprised entirely of common equity, its Tier 1 capital and Tier 1 common equity are the same. Notwithstanding the focus on Tier 1 common equity, regulators have expressed the need for increased capital in bank holding companies and their subsidiaries; management expects that minimum required capital levels will increase in the future. The Basel Committee has issued two consultative documents proposing reforms to bank capital and liquidity regulation; specific proposals, which are expected to emphasize common equity as the predominant component of Tier 1 capital and require new liquidity measures, will be released in December 2010.

There are various legal and regulatory limits on the amount of dividends and other funds SEB may pay or otherwise supply the Company and likewise, dividends the Company may pay its shareholders. In the current financial and economic environment, the Federal Reserve has cautioned bank holding companies about dividend policy and discouraged high payout ratios unless both asset quality and capital are stellar. See Part II, Item 5 for current dividend guidance. Federal and state regulatory agencies have the authority not only to prevent a bank or bank holding company from paying a dividend but also to prevent participation in any activity that, in the agency s opinion, would constitute an unsafe or unsound practice. The Federal Deposit Insurance Act provides that, in the event of the liquidation or other resolution of an insured depository institution, the claims of depositors of the institution (including the claims of the FDIC as subrogee of insured depositors) and certain claims for administrative expenses of the FDIC as a receiver will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, nondeposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

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The FDIC maintains the Deposit Insurance Fund (DIF) by assessing depository institutions an insurance premium. The amount each institution is assessed is based upon statutory factors that include the balance of insured deposits as well as the degree of risk the institution poses to the insurance fund. The FDIC recently increased the amount of deposits it insures from $100,000 to $250,000. This increase is temporary and will continue through December 31, 2013. Additionally, under the temporary liquidity guarantee program (the TLGP), many transactional accounts are fully insured, as described below. The Bank pays an insurance premium into the DIF based on the total amount in each individual deposit account held at the Bank, up to $250,000 for each account. The FDIC uses a risk-based premium system that assesses higher rates on those institutions that pose greater risks to the DIF. Specifically, the FDIC places each institution in one of four risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory group assignment). Subsequently, the rate for each institution within a risk category may be adjusted depending upon different factors that either enhance or reduce the risk the institution poses to the DIF, including the unsecured debt, secured liabilities, and brokered deposits applicable to each institution. Finally, certain risk multipliers may be applied to the adjusted assessment. In 2009, the FDIC increased the amount assessed on financial institutions by increasing its risk-based deposit insurance assessment scale uniformly by seven basis points. The assessment scale for 2009 ranged from twelve basis points of assessable deposits for the strongest institutions to fifty basis points for the weakest. In 2009, the FDIC also adopted a uniform three basis points increase across all risk categories to be effective starting January 1, 2011. The increased assessments significantly affected the Bank s profitability in 2009 and will continue to do so in 2010 and beyond. On November 12, 2009, the FDIC approved a rule requiring insured institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. An insured institutions s risk-based deposit insurance assessments will continue to be calculated on a quarterly basis, but will be paid from the amount the institution prepaid until the later of the date that amount is exhausted or June 30, 2013, at which point any remaining funds would be returned to the insured institution. Consequently, the Company s prepayment of DIF premiums made on December 29, 2009 resulted in a prepaid asset of $1,825,119, which is included in other assets on the Consolidated Balances Sheets.

In November 2008, the FDIC created the TLGP to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt and providing full coverage of noninterest-bearing transactional accounts of financial institutions. The Company did not issue any debt under the debt guarantee program, which closed to new issuances October 31, 2009. The Company continues to participate in the transaction account guarantee program, which is scheduled to expire December 31, 2010 if not extended for an additional year. Under this program, the FDIC insures the funds in all noninterest-bearing transaction accounts greater than $250,000, including NOW accounts with rates of 0.50% or less through June 30, 2010 and 0.25% thereafter. The FDIC assesses an annualized fee of 15 25 basis points on balances in noninterest-bearing transaction accounts exceeding $250,000 based on the institution s assigned risk category.

FDIC regulations require that management report annually on its responsibility for preparing its institution s financial statements, establishing and maintaining an internal control structure and procedures for financial reporting, and compliance with designated laws and regulations concerning safety and soundness.

On November 12, 1999, financial modernization legislation known as the Gramm-Leach-Bliley Act (GLB Act) was signed into law. Under the GLB Act, a bank holding company which elects to become a financial holding company may engage in expanded securities activities, insurance sales, and underwriting activities, and other financial activities, and may also acquire securities firms 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 Company has no present intention to change its status from a bank holding company to a financial holding company.

Under the Community Reinvestment Act (CRA), SEB, as an FDIC insured institution, has a continuing and affirmative obligation to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. CRA requires the appropriate federal regulator, in connection with its examination of an insured institution, to assess the institution s record of meeting the credit needs of its community and consider such record in its evaluation of certain applications, such as applications for a merger or establishment of a branch. An unsatisfactory rating may be used as the basis for denial of an application by the federal banking regulator. SEB received a satisfactory rating in its most recent CRA exam.

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The USA Patriot Act of 2001 (Patriot Act) substantially broadens existing anti-money laundering legislation and the extraterritorial jurisdiction of the United States; imposes new compliance and due diligence obligations; creates new crimes and penalties; compels the production of documents located both inside and outside the United States, and clarifies the safe harbor from civil liability to customers. The United States Department of the Treasury (the Treasury Department) has issued a number of regulations that further clarify the Patriot Act s requirements or provide more specific guidance on their application. The Patriot Act requires all financial institutions, as defined, to establish certain anti-money laundering compliance and due diligence programs. The Patriot Act requires financial institutions that maintain accounts for non-United States persons or their representatives to establish, appropriate, specific and, where necessary, enhanced due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering through those accounts. Bank regulators review anti-money laundering compliance during their examinations, and the Company continues to enhance its anti-money laundering compliance programs, as applicable.

Federal banking regulators, as required under the GLB Act, have adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers to nonaffiliated third parties. The rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to nonaffiliated third parties. The privacy provisions of the GLB Act affect how consumer information is transmitted through bank holding companies and conveyed to outside vendors.

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

In 2009, the Federal Reserve adopted amendments to its Regulation E that will restrict the Company s ability to charge overdraft fees on debit card and ATM transactions beginning in July 2010. Additionally, Congress is currently debating legislation that would impose further restrictions on overdraft fees. As overdraft fees have historically comprised a significant source of noninterest income, the new restrictions will adversely affect the Company s profitability.

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. Employees. At December 31, 2009, the Company and its subsidiary had 152 full-time and 7 part-time employees. The Company offers a competitive compensation and benefits package to its employees, and management considers its employee relations to be good.

6. Additional Information. Through its Internet website at www.southeasternbank.com, the Company provides a direct link to reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Act). Reports accessible from this link include annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and proxy materials. Copies of these filings may also be obtained free of charge directly from the Securities and Exchange Commission (SEC) website at www.sec.gov. Additionally, the public may read and copy any materials the Company files with the SEC at the SEC Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

Item 1A. Risk Factors

Our business is subject to certain risks, including those described below. These risks are not the only risks we face. New risks may emerge at any time, and risks we presently deem immaterial may become material. We cannot predict such risks or estimate the extent to which they may affect our financial performance, business, and prospects. More detailed information concerning these and other risks is contained in other sections of this Form 10-K.

Difficult market conditions have adversely affected our industry and business.

Dramatic declines in the housing market over the past three years, with falling home prices and increasing foreclosures, unemployment, and underemployment, have negatively impacted the credit performance of real estate-related loans and resulted in significant write-downs of asset values by financial institutions, including us. These write-downs have caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility, and widespread reduction of business activity generally. The resulting economic pressure on consumers and lack of confidence in the financial markets has adversely affected our business, financial condition, and results of operations. Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for loan losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us.

As a result of the negative developments in the financial industry, new federal and state laws and regulations regarding lending, funding practices, and liquidity standards have been enacted, and bank regulatory agencies have been, and are expected to continue being, aggressive in responding to concerns and trends identified in examinations. Difficult market conditions and the impact of new legislation in response to these developments could restrict our business operations, including our ability to originate loans.

Deteriorating credit quality, particularly with respect to real estate loans, has adversely impacted us and may continue to adversely impact us, leading to higher charge-offs and/or an increase in our provision for loan losses.

Beginning in late 2007 and continuing through 2010, the housing and real estate sectors in our markets experienced a severe economic downturn that accelerated through 2009 and continues in 2010. At December 31, 2009, approximately 84% of our total loans were collateralized by real estate, including $111,102,741 in construction and development loans. Our construction and development loans comprised 75.06% of nonperforming loans, 14.30% of loans past due 90 days or more, and 25.17% of loans past 30 - 89 days at December 31, 2009. The vast majority of our construction and development loans as well as nonperforming assets are based in our coastal Georgia markets. Most of our residential builders construct houses in the $150,000 - $250,000 selling price range and carry inventories of lots for new construction. The supply of vacant, developed lots has increased as the number of new building permits and housing starts declined. Additionally, since August 2008, the FDIC has placed over 50 Georgia and Florida-based financial institutions into receivership, and we believe institutions in our geographic footprint will be placed into receivership in the future. The sale of these financial institutions assets at depressed prices could negatively affect the value of our real estate collateral and other real estate. Aggressive discounting of foreclosed properties by larger banks will similarly affect asset values. We believe it may take more than three years for the market to fully absorb the existing lot inventories in some areas. If economic conditions continue to worsen or deteriorate, additional charge-offs and further increases to the allowance for loan losses will be necessary.

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

Our success depends, to a significant extent, on the quality of our assets, particularly loans. Like other financial institutions, we face the risk that our customers will not repay their loans, the collateral securing the payment of those loans may be insufficient to assure repayment, and we may be unsuccessful in recovering the remaining loan balances. The risk of loss varies with general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan, and the value of the real estate and other collateral, among other things. Management makes various assumptions and judgments about the collectibility of our loan portfolio after considering these and other factors. Based in part on those assumptions and judgments, we maintain an allowance for loan losses in an attempt to cover loan losses which may occur. In determining the size of the allowance, we also

rely on an analysis of the portfolio based on historical loss experience, volume and types of loans, trends in classification, delinquencies and nonaccruals, national and local economic conditions, and other pertinent information, including the results of external loan reviews. 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 charge-offs, based on judgments different than those of management. Higher charge-off rates and an increase in our allowance for loan losses may hurt our overall financial performance and increase our cost of funds. In 2009, we recorded a $5,890,000 provision for loan losses compared to $1,348,000 in 2008. The increase was necessary to cover substantial increases in nonperforming loan volumes during 2009. We expect overall credit conditions and the performance of our loan portfolio to continue deteriorating in the near term. And, although we expect to continue provisioning for loan losses in 2010 and beyond, we can make no assurance that our allowance will adequately cover future loan losses given current and future market conditions. The Company recognized a net loss approximating $1,200,000 in the first quarter of 2010 due largely to such provisioning.

Additionally, we will realize future losses if the proceeds we receive upon liquidation of nonperforming assets, particularly foreclosed real estate, are less than the carrying values of such assets.

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. Our failure to comply with these requirements can lead to administrative enforcement actions, termination or suspension of our licenses, rights of rescission for borrowers, and litigation, among other remedies. 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 are changing rapidly to reflect the government s concerns about the economy and the banking system, and we cannot predict the effects of these changes on our business and profitability. Legislative and regulatory changes could affect us in substantial and unpredictable ways, including limiting the types of financial services and products we offer and/or increasing the ability of non-banks to offer competing financial services and products. For example, the Federal Reserve recently adopted amendments to its Regulation E, which are effective on July 1, 2010. The changes will impact our ability to charge overdraft fees and reduce our corresponding fee income. Additionally, various legislative bodies have considered altering the existing framework governing creditors rights, which would change loan modification procedures and lengthen the foreclosure process.

Our net interest income could be negatively affected by the lower level of short-term interest rates, recent developments in the credit and real estate markets, and competition in our primary market area.

As a financial institution, our earnings are significantly dependent upon our net interest income, which is the difference between the interest income we earn on interest-earning assets, such as loans and investment securities, and the interest expense we pay on interest-bearing liabilities, such as deposits and borrowings. Changes in general market interest rates, including changes resulting from the Federal Reserve s fiscal and monetary policies, affect us more than non-financial institutions and can have a significant effect on our net interest income and total income.

The Federal Reserve most recently reduced benchmark interest rates for federal funds on three separate occasions in 2007 by a total of 100 basis points, to 4.25%, and by another 400 basis points, to a 0% - 0.25% range, during 2008. No changes were made to the federal funds rates in 2009. A significant portion of our loans, including residential construction and development loans and other commercial loans, bear interest at variable rates. The interest rates on these loans fall when the Federal Reserve reduces interest rates, while the interest we pay on deposits and other liabilities may not change in the same amount or at the same rates. Accordingly, declines in interest rates may reduce our net interest income. Conversely, an increase in interest rates may reduce demand for consumer and commercial credit. Increases in interest rates will reduce borrowers cash flow, which may adversely affect their ability to repay their loans.

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

Increased nonperforming loans and the overall decline in interest rates reduced our net interest income substantially during 2009 and could cause additional pressure on net interest income in 2010 and future periods. This reduction in net interest income may also be exacerbated by the competition we face in our primary market area and the higher cash balances being carried currently. Any significant reduction in our net interest income will negatively affect our business and could have a material adverse impact on our capital, financial condition, and results of operations.

We face strong competition from other financial service 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 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 super-regional and national financial institutions that operate offices in our market areas and elsewhere. Moreover, this competitive industry could become even more competitive as a result of legislative, regulatory, and technological changes, and continued consolidation. Many of our competitors have greater financial resources and/or 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. As a result of these various sources of competition, we could lose business to competitors or be forced to price products and services on less advantageous terms to keep or attract customers, either of which could adversely affect our profitability.

Additionally, customers could pursue alternatives to bank deposits and bank transactions, causing us to lose a relatively inexpensive source of funding and fee income. For example, customers may perceive other investments, such as the stock market, as providing superior returns. And, technology now allows consumers to completely bypass banks in paying bills, transferring funds, and completing other financial transactions. This process could result in loss of deposits and related fee income. Conversely, when customers move borrowing relationships to other parties, we lose interest income.

If problem asset levels and real estate concentrations are not reduced, we could face formal regulatory action and loss of liquidity facilities.

If our problem asset levels and real estate concentrations are not reduced, we could face a formal regulatory order and significant loss of liquidity facilities, including fed funds lines from correspondent banks. Our future lending activities and growth prospects could be significantly curtailed, and we could be required to take significant write-downs on problem assets. Publication of an enforcement order could harm our reputation and result in loss of deposits and market share. Besides our financial condition and operating results, our stock price could be materially and adversely affected.

Our financial instruments carried at fair value expose us to certain market risks.

We maintain an available-for-sale securities portfolio, which includes various types of debt instruments and maturities. Instruments carried at fair value are exposed to market risks related to changes in interest rates, market

liquidity, and default risks. Changes in the market values of these instruments could have a material adverse impact on our financial condition. Additionally, accounting regulations may require us to record other-than-temporary impairment losses as further disclosed in Notes 1 and 2 to the Consolidated Financial Statements. We may classify additional financial assets or liabilities at fair value in the future.

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

Our success has been and continues to be largely dependent on the services of our senior management team, including our senior loan officers, many of whom have significant relationships with our customers. Our continued success will depend, to a large extent, on the continued service of these key personnel.

Diminished access to alternative sources of liquidity could adversely affect our net income, net interest margin, and our overall liquidity.

We have historically had access to alternative sources of liquidity, but given the recent and dramatic downturn in the credit and liquidity markets, there is no assurance that we will be able to obtain such liquidity on terms that are favorable to us, or at all. For example, correspondent financial institutions may be unwilling to extend credit to banks because of concerns about the banking industry and the overall economy. If our access to these liquidity sources is diminished, or only available on unfavorable terms, then our net income, net interest margin, and overall liquidity position could be adversely affected.

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 competitors provides them with increased operational efficiencies, we must successfully manage such expenses. As our business develops, changes, or expands, additional expenses can arise.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

FDIC insurance premiums increased substantially in 2009, and we expect to pay significantly higher FDIC premiums in the future. Due to the large number of bank failures depleting the DIF, the FDIC adopted a revised risk-based deposit insurance assessment schedule in February 2009, which raised deposit insurance premiums. The FDIC also implemented a five basis point special assessment of each insured depository institution s assets minus Tier 1 capital as of June 30, 2009. This special assessment increased noninterest expense $177,000 in 2009. In addition, the FDIC required financial institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The Bank s prepayment approximated $2,000,000. The rule also provides for increasing the assessment rates three basis points effective January 1, 2011. If FDIC deposit insurance premiums and assessments continue to increase, our financial condition and results of operations will be adversely affected.

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

Our success depends, in part, on the ability to adapt products and services to evolving industry standards. Financial institutions face mounting pressure to provide products and services at lower prices which can significantly reduce profitability. This practice can reduce net interest income and noninterest income from fee-based products and services. In addition, the widespread adoption of new technologies could require us to make substantial capital expenditures to modify or adapt existing products and services or develop new products and services. We may not be successful in introducing new products and services in response to industry trends or development in technology, or those new products may not achieve market acceptance. As a result, we could lose business, be forced to price products and services on less advantageous terms to retain or attract customers, or be subject to cost increases.

We rely on other companies to provide key components of our business infrastructure.

Third parties provide key components of our business infrastructure such as processing, internet connections, and network access. Any disruption in services provided by these third parties could adversely affect our ability to deliver products and services to customers and otherwise conduct business. Technological or financial difficulties of a third party service provider could adversely affect our business if those difficulties result in the interruption or discontinuation of services provided by that party. Our insurance coverage may be inadequate to cover losses resulting from system failures or other disruptions. Failures in our business infrastructure could increase the costs of doing business.

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We rely on our systems, employees, and certain counterparties, and certain failures could materially and adversely affect our operations.

We are exposed to many types of operational risk, including the risk of fraud by employees and outsiders, clerical and record-keeping errors, and computer/telecommunications malfunctions. Our business is dependent on our ability to process a large number of increasingly complex transactions. If any of our financial, accounting, or other data processing systems fail or have other significant shortcomings, we could be materially and adversely affected. We are similarly dependent on our employees. We could be adversely affected if one of our employees causes a significant operational breakdown or failure of our operations or systems, either as a result of human error, sabotage, or fraudulent manipulation. Third parties with whom we do business could also be sources of operational risk to us due to breakdowns or failures of such parties own systems or employees. Any of these occurrences could diminish our ability to operate.

Disruptions of our operating systems from events wholly or partially beyond our control, including computer viruses, electrical or telecommunications outages, or natural disasters could occur. Such disruptions may interrupt our customer services and cause loss or liability to us. In addition, our controls and procedures as well as business continuity and data security systems could prove inadequate. For example, we could be susceptible to hacking or identity theft. Any such failure could require us to expend significant resources to correct the defect and expose us to litigation or losses not covered by insurance.

We depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions with clients and counterparties, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements and other data. We may also rely on representations of customers and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on independent auditors reports.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of clearing, counterparty, or other relationships. We have exposure to industries and counterparties, and we routinely execute transactions with other parties, including broker-dealers and other commercial banks. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or other institutions. Many of these transactions expose us to credit risk in the event of default of the other party or customer. Resultant losses could materially and adversely affect our results of operations.

Hurricanes and other natural disasters may adversely affect our loan portfolio and operations and increase the cost of doing business.

Large scale natural disasters may significantly affect our loan portfolio by damaging properties pledged as collateral and impairing the ability of certain borrowers to repay their loans. The nature and level of natural disasters cannot be predicted and may be intensified by global climate change. The ultimate impact of a natural disaster on future financial results is difficult to predict and will be affected by numerous factors, including the extent of damage to collateral, the extent to which damaged collateral is not covered by insurance, the extent to which unemployment and other economic conditions caused by the disaster affect borrowers ability to repay their loans, and the cost of collection, foreclosure moratoriums, and other accommodations granted to borrowers and other customers.

Negative public opinion could damage our reputation and adversely impact business and revenues.

As a financial institution, our earnings and capital are subject to risks associated with negative public opinion. Negative public opinion could result from our actual or alleged conduct in any number of activities, including lending practices, the failure of any product or service sold by us to meet our customers expectations or applicable regulatory requirements, corporate governance, or from actions taken by regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep or attract customers and expose us to litigation and regulatory action.

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Changes in accounting policies or standards could materially impact our financial statements.

Our accounting policies and processes are fundamental to how we record and report our financial condition and results of operations. From time to time, the Financial Accounting Standards Board (FASB) and SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes, which can be hard to predict, can materially impact how we record and report our financial condition and results of operations. Because of the uncertainty surrounding our judgments and estimates pertaining to our accounting policies, we cannot guarantee that we will not be required to adjust accounting policies or restate prior period financial statements. See the Critical Accounting Policies in Part II, Item 7, and Note 1 to the Consolidated Financial Statements for more information.

Our disclosure controls and procedures may not prevent or detect all errors or acts of fraud.

Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed in reports we file or submit to the SEC is accurately accumulated and communicated to management, and recorded, processed, summarized, and reported in accordance with the SEC s rules and forms. We believe that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

These inherent limitations include the realities that judgments in decision-making can be faulty, that alternative reasoned judgments can be drawn, or that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by an unauthorized override of the controls. Accordingly, because of the inherent limitations in our control system, misstatements due to error or fraud may occur and not be detected.

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.

From time to time, we may be involved in litigation, investigations, or similar matters arising out of our business. Our insurance may not cover all claims asserted against us, and such claims, 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, our business, financial condition, and results of operations will be impacted. 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.

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

Our directors and executive officers, as a group, beneficially owned approximately 29% of our outstanding common stock as of December 31, 2009. 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. As a result, it may be more difficult for you to sell a large block of shares at the same price you could sell a smaller number of shares.

Sales of substantial amounts of common stock, or the potential for large amounts of sales, may cause the price of our common stock to decline or impair our future ability to raise capital through sales of stock.

Our stock price can be volatile.

The current market price of our common stock may not be indicative of future prices. Our stock price could fluctuate widely in response to a variety of factors including:

- Actual or anticipated variations in earnings;

Changes in dividends;

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Actions by government regulators;

News reports of trends, concerns, and other issues related to the financial services industry;

Operating and stock performance of other companies deemed to be peers;

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