SOUTHEASTERN BANKING CORP
Form 10-Q
May 15, 2008
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**of the Securities Exchange Act of 1934**

**For the Quarterly Period Ended March 31, 2008**

**Commission File Number 000-32627**

# SOUTHEASTERN BANKING CORPORATION

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Georgia** | **58-1423423** |
| **(State or other jurisdiction of** | **(IRS Employer** |

**incorporation or organization)** **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)**

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 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

As of April 30, 2008, 3,178,331 shares of the registrant s common stock, par value $1.25 per share, were outstanding.

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**Item I - Financial Statements**

**Southeastern Banking Corporation**

**Consolidated Balance Sheets**

| | (Unaudited) March 31, 2008 | December 31, 2007 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | **$ 19,296,134** | $ 26,558,995 |
| Federal funds sold | **14,624,000** | |
| Cash and cash equivalents | **33,920,134** | 26,558,995 |
| Investment securities | | |
| Available-for-sale, at market value | **96,127,674** | 88,845,650 |
| Held-to-maturity (market value of approximately $31,787,000 and $32,111,000 at March 31, 2008 and December 31, 2007) | **30,852,030** | 31,614,785 |
| Total investment securities | **126,979,704** | 120,460,435 |
| Loans, gross | **261,773,937** | 269,613,025 |
| Unearned income | **(136,558)** | (136,405) |
| Allowance for loan losses | **(4,608,850)** | (4,510,231) |
| Loans, net | **257,028,529** | 264,966,389 |
| Premises and equipment, net | **12,229,343** | 12,376,959 |
| Bank-owned life insurance | **5,077,881** | 5,019,417 |
| Intangible assets | **433,723** | 448,277 |
| Other assets | **5,542,925** | 6,555,245 |
| **Total Assets** | **$ 441,212,239** | $ 436,385,717 |
| **Liabilities and Shareholders Equity** | | |
| **Liabilities** | | |
| Deposits | | |
| Noninterest-bearing deposits | **$ 61,562,690** | $ 64,436,226 |
| Interest-bearing deposits | **312,555,574** | 297,619,950 |
| Total deposits | **374,118,264** | 362,056,176 |
| Federal funds purchased | | 7,292,000 |
| U. S. Treasury demand note | **636,287** | 682,523 |
| Federal Home Loan Bank advances | **5,000,000** | 5,000,000 |
| Other liabilities | **4,055,319** | 4,617,708 |
| Total liabilities | **383,809,870** | 379,648,407 |
| **Commitments and Contingencies** (Notes 13 and 18) | | |
| **Shareholders Equity** | | |

| | | |
|---|---|---|
| Common stock ($1.25 par value; 10,000,000 shares authorized; 3,580,797 shares issued; 3,178,331 shares outstanding) | **4,475,996** | 4,475,996 |
| Additional paid-in-capital | **1,391,723** | 1,391,723 |
| Retained earnings | **59,576,340** | 59,161,894 |
| Treasury stock, at cost (402,466 shares) | **(8,307,905)** | (8,307,905) |
| Realized shareholders equity | **57,136,154** | 56,721,708 |
| Accumulated other comprehensive income | **266,215** | 15,602 |
| Total shareholders equity | **57,402,369** | 56,737,310 |
| **Total Liabilities and Shareholders Equity** | **$ 441,212,239** | $ 436,385,717 |

*See accompanying notes to consolidated financial statements.*

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**Southeastern Banking Corporation**

**Consolidated Statements of Income**

**(Unaudited)**

| *Three Months Ended March 31,* | **2008** | **2007** |
|---|---|---|
| **Interest income** | | |
| Loans, including fees | **$ 5,200,933** | $ 5,872,374 |
| Federal funds sold | **64,743** | 9,454 |
| Investment securities | | |
| Taxable | **1,040,199** | 1,007,170 |
| Tax-exempt | **302,183** | 321,771 |
| Other assets | **15,082** | 16,711 |
| Total interest income | **6,623,140** | 7,227,480 |
| **Interest expense** | | |
| Deposits | **2,246,895** | 2,174,067 |
| Federal funds purchased | **22,186** | 56,845 |
| U. S. Treasury demand note | **4,055** | 10,634 |
| Federal Home Loan Bank advances | **74,822** | 74,000 |
| Total interest expense | **2,347,958** | 2,315,546 |
| Net interest income | **4,275,182** | 4,911,934 |
| **Provision for loan losses** | **111,000** | 115,000 |
| Net interest income after provision for loan losses | **4,164,182** | 4,796,934 |
| **Noninterest income** | | |
| Service charges on deposit accounts | **666,859** | 609,289 |
| Investment securities gains, net | | 134,628 |
| Other operating income | **369,416** | 327,815 |
| Total noninterest income | **1,036,275** | 1,071,732 |
| **Noninterest expense** | | |
| Salaries and employee benefits | **2,072,211** | 2,091,815 |
| Occupancy and equipment, net | **709,777** | 655,443 |
| Other operating expense | **710,619** | 654,643 |
| Total noninterest expense | **3,492,607** | 3,401,901 |
| Income before income tax expense | **1,707,850** | 2,466,765 |
| **Income tax expense** | **498,822** | 795,998 |
| **Net income** | **$ 1,209,028** | $ 1,670,767 |
| **Basic earnings per common share** | **$ 0.38** | $ 0.52 |

| | | |
|---|---|---|
| Weighted average common shares outstanding | **3,178,331** | 3,212,889 |

*See accompanying notes to consolidated financial statements.*

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**Southeastern Banking Corporation**

**Consolidated Statements of Shareholders Equity**

**(Unaudited)**

| | *Common Stock* | *Additional Paid-In Capital* | *Retained Earnings* | *Treasury Stock* | *Accumulated Other Comprehensive (Loss) Income* | *Total* |
|---|---|---|---|---|---|---|
| **Balance, December 31, 2006** | $ 4,475,996 | $ 1,391,723 | $ 54,272,250 | $ (7,356,329) | $ (597,454) | $ 52,186,186 |
| Comprehensive income: | | | | | | |
| Net income | | | 1,670,767 | | | 1,670,767 |
| Change in unrealized losses on available-for-sale securities, net of tax effect of $46,844 | | | | | 90,932 | 90,932 |
| Total comprehensive income | | | | | | 1,761,699 |
| Cash dividends declared ($0.14 per share) | | | (449,344) | | | (449,344) |
| Purchase of treasury stock | | | | (118,000) | | (118,000) |
| **Balance, March 31, 2007** | $ 4,475,996 | $ 1,391,723 | $ 55,493,673 | $ (7,474,329) | $ (506,522) | $ 53,380,541 |
| **Balance, December 31, 2007** | $ 4,475,996 | $ 1,391,723 | $ 59,161,894 | $ (8,307,905) | $ 15,602 | $ 56,737,310 |
| Comprehensive income: | | | | | | |
| Net income | | | **1,209,028** | | | **1,209,028** |
| Change in unrealized gains on available-for-sale securities, net of tax effect of $129,104 | | | | | **250,613** | **250,613** |
| Total comprehensive income | | | | | | **1,459,641** |
| Cash dividends declared ($0.25 per share) | | | **(794,582)** | | | **(794,582)** |
| **Balance, March 31, 2008** | **$ 4,475,996** | **$ 1,391,723** | **$ 59,576,340** | **$ (8,307,905)** | **$ 266,215** | **$ 57,402,369** |

*See accompanying notes to consolidated financial statements.*

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**Southeastern Banking Corporation**

**Consolidated Statements of Cash Flows**

**(Unaudited)**

| *Three Months Ended March 31,* | **2008** | 2007 |
|---|---|---|
| **Operating activities** | | |
| Net income | **$ 1,209,028** | $ 1,670,767 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | **111,000** | 115,000 |
| Depreciation | **205,227** | 165,355 |
| Amortization and accretion, net | **(144,449)** | 4,370 |
| Investment securities gains, net | | (134,628) |
| Net gains on sales of other real estate | | (30,067) |
| Changes in assets and liabilities: | | |
| Decrease in other assets | **844,011** | 622,943 |
| Decrease in other liabilities | **(562,390)** | (246,666) |
| Net cash provided by operating activities | **1,662,427** | 2,167,074 |
| **Investing activities** | | |
| Principal collections and maturities of investment securities: | | |
| Available-for-sale | **193,096,096** | 121,907,683 |
| Held-to-maturity | **1,385,400** | 385,000 |
| Proceeds from sales of available-for-sale investment securities | | 3,126,500 |
| Purchases of available-for-sale investment securities | **(199,871,535)** | (107,384,891) |
| Purchases of held-to-maturity investment securities | **(643,726)** | (400,000) |
| Net decrease (increase) in loans | **7,860,818** | (19,579,281) |
| Proceeds from sales of other real estate | | 267,129 |
| Capital expenditures, net | **(57,611)** | (412,924) |
| Net cash used in investing activities | **1,769,442** | (2,090,784) |
| **Financing activities** | | |
| Net increase in deposits | **12,062,088** | 8,531,702 |
| Net decrease in federal funds purchased | **(7,292,000)** | (4,684,000) |
| Net decrease in U. S. Treasury demand note | **(46,236)** | (314,431) |
| Purchase of treasury stock | | (118,000) |
| Dividends paid | **(794,582)** | (1,976,365) |
| Net cash provided by financing activities | **3,929,270** | 1,438,906 |
| Net increase in cash and cash equivalents | **7,361,139** | 1,515,196 |
| Cash and cash equivalents at beginning of period | **26,558,995** | 23,410,228 |
| Cash and cash equivalents at end of period | **$ 33,920,134** | $ 24,925,424 |
| **Supplemental disclosure** | | |
| **Cash paid during the period** | | |
| Interest | **$ 2,116,482** | $ 2,135,003 |
| **Noncash investing and financing activities** | | |
| Real estate acquired through foreclosure | | 50,072 |

| | |
|---|---|
| Loans made in connection with sales of foreclosed real estate | 23,625 |

*See accompanying notes to consolidated financial statements.*

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**Southeastern Banking Corporation**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

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

The accompanying unaudited consolidated financial statements of Southeastern Banking Corporation and subsidiary (the Company ) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. These statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statement presentation. In the opinion of management, all adjustments necessary for a fair presentation have been made. These adjustments, consisting of normal, recurring accruals, include estimates for various fringe benefits and other transactions normally determined or settled at year-end. Operating results for the three months ended March 31, 2008 are not necessarily indicative of trends or results to be expected for the full year 2008. The Company operates within one business segment, community banking, providing a full range of services to individual, corporate, and government customers in southeast Georgia and northeast Florida. The condensed consolidated balance sheet as of December 31, 2007 has been extracted from the audited financial statements included in the Company s 2007 Annual Report to Shareholders. For further information, refer to the consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2007. There have been no significant changes to the Company s Accounting Policies as disclosed in the 2007 Form 10-K. Certain reclassifications, with no effect on total assets or net income, have been made to prior period amounts to conform to the current period presentation.

**2. Recent Accounting Standards**

In February 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 permits companies to fair value certain financial assets and liabilities on an instrument-by-instrument basis with changes in fair value recognized in earnings as they occur. The election to fair value a financial asset or liability is generally irrevocable. Adoption of this statement is not expected to have a material impact on the Company s financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations, which revises SFAS 141 and changes multiple aspects of the accounting for business combinations. Under the guidance in SFAS 141R, the acquisition method must be used, which requires the acquirer to recognize most identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree at their full fair value on the acquisition date. Goodwill is to be recognized as the excess of the consideration transferred plus the fair value of the noncontrolling interest over the fair values of the identifiable net assets acquired. Subsequent changes in the fair value of contingent consideration classified as a liability are to be recognized in earnings, while contingent consideration classified as equity is not to be remeasured. Costs such as transaction costs are to be excluded from acquisition accounting, generally leading to recognizing expense and additionally, restructuring costs that do not meet certain criteria at acquisition date are to be subsequently recognized as post-acquisition costs. For calendar year companies, SFAS 141R is effective for business combinations consummated on or after January 1, 2009. Adoption of this statement is not expected to have a material impact on the Company s financial position or results of operations.

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**Southeastern Banking Corporation**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. This statement requires enhanced disclosures about the use of derivative instruments, the accounting for derivative instruments under SFAS 133 and related interpretations, and the impact of derivative instruments and related hedged items on financial position, financial performance, and cash flows, particularly from a risk perspective. SFAS 157 is effective for fiscal years beginning after November 15, 2008. Adoption of this statement is not expected to have a material impact on the Company s financial position or results of operations.

**3. Fair Value Measurements**

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. The statement does not expand the use of fair value in any new circumstances.

SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the statement establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Level 1 and 2 of the hierarchy) and the reporting entity s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs other than quoted prices that are observable for the asset or liability such as interest rates, exchange rates, and yield curves that are observable at commonly quoted intervals, volatilities, prepayment speeds, credit risks, and default rates. Level 3 inputs are unobservable inputs for assets or liabilities, which are typically based on an entity s own assumptions, as there is little, if any, related market activity. The determination of the fair value hierarchy within which the measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment, considering factors specific to the asset or liability.

The table on the next page presents the Company s assets and liabilities measured at fair value on a recurring basis as of March 31, 2008, aggregated by the level in the fair value hierarchy within which those measurements fall.

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**Southeastern Banking Corporation**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

| *March 31, 2008* | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Available-for-sale investment securities | $ | $ 96,127,674 | $ | $ 96,127,674 |
| **Total assets at fair value** | $ | $ 96,127,674 | $ | $ 96,127,674 |

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

*This Analysis should be read in conjunction with the 2007 Annual Report on Form 10-K and the consolidated financial statements & related notes on pages 3 9 of this quarterly filing. The Company s accounting policies, which are described in detail in Form 10-K, are integral to understanding the results reported. The Company s accounting policies require management s judgment in valuing assets, liabilities, commitments, and contingencies. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset, or relieving a liability. This Analysis contains forward-looking statements with respect to business and financial matters. Actual results may vary significantly from those contained in these forward-looking statements. See the sections entitled Critical Accounting Policies and Forward-Looking Statements within this Analysis.*

**Description of Business**

Southeastern Banking Corporation, with assets exceeding $441,212,000, is a financial services company with operations in southeast Georgia and northeast Florida. Southeastern Bank ( SEB ), the Company s wholly-owned commercial bank subsidiary, offers a full line of commercial and retail services to meet the financial needs of its customer base through its seventeen 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 $441,212,239 at March 31, 2008, up $4,826,522 from year-end 2007. Asset growth year-to-date was concentrated in federal funds sold and investment securities. Specifically, federal funds sold grew $14,624,000 and investment securities, $6,519,269; loans declined $7,937,860. Loans comprised approximately 64%, investment securities, 31%, federal funds sold, 4%, and bank-owned life insurance, 1%, of earning assets at March 31, 2008 versus 68%, 31%, 0%, and 1% at December 31, 2007. Overall, earning assets approximated 91% of total assets at March 31, 2008. During the year-earlier period, total assets grew $2,953,939 or 0.72%. An increase in loans outstanding, particularly real estate construction and residential mortgage balances, was the main factor in the 2007 results. Refer to the Liquidity section of this Analysis for details on deposits and other funding sources.

Investment Securities

On a carrying value basis, investment securities grew $6,519,269 or 5.41% since December 31, 2007. Purchases of securities during the three-month period, primarily comprising short-term securities with original maturities of 90 days or less, approximated $200,515,000, and redemptions, $194,481,000. The use of Agency discount notes to collateralize public funds was the predominant factor in the purchase and redemption activity year-to-date. Due to yield availability and continuing strong credit profiles, additional purchases year-to-date were centered in mortgage-backed securities issued by Fannie Mae and Freddie Mac and corporate bonds. The remaining redemptions were primarily attributable to various issuers exercise of call options and other prepayments as a result of the current low-rate interest environment. The effective repricing of redeemed securities impacts current and future earnings results; refer to the Interest Rate and Market Risk/Interest Rate Sensitivity and Operations sections of this Analysis for more details. In conjunction with asset/liability management, the Company continues to increase its proportionate holdings of mortgage-backed securities, corporates, and municipals when feasible to reduce its exposure to Agency securities with call features. At March 31, 2008, mortgage-backed securities, corporates, and municipals comprised 23%, 17%, and 24% of the portfolio. Overall, securities continued to comprise 31% of earning assets at March 31, 2008. Including short-term Agency discount notes, the portfolio yield approximated 5.23% during the first quarter of 2008.

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Management believes the credit quality of the investment portfolio remains sound, with 58.64% of the carrying value of debt securities being backed by the U.S. Treasury or other U.S. Government-sponsored agencies at March 31, 2008. The Company does not own any collateralized debt obligations, widely known as CDOs, secured by subprime residential mortgage-backed securities. During the first quarter, the Company purchased an additional $10,574,468 in conventional mortgage-backed securities issued by Fannie Mae and Freddie Mac due to the spreads available in these investments relative to coupon Agencies. All of the Company s corporate bonds were rated BBB+ or higher, and the majority, A- or higher, by at least one nationally recognized rating agency at March 31, 2008 except for two non-rated trust preferred securities with a carrying value of $2,992,940. Management restricts purchases of trust preferred securities, which often are not rated, to issues of large bank holding companies domiciled in the southeastern United States. Although the individual security may not be rated, the issuing bank holding company or subsidiary must have a strong stand-alone credit rating. As previously discussed, the Company increased its holdings of corporate bonds, including longer-term corporates, by $11,060,965 or 104% during the first quarter due to the high yields and relative value available in this sector. Within the municipal portfolio, all holdings were highly rated, investment grade securities other than fifteen non-rated Georgia issues. In analyzing non-rated municipals, management considers debt service coverage and whether the bonds support essential services such as water/sewer systems and education. Management reviews bond ratings and market valuation on a regular basis.

The weighted average life of the portfolio approximated 3.5 years at March 31, 2008; management expects a moderate extension in duration during the remainder of 2008. The amortized cost and estimated fair value of investment securities are delineated in the table below:

***Investment Securities by Category***

| ***March 31, 2008*** ***(In thousands)*** | ***Amortized Cost*** | ***Unrealized Gains*** | ***Unrealized Losses*** | ***Fair Value*** |
|---|---|---|---|---|
| Available-for-sale: | | | | |
| U. S. Government agencies[1] | **$ 45,324** | $ 393 | $ 7 | **$ 45,710** |
| Mortgage-backed securities | **28,525** | 251 | 28 | **28,748** |
| Corporates | **21,875** | 140 | 345 | **21,670** |
| | **95,724** | 784 | 380 | **96,128** |
| Held-to-maturity: | | | | |
| States and political subdivisions | **30,852** | 1,049 | 114 | **31,787** |
| Total investment securities | **$ 126,576** | $ 1,833 | $ 494 | **$ 127,915** |

[1] Includes Agency discount notes with original maturities of three months or less.

As shown, the market value of the investment portfolio reflected $1,338,297 in net unrealized gains at March 31, 2008; refer to the Capital Adequacy section of this Analysis for more details on investment securities and related fair value. The Company did not have a concentration in the obligations of any issuer other than the U.S. Government and its agencies at March 31, 2008; the single largest corporate holding, securities issued by a regional bank holding company, comprised 4.16% of the total securities portfolio.

Loans

Loans, net of unearned income, declined 2.91% or $7,839,241 since year-end 2007. The net loans to deposits ratio aggregated 69.93% at March 31, 2008 versus 74.43% at December 31, 2007, and 76.26% a year ago. The decline in loans outstanding resulted primarily from pay-downs on large real estate credits

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in the normal course of business. Real estate construction balances, predominantly residential in nature and concentrated in the Company s coastal markets, accounted for the bulk of the decline, falling $7,277,123 year-to-date. 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 historically has not held or serviced 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. The Company is in the process of expanding and revamping its mortgage origination department and in the future may not just originate, but also hold and service such mortgage loans in-house. Balances in the real estate residential mortgage portfolio grew a modest $884,872 to $40,873,027 at March 31, 2008. Overall, the commercial portfolio declined $730,385 or 0.82% at March 31, 2008 compared to December 31, 2007. Nonfarm real estate and other commercial/industrial loans within the commercial portfolio grew $1,940,880 and $504,739; governmental and agricultural loans fell $2,133,531 and $1,042,473. Consumer loans declined $716,451 at March 31, 2008 compared to year-end 2007; these loans comprised 6.48% of the total portfolio at March 31, 2008.

Due to economic uncertainties within the Company s markets, particularly in the real estate sector, and resultant concerns regarding credit opportunities, management expects loan volumes to flatten or decline moderately throughout 2008. During the same period in 2007, net loans grew 7.87% or $19,502,180. An $18,456,000 increase in real estate construction and residential mortgage loans was the primary factor in the 2007 results. Loans outstanding are presented by type in the table below:

| ***Loans by Category*** ***(in thousands)*** | ***March 31, 2008*** | ***December 31, 2007*** | ***March 31, 2007*** |
|---|---|---|---|
| Commercial, financial, and agricultural[1] | **$ 88,114** | $ 88,844 | $ 89,030 |
| Real estate construction | **115,818** | 123,095 | 112,997 |
| Real estate residential mortgage[2] | **40,873** | 39,988 | 49,011 |
| Consumer, including credit cards | **16,969** | 17,686 | 16,340 |
| Loans, gross | **261,774** | 269,613 | 267,378 |
| Unearned income | **137** | 136 | 110 |
| Loans, net | **$ 261,637** | $ 269,477 | $ 267,268 |

1 Includes obligations of states and political subdivisions.

2 Typically have final maturities of 15 years or less.

Although the Company s loan portfolio is diversified, significant portions of its loans are collateralized by real estate. At March 31, 2008, approximately 83% 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. The Company continues to closely monitor real estate valuations in its markets and consider any implications on the allowance for loan losses and the related provision. On an aggregate basis, commitments to extend credit and standby letters of credit approximated $54,999,000 at March 31, 2008; because a substantial amount of these contracts expire without being drawn upon, total contractual amounts do not represent future credit exposure or liquidity requirements. The Company has not funded or incurred any losses on letters of credit in 2008 year-to-date.

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*Nonperforming Assets*

Nonperforming assets consist of nonaccrual loans, restructured loans, and foreclosed real estate and other assets. Overall, nonperforming assets aggregated $1,701,700 at March 31, 2008, up $634,866 or 59.51% from year-end 2007. As a percent of total assets, nonperforming assets totaled 0.39% at March 31, 2008 versus 0.24% at year-end 2007 and 0.23% at March 31, 2007. Other than the addition of a $475,000 residential real estate loan secured by waterfront property, no material credits were transferred to or removed from nonaccrual status during 2008 year-to-date. Individual concentrations within nonaccrual balances included the aforementioned $475,000 credit and loans to three separate borrowers averaging $74,000 each at March 31, 2008; due to the underlying real estate collateral coverage, no significant losses, if any, are expected on these balances. Nonaccrual balances did not include any industry concentrations at March 31, 2008. On May 11, 2008, tornadoes heavily damaged portions of McIntosh County, where the Company has two banking offices. As a result of these tornadoes, a single relationship of $450,000 was placed on nonaccrual status; due to available collateral, no loss is anticipated on this relationship. Additionally, no material losses are expected to result from other relationships impacted by the tornadoes. See the subsection entitled Policy Note for criteria used by management in classifying loans as nonaccrual. The allowance for loan losses approximated 3.29X the nonperforming loans balance at March 31, 2008 versus 6.16X at year-end 2007 and 4.98X a year ago. No significant activity occurred within foreclosed real estate balances during the first quarter of 2008. Foreclosed real estate balances remained concentrated in residential real estate at March 31, 2008.

Loans past due 90 days or more approximated $300,000, or less than 1% of net loans, at March 31, 2008. Management is unaware of any material concentrations within these past due balances; the vast majority, or 76%, of these past due balances were real estate-secured. The table below provides further information about nonperforming assets and loans past due 90 plus days:

| ***Nonperforming Assets (In thousands)*** | ***March 31, 2008*** | ***December 31, 2007*** | ***March 31, 2007*** |
|---|---|---|---|
| Nonaccrual loans: | | | |
| Commercial, financial, and agricultural | **$ 202** | $ 112 | $ 184 |
| Real estate construction | **164** | 109 | 89 |
| Real estate mortgage | **823** | 350 | 309 |
| Consumer, including credit cards | **210** | 161 | 282 |
| Total nonaccrual loans | **1,399** | $ 732 | 864 |
| Restructured loans[1] | | | |
| Total nonperforming loans | **1,399** | $ 732 | 864 |
| Foreclosed real estate[2] | **291** | 305 | 77 |
| Other repossessed assets | **12** | 30 | 7 |
| Total nonperforming assets | **$ 1,702** | $ 1,067 | $ 948 |
| Accruing loans past due 90 days or more | **$ 300** | $ 776 | $ 716 |
| Ratios: | | | |
| Nonperforming loans to net loans | **0.53%** | 0.27% | 0.32% |
| Nonperforming assets to net loans plus foreclosed/repossessed assets | **0.65%** | 0.40% | 0.35% |

1 Does not include restructured loans that yield a market rate.

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

Loans past due 30-89 days also comprised less than 1% of net loans at March 31, 2008, totaling approximately $2,021,000.

Additional loans classified as impaired under SFAS No. 114, Accounting by Creditors for Impairment of a Loan an amendment of FASB Statements No. 5 and 15, totaled approximately $12,918,000 at March 31, 2008. Approximately $10,976,000 of this classified balance pertained to four separate borrowers whose loan repayment was expected to come from commercial or residential real estate

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development or lot loan sales of the underlying collateral. Due to lagging sales and ongoing deterioration in the real estate market, payment of principal and interest on these coastal real estate loans has come from borrower reserves or other resources, constituting a change in the initial source of payment/terms of these loans. Management reviews all loans with total credit exposure of $500,000 or more at least quarterly and evaluates underlying collateral, assuming salvage values and estimating any allowance necessary to cover projected losses at worse case scenario liquidation. After adjustments for collateral value shortfalls, the allowance for loan losses allocated to these three credits approximated $595,000 at March 31, 2008. The $595,000 assumes a significant loss if the underlying real estate required liquidation currently. The remaining classified balance at March 31, 2008 pertained to one commercial borrower in the timber industry; this $1,942,000 credit relationship is secured primarily by accounts receivable and log inventory and secondly, by logging equipment. No allowance was deemed necessary for this credit under the SFAS 114 calculation at March 31, 2008. Although this timber credit was not past due as to either principal or interest, the long-term outlook for the hardwood industry is particularly troubling, and management is aggressively seeking to reduce its exposure. The Company continues to closely monitor real estate valuations in its markets, particularly given lingering distress in the coastal real estate sector, and consider any implications on the allowance for loan losses and the related provision. No additional relationships have been identified as impaired subsequent to March 31, 2008. As further discussed in the Allowance for Loan Losses subsection of this Analysis, management believes the allowance was adequate at March 31, 2008.

*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 debtor. 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; subsequent charge-offs may be required as a result of changes in the market value of collateral or other repayment prospects. 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 loans until all principal has been collected. The gross amount of interest income that would have been recorded in 2007, 2006, and 2005, if such loans had been accruing interest at their contractual rates, was $69,000, $95,000, and $99,000; interest income actually recognized totaled $66,000, $58,000, and $65,000. 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 three-month provision for loan losses at March 31, 2008 totaled $111,000, and net charge-offs, $12,381. The comparable provision and charge-off amounts at March 31, 2007 were $115,000 and $50,654. Economic uncertainties on loans pertaining to

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the timber industry was the primary impetus in the continuing provision in 2008; these and other loans will continue to be monitored, and the provision adjusted accordingly. Net charge-offs represented 0.02% of average loans at March 31, 2008 compared to 0.08% at March 31, 2007 and 0.16% in 2006. No single charge-off exceeded $10,000 at March 31, 2008. As further mentioned in other sections of this Analysis, the Company is committed to the early recognition of problem loans and to an appropriate and adequate level of allowance. The adequacy of the allowance is further discussed in the next subsection of this Analysis. Activity in the allowance is presented in the table below:

***Allowance for Loan Losses***

| ***Three Months Ended March 31, (Dollars in thousands)*** | ***2008*** | ***2007*** | ***2006*** |
|---|---|---|---|
| Allowance for loan losses at beginning of year | **$ 4,510** | $ 4,240 | $ 4,311 |
| Provision for loan losses | **111** | 115 | 60 |
| Charge-offs: | | | |
| Commercial, financial, and agricultural | **4** | 17 | 64 |
| Real estate construction | **1** | 15 | |
| Real estate mortgage | **1** | | 23 |
| Consumer, including credit cards | **50** | 59 | 46 |
| Total charge-offs | **56** | 91 | 133 |
| Recoveries: | | | |
| Commercial, financial, and agricultural | **2** | 4 | 3 |
| Real estate construction | | | |
| Real estate mortgage | **2** | 2 | 5 |
| Consumer, including credit cards | **40** | 34 | 34 |
| Total recoveries | **44** | 40 | 42 |
| Net charge-offs | **12** | 51 | 91 |
| Allowance for loan losses at end of period | **$ 4,609** | $ 4,304 | $ 4,280 |
| Net loans outstanding[1] at end of period | **$ 261,637** | $ 267,268 | $ 233,073 |
| Average net loans outstanding[1] at end of period | **$ 264,018** | $ 259,386 | $ 227,258 |
| Ratios: | | | |
| Allowance to net loans | **1.76%** | 1.61% | 1.84% |
| Net charge-offs to average loans[2] | **0.02%** | 0.08% | 0.16% |
| Provision to average loans[2] | **0.17%** | 0.20% | 0.11% |
| Recoveries to total charge-offs | **78.57%** | 43.96% | 31.58% |

1 Net of unearned income

2 Annualized.

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. Such evaluation considers prior loss experience, the risk rating distribution of the portfolio, the impact of current internal and external influences on credit loss, and the levels of nonperforming loans. Specific allowances for loan losses are established for large impaired loans evaluated on an individual basis. The specific allowance established for these loans is based on a thorough analysis of the most probable source of repayment, including the present value of the loan s expected future cash flows, the loan s estimated market value, or the estimated fair value of the underlying collateral. General allowances are established for loans grouped into pools based on similar characteristics. In this process, general allowance factors established are based on an analysis of historical charge-off experience and expected loss given default derived from the Company s internal risk rating process. Other adjustments may be made to the

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allowance for the pools after an assessment of internal and external influences on credit quality that are reflected in the historical loss or risk rating data. These influences typically include recent loss experience in specific portfolio segments, trends in loan quality, changes in market focus, and concentrations of credit. This element also requires a high degree of managerial judgment to anticipate the impact that economic trends, legislative or governmental actions, or other unique market and/or portfolio issues will have on credit losses. Unallocated allowances relate to inherent losses that are not included elsewhere in the allowance. The qualitative factors associated with unallocated allowances include the inherent imprecisions in models and lagging or incomplete data. Because of their subjective nature, these risk factors are carefully reviewed by management and revised as conditions indicate. Based on its analyses, management believes the allowance was adequate at March 31, 2008.

Other Commitments

Other than replacement of the branch facility in Yulee, Florida and renovation of other SEB offices, the Company had no material plans or commitments for capital expenditures as of March 31, 2008. Estimated remaining costs associated with new construction and renovations-in-progress at March 31, 2008 were $1,100,000.

**Liquidity**

Liquidity is managed to ensure sufficient cash flow to satisfy demands for credit, deposit withdrawals, and other corporate needs. The Company s sources of funds include a large, stable deposit base and secured advances from the Federal Home Loan Bank. Additional liquidity is provided by payments and maturities, including both principal and interest, of the loan and investment securities portfolios. At March 31, 2008, loans[1] and investment securities with carrying values exceeding $137,636,000 and $31,960,000 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 83% of the funding base at March 31, 2008, down 200 basis points from 2007 levels. The year-to-date variation in core deposits is primarily attributable to an increase in large time certificate balances held by local government customers. Borrowed funds, which variously encompass U.S. Treasury demand notes, federal funds purchased, and FHLB advances, totaled $5,636,287 at March 31, 2008 versus $12,974,523 at December 31, 2007. More specifically, the maximum amount of U.S. Treasury demand notes available to the Company at March 31, 2008 totaled $3,000,000, of which $636,287 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 March 31, 2008, unused borrowings, which are subject to collateral requirements, approximated $65,427,000. 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 2008. Refer to the Capital Adequacy section of this Analysis for details on treasury stock purchases and intercompany dividend policy and the Financial Condition section for details on unfunded loan commitments.

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[1] No cash flow assumptions other than final contractual maturities have been made for installment loans. Nonaccrual loans are excluded.

Deposits

Deposits grew $12,062,088 or 3.33% since year-end 2007. Noninterest-bearing deposits declined $2,873,536 or 4.46% while interest-bearing deposits grew $14,935,624 or 5.02%. More than 84%, or $12,615,653, of the growth in interest-bearing balances was due to time certificates; the remaining $2,319,971 or 16% of the growth was attributable to NOW/MMA accounts and savings. Time certificate balances of $100,000 or more comprised $10,036,955 or 80% of the three-month growth in certificates and 48% of certificate totals at March 31, 2008. Approximately 70% of the growth in large dollar certificates resulted from one government customer. Funding costs associated with deposits increased 3.35% overall at March 31, 2008 versus 2007 due mainly to higher average balances; see the Results of Operations section of this Analysis for more details. Overall, interest-bearing deposits comprised 83.54%, and noninterest-bearing deposits, 16.46%, of total deposits at March 31, 2008. The distribution of interest-bearing balances at March 31, 2008 and certain comparable quarter-end dates is shown in the table below:

| | March 31, 2008 | | December 31, 2007 | | March 31, 2007 | |
|---|---|---|---|---|---|---|
| *Deposits* | *Balances* | *Percent of Total* | *Balances* | *Percent of Total* | *Balances* | *Percent of Total* |
| *(Dollars in thousands)* | | | | | | |
| Interest-bearing demand deposits[1] | **$ 117,786** | **37.69%** | $ 116,154 | 39.03% | $ 95,505 | 36.09% |
| Savings | **63,461** | **20.30%** | 62,772 | 21.09% | 69,355 | 26.20% |
| Time certificates < $100,000 | **68,726** | **21.99%** | 66,148 | 22.23% | 57,471 | 21.71% |
| Time certificates >= $100,000 | **62,583** | **20.02%** | 52,546 | 17.65% | 42,337 | 16.00% |
| Total interest-bearing deposits | **$ 312,556** | **100.00%** | $ 297,620 | 100.00% | $ 264,668 | 100.00% |

[1] NOW and money market accounts.

Deposits of one local governmental body comprised approximately $33,976,000 and $39,525,000 of the overall deposit base at March 31, 2008 and December 31, 2007. The Company had no brokered deposits at March 31, 2008.

Approximately 78% of time certificates at March 31, 2008 were scheduled to mature within the next twelve months. The composition of average deposits and the fluctuations therein at March 31 for the last two years is shown in the Average Balances table included in the Operations section of this Analysis.

FHLB Advances

Advances outstanding with the FHLB totaled $5,000,000 at March 31, 2008, unchanged from year-end 2007. The outstanding advance, which matures March 17, 2010, accrues interest at an effective rate of 6.00%, payable quarterly. The advance is convertible into a three-month Libor-based floating rate anytime at the option of the FHLB. Year-to-date, interest expense on the advance approximated $75,000. Mortgage-backed securities with an aggregate carrying value of $5,172,322 were pledged to collateralize advances under this line of credit.

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

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

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An indicator of interest rate sensitivity is the difference between interest rate sensitive assets and interest rate sensitive liabilities; this difference is known as the interest rate sensitivity gap. In an asset sensitive, or positive, gap position, the amount of interest-earning assets maturing or repricing within a given period exceeds the amount of interest-bearing liabilities maturing or repricing within that same period. Conversely, in a liability sensitive, or negative, gap position, the amount of interest-bearing liabilities maturing or repricing within a given period exceeds the amount of interest-earning assets maturing or repricing within that time period. During a period of rising rates, a negative gap would tend to affect net interest income adversely, while a positive gap would theoretically result in increased net interest income. In a falling rate environment, a negative gap would tend to result in increased net interest income, while a positive gap would affect net interest income adversely. The gap analysis below provides a snapshot of the Company s interest rate sensitivity position at March 31, 2008:

| *Interest Rate Sensitivity* | | | *Repricing Within* | | |
|---|---|---|---|---|---|
| *March 31, 2008* *(Dollars in thousands)* | *0 - 3 Months* | *4 - 12 Months* | *One - Five Years* | *More Than Five Years* | *Total* |
| **Interest Rate Sensitive Assets** | | | | | |
| Federal funds sold | **$ 14,624** | **$** | **$** | **$** | **$ 14,624** |
| Securities[1] | **22,528** | **10,080** | **44,204** | **$ 49,765** | **126,577** |
| Loans, gross[2] | **148,110** | **36,387** | **69,914** | **5,964** | **260,375** |
| Other assets | **1,023** | | | | **1,023** |
| Total interest rate sensitive assets | **186,285** | **46,467** | **114,118** | **55,729** | **402,599** |
| **Interest Rate Sensitive Liabilities** | | | | | |
| Deposits[3] | **$ 210,749** | **73,652** | **28,155** | | **312,556** |
| U.S. Treasury demand note | **636** | | | | **636** |
| Federal Home Loan Bank advances | | | **5,000** | | **5,000** |
| Total interest rate sensitive liabilities | **211,385** | **73,652** | **33,155** | | **318,192** |
| Interest rate sensitivity gap | **$ (25,100)** | **$ (27,185)** | **$ 80,963** | **$ 55,729** | **$ 84,407** |
| **Cumulative gap** | **$ (25,100)** | **$ (52,285)** | **$ 28,678** | **$ 84,407** | |
| Ratio of cumulative gap to total rate sensitive assets | **(6.23)%** | **(12.99)%** | **7.12%** | **20.97%** | |
| Ratio of cumulative rate sensitive assets to rate sensitive liabilities | **88.13%** | **81.66%** | **109.01%** | **126.53%** | |
| Cumulative gap at December 31, 2007 | $ (10,016) | $ (41,623) | $ 47,258 | $ 79,738 | |
| Cumulative gap at March 31, 2007 | $ (10,528) | $ (29,389) | $ 77,885 | $ 110,876 | |

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

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

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

As shown in the preceding table, the Company s cumulative gap position remained negative through the short-term repricing intervals at March 31, 2008, approximating $(25,100,000) at three months and $(52,285,000) through one-year. Excluding traditionally nonvolatile NOW balances from the gap

calculation, the cumulative gap at March 31, 2008 totaled $75,777,000 at three months and $48,592,000 at twelve months, effectively reflecting the Company s asset sensitive position. Compared to year-end 2007, the cumulative three-month gap position widened 150.60%, and the one-year gap, 25.62%, at March 31, 2008. The widening of the short-term gap position at March 31, 2008 was attributable to multiple factors, including a) reductions in securities with original maturities of 90 days or less, b) increases in variable rate loans which have reached a floor and hence, do not float currently, c) pay-offs of other loans with pending maturities and/or variable rate characteristics, and d) increases in deposits with short maturities. Other than seasonal variations, primarily in deposit balances, and extension of maturities in the investment portfolio, no significant changes are anticipated in the gap position during the remainder of 2008; however, as further discussed below, the aggressive rate cuts promulgated by the Federal Reserve are expected to negatively affect net interest income in 2008. 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[2] and securities[1] will perform according to their contractual maturities when, in many cases, actual loan terms are much shorter than the original terms and securities are subject to early redemption.

In addition to gap analysis, the Company uses simulation modeling to test the interest rate sensitivity of net interest income and the balance sheet. Contractual maturity and repricing characteristics of loans are incorporated into the model, as are prepayment assumptions, maturity data, and call options within the investment portfolio. Non-maturity deposit accounts are modeled based on past experience. Simulation results quantify interest rate risks under various interest rate scenarios. Based on the Company s latest analysis, the simulation model estimates that a gradual 300 basis points rise in rates over the next twelve months would increase net interest income approximately 6%; a gradual 300 basis points decline in rates would reduce net interest income approximately 7.50%. An immediate downward shock of 200 basis points would adversely impact net interest income approximately 13% over the next year; a similar upward shock would increase net interest income approximately 15%. Limitations inherent with simulation modeling include: a) 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 securities with call or other prepayment features are likely to be redeemed prior to stated maturity and replaced at lower rates (lag effect); and b) Changes in balance sheet mix, for example, unscheduled pay-offs of large commercial loans, are oftentimes difficult to forecast.

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

**Impact of Inflation**

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

**Capital Adequacy**

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

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

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

| ***Capital Ratios*** ***(Dollars in thousands)*** | ***March 31, 2008*** | ***December 31, 2007*** | ***March 31, 2007*** |
|---|---|---|---|
| Tier 1 capital: | | | |
| Realized shareholders equity | **$ 57,136** | $ 56,721 | $ 53,887 |
| Intangible assets and other adjustments | **(434)** | (448) | (492) |
| Total Tier 1 capital | **56,702** | 56,273 | 53,395 |
| Tier 2 capital: | | | |
| Portion of allowance for loan losses | **3,980** | 3,930 | 3,763 |
| Allowable long-term debt | | | |
| Total Tier 2 capital | **3,980** | 3,930 | 3,763 |
| Total risk-based capital | **$ 60,682** | $ 60,203 | $ 57,158 |
| Risk-weighted assets | **$ 317,772** | $ 313,827 | $ 300,604 |
| Risk-based ratios: | | | |
| Tier 1 capital | **17.84%** | 17.93% | 17.76% |
| Total risk-based capital | **19.10%** | 19.18% | 19.01% |
| Tier 1 leverage ratio | **13.32%** | 13.60% | 12.91% |
| Realized shareholders equity to assets | **12.96%** | 13.00% | 13.03% |

Book value per share grew a modest $0.13 or 0.73% during the first three months of 2008 to $17.98 at March 31, 2008. Dividends declared totaled $0.25, up 78.57% or $0.11 from 2007. The increase in the declared dividend resulted primarily from a change in dividend structure: Traditionally, the Company has declared regular quarterly dividends, and in the fourth quarter, an extra dividend for payment the following January; in 2007, the Company did not declare an extra dividend, intending for future dividends to be paid in equal installments over four quarters, eventually in the same quarter as declared. In 2006, the regular quarterly dividends totaled $0.135 per share, and the extra dividend, $0.48. In 2007, although the dividend declared was $0.67 for the year or $0.14 per quarter, the paid dividend totaled $1.035. In February 2008, the Company declared a regular quarterly dividend of $0.25. Management believes the new dividend structure better aligns the Company with market practices. For more specifics on the Company s dividend policy, refer to the subsection immediately following. Accumulated other comprehensive loss, which measures net fluctuations in the fair values of investment securities, improved $250,613 at March 31, 2008 compared to year-end 2007. 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 $15,000,000 in treasury stock. From 2000 2007, the Company repurchased 402,466 shares on the open market and through private transactions at an average price of $20.64 per share. No treasury stock purchases have been made in 2008 year-to-date. The maximum consideration available for additional purchases, at prices to be determined in the future, is $6,692,095. Any acquisition of additional shares will be dictated by market conditions. There is no expiration date for the treasury authorization.

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. Year-to-date, SEB has paid 25% or $791,000 of the $3,164,000 in cash dividends available to the Company in 2008 without such approval. 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.

**Results of Operations**

Net income for the first quarter of 2008 totaled $1,209,028, down $461,739 or 27.64% from March 31, 2007. On a per share basis, quarterly earnings totaled $0.38 at March 31, 2008 versus $0.52 at March 31, 2007. The return on beginning equity for the three-month period totaled 8.53% at March 31, 2008 versus 12.66% at March 31, 2007. A reduction in net interest margin was the chief factor in the 2008 results to-date. Variations in net interest income and noninterest income/expense are further discussed within the next two subsections of this Analysis; the provision for loan losses is separately discussed within the Financial Condition section.

Net Interest Income

Due to asset sensitivity and margin compression, net interest income declined $636,752 or 12.96% during the first quarter of 2008 compared to 2007. Simply put, asset sensitivity means earnings on loans and other assets generally decline quicker than expenses on deposits and other liabilities when rates drop. Rate movements promulgated by the Federal Reserve in 2008 to-date have been particularly rapid and aggressive: Prime has dropped from 7.25% at December 31, 2007 to 5.25% at March 31, 2008 and subsequently, 5.00% at April 30, 2008. Loans tied to prime and other variable indexes reprice instantaneously in a down rate environment, and securities with call or other prepayment features are normally redeemed prior to stated maturity and replaced at lower rates. Management has cut deposit rates multiple times in 2008 although competitive and other factors preclude simultaneous and proportionate declines in these rates. Following the first quarter trend, net interest income for the entire fiscal 2008 is projected to lag 2007 results by approximately 14%. To recap, the net interest margin approximated 4.60% at March 31, 2008 versus 5.45% a year ago; the interest rate spread, 3.94% versus 4.46%. Interest earnings on loans and other earning assets fell $671,441 and $1,629, while earnings on investments and federal funds sold increased a marginal $13,441 and $55,289 from same period results in 2007. Significant declines in asset yields precipitated the 2008 results. Asset yields averaged 7.03% at March 31, 2008 versus 7.93% in 2007; see the interest differential table on page 23 for more details on changes in interest income attributable to volume and rates at March 31, 2008 versus 2007. Interest expense on deposits and other borrowed funds increased $32,412 or 1.38% during the first quarter of 2008 versus 2007 due to higher average balances, particularly in interest-bearing demand deposits and time certificates. Cost of funds actually declined 38 basis points from 2007 levels, totaling 3.09% at March 31, 2008 versus 3.47% at March 31, 2007. Refer to the Liquidity and Interest Sensitivity sections of this Analysis for more details on deposit fluctuations and the Company s asset sensitivity.

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The intense competition for loans and deposits continues in 2008 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 two years are provided in the table on the next page.

**Selected Average Balances, Income/Expense, and Average Yields Earned and Rates Paid**

| *Average Balances[6]* | | **2008** | | | **2007** | |
|---|---|---|---|---|---|---|
| *Three Months Ended March 31, (Dollars in thousands)* | *Average Balances* | *Income/ Expense* | *Yields/ Rates* | *Average Balances* | *Income/ Expense* | *Yields/ Rates* |
| **Assets** | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans, net[1,2,4] | **$ 264,018** | **$ 5,214** | **7.94%** | $ 259,386 | $ 5,894 | 9.22% |
| Federal funds sold | **9,207** | **65** | **2.84%** | 659 | 9 | 5.54% |
| Taxable investment securities[3] | **86,578** | **1,040** | **4.83%** | 88,170 | 1,007 | 4.63% |
| Tax-exempt investment securities[3,4] | **27,671** | **453** | **6.58%** | 29,826 | 487 | 6.62% |
| Other assets | **1,016** | **15** | **5.94%** | 1,104 | 17 | 6.24% |
| Total interest-earning assets | **$ 388,490** | **$ 6,787** | **7.03%** | $ 379,145 | $ 7,414 | 7.93% |
| **Liabilities** | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing demand deposits[5] | **$ 113,182** | **$ 549** | **1.95%** | $ 94,046 | $ 652 | 2.81% |
| Savings | **62,971** | **191** | **1.22%** | 69,360 | 364 | 2.13% |
| Time deposits | **121,733** | **1,507** | **4.98%** | 97,218 | 1,158 | 4.83% |
| Federal funds purchased | **2,130** | **22** | **4.15%** | 4,530 | 57 | 5.10% |
| U. S. Treasury demand note | **530** | **4** | **3.04%** | 861 | 11 | 5.18% |
| Federal Home Loan Bank advances | **5,000** | **75** | **6.03%** | 5,000 | 74 | 6.00% |
| Total interest-bearing liabilities | **$ 305,046** | **$ 2,348** | **3.09%** | $ 271,015 | $ 2,316 | 3.47% |
| Excess of interest-earning assets over interest-bearing liabilities | **$ 82,944** | | | $ 108,130 | | |
| **Interest rate spread** | | | **3.94%** | | | 4.46% |
| **Net interest income** | | **$ 4,439** | | | $ 5,098 | |
| **Net interest margin** | | | **4.60%** | | | 5.45% |

1 Average loans are shown net of unearned income. Nonperforming loans are included. Income on nonaccrual loans, if recognized, is recorded on a cash basis.

2 Includes loan fees and late charges.

3 Securities are presented on an amortized cost basis. Investment securities with original maturities of three months or less are included, as applicable.

4

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.

[5] NOW and money market accounts.

[6] Averages presented generally represent average daily balances.

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**Analysis of Changes in Net Interest Income**

The average balance table above provides detailed information about average balances, income/expense, and average yields earned and rates paid on interest-earning assets and interest-bearing liabilities for the three months ended March 31, 2008 and 2007. The table on the next page summarizes the changes in interest income and interest expense attributable to volume and rates during this period.

**Interest Differential[1]**

| *Three Months Ended March 31,* *(In thousands)* | 2008 Compared to 2007 Increase (Decrease) Due to Volume | Rate | Net |
|---|---|---|---|
| **Interest income** | | | |
| Loans[2,3] | $ 104 | $ (784) | $ (680) |
| Federal funds sold | 62 | (6) | 56 |
| Taxable investment securities | (18) | 51 | 33 |
| Tax-exempt investment securities[3] | (35) | 1 | (34) |
| Other interest-earning assets | (1) | (1) | (2) |
| Total interest income | 112 | (739) | (627) |
| **Interest expense** | | | |
| Interest-bearing demand deposits[4] | 117 | (220) | (103) |
| Savings | (31) | (142) | (173) |
| Time deposits | 302 | 47 | 349 |
| Federal funds purchased[5] | (26) | (9) | (35) |
| U.S. Treasury demand note | (3) | (4) | (7) |
| Federal Home Loan Bank advances | | 1 | 1 |
| Total interest expense | 359 | (327) | 32 |
| **Net change in net interest income** | $ (247) | $ (412) | $ (659) |

1 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.

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

3 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.

4 Now and money market accounts.

5 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 $35,457 or 3.31% during the first quarter of 2008 compared to 2007. Key elements in the quarterly results included:

a) Investment securities gains, net: The Company recognized a $134,628 gain on the sale of corporate securities totaling $2,991,872 in the first quarter of 2007. These securities were sold primarily to fund 2007 growth in the loan portfolio. No securities were sold during the first quarter of 2008.

b) Service charges on deposit accounts: Service charges on deposit accounts grew $57,570 or 9.45% at March 31, 2008 compared to 2007. Approximately 59% of the 2008 improvement was attributable to higher volume of NSF fees; the remaining improvement resulted primarily from increased analysis charges on commercial accounts.

c) Other operating income: The other operating portion of noninterest income increased $41,601 or 12.6% at March 31, 2008 compared to 2007. The recognition of $58,464 income on bank-owned life insurance was the predominant factor in the quarterly results. Specifically, the Company purchased $5,000,000 in bank-owned life insurance in November 2007; this single premium insurance currently yields 7.00% on a federal taxable-equivalent basis. By type and amount, the chief components of other operating income at March 31, 2008 were surcharge fees - ATM, $94,741; mortgage origination fees, $66,727; income on bank-owned life insurance, $58,464; income on sale of check products, $29,731; safe deposit box rentals, $23,920; and commissions on the sale of credit life insurance, $22,279. Together, these six income items comprised 80.01% of other operating income at March 31, 2008. In 2007, these same income components comprised 83.29% of other operating income. The Company is in the process of expanding and revamping its mortgage origination department and is optimistic that these initiatives will increase fee production and cross-sell opportunities long-term.

Noninterest expense increased $90,706 in 2008 year-to-date. The main factors impacting quarterly results comprised:

a) Salaries and employee benefits: Personnel costs declined a nominal 0.94% or $19,604 year-to-date. Declines in incentive accruals accounted for virtually all of the variation as base salary expense and fringe benefit costs actually increased year-over-year. The vast majority, or 84%, of employee expenses remained concentrated in salaries and other direct compensation, including related payroll taxes, at March 31, 2008. 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 2008.

b) Occupancy and equipment, net: When compared to the prior year, net occupancy and equipment expense increased $54,334 during the first three months of 2008 compared to 2007. Operating costs and depreciation associated with technology programs and the Company s permanent facility at 15 Trade Street in Brunswick were primary factors in the increase.

c) Other operating expense: Other operating expenses increased $55,976 or 8.55% at March 31, 2008 compared to 2007; net losses versus gains on sales of foreclosed real estate and other assets was the chief variable. Besides advertising expense, which approximated $91,000 in 2008 and $95,000 in 2007, no individual component of other operating expenses aggregated or exceeded 10% of the total in 2008 or 2007.

Overhead related to the Company s new Trade Street facility, as noted above, expansion/revamping of the mortgage origination department, and renovation of SEB s older facilities are expected to increase noninterest expense approximately $325,000 in 2008 compared to 2007.

**Critical Accounting Policies**

The Company s consolidated financial statements are prepared applying certain critical accounting policies. Critical accounting policies affect accounts such as the allowance for loan losses, income taxes, investment securities, and goodwill and other intangibles and require numerous estimates and strategic or economic assumptions that may prove inaccurate or subject to variations and may significantly affect the Company s reported results and financial position for the period or in future periods. Changes in underlying factors, assumptions, or estimates in any of these areas could have a material impact on the Company s future financial condition and results of operations. The Company s critical accounting policies are further discussed in the 2007 Form 10-K. There have been no material changes in the Company s critical accounting policies since December 31, 2007.

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**Recent Accounting Pronouncements**

Recent accounting pronouncements affecting the Company are discussed in the notes to the consolidated financial statements.

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.

**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.

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.

**Item 3. 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 I, Item 2.

**Item 4T. Controls and Procedures.**

The Company s management, with the participation of the Company s Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO or Treasurer), has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) or 15(d)-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, the CEO and Treasurer have concluded that the Company s current disclosure controls and procedures, as designed and implemented, were effective. No changes in controls occurred during the first quarter that have materially affected, or are likely to materially affect, the Company s internal controls over financial reporting.

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**Part II - Other Information**

**Item 1. Legal Proceedings.**
Not Applicable

**Item 1A. Risk Factors.**
There were no material changes to the Company s risk factors during the first quarter of 2008.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**
Not Applicable

**Item 3. Defaults Upon Senior Securities.**
Not Applicable

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

The Annual Meeting of Shareholders (the Meeting) was held on May 14, 2008. At the Meeting, the following individuals were elected directors:

| Directors | For | Withheld |
|---|---|---|
| Alyson G. Beasley | 2,340,599 | 684 |
| Leslie H. Blair | 2,340,599 | 684 |
| David H. Bluestein | 2,340,599 | 684 |
| Cornelius P. Holland, III | 2,304,614 | 36,669 |
| Alva J. Hopkins, III | 2,340,599 | 684 |
| A. Wade Strickland | 2,340,599 | 684 |

The shareholders also approved the following proposals:

(a) Setting the number of directors at a 9 member maximum, with 3 to remain vacant until the elected Board deems it in the Company s best interest to fill one or more of such vacancies.

| For | Against | Abstain | Broker Non-Votes |
|---|---|---|---|
| 2,298,900 | 37,335 | 5,048 | |

(b) The appointment of independent auditors by the Audit Committee for fiscal year 2008.

| For | Against | Abstain | Broker Non-Votes |
|---|---|---|---|
| 2,336,780 | | 4,503 | |

**Item 5. Other Information.**

Not Applicable

**Item 6. Exhibits.**

(a) Index to Exhibits:

| | |
|---|---|
| Exhibit 3 | Articles of Incorporation and Bylaws, incorporated by reference from the Company s Annual Report on Form 10-K for the year ended December 31, 1990 |
| Exhibit 31.1 | Rule 13a-14(a) Certification of CEO |
| Exhibit 31.2 | Rule 13a-14(a) Certification of Treasurer |
| Exhibit 32 | Section 1350 Certification of CEO/Treasurer |

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**Signatures**

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

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

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

*(Chief Accounting Officer)*

Date: May 15, 2008