

SOUTHEASTERN BANKING CORP  
Form 10-Q  
November 14, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**of the Securities Exchange Act of 1934**

**For the Quarterly Period Ended September 30, 2007**

**Commission File Number 2-83157**

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**SOUTHEASTERN BANKING CORPORATION**

(Exact name of registrant as specified in its charter)

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**Georgia**  
(State or other jurisdiction of

**58-1423423**  
(IRS Employer

incorporation or organization)

Identification No.)

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

(Address of principal executive offices) (Zip Code)

**(912) 437-4141**

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject

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to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of October 31, 2007, 3,199,330 shares of the registrant's common stock, par value \$1.25 per share, were outstanding.

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**Table of Contents****Item I Financial Statements****Southeastern Banking Corporation****Consolidated Balance Sheets**

	(Unaudited) September 30, 2007	December 31, 2006
<b>Assets</b>		
Cash and due from banks	\$ 18,663,108	\$ 23,410,228
Federal funds sold	3,796,000	
Cash and cash equivalents	22,459,108	23,410,228
<b>Investment securities</b>		
Available-for-sale, at market value	59,712,316	93,490,850
Held-to-maturity (market value of approximately \$32,765,000 and \$33,233,000 at September 30, 2007 and December 31, 2006)	32,644,038	32,795,375
Total investment securities	92,356,354	126,286,225
Loans, gross	273,838,626	247,877,870
Unearned income	(129,849)	(112,437)
Allowance for loan losses	(4,408,070)	(4,239,966)
Loans, net	269,300,707	243,525,467
Premises and equipment, net	11,739,999	9,842,875
Intangible assets	462,830	506,490
Other assets	5,886,448	6,730,771
<b>Total Assets</b>	<b>\$ 402,205,446</b>	<b>\$ 410,302,056</b>
<b>Liabilities and Shareholders Equity</b>		
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest-bearing deposits	\$ 62,040,747	\$ 80,979,450
Interest-bearing deposits	273,842,589	260,971,580
Total deposits	335,883,336	341,951,030
Federal funds purchased		4,684,000
U. S. Treasury demand note	1,936,993	1,905,141
Federal Home Loan Bank advances	5,000,000	5,000,000
Other liabilities	3,665,326	4,575,699
Total liabilities	346,485,655	358,115,870
<b>Shareholders Equity</b>		
Common stock (\$1.25 par value; 10,000,000 shares authorized; 3,580,797 shares issued; 3,199,330 and 3,213,600 shares outstanding at September 30, 2007 and December 31, 2006)	4,475,996	4,475,996
Additional paid-in-capital	1,391,723	1,391,723
Retained earnings	57,912,481	54,272,250
Treasury stock, at cost (381,467 and 367,197 shares at September 30, 2007 and December 31, 2006)	(7,758,333)	(7,356,329)

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Realized shareholders' equity	<b>56,021,867</b>	52,783,640
Accumulated other comprehensive loss	<b>(302,076)</b>	(597,454)
<b>Total shareholders' equity</b>	<b>55,719,791</b>	52,186,186
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 402,205,446</b>	\$ 410,302,056

*See accompanying notes to consolidated financial statements.*

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

<i>Period Ended September 30,</i>	<i>Quarter</i>		<i>Nine Months</i>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Interest income</b>				
Loans, including fees	\$ 6,226,804	\$ 5,376,231	\$ 18,207,205	\$ 15,474,705
Federal funds sold	9,416	68,024	49,409	191,928
Investment securities				
Taxable	823,152	904,881	2,719,530	2,782,595
Tax-exempt	314,466	320,590	954,580	979,126
Other assets	17,350	16,985	51,307	48,884
Total interest income	7,391,188	6,686,711	21,982,031	19,477,238
<b>Interest expense</b>				
Deposits	2,373,062	1,691,911	6,854,770	4,458,764
Federal funds purchased	72,235	1,479	160,245	19,701
U. S. Treasury demand note	10,649	8,854	32,713	22,722
Federal Home Loan Bank advances	75,644	75,644	224,466	224,466
Total interest expense	2,531,590	1,777,888	7,272,194	4,725,653
Net interest income	4,859,598	4,908,823	14,709,837	14,751,585
<b>Provision for loan losses</b>	70,000		205,000	59,500
Net interest income after provision for loan losses	4,789,598	4,908,823	14,504,837	14,692,085
<b>Noninterest income</b>				
Service charges on deposit accounts	668,982	623,500	1,981,219	1,812,474
Investment securities gains, net	(36,843)		97,785	
Other operating income	292,483	328,355	962,167	956,399
Total noninterest income	924,622	951,855	3,041,171	2,768,873
<b>Noninterest expense</b>				
Salaries and employee benefits	2,021,550	2,019,385	6,223,799	6,039,402
Occupancy and equipment, net	669,040	746,292	2,005,699	2,044,139
Other operating expense	574,693	658,351	1,973,664	1,987,761
Total noninterest expense	3,265,283	3,424,028	10,203,162	10,071,302
Income before income tax expense	2,448,937	2,436,650	7,342,846	7,389,656
<b>Income tax expense</b>	786,168	790,281	2,355,961	2,382,799
<b>Net income</b>	\$ 1,662,769	\$ 1,646,369	\$ 4,986,885	\$ 5,006,857
<b>Basic and diluted earnings per common share</b>	\$ 0.52	\$ 0.51	\$ 1.55	\$ 1.55

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Weighted average common shares outstanding

**3,204,787**    3,213,600    **3,208,760**    3,226,307  
*See accompanying notes to consolidated financial statements.*

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

	<i>Common Stock</i>	<i>Additional Paid-In Capital</i>	<i>Retained Earnings</i>	<i>Treasury Stock</i>	<i>Accumulated Other Comprehensive Income (Loss)</i>	<i>Total</i>
<b>Balance, December 31, 2005</b>	\$ 4,475,996	\$ 1,391,723	\$ 50,977,998	\$ (6,757,073)	\$ (687,744)	\$ 49,400,900
Comprehensive income:						
Net income			5,006,857			5,006,857
Change in unrealized losses on available-for-sale securities, net of tax effect of \$23,412					45,446	45,446
<b>Total comprehensive income</b>						<b>5,052,303</b>
Cash dividends declared (\$0.405 per share)			(1,304,399)			(1,304,399)
Purchase of treasury stock				(599,256)		(599,256)
<b>Balance, September 30, 2006</b>	\$ 4,475,996	\$ 1,391,723	\$ 54,680,456	\$ (7,356,329)	\$ (642,298)	\$ 52,549,548
<b>Balance, December 31, 2006</b>	\$ 4,475,996	\$ 1,391,723	\$ 54,272,250	\$ (7,356,329)	\$ (597,454)	\$ 52,186,186
Comprehensive income:						
Net income			<b>4,986,885</b>			<b>4,986,885</b>
Change in unrealized losses on available-for-sale securities, net of tax effect of \$152,164					<b>295,378</b>	<b>295,378</b>
<b>Total comprehensive income</b>						<b>5,282,263</b>
Cash dividends declared (\$0.42 per share)			<b>(1,346,654)</b>			<b>(1,346,654)</b>
Purchase of treasury stock				<b>(402,004)</b>		<b>(402,004)</b>
<b>Balance, September 30, 2007</b>	<b>\$ 4,475,996</b>	<b>\$ 1,391,723</b>	<b>\$ 57,912,481</b>	<b>\$ (7,758,333)</b>	<b>\$ (302,076)</b>	<b>\$ 55,719,791</b>

*See accompanying notes to consolidated financial statements.*



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

<i>Nine Months Ended September 30,</i>	<b>2007</b>	<b>2006</b>
<b>Operating activities</b>		
Net income	\$ 4,986,885	\$ 5,006,857
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	205,000	59,500
Depreciation	488,072	467,109
Amortization and accretion, net	131,756	174,213
Investment securities gains, net	(97,785)	
Net gains on sales of other real estate	(49,206)	(9,410)
Changes in assets and liabilities:		
Decrease (increase) in other assets	484,253	(140,994)
Decrease in other liabilities	617,721	247,490
Net cash provided by operating activities	<b>6,766,696</b>	5,804,765
<b>Investing activities</b>		
Principal collections and maturities of investment securities:		
Available-for-sale	132,540,310	47,386,709
Held-to-maturity	970,000	3,109,400
Proceeds from sales of available-for-sale investment securities	12,086,010	
Purchases of available-for-sale investment securities	(110,293,466)	(45,112,871)
Purchases of held-to-maturity investment securities	(900,000)	(1,590,000)
Net increase in loans	(26,102,912)	(15,437,815)
Proceeds from sales of other real estate	364,033	89,257
Capital expenditures, net	(2,385,196)	(1,111,132)
Net cash provided by (used in) investing activities	<b>6,278,779</b>	(12,666,452)
<b>Financing activities</b>		
Net (decrease) increase in deposits	(6,067,694)	2,572,456
Net decrease in federal funds purchased	(4,684,000)	
Net increase in U. S. Treasury demand note	31,852	415,443
Purchase of treasury stock	(402,004)	(599,256)
Dividends paid	(2,874,749)	(2,908,614)
Net cash provided by financing activities	<b>(13,996,595)</b>	(519,971)
Net decrease in cash and cash equivalents	<b>(951,120)</b>	(7,381,658)
Cash and cash equivalents at beginning of period	23,410,228	36,590,266
Cash and cash equivalents at end of period	<b>\$ 22,459,108</b>	\$ 29,208,608
<b>Supplemental disclosure</b>		
<b>Cash paid during the period</b>		
Interest	\$ 6,798,358	\$ 4,493,172
Income taxes	1,995,000	2,615,000
<b>Noncash investing and financing activities</b>		

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Real estate acquired through foreclosure	\$	<b>146,297</b>	\$	297,060
Loans made in connection with sales of foreclosed real estate		<b>23,625</b>		111,072

*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 quarter and nine months ended September 30, 2007 are not necessarily indicative of trends or results to be expected for the full year 2007. 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, 2006 has been extracted from the audited financial statements included in the Company's 2006 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, 2006. There have been no significant changes to the Company's Accounting Policies as disclosed in the 2006 Form 10-K.

**2. Recent Accounting Standards**

In June 2006, the Financial Accounting Standards Board (the FASB) issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, a clarification of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. FIN 48 provides a single model to address accounting for uncertainty in tax positions by prescribing a recognition threshold that an individual tax position must meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 effective January 1, 2007, and the adoption did not have a material impact on the Company's financial position or results of operations.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140. This statement requires that all separately recognized servicing rights be initially measured at fair value. Subsequently, an entity may either recognize its servicing rights at fair value or amortize its servicing rights over an estimated life and assess any impairment at least quarterly. SFAS No. 156 also amends how gains and losses are computed in transfers or securitizations that qualify for sale treatment in which the transferor retains the right to service the transferred financial asset. Additional disclosures for all separately recognized servicing rights are also required. SFAS No. 156 applies to loan participations sold by the Company to non-affiliated banks. In accordance with SFAS No. 156, the Company will initially measure servicing rights at fair value with any changes reported in earnings at least quarterly. The Company adopted the provisions of SFAS No. 156 effective January 1, 2007, and the adoption did not 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 September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This statement provides enhanced guidance for using fair value to measure assets and liabilities. The statement also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. 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 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157 on its financial position and results of operations.

In February 2007, the 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.

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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 2006 Annual Report on Form 10-K and the consolidated financial statements & related notes on pages 3 - 8 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 \$402,205,000, is a financial services holding 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 \$402,205,446 at September 30, 2007, down \$8,096,610 from year-end 2006. Growth in the loan portfolio was offset by declines in investment securities. Specifically, loans grew \$25,775,240 or 10.58% while investment securities declined \$33,929,871 or 26.87%. Loans comprised approximately 74%, investment securities, 25%, and fed funds sold, 1%, of earning assets at September 30, 2007 versus 66%, 34%, and 0% at December 31, 2006. Overall, earning assets approximated 91% of total assets at September 30, 2007. During the year-earlier period, total assets grew \$4,779,822 or 1.23%. An increase in loans outstanding was the main factor in the 2006 results. Refer to the Liquidity section of this Analysis for details on deposits and other funding sources.

**Investment Securities**

On a carrying value basis, investment securities declined \$33,929,871 or 26.87% since December 31, 2006. The maturity of agency discount notes purchased in December 2006 to collateralize public funds and the sale of corporate and agency securities were the predominant factors in the nine-month decline. Overall, purchases of securities during the nine-month period, primarily comprising short-term securities with original maturities of 90 days or less, approximated \$111,193,000, and redemptions, \$145,499,000. The Company recognized a net gain of \$97,785 on the sale of \$11,988,225 corporate and agency securities year-to-date; these securities were sold primarily to fund growth in the loan portfolio. The remaining redemptions were attributable to maturities and prepayments in the normal course of business. 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 September 30, 2007, mortgage-backed securities, corporates, and municipals comprised 21%, 9%, and 35% of the portfolio. Overall, securities comprised 25% of earning assets at September 30, 2007, down from 34% at year-end 2006. The portfolio yield approximated 5.14% during the first nine months of 2007.

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Management believes the credit quality of the investment portfolio remains sound, with 55.94% of the carrying value of debt securities being backed by the U.S. Treasury or other U.S. Government-sponsored agencies at September 30, 2007. The Company does not own any collateralized debt obligations, widely known as CDOs, secured by subprime residential mortgage-backed securities. The weighted average life of the portfolio approximated 3 years at September 30, 2007. The amortized cost and estimated fair value of investment securities are delineated in the table below:

*Investment Securities by Category*

<i>September 30, 2007 (In thousands)</i>	<i>Amortized Cost</i>	<i>Unrealized Gains</i>	<i>Unrealized Losses</i>	<i>Fair Value</i>
Available-for-sale:				
U. S. Government agencies	\$ 32,531	\$ 102	\$ 146	\$ 32,487
Mortgage-backed securities	19,580	36	435	19,181
Corporates	8,058	81	95	8,044
	<b>60,169</b>	219	676	<b>59,712</b>
Held-to-maturity:				
States and political subdivisions	32,644	424	303	32,765
Total investment securities	\$ 92,813	\$ 643	\$ 979	\$ 92,477

As shown, the market value of the investment portfolio reflected \$336,793 in net unrealized losses at September 30, 2007; refer to the Capital Adequacy section of this Analysis for more details on investment securities and related fair value. The Company does not have a concentration in the obligations of any issuer other than the U.S. Government and its agencies.

## Loans

Loans, net of unearned income, grew 10.47% or \$25,943,344 since year-end 2006. The net loans to deposits ratio aggregated 81.49% at September 30, 2007 versus 72.46% at December 31, 2006 and 72.10% a year ago. A \$20,963,390 or 14.60% increase in real estate construction and residential mortgage loans was the primary factor in the 2007 results. The majority of the growth within the real estate portfolio was residential in nature and concentrated in the Company's coastal markets. Most of the loans in the real estate construction portfolio are preparatory to customers' attainment of permanent financing or developer's sale and are, by nature, short-term and somewhat cyclical; swings in these account balances are normal and to be expected. Although the Company, like peer institutions of similar size, originates permanent mortgages for new construction, it traditionally does not hold or service long-term mortgage loans for its own portfolio. Rather, permanent mortgages are typically brokered through a mortgage underwriter or government agency. The Company receives mortgage origination fees for its participation in these origination transactions; refer to the disclosures provided under Results of Operations for more details. Overall, the commercial portfolio grew \$5,132,897 or 5.88% at September 30, 2007 compared to December 31, 2006; growth in nonfarm real estate and governmental loans were key factors in the September 30 results. Consumer loans declined \$135,532 year-to-date; these loans comprised 6.13% of the total portfolio at September 30, 2007.

Due to economic uncertainties within the Company's markets and resultant concerns regarding credit opportunities, management expects loan volumes to flatten or decline moderately during the fourth quarter of 2007 and into 2008. During the first nine months of 2006, net loans increased \$15,126,073. Loans outstanding are presented by type in the table on the next page.

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<i>Loans by Category</i> <i>(In thousands)</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>	<b>September 30, 2006</b>
Commercial, financial, and agricultural <sup>1</sup>	<b>\$ 92,388</b>	<b>\$ 87,255</b>	<b>\$ 86,174</b>
Real estate construction	<b>125,146</b>	<b>104,212</b>	<b>96,807</b>
Real estate residential mortgage <sup>2</sup>	<b>39,369</b>	<b>39,340</b>	<b>38,789</b>
Consumer, including credit cards	<b>16,936</b>	<b>17,071</b>	<b>17,272</b>
<b>Loans, gross</b>	<b>273,839</b>	<b>247,878</b>	<b>239,042</b>
Unearned income	<b>130</b>	<b>112</b>	<b>124</b>
<b>Loans, net</b>	<b>\$ 273,709</b>	<b>\$ 247,766</b>	<b>\$ 238,918</b>

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

<sup>2</sup> 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 September 30, 2007, 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 \$58,580,000 at September 30, 2007; 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 2007 year-to-date.

*Nonperforming Assets*

Nonperforming assets consist of nonaccrual loans, restructured loans, and foreclosed real estate and other assets. Overall, nonperforming assets aggregated \$790,812 at September 30, 2007, down \$476,460 or 37.60% from year-end 2006. As a percent of total assets, nonperforming assets totaled 0.20% at September 30, 2007 versus 0.31% at year-end 2006 and 0.35% at September 30, 2006. No material credits have been added to or removed from nonaccrual status during 2007 year-to-date. Individual concentrations within nonaccrual balances included loans to two separate borrowers averaging \$76,000 each at September 30, 2007; 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 September 30, 2007. Criteria used by management in classifying loans as nonaccrual is discussed in the subsection entitled Policy Note. The allowance for loan losses approximated 5.57X the nonperforming loans balance at September 30, 2007 versus 4.40X at year-end 2006 and 4.01X a year ago. Significant activity within foreclosed real estate balances included the sale of a residential parcel valued at approximately \$138,000. Management is unaware of any other material developments in nonperforming assets at September 30, 2007 that should be presented or otherwise discussed.

Loans past due 90 days or more approximated \$535,000, or less than 1% of net loans, at September 30, 2007. Management is unaware of any material concentrations within these past due balances. The table on the next page provides further information about nonperforming assets and loans past due 90 plus days.

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	September 30, 2007	December 31, 2006	September 30, 2006
<i>Nonperforming Assets</i>			
<i>(In thousands)</i>			
Nonaccrual loans:			
Commercial, financial, and agricultural	\$ 133	\$ 235	\$ 250
Real estate construction	79	121	126
Real estate mortgage	287	318	347
Consumer, including credit cards	182	290	336
Total nonaccrual loans	681	964	1,059
Restructured loans <sup>1</sup>			
Total nonperforming loans	681	964	1,059
Foreclosed real estate <sup>2</sup>	96	288	293
Other repossessed assets	14	15	26
Total nonperforming assets	\$ 791	\$ 1,267	\$ 1,378
Accruing loans past due 90 days or more	\$ 535	\$ 647	\$ 476
Ratios:			
Nonperforming loans to net loans	0.25%	0.39%	0.44%
Nonperforming assets to net loans plus foreclosed/repossessed assets	0.29%	0.51%	0.58%

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

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

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

*Allowance for Loan Losses*

The Company continuously reviews its loan portfolio and maintains an allowance for loan losses available to absorb losses inherent in the portfolio. The nine-month provision for loan losses at September 30, 2007 totaled \$205,000, and net charge-offs, \$36,896. The comparable provision and charge-off amounts at September 30, 2006 were \$59,500 and \$125,753. Economic uncertainties on loans pertaining to the timber industry was the primary impetus in the increased provision year-to-date; these loans will continue to be monitored, and the provision adjusted accordingly. Net charge-offs represented 0.02% of average loans at September 30, 2007 compared to 0.07% at September 30, 2006 and 0.06% in 2005. A \$48,000 recovery on an agricultural loan comprised approximately 26% of gross recoveries in



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2007 year-to-date. 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*

<i>Nine Months Ended September 30, (Dollars in thousands)</i>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Allowance for loan losses at beginning of year	<b>\$ 4,240</b>	\$ 4,311	\$ 4,134
Provision for loan losses	<b>205</b>	60	259
Charge-offs:			
Commercial, financial, and agricultural	<b>28</b>	80	1137
Real estate construction	<b>16</b>	1	
Real estate mortgage	<b>9</b>	23	35
Consumer, including credit cards	<b>171</b>	152	155
Total charge-offs	<b>224</b>	256	303
Recoveries:			
Commercial, financial, and agricultural	<b>65</b>	15	70
Real estate construction			
Real estate mortgage	<b>21</b>	12	13
Consumer, including credit cards	<b>101</b>	103	118
Total recoveries	<b>187</b>	126	201
Net charge-offs	<b>37</b>	119	102
Allowance for loan losses at end of period	<b>\$ 4,408</b>	\$ 4,245	\$ 4,291
Net loans outstanding <sup>1</sup> at end of period	<b>\$ 273,709</b>	\$ 238,918	\$ 218,236
Average net loans outstanding <sup>1</sup> at end of period	<b>\$ 268,165</b>	\$ 234,098	\$ 217,817
Ratios:			
Allowance to net loans	<b>1.61%</b>	1.78%	1.97%
Net charge-offs to average loans <sup>2</sup>	<b>0.02%</b>	0.07%	0.06%
Provision to average loans <sup>2</sup>	<b>0.10%</b>	0.03%	0.16%
Recoveries to total charge-offs	<b>83.53%</b>	50.78%	66.34%

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

<sup>2</sup> 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. The allowance for loan losses consists of three elements: a) specific allowances for individual loans; b) general allowances for loan pools based on historical loan loss experience and current trends; and c) allowances based on economic conditions and other risk factors in the Company's markets. The specific allowance for classified and other loans is based on a careful analysis of probable and potential sources of repayment, including cash flow, collateral value, and guarantor capacity. The general allowance is determined by the mix of loan products within the portfolio, an internal loan grading process, and associated allowance factors. These general allowance factors are updated at least

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annually and are based on a statistical loss analysis and current loan charge-off trends. The loss analysis examines loss experience for loan portfolio segments in relation to internal loan grades. Charge-off trends are analyzed for homogeneous loan categories (e.g., residential real estate, consumer loans, etc.). While formal loss and charge-off trend analyses are conducted annually, the Company continually monitors credit quality in all portfolio segments and revises the general allowance factors whenever necessary in order to address improving or deteriorating credit quality trends or specific risks associated with a given loan category.

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The third element, comprised of economic conditions, concentrations, and other risk factors, is based on marketplace conditions and/or events that may affect loan repayment in the near-term. This element requires a high degree of managerial judgment to anticipate the impact that economic trends, legislative or governmental actions, or other unique market and/or portfolio issues will have on credit losses. Consideration of other risk factors typically includes such issues as recent loss experience in specific portfolio segments, trends in loan quality, changes in market focus, and concentrations of credit. These factors are based on the influence of current external variables on portfolio risk, so there will typically be some movement between this element and the specific allowance component during various stages of the economic cycle. Because of their subjective nature, these risk factors are carefully reviewed by management and revised as conditions indicate. Based on its analyses, management believes the allowance was adequate at September 30, 2007.

**Other Commitments**

Other than a) construction of a permanent branch building to replace the temporary facility at Scranton Road in Brunswick, Georgia, which opened November 5, and b) renovation of other SEB offices, the Company had no material plans or commitments for capital expenditures as of September 30, 2007. Estimated remaining costs associated with new construction and renovations in progress at September 30, 2007 were \$600,000.

**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 September 30, 2007, loans<sup>1</sup> and investment securities with carrying values exceeding \$157,887,000 and \$10,129,000 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 86% of the funding base at September 30, 2007 versus 90% in 2006. Borrowed funds, which variously encompass U.S. Treasury demand notes, federal funds purchased, and FHLB advances, totaled \$6,936,993 at September 30, 2007 versus \$11,589,141 at December 31, 2006. More specifically, the maximum amount of U.S. Treasury demand notes available to the Company at September 30, 2007 totaled \$3,000,000, of which \$1,936,993 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 September 30, 2007, unused borrowings approximated \$59,149,000. 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 2007. 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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<sup>1</sup> No cash flow assumptions other than final contractual maturities have been made for installment loans. Nonaccrual loans are excluded. A portion of these loans may be refinanced by the Company.

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## Deposits

Deposits declined \$6,067,694 or 1.77% since year-end 2006. Noninterest-bearing deposits declined \$18,938,703 or 23.39% while interest-bearing deposits grew \$12,871,009 or 4.93%. The shift in deposits from noninterest- to interest-bearing status resulted largely from changes in product design during the third quarter. Specifically, effective July 2, senior demand deposits meeting minimum balance requirements are paid interest; these deposits approximated \$11,600,000 at September 30, 2007. The number of tiers and associated rates on other NOW and money market accounts was also increased effective July 2. Although these changes increase interest expense, management is optimistic that these and other product changes will enhance the Company's competitive position and aid deposit growth and cross-sell opportunities long-term. Other factors in the interest-bearing fluctuation year-to-date included seasonal variation in local government balances, particularly NOW accounts, and a continued increase in time certificate balances as customers took advantage of higher market rates. Overall, interest-bearing deposits comprised 81.53%, and noninterest-bearing deposits, 18.47%, of total deposits at September 30, 2007 versus 76.32% and 23.68% at year-end 2006. The distribution of interest-bearing balances at September 30, 2007 and certain comparable quarter-end dates is shown in the table below:

<i>Deposits (Dollars in thousands)</i>	<b>September 30, 2007</b>		<b>December 31, 2006</b>		<b>September 30, 2006</b>	
	<i>Balances</i>	<i>Percent of Total</i>	<i>Balances</i>	<i>Percent of Total</i>	<i>Balances</i>	<i>Percent of Total</i>
Interest-bearing demand deposits <sup>1</sup>	\$ 94,454	34.49%	\$ 97,305	37.28%	\$ 88,447	35.75%
Savings	67,574	24.68%	69,800	26.75%	72,915	29.48%
Time certificates < \$100,000	63,551	23.21%	54,419	20.85%	51,888	20.98%
Time certificates >= \$100,000	48,264	17.62%	39,448	15.12%	34,122	13.79%
<b>Total interest-bearing deposits</b>	<b>\$ 273,843</b>	<b>100.00%</b>	<b>\$ 260,972</b>	<b>100.00%</b>	<b>\$ 247,372</b>	<b>100.00%</b>

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

Deposits of one local governmental body comprised approximately \$26,908,000 and \$37,045,000 of the overall deposit base at September 30, 2007 and December 31, 2006. The Company had no brokered deposits at September 30, 2007.

Approximately 78% of time certificates at September 30, 2007 were scheduled to mature within the next twelve months. The composition of average deposits and the fluctuations therein at September 30 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 September 30, 2007, unchanged from year-end 2006. 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 \$224,000. Mortgage-backed securities were pledged to collateralize advances under this line of credit.

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

The normal course of business activity exposes the Company to interest rate risk. Fluctuations in interest rates may result in changes in the fair market value of the Company's financial instruments, cash flows, and net interest income. The asset/liability committee regularly reviews the Company's exposure to interest rate risk and formulates strategy based on acceptable levels of interest rate risk. The overall

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objective of this process is to optimize the Company's financial position, liquidity, and net interest income, while limiting volatility to net interest income from changes in interest rates. The Company uses gap analysis and simulation modeling to measure and manage interest rate sensitivity.

An indicator of interest rate sensitivity is the difference between interest rate sensitive assets and interest rate sensitive liabilities; this difference is known as the interest rate sensitivity gap. In an asset sensitive, or positive, gap position, the amount of interest-earning assets maturing or repricing within a given period exceeds the amount of interest-bearing liabilities maturing or repricing within that same period. Conversely, in a liability sensitive, or negative, gap position, the amount of interest-bearing liabilities maturing or repricing within a given period exceeds 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 September 30, 2007:

<i>Interest Rate Sensitivity</i>	<i>Repricing Within</i>				<i>Total</i>
	<i>0 - 3 Months</i>	<i>4 - 12 Months</i>	<i>One - Five Years</i>	<i>More Than Five Years</i>	
<i>September 30, 2007 (Dollars in thousands)</i>					
<b>Interest Rate Sensitive Assets</b>					
Federal funds sold	\$ 3,796				\$ 3,796
Securities <sup>1</sup>	924	\$ 9,528	\$ 53,273	\$ 29,088	92,813
Loans, gross <sup>2</sup>	164,143	32,684	71,753	4,578	273,158
Other assets	1,047				1,047
<b>Total interest rate sensitive assets</b>	<b>169,910</b>	<b>42,212</b>	<b>125,026</b>	<b>33,666</b>	<b>370,814</b>
<b>Interest Rate Sensitive Liabilities</b>					
Deposits <sup>3</sup>	\$ 185,958	63,425	24,450	10	273,843
U.S. Treasury demand note	1,937				1,937
Federal Home Loan Bank advances			5,000		5,000
<b>Total interest rate sensitive liabilities</b>	<b>187,895</b>	<b>63,425</b>	<b>29,450</b>	<b>10</b>	<b>280,780</b>
<b>Interest rate sensitivity gap</b>	<b>\$ (17,985)</b>	<b>\$ (21,213)</b>	<b>\$ 95,576</b>	<b>\$ 33,656</b>	<b>\$ 90,034</b>
<b>Cumulative gap</b>	<b>\$ (17,985)</b>	<b>\$ (39,198)</b>	<b>\$ 56,378</b>	<b>\$ 90,034</b>	
Ratio of cumulative gap to total rate sensitive assets	(4.85)%	(10.57)%	15.20%	24.28%	
Ratio of cumulative rate sensitive assets to rate sensitive liabilities	90.43%	84.40%	120.08%	132.07%	
Cumulative gap at December 31, 2006	\$ (35,279)	\$ (57,988)	\$ 71,836	\$ 102,621	
Cumulative gap at September 30, 2006	\$ (23,760)	\$ (46,901)	\$ 80,294	\$ 110,384	

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

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

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



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As shown in the preceding table, the Company's cumulative gap position remained negative through the short-term repricing intervals at September 30, 2007, approximating \$(17,985,000) at three months and \$(39,198,000) through one-year. Excluding traditionally nonvolatile NOW balances from the gap calculation, the cumulative gap at September 30, 2007 totaled \$63,654,000 at three months and \$42,441,000 at twelve months. The narrowing of the short-term gap position at September 30, 2007 versus year-end 2006 was primarily attributable to an increase in variable rate loans tied to prime. Other than seasonal variations, primarily in deposit balances, extension of maturities in the investment portfolio, and marginally lower loan balances, no significant changes are anticipated in the gap position the remainder of 2007. Shortcomings are inherent in any gap analysis since certain assets and liabilities may not move proportionally as rates change. For example, the gap analysis presumes that all loans<sup>2</sup> and securities<sup>1</sup> will perform according to their contractual maturities when, in many cases, actual loan terms are much shorter than the original terms and securities are subject to early redemption.

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

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

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ratio (Tier 1 to average quarterly assets) of 4%. To be considered a well-capitalized institution, the Tier 1 capital, total capital, and Tier 1 leverage ratios must equal or exceed 6%, 10%, and 5%, respectively. Banks and bank holding companies are prohibited from including unrealized gains and losses on debt securities in the calculation of risk-based capital but are permitted to include up to 45 percent of net unrealized pre-tax holding gains on equity securities in Tier 2 capital. The Company did not have any unrealized gains on equity securities includible in the risk-based capital calculations for any of the periods presented. 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:

<i>Capital Ratios</i> <i>(Dollars in thousands)</i>	September 30, 2007	December 31, 2006	September 30, 2006
<b>Tier 1 capital:</b>			
Realized shareholders' equity	\$ 56,022	\$ 52,784	\$ 53,192
Intangible assets and other adjustments	(463)	(507)	(521)
<b>Total Tier 1 capital</b>	<b>55,559</b>	<b>52,277</b>	<b>52,671</b>
<b>Tier 2 capital:</b>			
Portion of allowance for loan losses	3,852	3,568	3,463
Allowable long-term debt			
<b>Total Tier 2 capital</b>	<b>3,852</b>	<b>3,568</b>	<b>3,463</b>
<b>Total risk-based capital</b>	<b>\$ 59,411</b>	<b>\$ 55,845</b>	<b>\$ 56,134</b>
<b>Risk-weighted assets</b>	<b>\$ 307,605</b>	<b>\$ 284,789</b>	<b>\$ 276,286</b>
<b>Risk-based ratios:</b>			
Tier 1 capital	18.06%	18.36%	19.06%
<b>Total risk-based capital</b>	<b>19.31%</b>	<b>19.61%</b>	<b>20.32%</b>
Tier 1 leverage ratio	13.81%	13.05%	13.67%
Realized shareholders' equity to assets	13.93%	12.88%	13.50%

Book value per share grew \$1.08 or 6.57% during the first nine months of 2007 to \$17.51 at September 30, 2007. Dividends declared totaled \$0.42, up 3.70% or \$0.015 from 2006. 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, declined \$295,378 at September 30, 2007 compared to year-end 2006. Movement in interest rates remained a dominant factor in the fair value results. Further details on investment securities and associated fair values are contained in the Financial Condition section of this Analysis.

Under existing authorization, the Company can purchase up to \$10,000,000 in treasury stock. From 2000-2006, the Company repurchased 367,197 shares on the open market and through private transactions at an average price of \$20.03 per share. During the first nine months of 2007, the Company purchased an additional 14,270 shares at an aggregate purchase price of \$402,004 or \$28.17 per share. The maximum consideration available for additional purchases, at prices to be determined in the future, is \$2,241,667. 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.





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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 75% or \$2,459,400 of the \$3,279,200 in cash dividends available to the Company in 2007 without such prior 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 third quarter of 2007 totaled \$1,662,769, up \$16,400 or 1.00% from September 30, 2006 and 0.57% from June 30, 2007. On a per share basis, quarterly earnings totaled \$0.52 at September 30, 2007 versus \$0.51 at September 30, 2006 and \$0.52 at June 30, 2007. Year-to-date, net income declined \$19,972 to \$4,986,885 at September 30, 2007 from \$5,006,857 in 2006. Per share income for the nine-month period totaled \$1.55, unchanged from 2006. The return on beginning equity for the nine-month period totaled 12.60% at September 30, 2007 versus 13.33% at September 30, 2006. 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

Net interest income fell \$49,225 or 1.00% during the third quarter of 2007 compared to 2006. Year-to-date, net interest income declined \$41,748 from 2006. The net interest margin approximated 5.39% at September 30, 2007 versus 5.73% a year ago; the interest rate spread, 4.42% versus 4.97%. Higher funding costs on deposits and other liabilities absorbed virtually all improvements in net interest income from asset volumes and yields year-to-date. Specifically, interest earnings on loans and other earning assets improved \$2,732,500 and \$2,423, while earnings on investment securities and federal funds sold declined \$87,611 and \$142,519 from same period results in 2006. Asset yields averaged 7.96% at September 30, 2007 versus 7.50% in 2006. Interest expense on deposits and other borrowed funds increased \$753,702 or 42.39% during the third quarter of 2007 versus 2006 and \$2,546,541 year-to-date. Cost of funds increased 101 basis points from 2006 levels, totaling 3.54% at September 30, 2007 versus 2.53% at September 30, 2006. Approximately 94% of the increased funding costs year-to-date resulted from higher rates on deposits at September 30, 2007 compared to 2006. Net interest income and resultant margins and spreads are projected to decline the remainder of 2007 due to yield reductions, particularly on prime-based loans, as well as lower average balances on loans. As discussed in the Interest Sensitivity section of this Analysis, competitive and other factors preclude simultaneous and proportionate declines in deposit rates; additionally, the product changes discussed in the Deposits section will increase interest expense going forward. See the interest differential table on page 21 for more details on changes in interest income attributable to volume and rates at September 30, 2007 versus 2006.

The intense competition for loans and deposits continues in 2007 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. Long-term strategies implemented by management to increase average loans outstanding emphasize competitive pricing on loan products and development of additional loan relationships, but 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.

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

<i>Average Balances</i> <sup>6</sup>	2007			2006		
	Average Balances	Income/Expense	Yields/Rates	Average Balances	Income/Expense	Yields/Rates
<i>Nine Months Ended September 30, (Dollars in thousands)</i>						
<b>Assets</b>						
Interest-earning assets:						
Loans, net <sup>1,2,4</sup>	\$ 268,165	\$ 18,265	9.11%	\$ 234,098	\$ 15,517	8.86%
Federal funds sold	1,262	49	5.19%	5,373	192	4.78%
Taxable investment securities <sup>3</sup>	78,481	2,720	4.63%	86,094	2,783	4.32%
Tax-exempt investment securities <sup>3,4</sup>	29,562	1,445	6.54%	30,313	1,476	6.51%
Other assets	1,096	51	6.22%	1,105	49	5.93%
Total interest-earning assets	\$ 378,566	\$ 22,530	7.96%	\$ 356,983	\$ 20,017	7.50%
<b>Liabilities</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits <sup>5</sup>	\$ 92,211	\$ 1,920	2.78%	\$ 86,066	\$ 1,340	2.08%
Savings	69,469	1,128	2.17%	77,451	890	1.54%
Time deposits	102,890	3,807	4.95%	79,871	2,229	3.73%
Federal funds purchased	3,931	160	5.44%	486	20	5.50%
U. S. Treasury demand note	835	32	5.12%	646	23	4.76%
Federal Home Loan Bank advances	5,000	224	6.00%	5,000	224	6.00%
Total interest-bearing liabilities	\$ 274,336	\$ 7,271	3.54%	\$ 249,520	\$ 4,726	2.53%
Excess of interest-earning assets over interest-bearing liabilities	\$ 104,230			\$ 107,463		
<b>Interest rate spread</b>			<b>4.42%</b>			<b>4.97%</b>
<b>Net interest income</b>		<b>\$ 15,259</b>			<b>\$ 15,291</b>	
<b>Net interest margin</b>			<b>5.39%</b>			<b>5.73%</b>

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

<sup>2</sup> Includes loan fees and late charges.

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

<sup>4</sup> Interest income on tax-exempt loans and securities is presented on a taxable-equivalent basis, using a federal income tax rate of 34%. No adjustments have been made for any state tax benefits or the nondeductible portion of interest expense.

<sup>5</sup> NOW and money market accounts.

<sup>6</sup> Averages presented generally represent average daily balances.

**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 nine months ended September 30, 2007 and 2006. The table on the next page summarizes the changes in interest income and interest expense attributable to volume and rates during this period.



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Interest Differential <sup>1</sup> <i>Nine Months Ended September 30,</i> <i>(In thousands)</i>	2007 Compared to 2006 Increase (Decrease) Due to		
	Volume	Rate	Net
<b>Interest income</b>			
Loans <sup>2,3</sup>	\$ 2,310	\$ 438	\$ 2,748
Federal funds sold	(158)	15	(143)
Taxable investment securities	(256)	193	(63)
Tax-exempt investment securities <sup>3</sup>	(36)	5	(31)
Other interest-earning assets		2	2
<b>Total interest income</b>	<b>1,860</b>	<b>653</b>	<b>2,513</b>
<b>Interest expense</b>			
Interest-bearing demand deposits <sup>4</sup>	101	479	580
Savings	(99)	337	238
Time deposits	741	837	1,578
Federal funds purchased <sup>5</sup>	140		140
U.S. Treasury demand note	7	2	9
Federal Home Loan Bank advances			
<b>Total interest expense</b>	<b>890</b>	<b>1,655</b>	<b>2,545</b>
<b>Net change in net interest income</b>	<b>\$ 970</b>	<b>\$ (1,002)</b>	<b>\$ (32)</b>

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

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

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

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

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

**Noninterest Income and Expense**

Noninterest income declined \$27,233 or 2.86% during the third quarter of 2007 compared to 2006 but increased \$272,298 year-to-date. Key elements in the quarterly and year-to-date results included:

- a) Investment securities (losses) gains, net: As further discussed in the Financial Condition section of this Analysis, the Company recognized a \$36,843 loss on the sale of agency securities totaling \$8,996,353 in the third quarter. A gain of \$134,628 was previously recognized on the sale of corporate securities totaling \$2,991,872 in the first quarter. These securities were sold primarily to fund growth in the loan portfolio.
- b) Service charges on deposit accounts: Service charges on deposit accounts grew \$45,482 on a quarterly basis and \$168,745 or 9.31% year-to-date; the 2007 improvement was primarily attributable to higher volume of NSF fees.
- c)

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Other operating income: The other operating portion of noninterest income declined \$35,872 during the third quarter of 2007 versus 2006 but increased a marginal \$5,768 year-to-date. A 39.16% decline in mortgage origination fees was the primary factor in the quarterly results. Improvements in safe deposit box rents and other fees largely offset the decline in mortgage origination income year-to-date. The Company is in the process of expanding and revamping its mortgage origination department and is optimistic that these initiatives will increase production and cross-sell opportunities long-term. By type and amount, the chief

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components of other operating income at September 30, 2007 were mortgage origination fees, \$299,540; income on sale of check products, \$103,318; surcharge fees - ATM, \$108,528; commissions on the sale of credit life insurance, \$67,765; and safe deposit box rentals, \$63,612. Together, these five income items comprised 66.80% of other operating income at September 30, 2007. In 2006, these same five income components comprised 72.92% of other operating income.

Noninterest expense declined \$158,745 during the third quarter of 2007 compared to 2006 but increased \$131,860 or 1.31% year-to-date. The main factors impacting quarterly and year-to-date results comprised:

- a) Salaries and employee benefits: Personnel costs increased a mere \$2,165 on a quarterly basis but \$184,379 year-to-date. Increases in nonofficer salaries and premiums on group medical insurance accounted for virtually all of the variation year-to-date. The increase in nonofficer salaries resulted largely from the hiring of personnel to staff SEB's new Southport facility, operational since January 2007, to fill vacancies at other branch locations, and to provide administrative support. The vast majority, or 84%, of employee expenses remained concentrated in salaries and other direct compensation, including related payroll taxes, at September 30, 2007. 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 2007.
- b) Occupancy and equipment, net: When compared to the same periods in 2006, net occupancy and equipment expense declined \$77,252 on a quarterly basis and \$38,440 year-to-date. Costs associated with renovations at SEB's older facilities declined in 2007 versus 2006; the pace of these renovations is expected to resume in 2008. The reduction in renovation expenses was largely offset by costs associated with SEB's new facility at Southport.
- c) Other operating expense: Other operating expenses declined \$14,097 or 0.71% year-to-date; declines in advertising and legal and accounting fees were primary variables. Besides advertising expense, which approximated \$235,000 in 2007 and \$245,000 in 2006, no individual component of other operating expenses aggregated or exceeded 10% of the total in 2007 or 2006.

Overhead related to the Company's Southport facility, as noted above; new core banking software, as discussed in prior filings; and expansion/revamping of the mortgage origination department are expected to increase noninterest expense approximately \$430,000 in 2007 compared to 2006.

**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 2006 Form 10-K. There have been no material changes in the Company's critical accounting policies since December 31, 2006.

**Recent Accounting Pronouncements**

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

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Additional accounting proposals affecting the banking industry are pending with the Financial Accounting Standards Board and other authorities. 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.



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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.

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**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 4. 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.

**Table of Contents****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 nine months of 2007.

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

Treasury purchases made during the quarter and nine months ended September 30, 2007 are summarized in the table below:

Share Repurchases	Nine Months Ended September 30, 2007	Total Number of Shares Purchased	Average Price Paid per Share	Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet be Purchased under the Plans or Programs <sup>1</sup>
January 1 - June 30		6,170	\$ 29.17	6,170	\$ 2,463,690
July 1 - 31					2,463,690
August 1 - 31		5,500	27.81	5,500	2,310,729
September 1 - 30		2,600	26.56	2,600	2,241,667
<b>Total</b>		<b>14,270</b>	<b>\$ 28.17</b>	<b>14,270</b>	

<sup>1</sup> The Board of Directors approved the repurchase of up to \$10,000,000 in Company common stock at its December 9, 2003 meeting. This action increased the previous repurchase resolution of \$7,000,000, which was approved by the Company's Board on March 14, 2000 and had a remaining balance of \$2,399,833. There is no expiration date for the treasury authorization.

**Item 3. Defaults Upon Senior Securities.**

Not Applicable

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

Not Applicable

**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

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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: November 14, 2007