

SOUTHEASTERN BANKING CORP

Form 10-Q

June 10, 2011

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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, 2011

Commission File Number 000-32627

(Exact name of registrant as specified in its charter)

Georgia
(State or other jurisdiction of

incorporation or organization)

58-1423423
(IRS Employer

Identification No.)

P. O. Box 455, 1010 North Way, Darien, Georgia 31305

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(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 No

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

Indicate by check mark 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

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 May 23, 2011, 3,129,388 shares of the Registrant's common stock, par value \$1.25 per share, were outstanding.

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Table of Contents**Part I - Financial Information****Item 1. Financial Statements.****Southeastern Banking Corporation****Consolidated Balance Sheets**

| | (Unaudited) March 31, 2011 | December 31, 2010 |
|---|----------------------------------|-----------------------|
| Assets | | |
| Cash and due from banks | \$ 9,459,545 | \$ 8,206,514 |
| Interest-bearing deposits in other banks | 82,015,008 | 70,511,991 |
| Federal funds sold | 2,150,000 | 2,150,000 |
| Cash and cash equivalents | 93,624,553 | 80,868,505 |
| Investment securities: | | |
| Available-for-sale, at market value (amortized cost of \$75,374,654 and \$73,893,247 at March 31, 2011 and December 31, 2010) | 75,841,661 | 74,299,903 |
| Loans, gross | 235,703,640 | 245,688,555 |
| Unearned income | (60,873) | (65,007) |
| Allowance for loan losses | (8,370,191) | (9,915,559) |
| Net loans | 227,272,576 | 235,707,989 |
| Premises and equipment, net | 11,984,017 | 12,107,464 |
| Bank-owned life insurance, at cash surrender value | 5,796,561 | 5,738,642 |
| Other real estate | 12,914,943 | 11,636,290 |
| Other assets | 6,933,291 | 7,274,264 |
| Total Assets | \$ 434,367,602 | \$ 427,633,057 |
| Liabilities and Shareholders Equity | | |
| Liabilities | | |
| Deposits: | | |
| Noninterest-bearing demand deposits | \$ 56,965,413 | \$ 55,377,519 |
| Interest-bearing demand, savings, and time deposits | 324,622,920 | 319,817,600 |
| Total deposits | 381,588,333 | 375,195,119 |
| U. S. Treasury demand note | 1,042,509 | 762,782 |
| Federal Home Loan Bank advances | 5,000,000 | 5,000,000 |
| Other liabilities | 1,853,843 | 1,869,597 |
| Total liabilities | 389,484,685 | 382,827,498 |
| Shareholders Equity | | |
| Common stock, \$1.25 par value | 4,475,996 | 4,475,996 |
| Additional paid-in-capital | 1,507,008 | 1,495,668 |
| Retained earnings | 47,486,150 | 47,459,963 |
| Treasury stock, at cost | (8,894,461) | (8,894,461) |
| Accumulated other comprehensive income | 308,224 | 268,393 |

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| | | |
|---|-----------------------|----------------|
| Total shareholders' equity | 44,882,917 | 44,805,559 |
| Total Liabilities and Shareholders' Equity | \$ 434,367,602 | \$ 427,633,057 |
| Common shares issued | 3,580,797 | 3,580,797 |
| Common shares authorized | 10,000,000 | 10,000,000 |
| Common shares outstanding | 3,129,388 | 3,129,388 |
| Treasury shares | 451,409 | 451,409 |

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation
Consolidated Statements of Operations
(Unaudited)

| <i>Three Months Ended March 31,</i> | 2011 | 2010 |
|---|------------------|-----------------------|
| Interest income: | | |
| Interest and fees on loans | \$ 3,377,795 | \$ 3,653,226 |
| Interest on investment securities: | | |
| Taxable | 455,343 | 662,416 |
| Tax-exempt | 146,520 | 204,414 |
| Other interest income | 51,186 | 23,653 |
| Total interest income | 4,030,844 | 4,543,709 |
| Interest expense: | | |
| Interest on deposits | 917,767 | 1,181,509 |
| Interest on Federal Home Loan Bank advances | 32,301 | 93,968 |
| Total interest expense | 950,068 | 1,275,477 |
| Net interest income | 3,080,776 | 3,268,232 |
| Provision for loan losses | 660,000 | 2,985,000 |
| Net interest income after provision for loan losses | 2,420,776 | 283,232 |
| Noninterest income: | | |
| Service charges on deposit accounts | 550,877 | 641,912 |
| Net loss on sales of investment securities available-for-sale | (18,191) | |
| Other noninterest income | 337,434 | 337,114 |
| Total noninterest income | 870,120 | 979,026 |
| Noninterest expense: | | |
| Salaries and employee benefits | 1,682,707 | 1,826,314 |
| Occupancy and equipment expense, net | 612,777 | 694,070 |
| Net gain on sales of other real estate | (22,029) | (3,820) |
| Write-downs on other real estate | 161,127 | |
| Other noninterest expense | 830,127 | 794,712 |
| Total noninterest expense | 3,264,709 | 3,311,276 |
| Income (loss) before income tax expense (benefit) | 26,187 | (2,049,018) |
| Income tax expense (benefit) | | (876,609) |
| Net income (loss) | \$ 26,187 | \$ (1,172,409) |
| Basic and diluted earnings (loss) per common share | \$ 0.01 | \$ (0.37) |
| Basic and diluted weighted average common shares outstanding | 3,129,388 | 3,138,531 |

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation
Consolidated Statements of Stockholders' 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> |
|---|---------------------|-------------------------|---|------------------------------|---------------------------|--|---------------|----------------------|
| | <i>Shares</i> | <i>Stated Value</i> | | | | <i>Comprehensive Income (Loss)</i> | | |
| Balance, December 31, 2009 | 3,138,531 | \$ 4,475,996 | \$ 1,449,696 | \$ 60,512,342 | \$ (8,803,031) | \$ (1,076,320) | \$ 56,558,683 | |
| Comprehensive loss: | | | | | | | | |
| Net loss | | | | (1,172,409) | | | | (1,172,409) |
| Unrealized holding gains (losses) on investment securities available-for-sale arising during the period, net of tax (benefit) of \$553,088 | | | | | | 1,073,642 | | 1,073,642 |
| Total comprehensive loss | | | | | | | | (98,767) |
| Cash dividends declared, \$0.065 per share | | | | (204,005) | | | | (204,005) |
| Stock-based compensation | | | 13,541 | | | | | 13,541 |
| Balance, March 31, 2010 | 3,138,531 | \$ 4,475,996 | \$ 1,463,237 | \$ 59,135,928 | \$ (8,803,031) | \$ (2,678) | | \$ 56,269,452 |
| Balance, December 31, 2010 | 3,129,388 | \$ 4,475,996 | \$ 1,495,668 | \$ 47,459,963 | \$ (8,894,461) | \$ 268,393 | \$ 44,805,559 | |
| Comprehensive income: | | | | | | | | |
| Net income | | | | 26,187 | | | | 26,187 |
| Unrealized holding gains (losses) on investment securities available-for-sale arising during the period, net of tax (benefit) of \$14,334 | | | | | | 27,825 | | 27,825 |
| Reclassification adjustment for net (gain) loss on sales of investment securities available-for-sale included in net income, net of tax (benefit) of \$(6,185) | | | | | | 12,006 | | 12,006 |
| Total comprehensive income | | | | | | | | 66,018 |
| Stock-based compensation | | | 11,340 | | | | | 11,340 |
| Balance, March 31, 2011 | 3,129,388 | \$ 4,475,996 | \$ 1,507,008 | \$ 47,486,150 | \$ (8,894,461) | \$ 308,224 | | \$ 44,882,917 |

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation
Consolidated Statements of Cash Flows
(Unaudited)

| <i>Three Months Ended March 31,</i> | 2011 | 2010 |
|---|----------------------|----------------------|
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 26,187 | \$ (1,172,409) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation | 174,972 | 209,850 |
| Amortization and accretion, net | 17,539 | 62,544 |
| Provision for loan losses | 660,000 | 2,985,000 |
| Deferred income tax expense | | 327,684 |
| Net loss on sales of investment securities available-for-sale | 18,191 | |
| Increase in cash surrender value of bank-owned life insurance | (57,919) | (58,815) |
| Net gain on sales of other real estate | (22,029) | (3,820) |
| Write-downs on other real estate | 161,127 | |
| Stock-based compensation | 11,340 | 13,541 |
| Decrease in interest receivable | 100,213 | 192,104 |
| Decrease in interest payable | (102,013) | (78,001) |
| Net change in income tax receivable or payable | 9,953 | (1,209,543) |
| Decrease in prepaid FDIC assessments | 189,000 | 134,267 |
| Net decrease (increase) in other assets | 36,557 | (92,721) |
| Net increase in other liabilities | 65,740 | 208,285 |
| Net cash provided by operating activities | 1,288,858 | 1,517,966 |
| Cash flows from investing activities: | | |
| Purchase of investment securities available-for-sale | (152,101,435) | |
| Proceeds from sales of investment securities available-for-sale | 474,000 | |
| Proceeds from maturities, calls, and paydowns of investment securities available-for-sale | 150,115,547 | 3,268,134 |
| Net decrease in loans | 5,742,537 | 12,029,706 |
| Capital expenditures, net | (51,525) | (37,879) |
| Proceeds from sales of other real estate | 615,125 | 113,528 |
| Net cash provided by investing activities | 4,794,249 | 15,373,489 |
| Cash flows from financing activities: | | |
| Net increase in deposits | 6,393,214 | 11,136,025 |
| Net increase in U. S. Treasury demand note | 279,727 | 422,421 |
| Repayment of advances from Federal Home Loan Bank | | (5,000,000) |
| Dividends paid | | (204,005) |
| Net cash provided by financing activities | 6,672,941 | 6,354,441 |
| Net increase in cash and cash equivalents | 12,756,048 | 23,245,896 |
| Cash and cash equivalents at beginning of period | 80,868,505 | 42,632,459 |
| Cash and cash equivalents at end of period | \$ 93,624,553 | \$ 65,878,355 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid (received) during the year for: | | |

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| | | |
|---|--------------|--------------|
| Interest | \$ 1,052,081 | \$ 1,353,478 |
| Income taxes paid (refunded), net | (9,953) | |
| Noncash investing and financing transactions: | | |
| Change in unrealized gains (losses) on investment securities available-for-sale | 60,350 | 1,626,728 |
| Loans charged-off to allowance for loan losses | 2,245,855 | 3,563,225 |
| Real estate acquired through foreclosure | 2,032,875 | 1,962,779 |
| Loans made in connection with sales of other real estate | | 257,718 |

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation
Notes to Consolidated Financial Statements
(Unaudited)

1. BASIS OF PRESENTATION

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 (U.S. GAAP) for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

The accounting and reporting policies followed in the presentation of the accompanying unaudited consolidated financial statements are consistent with those described in note 1 of the notes to the consolidated financial statements included in the Company's 2010 Form 10-K, as updated by the information contained in this Form 10-Q. In the opinion of management, these consolidated financial statements reflect all adjustments necessary to fairly present such information for the periods and dates indicated. Such adjustments, which include transactions typically determined or settled at year-end, are normal and recurring in nature. All significant intercompany accounts and transactions have been eliminated. The consolidated balance sheet as of December 31, 2010 has been extracted from the audited consolidated balance sheet included in the Company's 2010 Form 10-K. Certain reclassifications, with no effect on total assets or net operating results, have been made to prior period amounts to conform to the current period presentation.

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Results of operations for interim periods are not necessarily indicative of trend or results to be expected for the full year, due in part to seasonal variations and unusual or infrequently occurring items.

Earnings (Loss) Per Share

Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during each period. Diluted earnings per share are based on the weighted average number of common shares outstanding adjusted to include the effect of potentially dilutive common shares. Potentially dilutive common shares include incremental shares issuable upon exercise of outstanding stock options using the treasury stock method. In any periods of net loss, diluted loss per share is calculated in the same manner as basic earnings per share. Since they were non-dilutive, 70,250 and 83,500 equivalent shares related to stock options were excluded from the computation of diluted earnings (loss) per share at March 31, 2011 and 2010.

2. NEW ACCOUNTING PRONOUNCEMENTS

In January 2010, the Financial Accounting Standards Board (FASB) issued an accounting standards update requiring additional disclosures on transfers in and out of the fair value hierarchy and activity within level 3 financial instruments. This update also provides clarification on classification of financial instruments and the discussion of inputs and valuation techniques. The new disclosures and clarification were effective for the Company as of December 31, 2009, except for disclosures related to activity within level 3 financial instruments. The level 3 disclosures were effective in the interim reporting period ending March 31, 2011. Adoption of the new disclosure requirements has not affected the Company's financial position or results of operations.

In May 2011, the FASB issued additional guidance on fair value measurement. The new guidance results in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. The amendments do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The amendments clarify the proper application of the highest and best use and valuation premise concepts and the fair value measurement of an instrument classified in shareholders' equity. Additionally, the amendments permit a reporting entity that manages financial instruments on the basis of its net exposure, rather than gross exposure, to measure the underlying financial

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Southeastern Banking Corporation
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(Unaudited)

assets and liabilities at the price that would be received to sell a net asset position or transfer a net liability position for a particular risk in an orderly transaction between market participants at the measurement date and clarify that premiums and discounts in fair value measurements relate to the unit of account, and not size, as a characteristic of an entity's holding. Expanded disclosure must be provided about valuation processes used for level 3 instruments, including quantitative information on unobservable inputs and sensitivity of fair value measurement to changes in unobservable inputs; use of nonfinancial assets if that use varies from its highest and best use, and that asset is measured at fair value on the balance sheets or its fair value is based on highest and best use; and categorization by level of the fair value hierarchy for items not measured at fair value on the balance sheets but for which fair value must be disclosed. The amendments are effective for interim and annual periods beginning after December 15, 2011. Adoption of the new guidance will not impact the Company's financial position or results of operations.

In July 2010, the FASB issued an accounting pronouncement requiring more robust disclosures about the credit quality of loans and the allowance for loan losses. The additional disclosures include a rollforward of the allowance for loan losses on a disaggregated basis and more information, by type of loan, on credit quality indicators including aging and troubled debt restructurings (TDRs) as well as any significant purchases and sales. Most of the new disclosure requirements were effective beginning December 31, 2010. Disclosures about activity that occurs during a reporting period are effective the first quarter of 2011 and are included in note 4. In April 2011, the FASB issued an accounting standards update deferring the disclosure of TDR credit quality indicators until the third quarter of 2011. The new disclosure requirements have not affected the Company's financial position or results of operations.

In December 2010, the FASB issued an accounting standards update addressing differences in the ways entities have disclosed pro forma revenue and earnings in a business combination. If an entity presents comparable financial statements, the guidance requires the entity to disclose revenue and earnings of the combined entity as if the business combination(s) occurring during the current year had occurred as of the beginning of the comparable prior annual reporting period. Supplemental pro forma disclosures must also be expanded to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination(s). The new requirements, which became effective as of January 1, 2011, have not affected the Company's financial position, results of operations, or cash flows.

3. INVESTMENT SECURITIES

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

| <i>March 31, 2011</i> | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| Available-for-sale: | | | | |
| Debt securities: | | | | |
| U. S. Government and federal agency securities | \$ 4,259,693 | \$ 161,912 | \$ 582 | \$ 4,421,023 |
| U. S. Government-sponsored enterprise securities | 32,820,493 | 79,219 | 5,060 | 32,894,652 |
| Agency residential mortgage-backed securities | 15,264,089 | 619,510 | 5,224 | 15,878,375 |
| Obligations of states and political subdivisions | 14,644,318 | 343,651 | 117,704 | 14,870,265 |
| Corporate debt obligations | 8,386,061 | 64,333 | 673,048 | 7,777,346 |
| Total investment securities | \$ 75,374,654 | \$ 1,268,625 | \$ 801,618 | \$ 75,841,661 |

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Southeastern Banking Corporation
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(Unaudited)

| <i>December 31, 2010</i> | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|-------------------|------------------------------|-------------------------------|-------------------|
| Available-for-sale: | | | | |
| Debt securities: | | | | |
| U. S. Government and federal agency securities | \$ 4,551,010 | \$ 187,524 | \$ | \$ 4,738,534 |
| U. S. Government-sponsored enterprise securities | 33,549,865 | 118,203 | 31 | 33,668,037 |
| Agency residential mortgage-backed securities | 10,323,420 | 642,201 | | 10,965,621 |
| Obligations of states and political subdivisions | 16,587,458 | 370,210 | 136,664 | 16,821,004 |
| Corporate debt obligations | 8,881,494 | 20,710 | 795,497 | 8,106,707 |
| Total investment securities | \$ 73,893,247 | \$ 1,338,848 | \$ 932,192 | \$ 74,299,903 |

The amortized cost and fair value of debt securities by contractual maturity at March 31, 2011 are shown in the table below. In some cases, issuers may have the right to call or prepay obligations without call or prepayment penalties prior to the contractual maturity date.

Mortgage-backed securities are shown separately from other debt securities due to customary prepayment features which cause average lives to differ significantly from contractual maturities.

| <i>March 31, 2011</i> | Available-for-Sale | |
|---|--------------------|-------------------|
| | Amortized Cost | Fair Value |
| Due within one year | \$ 25,164,654 | \$ 25,185,949 |
| Due from one to five years | 14,538,569 | 14,782,871 |
| Due from five to ten years | 8,607,954 | 8,892,739 |
| Due after ten years | 11,799,388 | 11,101,727 |
| | 60,110,565 | 59,963,286 |
| Agency residential mortgage-backed securities | 15,264,089 | 15,878,375 |
| Total investment securities | \$ 75,374,654 | \$ 75,841,661 |

Securities with carrying values of \$68,462,091 and \$65,127,641 at March 31, 2011 and December 31, 2010, respectively, were pledged to secure public deposits and other borrowings as required by law.

Year-to-date, the Company sold one B+ rated corporate debt obligation, recording an \$18,191 loss on proceeds totaling \$474,000. In fiscal 2010, the Company sold four B+ holdings of this same issuer, recognizing a \$141,088 loss on sales and also recording a \$45,069 other-than-temporary impairment charge, which is further discussed in the Company's 2010

Form 10-K. The Company had no residual holdings of this issuer at March 31, 2011. The 2011 year-to-date sales activity is further enumerated in the next table.

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Southeastern Banking Corporation
Notes to Consolidated Financial Statements
(Unaudited)

Three Months Ended March 31, 2011

| | |
|--------------------------|--------------------|
| Gross realized gains | \$ |
| Gross realized losses | 18,191 |
| Net realized loss | \$ (18,191) |
| | |
| Proceeds from sales | \$ 474,000 |

The cost of investment securities sold, and the resultant gain or loss, were based on the specific identification method. No securities were sold during the three months ended March 31, 2010. Additionally, no other-than-temporary impairment losses were recognized during the three months ended March 31, 2011 and March 31, 2010.

Securities with unrealized losses that were not deemed other-than-temporarily impaired at March 31, 2011 and December 31, 2010 are shown in the table on the next page.

Table of Contents**Southeastern Banking Corporation****Notes to Consolidated Financial Statements****(Unaudited)**

| | Less than Twelve Months | | Twelve Months or More | | Total | |
|--|-------------------------|-------------------|-----------------------|-------------------|---------------|-------------------|
| | Gross | | Gross | | Gross | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| <i>March 31, 2011</i> | | | | | | |
| Available-for-sale: | | | | | | |
| Debt securities: | | | | | | |
| U. S. Government and federal agency securities | \$ 1,025,034 | \$ 582 | \$ | \$ | \$ 1,025,034 | \$ 582 |
| U. S. Government-sponsored enterprise securities | 26,994,700 | 5,060 | | | 26,994,700 | 5,060 |
| Agency residential mortgage-backed securities | 1,982,899 | 5,224 | | | 1,982,899 | 5,224 |
| Obligations of states and political subdivisions | 1,038,899 | 17,679 | 842,520 | 100,025 | 1,881,419 | 117,704 |
| Corporate debt obligations | 2,308,030 | 147,344 | 3,927,378 | 525,704 | 6,235,408 | 673,048 |
| Total temporarily impaired securities | \$ 33,349,562 | \$ 175,889 | \$ 4,769,898 | \$ 625,729 | \$ 38,119,460 | \$ 801,618 |

| | Less than Twelve Months | | Twelve Months or More | | Total | |
|--|-------------------------|-------------------|-----------------------|-------------------|---------------|-------------------|
| | Gross | | Gross | | Gross | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| <i>December 31, 2010</i> | | | | | | |
| Available-for-sale: | | | | | | |
| Debt securities: | | | | | | |
| U. S. Government and federal agency securities | \$ | \$ | \$ | \$ | \$ | \$ |
| U. S. Government-sponsored enterprise securities | 22,099,730 | 31 | | | 22,099,730 | 31 |
| Agency residential mortgage-backed securities | | | | | | |
| Obligations of states and political subdivisions | 978,233 | 28,015 | 834,049 | 108,649 | 1,812,282 | 136,664 |
| Corporate debt obligations | 2,325,199 | 132,946 | 4,284,304 | 662,551 | 6,609,503 | 795,497 |
| Total temporarily impaired securities | \$ 25,403,162 | \$ 160,992 | \$ 5,118,353 | \$ 771,200 | \$ 30,521,515 | \$ 932,192 |

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Southeastern Banking Corporation
Notes to Consolidated Financial Statements
(Unaudited)

On March 31, 2011, the Company held certain investment securities having unrealized loss positions. Market changes in interest rates and credit spreads will result in temporary unrealized losses as the market price of securities fluctuates. The turmoil and illiquidity in the financial markets during 2010 and 2011 year-to-date increased market yields on certain securities as a result of credit spreads widening. This shift in market yields resulted in unrealized losses on certain securities within the Company's portfolio.

Unrealized losses continued to be concentrated in corporate debt obligations at March 31, 2011. The unrealized loss of \$673,048 related to five corporate debt obligations was attributable exclusively to issues of banks or bank holding companies domiciled in the southeastern United States. At March 31, 2011, two holdings, both pertaining to the same issuer, with fair values of \$3,153,500 and unrealized losses of \$284,050, were rated BB. Three non-rated trust preferred securities had an aggregate carrying value of \$3,081,908 and unrealized loss of \$388,998 at March 31, 2011. The total unrealized loss on these five corporate securities, including the trust preferred holdings, is largely reflective of the illiquidity and risk premiums reflected in the market for bank-issued securities due to pervasive capital, asset quality, and other issues which have continued to affect the banking industry. Although a) major rating agencies downgraded certain of these securities during the last 12 months and b) recent profitability and near-term profit forecasts by industry analysts reflect continuing pressure due to loan losses and other issues, the Company currently expects the issuers to settle the securities at par. In particular, the issuer of the BB rated securities was a recipient of government capital and continues to meet its obligations. However, management's position regarding the impairment of these securities is subject to change as circumstances evolve.

Within the municipal portfolio, three or \$842,520 of total holdings had been in a continuous unrealized loss position for twelve months or more at March 31, 2011 and four or \$1,038,899 in a continuous loss position less than twelve months. These municipals were all rated A1 or higher by at least one nationally recognized rating agency except for three non-rated securities. The unrealized loss position on these seven securities resulted primarily from changes in market yields and/or withdrawn ratings on municipals that had received credit support from bond insurance. Ratings withdrawals were widespread during the recent economic crisis as many bond insurers faltered. As discussed further below, the Company does not rely solely on bond insurance in making investment decisions and did not consider these particular securities to be impaired at March 31, 2011. Other than fourteen non-rated issues with fair values aggregating \$3,409,157, all holdings in the municipal portfolio comprised rated, investment grade securities. The majority, or 79%, of the non-rated issues were based in Georgia. In analyzing non-rated municipals, management considers debt service coverage and whether the bonds support essential services such as water/sewer systems and education.

Within a) U.S. Government and federal agency securities, which comprise U.S. Small Business Administration participation certificates; b) U.S. Government-sponsored enterprise securities, which principally comprise Federal Home Loan Bank (FHLB), Fannie Mae, and Federal Farm Credit Bank obligations; and c) agency residential mortgage-backed securities, which comprise Fannie Mae, Freddie Mac, and Ginnie Mae issues, the cumulative unrealized loss position totaled \$10,866, or less than 1%, on a carrying value of \$30,002,633 at March 31, 2011. These particular securities all carried an Aaa or AAA rating from the rating agencies. The Company does not own any private label mortgage-backed securities.

Management evaluates investment securities for other-than-temporary impairment on a quarterly basis, and more frequently when conditions warrant. This analysis requires management to consider various factors, including the duration and magnitude of the decline in value; the financial condition of the issuer or issuers; structure of the security; and, notwithstanding classification of the portfolio as available-for-sale, the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before the anticipated recovery in market value. At March 31, 2011, management reviewed securities with an unrealized loss and concluded that no material individual securities were other-than-temporarily impaired. Impairment charges on the Company's holdings could become necessary in the future if the economic crisis facing the banking industry does not fully abate and various issuers' financial condition weakens.

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The Company held stock in the FHLB of Atlanta totaling \$1,173,700 at March 31, 2011. The Company carries the stock, which is included in other assets, at cost and evaluates it for impairment based on ultimate recoverability of par value. The Company evaluated its holding in FHLB stock at March 31, 2011 and believes its holdings are recoverable at par. In addition, the Company does not have operational or liquidity needs that would require a redemption of the stock in the foreseeable future and therefore determined that the stock was not other-than-temporarily impaired.

Concentrations of credit risk pertaining to investment securities are discussed in other sections of this Form 10-Q.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the Company's loan portfolio at March 31, 2011 and December 31, 2010 is shown below:

| | March 31, 2011 | | December 31, 2010 | |
|---|----------------|------------------|-------------------|------------------|
| | Balance | Percent of Total | Balance | Percent of Total |
| Commercial real estate: | | | | |
| Construction and development | \$ 80,361,545 | 34.09% | \$ 86,972,052 | 35.39% |
| Owner-occupied | 36,197,929 | 15.36 | 35,300,711 | 14.37 |
| Non owner-occupied | 28,975,443 | 12.29 | 29,523,640 | 12.02 |
| Residential real estate - mortgage | 47,971,601 | 20.35 | 48,686,595 | 19.82 |
| Other commercial, financial, and agricultural | 31,380,986 | 13.32 | 33,504,726 | 13.64 |
| Consumer, including credit cards | 10,816,136 | 4.59 | 11,700,831 | 4.76 |
| Loans, gross | 235,703,640 | 100.00% | 245,688,555 | 100.00% |
| Unearned income | (60,873) | | (65,007) | |
| Allowance for loan losses | (8,370,191) | | (9,915,559) | |
| Net loans | \$ 227,272,576 | | \$ 235,707,989 | |

Commercial real estate loans represented approximately 62% of the total loan portfolio at both March 31, 2011 and December 31, 2010. Due to continued instability of real estate values, loans in the commercial real estate portfolio may have a greater risk of uncollectibility than other loans. Additionally, because a substantial portion of the loan portfolio is secured by real estate in southeast Georgia and northeast Florida, the loan portfolio is particularly susceptible to changes in market conditions in those areas. Refer to Part I, Item 2 of this Form 10-Q for additional disclosure on loan concentrations.

In accordance with GAAP, the loan portfolio was disaggregated into four segments and further disaggregated into classes for certain disclosures. A portfolio segment is defined as the level in which an entity develops and documents a systematic method for determining its allowance for loan losses. The segments used in the portfolio include commercial real estate; residential real estate - mortgage; other commercial, financial, agricultural; and consumer. Commercial real estate has been divided into three classes, including construction and development, owner-occupied, and non owner-occupied credits. All land and lot development loans have been included in the construction and development class, regardless of whether the underlying real estate is zoned commercial or residential. This classification of construction and development loans corresponds with definitions used by banking regulators for examination and other purposes.

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Aging of past due loans is presented by segment in the next table. Balances presented are based on book balance, or recorded investment.

| <i>March 31, 2011</i> | Current | Accruing 30 - 89 Days Past Due | Accruing 90 Days or More Past Due | Total Accruing Past Due | Nonaccrual | Total |
|---|-----------------------|--------------------------------------|---|----------------------------|----------------------|-----------------------|
| Commercial real estate: | | | | | | |
| Construction and development | \$ 58,749,183 | \$ 985,820 | \$ 17,728 | \$ 1,003,548 | \$ 20,608,814 | \$ 80,361,545 |
| Owner-occupied | 35,470,903 | 350,001 | | 350,001 | 377,025 | 36,197,929 |
| Non owner-occupied | 28,164,303 | 278,142 | | 278,142 | 532,998 | 28,975,443 |
| Residential real estate - mortgage | 42,225,945 | 1,181,375 | 26,191 | 1,207,566 | 4,538,090 | 47,971,601 |
| Other commercial, financial, and agricultural | 30,516,038 | 527,233 | | 527,233 | 337,715 | 31,380,986 |
| Consumer, including credit cards | 10,226,975 | 307,189 | 24,365 | 331,554 | 257,607 | 10,816,136 |
| Loans, gross | \$ 205,353,347 | \$ 3,629,760 | \$ 68,284 | \$ 3,698,044 | \$ 26,652,249 | \$ 235,703,640 |

| <i>December 31, 2010</i> | Current | Accruing 30 - 89 Days Past Due | Accruing 90 Days or More Past Due | Total Accruing Past Due | Nonaccrual | Total |
|---|-----------------------|--------------------------------------|--|-------------------------------|----------------------|-----------------------|
| Commercial real estate: | | | | | | |
| Construction and development | \$ 64,560,275 | \$ 553,271 | \$ 18,555 | \$ 571,826 | \$ 21,839,951 | \$ 86,972,052 |
| Owner-occupied | 33,422,584 | 1,197,251 | | 1,197,251 | 680,876 | 35,300,711 |
| Non owner-occupied | 28,745,303 | 81,151 | | 81,151 | 697,186 | 29,523,640 |
| Residential real estate - mortgage | 43,425,467 | 678,612 | 75,848 | 754,460 | 4,506,668 | 48,686,595 |
| Other commercial, financial, and agricultural | 32,925,618 | 155,384 | | 155,384 | 423,724 | 33,504,726 |
| Consumer, including credit cards | 10,890,188 | 410,570 | 26,536 | 437,106 | 373,537 | 11,700,831 |
| Loans, gross | \$ 213,969,435 | \$ 3,076,239 | \$ 120,939 | \$ 3,197,178 | \$ 28,521,942 | \$ 245,688,555 |

Within accruing loans 30 - 89 days past due, \$2,592,201 of the total was past due 30 - 59 days, and \$1,037,559, 60 - 89 days, at March 31, 2011; accruing loans past due 30 - 59 days and 60 - 89 days totaled \$2,442,451 and \$633,788 at December 31, 2010.

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Internal risk-ratings, or grades, are assigned to each loan based on an analysis of the financial strength, collateral, and other credit attributes underlying each loan. Management analyzes the resulting ratings, as well as other external statistics and factors such as delinquency, to track the migration performance of the portfolio balances. The rating methodology complies with the asset classification system promulgated by the federal banking agencies. Loan grades range from one to eight, with one-graded loans having the least credit risk, as defined below:

Pass (Grades 1 -4) - Loans included in or migrating towards a pass grade of one to four carry the lowest risk of loss. Such loans are well-protected by the current net worth and paying capacity of the obligor (or guarantors, if any) or by the fair value, less selling costs, of underlying collateral.

Special Mention (Grade 5) Loans in this category have potential weaknesses requiring additional monitoring. These loans are not adversely classified and do not currently have sufficient risk to warrant adverse classification. Substantially all special mention loans are performing.

Substandard (Grade 6) These loans are inadequately supported by the current worth and paying capacity of the obligor or collateral pledged, if any. A distinct possibility of loss exists if the underlying deficiencies are not corrected. At March 31, 2011 and December 31, 2010, all nonaccrual loans were graded substandard.

Doubtful (Grade 7) These loans have all the weaknesses of a substandard loan with the added detriment that full collection or liquidation is highly questionable and improbable on the basis of currently known facts, conditions, and values.

Loss (Grade 8) These loans are deemed uncollectible and have, at best, nominal value. Maintaining these loans on the books, without establishment of specific valuation allowances, is not warranted.

Loans considered doubtful or loss are normally charged-off upon such determination and hence, no balances apply to these categories. Risk ratings of the loan portfolio are shown in the next table.

| | Pass (1 - 4) | Special Mention (5) | Substandard (6) | Doubtful (7) | Loss (8) | Total |
|---|-----------------|------------------------|--------------------|-----------------|-------------|----------------|
| <i>March 31, 2011</i> | | | | | | |
| Commercial real estate: | | | | | | |
| Construction and development | \$ 34,056,253 | \$ 21,433,587 | \$ 24,871,705 | \$ | \$ | \$ 80,361,545 |
| Owner-occupied | 32,921,186 | 1,872,774 | 1,403,969 | | | 36,197,929 |
| Non owner-occupied | 16,910,475 | 8,609,053 | 3,455,915 | | | 28,975,443 |
| Residential real estate - mortgage | 35,897,373 | 4,221,038 | 7,853,190 | | | 47,971,601 |
| Other commercial, financial, and agricultural | 30,161,684 | 722,151 | 497,151 | | | 31,380,986 |
| Consumer, including credit cards | 10,322,020 | 163,715 | 330,401 | | | 10,816,136 |
| Loans, gross | \$ 160,268,991 | \$ 37,022,318 | \$ 38,412,331 | \$ | \$ | \$ 235,703,640 |

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| <i>December 31, 2010</i> | Pass (1 4) | Special Mention (5) | Substandard (6) | Doubtful (7) | Loss (8) | Total |
|---|--------------------|------------------------|--------------------|-----------------|-------------|--------------------|
| Commercial real estate: | | | | | | |
| Construction and development | \$ 35,170,540 | \$ 21,525,120 | \$ 30,276,392 | \$ | \$ | \$ 86,972,052 |
| Owner-occupied | 31,702,978 | 2,649,760 | 947,973 | | | 35,300,711 |
| Non owner-occupied | 22,531,694 | 3,242,934 | 3,749,012 | | | 29,523,640 |
| Residential real estate - mortgage | 35,813,611 | 5,194,612 | 7,678,372 | | | 48,686,595 |
| Other commercial, financial, and agricultural | 30,000,682 | 610,926 | 2,893,118 | | | 33,504,726 |
| Consumer, including credit cards | 10,988,957 | 240,987 | 470,887 | | | 11,700,831 |
| Loans, gross | \$ 166,208,462 | \$ 33,464,339 | \$ 46,015,754 | \$ | \$ | \$ 245,688,555 |

Activity in the allowance for loan losses is summarized by loan segment below:

| <i>As of and for the Three Months Ended March 31, 2011</i> | Commercial Real Estate | Residential Real Estate | Other Commercial, Financial, & Agricultural | Consumer | Unallocated | Total |
|---|---------------------------|----------------------------|--|----------------|----------------|-------------------|
| Allowance for loan losses: | | | | | | |
| Balance, beginning of year | \$ 7,442,941 | \$ 1,747,843 | \$ 405,830 | \$ 262,223 | \$ 56,722 | \$ 9,915,559 |
| Provision for loan losses | 211,790 | 445,255 | (49,913) | (52,295) | 105,163 | 660,000 |
| Charge-offs | (2,016,469) | (180,426) | (12,849) | (36,111) | | (2,245,855) |
| Recoveries | 287 | 7,081 | 4,394 | 28,725 | | 40,487 |
| Ending balance | \$ 5,638,549 | \$ 2,019,753 | \$ 347,462 | \$ 202,542 | \$ 161,885 | \$ 8,370,191 |
| Ending balance, loans individually evaluated for impairment | \$ 1,123,722 | \$ 1,277,339 | \$ 562 | \$ | \$ | \$ 2,401,623 |
| Loans: | | | | | | |
| Gross ending balance | \$ 145,534,917 | \$ 47,971,601 | \$ 31,380,986 | 10,816,136 | \$ | \$ 235,703,640 |
| Ending balance, gross loans individually evaluated for impairment | \$ 28,221,913 | \$ 6,362,967 | \$ 18,741 | \$ 26,610 | \$ | \$ 34,630,231 |

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Within the commercial real estate classes specifically, activity included:

| <i>As of & for the Three Months</i> | Construction & Development | Owner- Occupied | Non Owner- Occupied | Total Commercial Real Estate |
|---|----------------------------------|--------------------|------------------------|------------------------------------|
| <i>Ended March 31, 2011</i> | | | | |
| Allowance for loan losses: | | | | |
| Balance, beginning of year | \$ 7,133,461 | \$ 124,729 | \$ 184,751 | \$ 7,442,941 |
| Provision for loan losses | (4,043) | 51,372 | 164,461 | 211,790 |
| Charge-offs | (1,852,280) | | (164,189) | (2,016,469) |
| Recoveries | 287 | | | 287 |
| Ending balance | \$ 5,277,425 | \$ 176,101 | \$ 185,023 | \$ 5,638,549 |
| Ending balance, loans individually evaluated for impairment | \$ 966,023 | \$ 55,106 | \$ 102,593 | \$ 1,123,722 |
| Loans: | | | | |
| Gross ending balance | \$ 80,361,545 | \$ 36,197,929 | \$ 28,975,443 | \$ 145,534,917 |
| Ending balance, gross loans individually evaluated for impairment | \$ 23,538,459 | \$ 1,263,690 | \$ 3,419,764 | \$ 28,221,913 |

A loan is considered impaired when it is probable, based on current information and events, the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans include loans placed on nonaccrual status as well as TDRs, loans past due 90 days or more and still accruing, and other accruing loans individually evaluated for impairment. All of the Company's impaired loans have a valuation allowance. Impaired loans comprised the following at March 31, 2011 and December 31, 2010:

| | March 31, 2011 | December 31, 2010 |
|--|----------------------|----------------------|
| Nonaccrual loans | \$ 26,652,249 | \$ 28,521,942 |
| Troubled debt restructurings not included above | 5,669,751 | 12,669,230 |
| Loans past due 90 days or more and still accruing | 68,284 | 120,939 |
| Other accruing loans individually evaluated for impairment | 5,075,932 | 4,520,331 |
| Total impaired loans | \$ 37,466,216 | \$ 45,832,442 |
| Valuation allowance related to total impaired loans | \$ 2,497,413 | \$ 3,580,409 |

Total impaired loans are disaggregated by segment and class below:

| <i>As of & for the Three Months</i> | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|---|------------------------|--------------------------------|----------------------|
| <i>Ended March 31, 2011</i> | | | |

Impaired loans with a valuation allowance:

Commercial real estate:

| | | | |
|---|---------------|---------------|--------------|
| Construction and development | \$ 24,411,874 | \$ 35,336,124 | \$ 1,030,344 |
| Owner-occupied | 1,428,915 | 1,569,961 | 55,665 |
| Non owner-occupied | 3,419,764 | 3,704,149 | 102,593 |
| Residential real estate - mortgage | 7,585,975 | 8,663,368 | 1,298,247 |
| Other commercial, financial, and agricultural | 337,715 | 480,818 | 7,085 |
| Consumer, including credit cards | 281,973 | 664,671 | 3,479 |

| | | | |
|-----------------------------|----------------------|----------------------|---------------------|
| Total impaired loans | \$ 37,466,216 | \$ 50,419,091 | \$ 2,497,413 |
|-----------------------------|----------------------|----------------------|---------------------|

| | |
|--------------------------------------|---------------|
| Average investment in impaired loans | \$ 40,690,240 |
|--------------------------------------|---------------|

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| <i>December 31, 2010</i> | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|---|------------------------|--------------------------------|----------------------|
| Impaired loans with a valuation allowance: | | | |
| Commercial real estate: | | | |
| Construction and development | \$ 30,017,176 | \$ 39,673,998 | \$ 2,459,478 |
| Owner-occupied | 1,337,701 | 1,483,080 | 35,631 |
| Non owner-occupied | 3,749,011 | 3,869,208 | 117,131 |
| Residential real estate - mortgage | 7,544,914 | 8,558,866 | 881,587 |
| Other commercial, financial, and agricultural | 2,751,545 | 2,882,978 | 80,651 |
| Consumer, including credit cards | 432,095 | 812,241 | 5,931 |
| Total impaired loans | \$ 45,832,442 | \$ 57,280,371 | \$ 3,580,409 |

Impaired loans with a valuation allowance include pools of impaired loans. At March 31, 2011, these pools had a recorded investment, or book balance, of \$2,835,985, unpaid principal balance of \$3,966,802, and related allowance of \$95,790. The recorded investment, unpaid principal, and related allowance in such pools totaled \$3,135,061, \$4,179,940, and \$106,737, respectively, at December 31, 2010. The gross amount of interest income that would have been recorded on nonaccrual loans and TDRs, if all such loans had been accruing interest at their contractual rates, approximated \$410,000 during the first quarter of 2011. Cash basis interest income actually recognized on nonaccrual loans approximated \$15,000. Nonaccrual and TDRs included in impaired loans averaged approximately \$36,229,000 in 2011 year-to-date.

5. Fair Value**Determination of Fair Value**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and for disclosure purposes. Accounting guidance on fair value measurements and disclosures specifies that the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best defined using quoted market prices, but in many instances, quoted market prices for the Company's various financial instruments may not be available. Under these circumstances, fair values are estimated using present value or other variation techniques. Those techniques are significantly affected by the underlying assumptions, including the discount rate and estimates of future cash flows; accordingly, the resulting fair value estimate may not be realized in an immediate settlement of the instrument.

Recent fair value guidance clarifies that exit prices based on orderly transactions between market participants under current market conditions, not forced liquidations or distressed sales, should be the basis for determining fair value. If the volume and level of activity for the asset or liability has declined significantly, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In this instance, determining the price at which willing market participants would transact depends on the various facts and circumstances and requires significant judgment. The resulting fair value is a reasonable point within the determined range that best indicates fair value under current conditions.

Fair Value Hierarchy

In accordance with accounting guidance, the Company groups its financial assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities trade and the reliability of the assumptions used to determine fair value:

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Level 1 Valuation is based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Level 1 assets and liabilities generally include debt and equity securities that are traded on an active exchange. Valuations are obtained from readily available pricing sources for market transactions involving such assets or liabilities.

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Level 2 Valuation is based on inputs other than level 1 prices that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability. Level 2 inputs may incorporate interest rates and yield curves that are observable at commonly quoted intervals, volatilities, prepayment speeds, credit risks, and default rates.

Level 3 Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments whose valuation requires significant management judgment or estimation. Level 3 valuation also includes observable inputs for single dealer nonbinding quotes not corroborated by observable market data.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Risk premiums that a market participant would require must be considered.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Fair value is the primary basis of accounting for investment securities available-for-sale. The Company does not currently measure any other assets or liabilities at fair value on a recurring basis. When quoted market prices for identical securities are available in an active market, these securities are classified within level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, such as U.S. Treasury notes or exchange-traded equities. If quoted market prices for identical securities are not available, then fair values are estimated using matrix models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within level 2, include U.S. Government-sponsored enterprise securities, agency mortgage-backed securities, obligations of states and political subdivisions, and certain corporate debt obligations. Due to limited activity and less transparency regarding input factors, one corporate debt obligation was classified in level 3 at March 31, 2011 and December 31, 2010.

Securities measured at fair value on a recurring basis are presented in the next table.

| | Fair Value Measurements Using | | | Total Carrying Value |
|--|---|---|--|----------------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| <i>March 31, 2011</i> | | | | |
| Investment securities available-for-sale: | | | | |
| Debt securities: | | | | |
| U. S. Government and federal agency securities | \$ | \$ 4,421,023 | \$ | \$ 4,421,023 |
| U. S. Government-sponsored enterprise securities | | 32,894,652 | | 32,894,652 |
| Agency residential mortgage-backed securities | | 15,878,375 | | 15,878,375 |
| Obligations of states and political subdivisions | | 14,870,265 | | 14,870,265 |
| Corporate debt obligations | | 7,277,346 | 500,000 | 7,777,346 |
| Total investment securities | \$ | \$ 75,341,661 | \$ 500,000 | \$ 75,841,661 |

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| | Fair Value Measurements Using | | | Total Carrying Value |
|--|---|---|--|----------------------------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| <i>December 31, 2010</i> | | | | |
| Investment securities available-for-sale: | | | | |
| Debt securities: | | | | |
| U. S. Government and federal agency securities | \$ | \$ 4,738,534 | \$ | \$ 4,738,534 |
| U. S. Government-sponsored enterprise securities | | 33,668,037 | | 33,668,037 |
| Agency residential mortgage-backed securities | | 10,965,621 | | 10,965,621 |
| Obligations of states and political subdivisions | | 16,821,004 | | 16,821,004 |
| Corporate debt obligations | | 7,606,707 | 500,000 | 8,106,707 |
| Total investment securities | \$ | \$ 73,799,903 | \$ 500,000 | \$ 74,299,903 |

The corporate debt obligation measured at fair value using level 3 inputs at March 31, 2011 and December 31, 2010 comprised one trust preferred security with a cost basis of \$500,000, for which there is currently no active market. Like the Company's other corporate debt holdings, this security is also an issue of a bank/bank holding company domiciled in the southeastern United States. No transfers or activity involving other securities occurred within the level 3 category during the first quarter of 2011. Should transparency in input factors diminish, additional obligations could be classified as level 3 assets in the future. No transfers were made between level 1 or 2 assets measured at fair value on a recurring basis during the first quarter.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain instruments are measured at fair value on a nonrecurring basis; in other words, these instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances—for example, when evidence of impairment exists. Such instruments include impaired loans and other real estate. Loan impairment is reported when full payment under the original loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate or the fair value of collateral if the loan is collateral-dependent. When management believes the uncollectibility of all or any portion of a loan is confirmed, a loss is charged against the allowance. Any necessary increase to the allowance resulting from impaired loans is recorded as a component of the provision for loan losses. During the first quarter of 2011, the Company recognized losses of \$836,916 on impaired loans outstanding through the allowance for loan losses. At March 31, 2011, impaired loans with an aggregate outstanding principal balance of \$37,466,216 were measured and reported net of specific allowances at a fair value of \$34,968,803. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan impairment as a level 2 instrument. When an appraised value is not available or management determines the fair value of the collateral is impaired beyond appraised value and no observable market price exists, the Company records the loan impairment in level 3. Given the current difficulties in obtaining comparable sales and other observable inputs due to high inventories and distressed sales prevalent in the market, particularly for certain real estate collateral, the Company classified all impaired loans in level 3 at March 31, 2011.

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Other real estate is recorded at fair value upon transfer of the underlying loan to foreclosed balances. Fair value is based upon independent market prices, appraised values, or management's estimate of collateral value. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies other real estate as level 2; otherwise, other real estate is classified as level 3. Any write-down to fair value at foreclosure is charged to the allowance for loan losses while subsequent devaluations are included in noninterest expense. During the quarter ended March 31, 2011, devaluations of other real estate currently outstanding totaled \$161,127. All foreclosed real estate balances were classified in level 3 at March 31, 2011.

Level 3 assets also include FHLB stock, which is only redeemable with the issuer at par and cannot be traded in the market; as such, no observable market data for this holding is available. The Company evaluated its holding in FHLB stock at March 31, 2011 and determined no impairment charge was necessary. Other assets are similarly evaluated under fair value accounting on a nonrecurring basis.

The table below presents the Company's outstanding assets for which a nonrecurring change in fair value was recorded during the three months ended March 31, 2011, aggregated by the level in the fair value hierarchy within which those measurements fall. Assets reviewed for impairment such as level 3 FHLB stock, but for which no corresponding impairment charge was recorded, are not included in these totals.

| | Fair Value Measurements Using | | | | |
|--|---|--|--|--------------------------|--|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Net Carrying Value | Total Gains (Losses) for the Three Months |
| <i>March 31, 2011</i> | | | | | |
| Assets: | | | | | |
| Impaired loans | \$ | \$ | \$ 37,466,216 | \$ 37,466,216 | \$ (836,916) |
| Other real estate | | | 1,188,740 | 1,188,740 | (161,127) |
| Total fair value of assets on a nonrecurring basis | \$ | \$ | \$ 38,654,956 | \$ 38,654,956 | \$ (998,043) |

As disclosed on the prior page, the loss amount shown for impaired loans includes charge-offs as well as the provision allocated for these loans during the first quarter. The loss amount for other real estate does not include charge-offs recognized on these credits prior to foreclosure of the underlying collateral; these charge-offs totaled \$191,576 in 2011 year-to-date. No transfers were made between level 1, 2, and 3 assets evaluated under fair value accounting on a nonrecurring basis. Additionally, no nonrecurring change in fair value was recognized on any liabilities in 2011 year-to-date.

Fair Value of Financial Instruments

Methodologies for estimating the fair value of financial assets and liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. For certain other financial assets and liabilities, fair value approximates carrying value due to the nature of the financial instrument. These instruments include cash and cash equivalents, demand and other non-maturity deposits, and overnight borrowings. The following methods and assumptions were used in estimating the fair value of other financial instruments:

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Variable rate loans that reprice frequently and have no significant change in credit risk are fairly valued at their carrying amounts. For fixed rate loans, fair values are estimated based on discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The Company did not use an incremental market risk and liquidity discount in deriving loan fair values as management has no present intention to sell any portion of the loan portfolio. Impaired loans are valued using discounted cash flow analyses or underlying collateral values, as discussed.

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Southeastern Banking Corporation
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Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities. The intangible value of long-term relationships with depositors is not considered in estimating fair values.

The U. S. Treasury demand note and other variable rate borrowings are fairly valued at their carrying amounts. Fair values for other borrowings, including FHLB advances with fixed rates, are based on quoted market prices for similar instruments or estimated using discounted cash flow analysis and the Company's current incremental borrowing rate for similar instruments.

The carrying amount of accrued interest and other financial assets approximates their fair values.

The table below presents the fair value of financial assets and liabilities carried on the Company's consolidated balance sheet, including those financial assets and liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis:

| | March 31, 2011 | | December 31, 2010 | |
|--|--------------------|----------------|--------------------|----------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | \$ 93,624,553 | \$ 93,624,553 | \$ 80,868,505 | \$ 80,868,505 |
| Investment securities available-for-sale | 75,841,661 | 75,841,661 | 74,299,903 | 74,299,903 |
| Net loans | 227,272,576 | 227,319,418 | 235,707,989 | 237,411,612 |
| Accrued interest receivable | 1,386,913 | 1,386,913 | 1,487,126 | 1,487,126 |
| Other financial assets | 1,173,700 | 1,173,700 | 1,173,700 | 1,173,700 |
| Financial liabilities: | | | | |
| Deposits | \$ 381,588,333 | \$ 382,860,016 | \$ 375,195,119 | \$ 376,619,703 |
| U.S. Treasury demand note | 1,042,509 | 1,042,509 | 762,782 | 762,782 |
| FHLB advances | 5,000,000 | 5,210,330 | 5,000,000 | 5,191,353 |
| Accrued interest payable | 1,185,903 | 1,185,903 | 1,287,916 | 1,287,916 |

Bank premises and equipment, customer relationships, deposit base, and other information needed to compute the Company's aggregate fair-value are not included in the table above. Accordingly, the fair values above are not intended to represent the underlying market value of the Company.

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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 2010 Annual Report on Form 10-K and the consolidated financial statements & related notes on pages 3 – 22 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 \$434,367,000, is a financial services company with operations in southeast Georgia and northeast Florida. Southeastern Bank (SEB), the Company's wholly-owned commercial bank subsidiary chartered in 1888, offers a full line of commercial and retail services to meet the financial needs of its customer base through its sixteen branch locations and ATM network. Services offered include traditional deposit and credit services, long-term mortgage originations, and credit cards. SEB also offers 24-hour delivery channels, including internet and telephone banking and through an affiliation with a third party broker-dealer, provides insurance and investment brokerage services.

Financial Condition

Consolidated assets totaled \$434,367,602 at March 31, 2011, up \$6,734,545 or 1.57% from year-end 2010. A substantial increase in cash & cash equivalents offset by a 3.58% decline in net loans was the chief factor in the three-month results. Specifically, cash & cash equivalents, which include correspondent balances at the Federal Reserve and federal funds sold, increased \$12,756,048 while investment securities and other real estate grew \$1,541,758 and \$1,278,653; net loans declined \$8,435,413. A \$6,393,214 increase in deposits precipitated the asset rise. Loans comprised approximately 59%, investment securities, 19%, and interest-bearing deposits in other banks, 21%, of earning assets at March 31, 2011 versus 62%, 19%, and 18%, at December 31, 2010. Overall, earning assets approximated 91% of total assets at March 31, 2011. During the year-earlier period, total assets grew \$6,399,499 or 1.52%. A \$23,245,896 increase in cash & cash equivalents and a \$16,719,767 decline in net loans were the predominant factors in the 2010 results. Refer to the Liquidity section of this Analysis for details on deposits and other funding sources as well as the higher cash balances being maintained currently. Loans are discussed beginning on page 25.

Investment Securities

Overall, investment securities increased \$1,541,758 or 2.08% since December 31, 2010. Purchases of securities in the first three months of 2011, primarily comprising short-term securities with original maturities of 90 days or less, approximated \$152,101,000, and redemptions, \$150,590,000. The use of Agency discount notes and U.S. Treasury bills to collateralize public funds was the predominant factor in the 2011 purchase and redemption activity. Effective December 31, 2010, the FDIC amended its deposit insurance program to eliminate insurance coverage above \$250,000 on NOW accounts, which are the predominant account type used by public funds. The change in insurance coverage necessitated the purchase of securities to collateralize affected public funds. One security was sold year-to-date. Specifically, a corporate holding with a cost basis of \$492,191 was sold at an \$18,191 loss. The

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remaining redemptions were largely attributable to various issuers' exercise of call options and prepayments in the normal course of business and also, the relatively 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. At March 31, 2011, agency residential mortgage-backed securities, municipals, and corporates comprised 21%, 20%, and 10% of the portfolio; other agency and U.S. Government enterprise securities together comprised 49%. Overall, securities comprised 19% of earning assets at March 31, 2011, virtually unchanged from year-end 2010. The portfolio yield approximated 3.51% during the first three months of 2011, down 171 basis points from 2010. Yields are expected to decline further during 2011 due largely to anticipated short-term purchases and year-over-year reductions in corporate securities; on a weighted average basis, these corporate securities had higher yields than many of the other holdings in the portfolio.

Management believes the credit quality of the investment portfolio remains fundamentally sound, with 70.14% of the carrying value of debt securities, including mortgage-backed securities, being backed by U.S. Government agency and U.S. Government-sponsored enterprises at March 31, 2011. The Company does not own any collateralized debt obligations, widely known as CDOs, secured by subprime residential mortgage-backed securities. Additionally, the Company does not own any private label mortgage-backed securities. The Company held \$15,716,372 residential mortgage-backed securities issued by Fannie Mae (FNMA) and Freddie Mac (FHLMC) at March 31, 2011. Residential mortgage-backed securities issued by FNMA and FHLMC are collateralized foremost by the underlying mortgages and secondly, by FNMA and FHLMC themselves. Management continues to monitor the viability of both FNMA and FHLMC as going concerns: In early 2011, the U.S. Treasury again reiterated its support for FNMA and FHLMC although changes are expected in the business model going forward. Besides FNMA and FHLMC, the Company also owned Ginnie Mae residential mortgage securities with a carrying value of \$162,003 at March 31, 2011. U.S. Government and federal agency holdings comprised U.S. Small Business Administration obligations, and U.S. Government-sponsored enterprise holdings comprised FHLB, FNMA, FHLMC, and Federal Farm Credit Bank obligations at March 31, 2011. Credit concern surrounding the FHLB system continues to be widespread. The FHLB obligations owned by the Company carry the highest rating available from Moody's and Standard and Poor's. Nonetheless, the Company reviewed its holdings of FHLB debt securities and stock and concluded that its bond and stock holdings are recoverable at par. The Company's ownership of FHLB stock, which totaled \$1,173,700 at March 31, 2011, is included in other assets and recorded at cost.

At March 31, 2011 and also, year-end 2010, the entire corporate portfolio comprised issues of banks and bank holding companies domiciled in the southeastern United States. These corporate debt obligations were all rated BB or higher by at least one nationally recognized rating agency at March 31, 2011 except for three non-rated trust preferred securities with an aggregate carrying value of \$3,081,908 and unrealized loss of \$388,998. The \$673,048 net unrealized loss on the total corporate portfolio, down \$122,449 or 15.39% from year-end 2010, including the trust preferred holdings, is largely reflective of the illiquidity and risk premiums reflected in the market for bank-issued securities due to pervasive capital, asset quality, and other issues which have continued to afflict the banking industry. Although a) major rating agencies have downgraded certain of these securities during the last 12 months and b) recent profitability and near-term profit forecasts by industry analysts reflect continuing pressure due to loan losses and other issues, the Company currently expects the issuers to settle the securities at par. In particular, the issuer of the BB rated securities was a recipient of government capital and continues to meet its obligations. As discussed in note 3 to the consolidated financial statements, the Company sold a B+ rated corporate and recognized an \$18,191 loss during the first three months of 2011; the Company had no residual holdings of this particular issuer at March 31, 2011. Except for fourteen non-rated issues with fair values aggregating \$3,409,157, all holdings in the municipal portfolio were rated, investment grade securities. The majority, or 79%, of the non-rated issues were based in Georgia. In analyzing non-rated municipals, management considers debt service coverage and whether the bonds support essential services such as water/sewer systems and education.

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Management evaluates investment securities for other-than-temporary impairment on a quarterly basis, and more frequently when conditions warrant. This analysis requires management to consider various factors, including the duration and magnitude of the decline in value; the financial condition of the issuer or issuers; structure of the security; and, notwithstanding classification of the portfolio as available-for-sale, the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before the anticipated recovery in market value. At March 31, 2011, management reviewed securities with an unrealized loss and concluded that no material individual securities were other-than-temporarily impaired. Impairment charges could become necessary in the future if the economic crisis facing the banking industry does not fully abate and various issuers' financial condition weakens.

The weighted average life of the portfolio approximated 2.59 years at March 31, 2011; management does not expect any material extension in duration during 2011. The amortized cost and estimated fair value of investment securities, all available-for-sale, are delineated in the next table.

Investment Securities by Category

| <i>March 31, 2011</i> | <i>Amortized</i> | <i>Unrealized</i> | <i>Unrealized</i> | <i>Fair</i> |
|---|------------------|-------------------|-------------------|---------------|
| <i>(Dollars in thousands)</i> | <i>Cost</i> | <i>Gains</i> | <i>Losses</i> | <i>Value</i> |
| U. S. Government and federal agency securities | \$ 4,260 | \$ 162 | \$ 1 | \$ 4,421 |
| U. S. Government-sponsored enterprise securities ¹ | 32,821 | 79 | 5 | 32,895 |
| Agency residential mortgage-backed securities | 15,264 | 620 | 5 | 15,879 |
| Obligations of states and political subdivisions | 14,644 | 344 | 118 | 14,870 |
| Corporate debt obligations | 8,386 | 64 | 673 | 7,777 |
| Total investment securities | \$ 75,375 | \$ 1,269 | \$ 802 | 75,842 |

¹ Includes agency discount notes with original maturities of three months or less, as applicable.

At March 31, 2011, the market value of the investment portfolio reflected \$801,618 in gross unrealized losses, mostly in the corporate portfolio. Management continues to monitor these market values closely and hopes for an eventual recovery as issues facing banks and their affiliates are fully addressed. Capital raises and strategic initiatives enacted by these organizations have been positive developments for these corporate holdings; nonetheless, ratings downgrades and additional losses have occurred and may continue. For more details on investment securities and related fair value, refer to the Capital Adequacy section of this analysis.

The Company did not have a concentration in the obligations of any issuer at March 31, 2011 other than U.S. Government agencies, U.S. Government enterprises, and certain corporate holdings. At March 31, 2011, the Company held \$5,461,530 in corporate securities issued by two separate regional bank holding companies; these holdings comprised 7.20% of the total securities portfolio and 70.22% of the corporate portfolio.

Loans

Loans, net of unearned income, fell 4.06% or \$9,980,781 since year-end 2010. The net loans to deposits ratio aggregated 61.75% at March 31, 2011 versus 65.47% at December 31, 2010 and 71.22% a year ago. The loan categorization table below reflects declines of \$6,610,507 in real estate - construction balances, \$1,774,719 in the commercial portfolio, \$884,695 in consumer loans, and \$714,994 in real estate - residential mortgage balances at March 31, 2011 compared to year-end 2010. The \$6,610,507 or 7.60% decline in real estate - construction balances resulted from multiple factors, including pay-downs, and as further discussed in the next two subsections, significant charge-offs and foreclosures. These loans, widely known as acquisition and development loans, continued to be predominantly residential in nature

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and concentrated in the Company's coastal markets at March 31. These type loans are typically short-term and somewhat cyclical; swings in these account balances are normal and to be expected. Due to the current slowdown in real estate activity, overall duration of these particular loans has increased the last few years. The escalation in nonperforming assets attributable to these loans is expected to continue in 2011, albeit at a slower pace. With the exception of existing commitments, the Company is originating new acquisition and development loans only to customers with extraordinary equity injections, outside financial strength, or other performance metrics with low dependence on the underlying collateral. Although the Company, comparable to peer institutions of similar size, originates permanent mortgages for new construction, it historically has not held or serviced long-term mortgage loans of any volume in its own portfolio. Rather, permanent mortgages are typically brokered through a mortgage underwriter or government agency. The Company receives mortgage origination fees, which are included in other noninterest income, for its participation in these origination transactions. Overall, the commercial portfolio declined 1.80% or \$1,774,719 year-to-date. Agricultural loans and tax-free government loans within this portfolio declined \$241,196 and \$1,936,040; nonfarm real estate loans and other commercial/industrial loans grew \$349,021 and \$53,496. The tax-free loans serve as a bridge for local government bodies anticipating property tax collections and are intended to be short-term. Tighter credit policies and less demand throughout SEB's branches both contributed to the 7.56% and 1.47% declines in consumer and real estate residential mortgage loans at March 31, 2011 compared to December 31, 2010.

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 further the remainder of 2011. Additionally, as further discussed in the next subsection of this Analysis, management expects problem asset volumes to remain elevated given the Company's significant real estate portfolio. During the same period in 2010, net loans declined 6.26% or \$17,259,892. The commercial and real estate construction portfolios contributed most of the 2010 decline. Loans outstanding are presented by type in the following table.

| <i>Loans by Category</i> <i>(Dollars in thousands)</i> | March 31, 2011 | December 31, 2010 | March 31, 2010 |
|---|---------------------------|----------------------|-------------------|
| Commercial, financial, and agricultural ¹ | \$ 96,554 | \$ 98,329 | \$ 89,677 |
| Real estate construction ² | 80,362 | 86,972 | 104,895 |
| Real estate residential mortgage ³ | 47,972 | 48,687 | 51,682 |
| Consumer, including credit cards | 10,816 | 11,701 | 12,305 |
| Loans, gross | 235,704 | 245,689 | 258,559 |
| Unearned income | (61) | (65) | (93) |
| Net loans | \$ 235,643 | \$ 245,624 | \$ 258,466 |

¹ Includes obligations of states and political subdivisions.

² Typically have final maturities of 15 years or less.

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

Many commercial and real estate credits with floating rates have reached their contractual floors. Additionally, many recent originations and renewals have been priced at fixed rather than adjustable rates, unless floors applied. Loans with floating rates that had reached a contractual floor approximated \$104,900,000 at March 31, 2011 compared to \$105,800,000 at December 31, 2010 and \$111,900,000 at March 31, 2010. The average yield on these particular outstanding balances, which included all loan types, was 5.54%, or 229 basis points above New York prime, at March 31, 2011. Management continues to shorten maturity options on commercial credits as feasible, a move that should mitigate the Company's interest sensitivity position when prime adjusts upward.

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Although the Company's loan portfolio is diversified, significant portions of its loans are collateralized by real estate. At March 31, 2011, approximately 83.17% of the loan portfolio was comprised of loans with real estate as the primary collateral, including land tracts and lots. 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 northeast Florida and particularly, southeast Georgia. 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 \$28,616,000 at March 31, 2011, compared to \$31,685,000 at year-end 2010 and \$39,585,000 at March 31, 2010. The decline in overall commitments results from the Company's decision to reduce its exposure to higher risk areas, including acquisition and development lending, as well as customer decisions not to renew their lines. Because a substantial amount of these contracts expire without being drawn upon, total contractual amounts do not necessarily represent future credit exposure or liquidity requirements. The Company has not funded or incurred any losses on letters of credit in 2011 year-to-date.

Nonperforming Assets

Nonperforming assets, which consist of nonaccrual loans, restructured loans, foreclosed real estate, and other repossessions, totaled \$44,665,844 at March 31, 2011. Aggregate balances declined 14.50% or \$7,574,173 at March 31, 2011 from December 31, 2010 but increased \$3,201,854 from March 31, 2010. As a percent of total assets, nonperforming assets totaled 10.28% at March 31, 2011 versus 12.22% at December 31, 2010 and 9.70% at March 31, 2010. Nonperforming assets materially and adversely affected the Company's business, resources, and operating results during the first three months of 2011, and management expects continuing adverse effects until real estate markets, particularly coastal markets, improve. Acquisition and development loans secured by land tracts and lots remained the primary factor in the nonperforming trends. Summary information about nonperforming assets and accruing loans past due 90 days or more is provided in the following table; narrative discussing each major category begins thereafter.

| | March 31, 2011 | December 31, 2010 | March 31, 2010 |
|--|-------------------|----------------------|-------------------|
| <i>Nonperforming Assets</i> ¹ (Dollars in thousands) | | | |
| Nonaccrual loans: | | | |
| Commercial, financial, and agricultural | \$ 1,248 | \$ 1,802 | \$ 1,723 |
| Real estate construction | 20,609 | 21,840 | 21,845 |
| Real estate mortgage | 4,538 | 4,507 | 2,551 |
| Consumer, including credit cards | 257 | 373 | 299 |
| Total nonaccrual loans | \$ 26,652 | \$ 28,522 | \$ 26,418 |
| Troubled debt restructured loans ² | 5,670 | 12,669 | 5,467 |
| Total nonperforming loans | \$ 32,322 | \$ 41,191 | \$ 31,885 |
| Foreclosed real estate ³ | 12,315 | 11,034 | 9,514 |
| Other repossessed assets | 28 | 15 | 65 |
| Total nonperforming assets | \$ 44,665 | \$ 52,240 | \$ 41,464 |
| Accruing loans past due 90 days or more | \$ 68 | \$ 121 | \$ 201 |
| Ratios: | | | |
| Nonperforming loans to net loans ⁴ | 13.72% | 16.77% | 12.34% |
| Nonperforming assets to net loans ⁴ plus foreclosed/repossessed assets | 18.01% | 20.35% | 15.47% |

¹ See Note 4 to the consolidated financial statements for definitional variance between impaired and nonperforming loans and also, categorization differences resulting from disaggregation of loan portfolio required in footnote disclosure.

² Does not include restructured loans reported as nonaccrual.

- ³ Includes only other real estate acquired through foreclosure or in settlement of debts previously contracted.
- ⁴ Net of unearned income.

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Nonaccrual Loans. Nonaccrual loans comprised \$26,652,249 or 59.67% of nonperforming asset balances at March 31, 2011. Approximately \$4,962,000 of loans were placed on nonaccrual status during the three-month period, \$2,246,000 charged-off, \$2,033,000 transferred out by foreclosure, and \$2,553,000 reduced by payments or other repossession. At March 31, 2011, real estate-secured loans comprised \$26,228,303 or 98.41% of total nonaccrual balances. Nonaccrual balances did not contain any other industry concentrations at March 31, 2011. The collateral underlying nonaccrual balances is presented in the next table.

| <i>Nonaccrual Loans by Collateral Type</i> (Dollars in thousands) | March 31, 2011 | December 31, 2010 |
|--|-------------------|----------------------|
| Collateral type: | | |
| Real estate: | | |
| Land tracts | \$ 6,778 | \$ 6,027 |
| Lots within developments | 9,960 | 11,682 |
| Residential dwellings | 8,574 | 8,828 |
| Commercial buildings | 916 | 1,385 |
| Total real estate | \$ 26,228 | 27,922 |
| Equipment | 312 | 442 |
| Other | 112 | 158 |
| Total nonaccrual loans | \$ 26,652 | \$ 28,522 |

Approximately 96% of the real estate collateral underlying nonaccrual balances at March 31, 2011 was located in Georgia, predominantly coastal Georgia, with the balance in Florida. Nonaccrual balances included one purchased participation loan at March 31, 2011. This particular loan, with a balance of \$532,998 and secured by a commercial building, is the only purchased participation on the Company's books; a \$164,189 charge-off was recorded on this credit during the first quarter of 2011 and in June, the underlying property was foreclosed.

Relationships above \$250,000 comprised 85.03% or \$22,661,300 of nonaccrual balances at March 31, 2011. Cumulative charge-offs recognized on these 13 large relationships, primarily acquisition and development relationships, totaled \$11,500,020 at March 31, 2011; \$9,480,297 of these charge-offs were recognized in 2010 and prior years and \$2,019,723 year-to-date. The specific allowance allocated to these 13 relationships totaled \$679,836 at March 31, 2011. Additional charge-offs recognized on these particular credits since March 31, 2011 were nominal. The table below presents nonaccrual loans by relationship tiers.

| <i>Nonaccrual Loans by Relationship Tiers</i> (Dollars in thousands) | Number of Relationships | Balances | Percent of Total Balance | Average Balance within Tier |
|---|-------------------------------|------------------|--------------------------------|-----------------------------------|
| March 31, 2011 | | | | |
| Relationship tier: | | | | |
| ≤ \$250,000 | 142 | \$ 3,991 | 14.97% | \$ 28 |
| > \$250,000 - £ \$750,000 | 6 | 2,412 | 9.05% | 402 |
| > \$750,000 | 7 | 20,249 | 75.98% | 2,893 |
| Total | 155 | \$ 26,652 | 100.00% | \$ 172 |

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| <i>December 31, 2010</i> <i>(Dollars in thousands)</i> | Number of Relationships | Balances | Percent of Total Balance | Average Balance within Tier |
|---|----------------------------|------------------|--------------------------------|-----------------------------------|
| Relationship tier: | | | | |
| £ \$250,000 | 145 | \$ 4,244 | 14.88% | \$ 29 |
| > \$250,000 - £ \$750,000 | 5 | 2,223 | 7.79% | 445 |
| > \$750,000 | 9 | 22,055 | 77.33% | 2,451 |
| Total | 159 | \$ 28,522 | 100.00% | \$ 179 |

Management continues to evaluate collateral underlying nonaccrual loans and adjusts valuations based on appraisal and similar information available. Unfortunately, valuation estimates can change, resulting in additional charge-offs and provisioning for loan losses. Unless collected, higher nonaccrual balances also adversely affect interest income versus performing loans. The impact of nonaccrual loans on the Company's interest income and other operating results is further discussed in the Operations section of this Analysis.

Subsequent to March 31, loans with principal balances approximating \$4,086,000 were placed on nonaccrual status, reduced by charge-offs totaling \$40,794. The largest credit within this group, secured primarily by tracts and residential lots, including lots in established subdivisions, had a \$3,422,000 book balance. Management is currently reappraising the underlying real estate on this credit and reviewing legal remedies and other solutions prior to foreclosure. Unless pricing and demand in the real estate markets improve, management expects other borrowers, including other borrowers with loan balances above \$250,000, to also stop servicing their loans. As noted in the Operations section of this Analysis, management expects the Company to be only marginally profitable in fiscal 2011, if at all. The Company regularly stress tests its capital position to measure its ability to withstand deterioration in operating performance and asset quality. Nonaccrual and other impaired loans, including acquisition and development loans, figure prominently in these stress tests. Currently, the Company's capital levels remain able to withstand considerable reductions before reaching regulatory minimums. At May 31, 2011, nonaccrual loans totaled \$28,824,281, reflecting \$2,172,032 net inflows since March 31, 2011. Although nonaccrual levels are expected to remain elevated in the near-term, management remains cautiously optimistic that charge-offs and the associated provision peaked last year. Comparative details on charge-offs and the provision are provided in the Allowance for Loan Losses table. Details on nonperforming assets which have migrated from nonaccrual to foreclosed status are provided in the Foreclosed Real Estate subsection below.

TDRs. The \$5,669,751 troubled debt restructurings (TDR) balance at March 31, 2011 comprised loan relationships for which payment concessions were granted. Four large relationships with balances ranging from \$267,000 - \$2,850,000 comprised the entire TDR balance at March 31, 2011. These balances were variously secured by commercial & residential real estate. The specific allowance allocated to the aggregate TDR balance totaled \$303,765 at March 31, 2011. No additional loans were placed on TDR status subsequent to March 31, 2011.

The allowance for loan losses approximated 0.26X the nonperforming loans balance at March 31, 2011 versus 0.24X at year-end 2010 and 0.21X a year ago. As noted earlier, management expects overall credit conditions and the performance of the loan portfolio to remain weak in the near term, resulting in additional charge-offs and more provisioning until real estate markets stabilize.

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Foreclosed Real Estate. Foreclosures, sales, and subsequent devaluations within foreclosed real estate balances totaled \$2,032,875, \$590,075, and \$161,127 during the 2011 first quarter. One foreclosure of raw land in an established neighborhood comprised 58% or \$1,173,000 of the first quarter foreclosures; separately, a single home sale in this same subdivision comprised 97% of sales activity through March 31, 2011. The remaining first quarter foreclosures, including residential lots and a former barbecue restaurant, had values ranging from \$4,600 - \$334,000. Charge-offs recognized on all underlying credits prior to their 2011 foreclosures approximated \$586,000; 33% or \$192,000 of these charge-offs were recognized in 2011 and \$394,000 in prior years. The next table details foreclosed real estate by real estate type.

| <i>Foreclosed Real Estate by Type</i> (Dollars in thousands) | March 31, 2011 | December 31, 2010 |
|---|-------------------|----------------------|
| Real estate: | | |
| Land tracts | \$ 6,863 | \$ 5,584 |
| Lots within developments | 2,300 | 2,025 |
| Residential dwellings | 2,403 | 2,986 |
| Commercial buildings | 749 | 439 |
| Total foreclosed real estate | \$ 12,315 | \$ 11,034 |

Approximately 83% of these holdings were located in Georgia with the balance in Nassau County, Florida at March 31, 2011. Aggregate holdings in a single established subdivision increased from approximately \$2,750,000 at year-end 2010 to \$3,350,000 at March 31, 2011 due to net foreclosure activity. The next largest holding in any established subdivision approximated \$337,000 at March 31, 2011.

The following table presents foreclosed real estate based on collateral values of individual properties.

| <i>Foreclosed Real Estate by Collateral Values</i> | Number of Properties | Balances | Percent of Total Balance | Average Balance within Tier |
|--|-------------------------|---------------|--------------------------------|--------------------------------------|
| <i>March 31, 2011</i> (Dollars in thousands) | | | | |
| Collateral value: | | | | |
| ≤ \$250,000 | 51 | \$ 3,018 | 24.51% | \$ 59 |
| > \$250,000 - £ \$750,000 | 5 | 2,398 | 19.47% | 480 |
| > \$750,000 | 6 | 6,899 | 56.02% | 1,150 |
| Total | 62 | \$ 12,315 | 100.00% | \$ 199 |

| <i>Foreclosed Real Estate by Collateral Values</i> | Number of Properties | Balances | Percent of Total Balance | Average Balance within Tier |
|--|-------------------------|---------------|--------------------------------|--------------------------------------|
| <i>December 31, 2010</i> (Dollars in thousands) | | | | |
| Collateral value: | | | | |
| ≤ \$250,000 | 49 | \$ 2,940 | 26.64% | \$ 60 |
| > \$250,000 - £ \$750,000 | 4 | 2,365 | 21.44% | 591 |
| > \$750,000 | 5 | 5,729 | 51.92% | 1,146 |
| Total | 58 | \$ 11,034 | 100.00% | \$ 190 |

As shown in the preceding table, foreclosed real estate balances included eleven material properties aggregating \$9,296,849 at March 31, 2011; individual values ranged from \$309,750 - \$1,402,000. Charge-offs recognized on these larger properties prior to foreclosure approximated

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\$2,228,000; these charge-offs were all recognized prior to 2011. Charge-offs recognized life-to-date on all active properties totaled \$3,246,971; devaluations recognized subsequent to foreclosure on these properties totaled \$2,488,251 life-to-date at March 31, 2011. Approximately 6% or \$161,127 of these devaluation charges were recorded in the first quarter of 2011.

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Certain foreclosed real estate balances pertain to the same borrower. The next table presents foreclosed real estate aggregated by relationship tiers.

| <i>Foreclosed Real Estate by Relationship Tiers</i> | | | | |
|---|-------------------------------|------------------|--------------------------------|--------------------------------------|
| | Number of Relationships | Balances | Percent of Total Balance | Average Balance within Tier |
| <i>March 31, 2011</i> | | | | |
| <i>(Dollars in thousands)</i> | | | | |
| Relationship tier: | | | | |
| ≤ \$250,000 | 35 | \$ 2,090 | 16.97% | \$ 60 |
| > \$250,000 - £ \$750,000 | 4 | 1,701 | 13.81% | 425 |
| > \$750,000 | 7 | 8,524 | 69.22% | 1,218 |
| Total | 46 | \$ 12,315 | 100.00% | \$ 268 |

| <i>Foreclosed Real Estate by Relationship Tiers</i> | | | | |
|---|-------------------------------|------------------|--------------------------------|--------------------------------------|
| | Number of Relationships | Balances | Percent of Total Balance | Average Balance within Tier |
| <i>December 31, 2010</i> | | | | |
| <i>(Dollars in thousands)</i> | | | | |
| Relationship tier: | | | | |
| ≤ \$250,000 | 31 | \$ 1,995 | 18.08% | \$ 64 |
| > \$250,000 - £ \$750,000 | 2 | 1,058 | 9.59% | 529 |
| > \$750,000 | 6 | 7,981 | 72.33% | 1,330 |
| Total | 39 | \$ 11,034 | 100.00% | \$ 283 |

Foreclosures from April 1 – June 6 approximated \$2,272,000; sales, all pertaining to smaller properties, \$75,000; and devaluations, \$82,000. These eight foreclosures, or deeds in lieu of, had values ranging from \$13,500 - \$553,500 and included multiple lots, two dwellings, and the commercial building discussed earlier.

Although foreclosed properties continue to be marketed aggressively, management expects to incur carrying costs for at least one year. Any additional devaluation will be charged to operations. The Company's foreclosed real estate holdings can be viewed via a link from its website at www.southeasternbank.com or directly at www.liveatthecoast.com. No significant activity occurred within other repossessed assets during 2011 year-to-date.

Accruing Loans Past Due. Loans past due 90 days or more and still accruing totaled \$68,284, or less than 1% of net loans, at March 31, 2011. Management is unaware of any material concentrations within these past due balances; the majority, or 64%, of these past due balances were secured by real estate.

Other. Loans past due 30-89 days comprised 1.54% of net loans at March 31, 2011, totaling \$3,629,760. Approximately 77% of these past due loans were secured by real estate, predominantly 1 – 4 family residential properties with first liens and raw land. No loans in these past due balances exceeded \$250,000 at March 31, 2011.

Accruing loans classified as individually impaired under accounting guidance to creditors on impairment of loans totaled \$5,075,932 at March 31, 2011, up \$555,601 or 12.29% from year-end 2010. The March 31 balance pertained to eight separate borrowers whose loan repayment was expected to come foremost from sales of underlying real estate collateral. Due to lagging sales and lingering distress in the real estate markets, payment of principal and interest on these 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 \$250,000 or more on a monthly basis 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 eight classified credits totaled \$1,306,073 at March 31, 2011. The \$1,306,073 assumes a loss if the underlying collateral required liquidation currently. Management

fully expects additional relationships to be identified as impaired throughout 2011, necessitating specific allowances for the underlying loans.

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Fluctuations in nonperforming assets, charge-offs, and recoveries for earlier periods are discussed in the Form 10-Qs and 10-Ks filed for those periods. Problem asset information for current and prior periods is also available from the quarterly call reports SEB files with the Federal Deposit Insurance Corporation (FDIC). These reports are easily accessible from the FDIC 's website at www.fdic.gov.

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, 2011 totaled \$660,000 and net charge-offs, \$2,205,368. The comparable provision and net charge-off amounts at March 31, 2010 were \$2,985,000 and \$3,525,125. Deterioration in the real estate portfolio, particularly land acquisition and development loans, was the overriding factor in the three-month provision; these and other loans will continue to be monitored, and the provision adjusted accordingly. Net charge-offs represented 3.67% of average loans at March 31, 2011, down significantly from 5.27% at March 31, 2010 but up 78 basis points from 0.14% in 2009. Charge-offs on acquisition and development credits, which were discussed in the nonaccrual section, comprised \$1,852,280 or 82.48% of gross charge-offs at March 31, 2011. No material recoveries were recognized in the first three months of 2011. Refer to the Nonperforming Assets subsection of this Analysis for references on charge-offs and recoveries recognized in earlier periods. 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 following table.

Allowance for Loan Losses

| <i>Three Months Ended March 31,</i> <i>(Dollars in thousands)</i> | 2011 | 2010 | 2009 |
|--|------------|------------|------------|
| Allowance for loan losses at beginning of year | \$ 9,916 | \$ 7,170 | \$ 4,929 |
| Provision for loan losses | 660 | 2,985 | 940 |
| Charge-offs: | | | |
| Commercial, financial, and agricultural | 177 | 188 | 136 |
| Real estate construction | 1,852 | 3,182 | 49 |
| Real estate mortgage | 181 | 117 | 42 |
| Consumer, including credit cards | 36 | 76 | 66 |
| Total charge-offs | 2,246 | 3,563 | 293 |
| Recoveries: | | | |
| Commercial, financial, and agricultural | 4 | 13 | 6 |
| Real estate construction | | | 150 |
| Real estate mortgage | 7 | 5 | 2 |
| Consumer, including credit cards | 29 | 20 | 38 |
| Total recoveries | 40 | 38 | 196 |
| Net charge-offs | 2,206 | 3,525 | 97 |
| Allowance for loan losses at end of period | \$ 8,370 | \$ 6,630 | \$ 5,772 |
| Net loans outstanding ¹ at end of period | \$ 235,643 | \$ 258,466 | \$ 282,335 |
| Average net loans outstanding ¹ at end of period | \$ 240,554 | \$ 267,358 | \$ 280,966 |
| Ratios: | | | |
| Allowance to net loans | 3.55% | 2.57% | 2.04% |
| Net charge-offs to average loans ² | 3.67% | 5.27% | 0.14% |

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| | | | |
|---|--------------|-------|--------|
| Provision to average loans ² | 1.11% | 4.47% | 1.34% |
| Recoveries to total charge-offs | 1.78% | 1.07% | 66.89% |

¹ Net of unearned income.

² Annualized.

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The Company prepares a comprehensive analysis of the allowance for loan losses monthly. 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 numerous factors, including, but not limited to, net charge-off trends, internal risk ratings, loss forecasts, collateral values, geographic location, delinquency rates, nonperforming loans, underwriting practices, industry conditions, and economic trends. 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 are established 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 allowance for the pools after an assessment of internal and external influences on credit quality that are not fully 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 necessarily 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, 2011 but expects further provisioning throughout 2011. Cumulatively in April and May 2011, an additional \$500,000 was provisioned and \$173,629 charged-off, net of recoveries.

Other Commitments

The Company had no material plans or commitments for capital expenditures as of March 31, 2011.

Liquidity

Liquidity is managed to ensure sufficient cash flow to satisfy demands for credit, deposit withdrawals, and other corporate needs. Liquidity is vital to any financial institution and its importance cannot be overstated, particularly during periods of economic crisis. Overall liquidity position is determined by the types of assets, and their duration, on the balance sheet; encumbrances; borrowing capacity from customer deposits or other sources; and retained earnings. In short, assets, predominantly loans and investment securities, are funded by customer deposits, borrowed funds, and retained earnings. The last few years, in an effort to become more liquid, the Company has increased its most liquid assets, namely cash and cash equivalents. Cash and cash equivalents, which variously comprise cash and due from banks, interest-bearing deposits in other banks, and federal funds sold, increased \$12,756,048 or 15.77% at March 31, 2011 compared to year-end 2010. Cash and cash equivalents represented 21.55% of total assets at March 31, 2011 versus 18.91% at December 31, 2010. The cost of the liquidity improvement has been a sacrifice of some earnings potential. Liquidity sources are discussed further in the next subsections of this Analysis.

Cash flows from the loan and securities portfolios represent important components of the Company's overall liquidity position. At March 31, 2011, loans¹ and investment securities with carrying values exceeding \$137,000,000 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. Refer to note 3 of the consolidated financial statements for pertinent information on contractual and other redemptions of these

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

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instruments. Of course, loans are subject to refinancing, and loans and particularly, securities, may be pledged to secure public funds and other borrowing arrangements. At March 31, 2011, 90.27% or \$68,462,091 of the Company's securities portfolio was pledged; when adjusted for overpledging due to cyclical variations in public funds and contingency pledging to the Federal Reserve Bank discount window, approximately \$17,700,000 or 23% of the securities portfolio was unencumbered at March 31, 2011. The entities to which the excess collateral is pledged have no legal claim on such collateral unless amounts are owed under other obligations. As discussed in the Financial Condition section of this Analysis and also below, the FDIC amended its deposit insurance program effective December 31, 2010 and NOW accounts will no longer be insured above \$250,000. The change in insurance coverage necessitated the purchase of securities to collateralize affected public funds in the first quarter of 2011 and will continue throughout 2011 and beyond.

The Company has long benefited from a relatively large, stable deposit base. Customer-based core deposits, traditionally the Company's largest and most cost-effective source of funding, comprised 83% of the funding base at March 31, 2011, up 200 basis points from year-end 2010 levels. The variation in core deposits is largely attributable to a decrease in time certificates with balances of \$100,000 or more at March 31, 2011 compared to year-end; these particular balances declined over \$3,851,000 in the first three months of 2011. Funding sources primarily comprise customer-based core deposits but also include borrowed funds and cash flows from operations. Borrowed funds, which variously encompass U.S. Treasury demand notes, Federal Reserve discount window borrowings, federal funds purchased, and FHLB advances, totaled \$6,042,509 at March 31, 2011 versus \$5,762,782 at December 31, 2010. The \$279,727 or 4.85% growth in borrowed funds resulted from an increase in U.S. Treasury demand notes outstanding. The maximum amount of U.S. Treasury demand notes available to the Company at March 31, 2011 totaled \$1,816,514, of which \$1,042,509 was outstanding. At March 31, 2011, the Company also had \$5,448,065 of borrowing capacity at the Federal Reserve Bank discount window; no amounts were outstanding against this capacity at March 31, 2011, and except for periodic testing of availability, the Company intends to use this capacity on a limited basis. Due to nonperforming assets and other trends, the Company is not currently eligible for any unsecured federal funds lines of credit from its correspondent banks.

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. The statements of cash flows within this Form 10-Q provide a comprehensive breakdown of cash flows provided by or used in operating, investing, and financing activities.

In the third quarter of 2009, the FDIC announced its plan to restore DIF balances as a result of recent bank failures. The restoration plan required all FDIC-insured banks to prepay their risk-based assessments for the years 2010, 2011, and 2012. The assessments, usually due quarterly, were instead estimated for the three future years and paid prior to December 31, 2009. The Company paid the required assessment on December 29, 2009 and concurrently recorded a prepaid asset within other assets on the consolidated balance sheets. This prepaid asset totaled \$936,000 at March 31, 2011. Any differences between the prepaid and actual amounts due each quarter will be funded using existing available liquidity.

Management believes the Company has the funding capacity, from operating activities or otherwise, to meet its financial commitments in 2011. Refer to the Capital Adequacy section of this Analysis for details on dividend policy and the Financial Condition section for details on unfunded loan commitments.

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Deposits

Deposits increased 1.70% or \$6,393,214 since year-end 2010. Interest-bearing deposits grew \$4,805,320 or 1.50% while noninterest-bearing deposits increased \$1,587,894 or 2.87%. Within interest-bearing deposits, time certificate balances declined \$5,222,840 while NOW, money market, and savings balances grew \$5,871,490, \$660,972, and \$3,495,698. Time certificate balances of \$100,000 or more decreased \$3,851,132 year-to-date and represented 49.47% of certificate totals at March 31, 2011. Lower balance certificate totals declined \$1,371,708 or 2.00% since December 31, 2010. The Company has focused certificate pricing on customers who also have non-certificate deposit and/or loan balances. The increase in NOW balances occurred in personal accounts as well as local government accounts, predominantly Georgia-based. The modest growth in money market balances likewise resulted largely from personal accounts, also Georgia-based. The increase in savings deposits was due to customers, both personal and non-personal accounts, seeking FDIC-insured investments in this low rate environment. Funding costs associated with deposits declined 22.32% overall at March 31, 2011 versus March 31, 2010 due to reductions in cost of funds; see the Results of Operations section of this Analysis for more details. No single factor precipitated the 2.87% increase in noninterest-bearing deposits since year-end; these balances tend to be somewhat cyclical. Noninterest-bearing deposits will continue to carry unlimited deposit insurance, regardless of dollar amount, until December 31, 2012 under provisions of the Dodd-Frank Act. A separate surcharge will no longer apply as enrollment is automatic for all banks.

Overall, interest-bearing deposits comprised 85.07%, and noninterest-bearing deposits, 14.93%, of total deposits at March 31, 2011. Approximately 82% of quarter-end deposits were based in Georgia and the residual 18% in Florida. The distribution of interest-bearing balances at March 31, 2011 and certain comparable quarter-end dates is shown in the next table.

| <i>Deposits</i> <i>(Dollars in thousands)</i> | March 31, 2011 | | December 31, 2010 | | March 31, 2010 | |
|--|-----------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <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 ¹ | \$ 134,163 | 41.33% | \$ 127,631 | 39.91% | \$ 115,841 | 37.77% |
| Savings | 57,529 | 17.72% | 54,033 | 16.89% | 54,044 | 17.62% |
| Time certificates < \$100,000 | 67,166 | 20.69% | 68,538 | 21.43% | 69,610 | 22.70% |
| Time certificates >= \$100,000 | 65,765 | 20.26% | 69,616 | 21.77% | 67,207 | 21.91% |
| Total interest-bearing deposits | \$ 324,623 | 100.00% | \$ 319,818 | 100.00% | \$ 306,702 | 100.00% |

¹ NOW and money market accounts.

Deposits of one local governmental body comprised approximately \$22,000,000 and \$24,402,000 of the overall deposit base at March 31, 2011 and December 31, 2010. On an aggregate basis, public funds comprised approximately 19% of the deposit base at March 31, 2011 and 18% at December 31, 2010. The Company had no brokered deposits at March 31, 2011 and year-end 2010.

As shown in the next table, approximately 94% of time certificates at March 31, 2011 were scheduled to mature within the next twelve months.

Maturities of Time Certificates

| <i>March 31, 2011</i> <i>(Dollars in thousands)</i> | Balances | | |
|--|-----------------------|-------------------------------|-------------------|
| | < \$100,000 | ³ \$100,000 | Total |
| Months to maturity: | | | |
| 3 or less | \$ 16,580 | \$ 12,062 | \$ 28,642 |
| Over 3 through 12 | 44,549 | 51,182 | 95,731 |
| Over 12 through 36 | 5,064 | 2,421 | 7,485 |
| Over 36 | 973 | 100 | 1,073 |
| Total | \$ 67,166 | \$ 65,765 | \$ 132,931 |

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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, 2011, unchanged from December 31, 2010. The advances outstanding included a \$2,500,000 fixed rate advance due July 30, 2012 with an effective rate of 2.35% and another \$2,500,000 fixed rate advance due July 29, 2013 with an effective rate of 2.89%. At March 31, 2011, the two advances were collateralized by cash balances held at the FHLB. Additional funding is not currently available from the FHLB.

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 periodically 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 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 over a twelve-month period. Based on the latest analysis, the Company continues to be asset sensitive and exposed to declining earnings if interest rates fall. The simulation model estimates changes in net interest income based on various gradual and shocked/instantaneous scenarios, as shown in the table below. The model projects that the Company's earnings will increase as rates rise and decrease if rates drop. The base fed funds rate used in the model assumes a 0.00% - 0.25% range.

| <i>Market Rate Change</i> | Effect on Net Interest Income | |
|---------------------------|--------------------------------------|------------------------|
| | Gradual | Immediate Shock |
| +300 basis points | 5.70% | 21.08% |
| +200 basis points | 2.37% | 10.38% |
| +100 basis points | 0.77% | 3.53% |
| -100 basis points | (0.30)% | (3.71)% |

The Company's asset sensitivity has increased since year-end 2010 due largely to growth in interest-bearing balances in other banks; the increase in these balances is further discussed in the Liquidity section of this Analysis.

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 and significant increases in nonaccrual 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.

Table of Contents**Impact of Inflation**

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

Capital Adequacy

Federal banking regulators have established certain capital adequacy standards required to be maintained by banks and bank holding companies. These regulations define capital as either Tier 1 (primarily realized shareholders' equity) or Tier 2 (for the Company, a portion of the allowance for loan losses). The Company and SEB are subject to a minimum Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) of 4%, total capital ratio (Tier 1 plus Tier 2 to risk-weighted assets) of 8%, and Tier 1 leverage ratio (Tier 1 to average quarterly assets) of 4%. To be considered a well-capitalized institution, the Tier 1 capital, total capital, and Tier 1 leverage ratios must equal or exceed 6%, 10%, and 5%, respectively. Banks and bank holding companies are prohibited from including unrealized gains and losses on debt securities in the calculation of risk-based capital but are permitted to include up to 45 percent of net unrealized pre-tax holding gains on equity securities in Tier 2 capital. The Company did not have any unrealized gains on equity securities includible in the risk-based capital calculations for any of the periods presented. At March 31, 2011, the Company's Tier 1, total capital, and Tier 1 leverage ratios totaled 16.41%, 17.68%, and 10.25%. On a stand-alone basis, SEB's same ratios totaled 15.97%, 17.24%, and 9.97%. As discussed in the 2010 Form 10-K, minimum capital standards are slated to increase in the future and will include a capital conservation buffer; management believes the Company already complies with the proposed standards. The Company is committed to maintaining its well-capitalized status and stress tests its capital position on a regular basis to gauge its ability to withstand deterioration in asset quality and operating performance.

Capital ratios for the most recent periods are presented in the next table.

| <i>Capital Ratios</i> (Dollars in thousands) | March 31, 2011 | December 31, 2010 | March 31, 2010 |
|---|-------------------|----------------------|-------------------|
| Tier 1 capital: | | | |
| Total shareholders' equity | \$ 44,883 | \$ 44,806 | \$ 56,269 |
| Accumulated other comprehensive (income) loss | (308) | (269) | 3 |
| Intangible assets and other adjustments | | | |
| Total Tier 1 capital | 44,575 | 44,537 | 56,272 |
| Tier 2 capital: | | | |
| Portion of allowance for loan losses | 3,457 | 3,585 | 3,762 |
| Total risk-based capital | \$ 48,032 | \$ 48,122 | \$ 60,034 |
| Risk-weighted assets | \$ 271,642 | \$ 280,441 | \$ 298,122 |
| Risk-based ratios: | | | |
| Tier 1 capital ¹ | 16.41% | 15.88% | 18.88% |
| Total risk-based capital | 17.68% | 17.16% | 20.14% |
| Tier 1 leverage ratio | 10.25% | 10.29% | 13.41% |
| Shareholders' equity to assets | 10.33% | 10.48% | 13.16% |

¹ The Company's tier 1 common equity ratio is the same as its tier 1 capital ratio.

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Book value per share increased a nominal \$0.02 per share during the 2011 first quarter to \$14.34 at March 31, 2011. No dividends were declared or paid in the first quarter of 2011, a \$0.06 1/2 decline from the same period in 2010. The Company has suspended future dividend payments and treasury stock purchases until operating performance improves and credit losses abate. Regulatory approval will be required prior to payment of a future dividend or treasury stock purchases. For more specifics on equity matters, refer to Part II, Item 2, of this Form 10-Q.

The Company has granted various employees options to purchase shares of common stock; refer to the 2010 Form 10-K previously filed for details on the number of options outstanding and the range of exercise prices.

Accumulated other comprehensive income (loss), which measures net fluctuations in the fair values of investment securities, improved \$39,831 since year-end 2010. Further details on investment securities, including corporates, and their associated fair values are contained in the Financial Condition section of this analysis.

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

Results of Operations

The Company recognized net income of \$26,187 in the 2011 first quarter compared to a net loss of \$1,172,409 during the same period in 2010. On a per share basis, quarterly income totaled \$0.01 at March 31, 2011, a \$0.38 increase from the \$0.37 net loss at March 31, 2010. Major variances in the 2011 2010 quarterly results included:

\$2,325,000 decline in the provision for loan losses;

\$187,456 reduction in net interest income due to yield reductions resulting from higher cash equivalent balances and shortened maturities on investment securities, overall lower average balances on loans, and an increase in nonperforming assets, particularly nonaccrual loans and also on an average basis, offset by a reduction in interest expense on deposits and other borrowed funds; and

Nonrecognition of income tax for both regulatory and financial accounting purposes in 2011 year-to-date versus \$876,609 benefit recognized in 2010.

Variations in net interest income and noninterest income/expense are further discussed in the next two subsections of this Analysis; the provision for loan losses is separately discussed within the Financial Condition section.

Net Interest Income

Due to margin compression resulting largely from increased nonaccrual loans and high cash equivalent balances, net interest income declined \$187,456 or 5.74% during the first three months of 2011 compared to 2010. Additionally, reducing cost of funds in the current economic cycle to mitigate earnings pressure on assets has been particularly difficult since liquidity constraints have compelled regional and other banks to rely more heavily on deposits, particularly time certificates, for funding; this reliance has kept deposit rates higher and lowered margins and spreads for competitor banks attempting to maintain market share. Although many variable rate loans have reached a contractual floor, reducing asset sensitivity, asset rates remain exceedingly low and deposit costs high on a relative basis. Net interest income and resultant margins and spreads are projected to decline further the remainder of 2011 due to a) yield reductions on a year-over-year basis, due largely to higher cash equivalent balances and shortened maturities on investment securities; b) overall lower average balances on loans; and c) increases in

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nonperforming assets, particularly nonaccrual loans and foreclosed real estate, also on an average basis. As discussed earlier, unless collected, nonaccrual balances adversely affect interest income two ways - interest reversals and nonearning status. To recap, the net interest margin approximated 3.26% at March 31, 2011 versus 3.58% in 2010; the interest rate spread, 3.07% versus 3.28%. Interest earnings on loans and investment securities fell \$275,431 and \$264,967 in the first three months of 2011 compared to 2010 while interest income on other assets, which includes cash equivalent balances, increased \$27,533. Asset yields averaged 4.24% at March 31, 2011, down 69 basis points from 4.93% in 2010; see the interest differential table on the next page for more details on changes in interest income attributable to volume and rates at March 31, 2011 versus 2010. Interest expense on deposits and other borrowed funds declined \$325,409 or 25.51% during the first three months of 2011 versus 2010. Cost of funds fell 48 basis points from 2010 levels, totaling 1.17% at March 31, 2011 versus 1.65% at March 31, 2010. The reduced funding costs resulted mainly from lower rates on deposits at March 31, 2011 compared to 2010. Although interest expense on time certificates declined \$215,142 or 24.74% in the first three months of 2011 compared to 2010, higher average balances, competitive pressure, and the aforementioned lag effect have constrained desired rate reductions in this product. Nonetheless, rate pressure on certificates continued to ease year-to-date and is expected to drop further this year. Refer to the Liquidity and Interest Sensitivity sections of this Analysis for more details on deposit/funding fluctuations and the Company's asset/liability sensitivity position.

The intense competition for deposits and certain loans continues in 2011 and shows no sign of abating. The high number of financial institutions in the Company's market areas essentially guarantees downward pressure on net interest spreads and margins as all participants struggle to amass, grow, and/or maintain market share. Volume of assets and deposits 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, 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.

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

| <i>Average Balances</i> ⁶ | 2011 | | | 2010 | | |
|---|-------------------------|-----------------------|---------------------|-------------------------|-----------------------|---------------------|
| | <i>Average Balances</i> | <i>Income/Expense</i> | <i>Yields/Rates</i> | <i>Average Balances</i> | <i>Income/Expense</i> | <i>Yields/Rates</i> |
| <i>Three Months Ended March 31, (Dollars in thousands)</i> | | | | | | |
| Assets | | | | | | |
| Interest-earning assets: | | | | | | |
| Net loans ^{1,2,4} | \$ 240,554 | \$ 3,424 | 5.77% | \$ 267,358 | \$ 3,682 | 5.59% |
| Interest-bearing deposits in other banks | 76,849 | 48 | 0.25% | 39,584 | 20 | 0.20% |
| Federal funds sold | 2,150 | 1 | 0.19% | 2,150 | 1 | 0.19% |
| Taxable investment securities ³ | 63,442 | 455 | 2.91% | 55,442 | 663 | 4.85% |
| Tax-exempt investment securities ^{3,4} | 13,231 | 217 | 6.65% | 18,990 | 308 | 6.58% |
| Other interest-earning assets | 1,174 | 2 | 0.69% | 1,314 | 1 | 0.31% |
| Total interest-earning assets | \$ 397,400 | \$ 4,147 | 4.24% | \$ 384,838 | \$ 4,675 | 4.93% |
| Liabilities | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing demand deposits ⁵ | \$ 132,997 | \$ 186 | 0.57% | \$ 115,553 | \$ 210 | 0.74% |
| Savings | 55,272 | 77 | 0.56% | 54,227 | 102 | 0.76% |
| Time certificates | 136,115 | 655 | 1.95% | 133,386 | 870 | 2.65% |
| U. S. Treasury demand note | 728 | | | 592 | | |
| FHLB advances | 5,000 | 32 | 2.60% | 9,167 | 94 | 4.16% |
| Total interest-bearing liabilities | \$ 330,112 | \$ 950 | 1.17% | \$ 312,925 | \$ 1,276 | 1.65% |
| Excess of interest-earning assets over interest-bearing liabilities | \$ 67,288 | | | \$ 71,913 | | |
| Interest rate spread | | | 3.07% | | | 3.28% |
| Net interest income | | \$ 3,197 | | | \$ 3,399 | |
| Net interest margin | | | 3.26% | | | 3.58% |

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.

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, 2011 and 2010. 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 Differential¹ <i>Three Months Ended March 31,</i> <i>(Dollars in thousands)</i> | 2011 Compared to 2010 | | |
|--|------------------------------|---------------|-----------------|
| | Volume | Rate | Net |
| Interest income: | | | |
| Net loans ^{2,3} | \$ (377) | \$ 119 | \$ (258) |
| Interest-bearing deposits in other banks | 22 | 6 | 28 |
| Federal funds sold | | | |
| Taxable investment securities | 85 | (293) | (208) |
| Tax-exempt investment securities ³ | (94) | 3 | (91) |
| Other interest-earning assets | | 1 | 1 |
| Total interest income | (364) | (164) | (528) |
| Interest expense: | | | |
| Interest-bearing demand deposits ⁴ | 29 | (53) | (24) |
| Savings | 2 | (27) | (25) |
| Time certificates | 17 | (232) | (215) |
| U.S. Treasury demand note | | | |
| FHLB advances | (34) | (28) | (62) |
| Total interest expense | 14 | (340) | (326) |
| Net change in net interest income | \$ (378) | \$ 176 | \$ (202) |

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.

Noninterest Income and Expense

Noninterest income declined \$108,906 or 11.12% during the first three months of 2011 compared to 2010. Key elements in the year-to-date results included:

- a) Net loss on sales of investment securities available-for-sale: As further discussed in note 3 to the consolidated financial statements, the Company recognized a net loss of \$18,191 on the sale of one corporate bond in the first quarter of 2011. No securities were sold during the same period in 2010.
- b) Service charges on deposit accounts: Service charges on deposit accounts declined \$91,035 or 14.18% at March 31, 2011 compared to 2010. Lower volume of overdraft fees, as well as regulatory changes impacting the collection of these fees, were the main factors in the year-to-date decline. These regulatory changes, which stem largely from amendments to Federal Reserve Regulation E, became effective July 2010; as a result of the Regulation E amendment, this income category will continue to decline in 2011 when compared to comparable periods in 2010.
- c)

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Other operating income: The other operating portion of noninterest income was virtually unchanged at March 31, 2011 compared to 2010. By type and amount, the chief components of other operating income at March 31, 2011 were ATM and debit fee income, \$157,229; income on bank-owned life insurance, with a resultant yield exceeding 6.00% on a federal taxable-equivalent basis, \$57,919; income on sale of check products, \$23,592; safe deposit box rentals, \$23,080; credit card interchange fees, \$21,867; and commissions on the sale of

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credit life insurance (separate from third party broker-dealer affiliation), \$14,940. Together, these six income items comprised 88.50% of other operating income. In 2010, these same six income components comprised 83.34% of other operating income. Dodd-Frank Act regulation, if enacted as proposed, could limit ATM and debit card fee income going forward.

Noninterest expense dropped \$46,567 in 2011 year-to-date compared to 2010. The chief factors impacting year-to-date results comprised:

- a) Salaries and employee benefits: Personnel costs fell 7.86% or \$143,607 year-to-date. Declines in salaries and payroll taxes accounted for most of the 2011 variation. Specifically, salaries declined \$120,015 overall and payroll taxes, \$9,376, in 2011 year-to-date compared to 2010. The vast majority, or 83%, of employee expenses remained concentrated in salaries and other direct compensation, including related payroll taxes, at March 31, 2011. Profit-sharing/401-K accruals and other fringe benefits constituted the remaining 3% and 14% of employee expenses. The division of employee expenses between compensation, profit-sharing, and other fringe benefits remained consistent with historical norms in 2011.
- b) Occupancy and equipment expense, net: Net occupancy and equipment expense fell \$81,293 or 11.71% during the first three months of 2011 compared to 2010. Savings of \$19,645 and \$34,878 related to data line communications and depreciation/amortization expense were the main reasons for the decline. The decrease in data line expense resulted from an efficiency upgrade pertaining to new bandwidth over the Company's network system; the telecommunications upgrade will also reduce comparative expense in other periods this year. The depreciation/amortization reduction is directly related to various furniture and equipment, as well as software, reaching fully depreciated status. These depreciated assets remain in good working condition and have not been replaced as management curtails spending on high dollar items.
- c) Write-downs on other real estate: Write-downs on foreclosed real estate increased \$161,127 in the first three months of 2011 compared to 2010. These write-downs correlate with updated appraisals of property held for sale. As further discussed in the Financial Condition section of this Analysis, real estate values in coastal Georgia and northeast Florida remain depressed.
- d) Other noninterest expense: Other noninterest expense increased \$35,415 or 4.46% at March 31, 2011 compared to 2010. A \$66,657 jump in FDIC costs was the primary factor in the 2011 2010 comparative results. Besides FDIC expense, which approximated \$214,000 in 2011 & \$147,000 in 2010 and aggregated accounting, consulting, & legal fees, which approximated \$104,000 in both 2011 and 2010, no individual component of noninterest expense aggregated or exceeded 10% of the total in 2011.

Management anticipates that losses and other costs associated with foreclosed real estate will remain elevated unless the Company's coastal real estate markets stabilize and demand for properties - at reasonable prices - improves. Due to problem asset resolutions and continued margin compression, the Company expects to be only marginally profitable in 2011, if at all.

Critical Accounting Policies

The Company's consolidated financial statements are prepared applying certain critical accounting policies. Critical accounting policies 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 financial statements are prepared in

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accordance with U.S. GAAP, and they conform to general practices in the banking industry. The Company applies its critical accounting policies consistently from period to period and intends that any change in methodology occur in an appropriate manner. Accounting policies currently deemed critical, including the a) allowance for loan losses; b) estimates of fair value pertinent to investment securities, other real estate, loans, and other assets; and c) income taxes are further discussed in the 2010 Form 10-K. There have been no material changes in the Company's critical accounting policies since December 31, 2010.

Recent Accounting Pronouncements

The provisions of recent pronouncements and the related impact on the Company's consolidated financial statements, if any, are discussed in note 2.

Various other accounting proposals affecting the banking industry are pending with the FASB and other regulatory 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

Certain statements set forth in this Quarterly Report on Form 10-Q or incorporated herein by reference, including matters discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements within the meaning of federal securities laws, including, without limitation, statements regarding the Company's outlook on earnings, stock performance, asset quality, economic conditions, real estate markets, and projected growth, and are based upon management's beliefs as well as assumptions based on data currently available. When words like anticipate, believe, intend, plan, may, continue, project, would, expect, estimate, should, will, and similar expressions are used, they should be considered forward-looking statements. Forward-looking statements are subject to significant risks and uncertainties. Investors are cautioned against placing undue reliance on such statements. Actual results may differ materially from those set forth in forward-looking statements. Factors that could cause actual results to differ materially from those described in the forward-looking statements include: (1) difficult economic conditions, both generally and in local markets, may persist, resulting in, among other things, further deterioration in credit quality, a reduction in demand for credit, or additional declines in real estate values; (2) the severe decline in the real estate and lending market, particularly in the Company's coastal markets and primarily comprising acquisition and development loans, may continue to negatively affect financial results; (3) the allowance for loan losses may not be adequate to cover eventual loss; (4) future losses will be realized if proceeds received upon liquidation of nonperforming assets are less than carrying values of such assets; (5) restrictions or conditions imposed by regulators on the Company's operations may make it more difficult for the Company to achieve its goals; (6) the Company's recovery of its deferred tax asset could be delayed for an extended period; (7) the Company's ability to raise any needed capital in a prolonged economic downturn may be impaired if market disruption and volatility continue or worsen; (8) legislative or regulatory changes, including changes in accounting standards and compliance requirements, may adversely affect the Company's business, revenue, and profit margins; (9) poor financial results may negatively affect liquidity, including liquidity from core deposits; (10) competitive pressures among depository and other financial institutions may increase significantly, resulting in lost business relationships or reduced margins; (11) changes in the interest rate environment may reduce margins or the volumes or values of loans made; (12) competitors may have greater financial resources and develop products that enable them to compete more successfully; (13) the Company's ability to attract and retain key personnel can be affected by increased competition for experienced employees in the banking industry; (14) adverse changes may occur in the bond markets, affecting portfolio valuation and causing impairment; (15) war or terrorist activities may cause further

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deterioration in the economy or cause instability in credit markets; (16) economic, governmental, or other factors may prevent growth in the Company's markets; (17) changes in consumer spending and savings habits could impede the Company's ability to grow its loan and deposit portfolios; (18) the Company may be unfavorably impacted by litigation, which depends on judicial interpretations of law and findings of juries; (19) the dividend suspension may adversely affect the market price of the Company's stock; (20) third party vendors who provide key components of the Company's business infrastructure may have system failures or other difficulties which could materially affect operations; and (21) the risk factors discussed from time to time in the Company's periodic reports filed with the SEC, including but not limited to, this Report. The Company undertakes no obligation to, and does not intend to, update or revise these statements following the date of this filing, whether as a result of new information, future events or otherwise, except as may be required by law.

As noted, the foregoing list of factors is not exclusive. 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 4. Controls and Procedures.

An evaluation of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Act") was carried out under the supervision and with the participation of the Company's Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO"), and other members of management as of March 31, 2011. The CEO and CFO concluded that, as of March 31, 2011, the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is: (i) accumulated and communicated to the Company's management, including the CEO and the CFO, and (ii) recorded, processed, summarized, and reported in accordance with the SEC's rules and forms. There were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Act) that occurred during the quarter ended March 31, 2011 that has materially affected, or is likely to materially affect, such internal controls.

The Company does not expect that its disclosure controls and procedures will prevent all error and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

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The Company intends to continually review and evaluate the design and effectiveness of its disclosure controls and procedures, to improve its controls and procedures over time, and to correct any deficiencies it may discover in the future. The goal is to ensure that management has timely access to all material financial and non-financial information concerning the Company's business. While the Company believes the present design of its disclosure controls and procedures is effective to achieve its goal, future events affecting its business may cause the Company to modify its disclosure controls and procedures. The Company continues to use the widely accepted Committee of Sponsoring Organization of the Treadway Commission (COSO) framework for its evaluation of such internal controls.

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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 2011.

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

On July 21, 2010, the Company suspended dividend payments and treasury stock purchases until operating performance improves and credit losses abate. The Company's ability to pay dividends in the future will be dependent on earnings, capital adequacy, the availability of liquid assets for distribution, and regulatory approval. The Company is a legal entity separate from its bank subsidiary, and its revenues depend primarily on the payment of dividends from SEB. Separate regulatory approval will be required before SEB can itself pay a dividend. See the Capital Adequacy section of Part I, Item 2 for more details on the Company's capital position and the Nonperforming Assets section of Part I, Item 2 for particulars on problem asset trends and their resultant effect on earnings.

Item 3. Defaults Upon Senior Securities.

Not Applicable

Item 4. (Removed and Reserved).

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 4 | Specimen Common Stock Certificate, incorporated by reference from Form 8-A filed April 30, 2001. |
| Exhibit 10 | 2006 Stock Option Plan, as amended and restated effective January 1, 2008, incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008. |
| 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
(Principal Accounting Officer)

Date: June 6, 2011