SOUTHEASTERN BANKING CORP
Form 10-Q
November 14, 2006
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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 September 30, 2006

Commission File Number 2-83157

SOUTHEASTERN BANKING CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(Address of principal executive offices) (Zip Code)

(912) 437-4141

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

As of October 31, 2006, 3,213,600 shares of the registrant s common stock, par value $1.25 per share, were outstanding.

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Item I - Financial Statements

Southeastern Banking Corporation

Consolidated Balance Sheets

	(Unaudited) September 30, 2006	December 31, 2005
Assets		
Cash and due from banks	**$ 18,263,608**	$ 21,587,266
Federal funds sold	**10,945,000**	15,003,000
Cash and cash equivalents	**29,208,608**	36,590,266
Investment securities		
Available-for-sale, at market value	**80,564,860**	82,791,294
Held-to-maturity (market value of approximately $33,535,000 and $35,381,000 at September 30, 2006 and December 31, 2005)	**32,971,992**	34,584,741
Total investment securities	**113,536,852**	117,376,035
Loans, gross	**239,041,667**	223,947,365
Unearned income	**(123,960)**	(155,731)
Allowance for loan losses	**(4,244,754)**	(4,311,007)
Loans, net	**234,672,953**	219,480,627
Premises and equipment, net	**9,461,573**	8,817,550
Intangible assets	**521,044**	564,704
Other assets	**6,069,964**	5,861,990
Total Assets	**$ 393,470,994**	$ 388,691,172
Liabilities and Shareholders Equity		
Liabilities		
Deposits		
Noninterest-bearing deposits	**$ 84,001,931**	$ 79,750,623
Interest-bearing deposits	**247,371,613**	249,050,465
Total deposits	**331,373,544**	328,801,088
U. S. Treasury demand note	**1,771,002**	1,355,559
Federal Home Loan Bank advances	**5,000,000**	5,000,000
Other liabilities	**2,776,900**	4,133,625
Total liabilities	**340,921,446**	339,290,272
Shareholders Equity		
Common stock ($1.25 par value; 10,000,000 shares authorized; 3,580,797 shares issued; 3,213,600 and 3,235,002 shares outstanding at September 30, 2006 and December 31, 2005)	**4,475,996**	4,475,996
Additional paid-in-capital	**1,391,723**	1,391,723

Retained earnings	**54,680,456**	50,977,998
Treasury stock, at cost (367,197 and 345,795 shares at September 30, 2006 and December 31, 2005)	**(7,356,329)**	(6,757,073)
Realized shareholders equity	**53,191,846**	50,088,644
Accumulated other comprehensive loss	**(642,298)**	(687,744)
Total shareholders equity	**52,549,548**	49,400,900
Total Liabilities and Shareholders Equity	**$ 393,470,994**	$ 388,691,172

See accompanying notes to consolidated financial statements.

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Southeastern Banking Corporation

Consolidated Statements of Income

(Unaudited)

Period Ended September 30,	*Quarter* **2006**	**2005**	*Nine Months* **2006**	**2005**
Interest income				
Loans, including fees	**$ 5,376,231**	$ 4,381,715	**$ 15,474,705**	$ 12,573,629
Federal funds sold	**68,024**	84,375	**191,928**	367,851
Investment securities				
Taxable	**904,881**	987,731	**2,782,595**	2,849,362
Tax-exempt	**320,590**	372,216	**979,126**	1,121,696
Other assets	**16,985**	10,793	**48,884**	36,987
Total interest income	**6,686,711**	5,836,830	**19,477,238**	16,949,525
Interest expense				
Deposits	**1,691,911**	992,589	**4,458,764**	2,857,417
Federal funds purchased	**1,479**	2,840	**19,701**	2,840
U. S. Treasury demand note	**8,854**	4,772	**22,722**	11,687
Federal Home Loan Bank advances	**75,644**	75,644	**224,466**	224,466
Total interest expense	**1,777,888**	1,075,845	**4,725,653**	3,096,410
Net interest income	**4,908,823**	4,760,985	**14,751,585**	13,853,115
Provision for loan losses		33,000	**59,500**	258,833
Net interest income after provision for loan losses	**4,908,823**	4,727,985	**14,692,085**	13,594,282
Noninterest income				
Service charges on deposit accounts	**623,500**	609,671	**1,812,474**	1,729,664
Other operating income	**328,355**	363,215	**956,399**	963,941
Total noninterest income	**951,855**	972,886	**2,768,873**	2,693,605
Noninterest expense				
Salaries and employee benefits	**2,019,385**	1,919,915	**6,039,402**	5,784,088
Occupancy and equipment, net	**746,292**	610,335	**2,044,139**	1,895,591
Other operating expense	**658,351**	676,502	**1,987,761**	1,874,642
Total noninterest expense	**3,424,028**	3,206,752	**10,071,302**	9,554,321
Income before income tax expense	**2,436,650**	2,494,119	**7,389,656**	6,733,566
Income tax expense	**790,281**	792,636	**2,382,799**	2,090,603
Net income	**$ 1,646,369**	$ 1,701,483	**$ 5,006,857**	$ 4,642,963
Basic earnings per common share	**$ 0.51**	$ 0.52	**$ 1.55**	$ 1.41

Weighted average common shares outstanding	**3,213,600**	3,299,978	**3,226,307**	3,302,743

See accompanying notes to consolidated financial statements.

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Southeastern Banking Corporation

Consolidated Statements of Shareholders Equity

(Unaudited)

	Common Stock	*Additional Paid-In Capital*	*Retained Earnings*	*Treasury Stock*	*Accumulated Other Comprehensive Income (Loss)*	*Total*
Balance, December 31, 2004	$ 4,475,996	$ 1,391,723	$ 47,828,636	$ (4,815,629)	$ 361,035	$ 49,241,761
Comprehensive income:						
Net income			4,642,963			4,642,963
Other comprehensive loss, net of tax effect of $265,371:						
Change in unrealized gains (losses) on available-for-sale securities					(515,131)	(515,131)
Total comprehensive income						4,127,832
Cash dividends declared ($0.39 per share)			(1,287,221)			(1,287,221)
Purchase of treasury stock				(291,641)		(291,641)
Balance, September 30, 2005	$ 4,475,996	$ 1,391,723	$ 51,184,378	$ (5,107,270)	$ (154,096)	$ 51,790,731
Balance, December 31, 2005	$ 4,475,996	$ 1,391,723	$ 50,977,998	$ (6,757,073)	$ (687,744)	$ 49,400,900
Comprehensive income:						
Net income			**5,006,857**			**5,006,857**
Other comprehensive loss, net of tax effect of $23,412:						
Change in unrealized losses on available-for-sale securities					**45,446**	**45,446**
Total comprehensive income						**5,052,303**
Cash dividends declared ($0.405 per share)			**(1,304,399)**			**(1,304,399)**
Purchase of treasury stock				**(599,256)**		**(599,256)**
Balance, September 30, 2006	**$ 4,475,996**	**$ 1,391,723**	**$ 54,680,456**	**$ (7,356,329)**	**$ (642,298)**	**$ 52,549,548**

See accompanying notes to consolidated financial statements.

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Southeastern Banking Corporation

Consolidated Statements of Cash Flows

(Unaudited)

Nine Months Ended September 30,	2006	2005
Operating activities		
Net income	**$ 5,006,857**	$ 4,642,963
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**59,500**	258,833
Depreciation	**467,109**	593,079
Amortization and accretion, net	**174,213**	298,993
Net gains on sales of other real estate	**(9,410)**	(89,869)
Changes in assets and liabilities:		
Increase in other assets	**(140,994)**	(101,503)
Increase in other liabilities	**247,490**	129,087
Net cash provided by operating activities	**5,804,765**	5,731,583
Investing activities		
Principal collections and maturities of investment securities:		
Available-for-sale	**47,386,709**	42,263,613
Held-to-maturity	**3,109,400**	2,737,000
Proceeds from sales of available-for-sale investment securities		4,373,125
Purchases of available-for-sale investment securities	**(45,112,871)**	(55,818,378)
Purchases of held-to-maturity investment securities	**(1,590,000)**	(1,438,414)
Net (increase) decrease in loans	**(15,437,815)**	118,585
Proceeds from sales of other real estate	**89,257**	376,846
Capital expenditures, net	**(1,111,132)**	(305,063)
Net cash used in investing activities	**(12,666,452)**	(7,692,686)
Financing activities		
Net increase (decrease) in deposits	**2,572,456**	(22,988,823)
Net increase in federal funds purchased		1,319,000
Net increase (decrease) in U. S. Treasury demand note	**415,443**	(473,637)
Purchase of treasury stock	**(599,256)**	(291,641)
Dividends paid	**(2,908,614)**	(2,924,172)
Net cash used in financing activities	**(519,971)**	(25,359,273)
Net decrease in cash and cash equivalents	**(7,381,658)**	(27,320,376)
Cash and cash equivalents at beginning of period	**36,590,266**	49,041,519
Cash and cash equivalents at end of period	**$ 29,208,608**	$ 21,721,143
Supplemental disclosure		
Cash paid during the period		
Interest	**$ 4,493,172**	$ 3,119,586
Income taxes	**$ 2,615,000**	$ 2,105,000
Noncash investing and financing activities		
Broker receivable for security sales	**$**	$ (4,373,125)

Broker payable for security purchases		(1,981,680)
Real estate acquired through foreclosure	**297,060**	275,961
Loans made in connection with sales of foreclosed real estate	**111,072**	213,517

See accompanying notes to consolidated financial statements.

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Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

1. Accounting and Reporting Policy for Interim Periods

The accompanying unaudited consolidated financial statements of Southeastern Banking Corporation and subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. These statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statement presentation. In the opinion of management, all adjustments necessary for a fair presentation have been made. These adjustments, consisting of normal, recurring accruals, include estimates for various fringe benefits and other transactions normally determined or settled at year-end. Operating results for the quarter and nine months ended September 30, 2006 are not necessarily indicative of trends or results to be expected for the full year 2006. The Company operates within one business segment, community banking, providing a full range of services to individual, corporate, and government customers in southeast Georgia and northeast Florida. The condensed consolidated balance sheet as of December 31, 2005 has been extracted from the audited financial statements included in the Company s 2005 Annual Report to Shareholders. For further information, refer to the consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2005. There have been no significant changes to the Company s Accounting Policies as disclosed in the 2005 Form 10-K.

2. Recent Accounting Standards

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, a clarification of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. This interpretation clarifies the application of SFAS 109 by defining a recognition threshold and measurement criterion that an individual tax position must meet for any part of the benefit of that tax position to be recognized in a company s financial statements. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of Interpretation 48 on its financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This statement provides enhanced guidance for using fair value to measure assets and liabilities. The statement also responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. The statement does not expand the use of fair value in any new circumstances. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157 on its financial position and results of operations.

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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 2005 Annual Report on Form 10-K and the consolidated financial statements & related notes on pages 3 7 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 $393,400,000, is a financial services company with operations in southeast Georgia and northeast Florida. Southeastern Bank (SEB), the Company s principal subsidiary, offers a full line of commercial and retail services to meet the financial needs of its customer base through its sixteen branch locations and ATM network. Services offered include traditional deposit and credit services, long-term mortgage originations, and credit cards. SEB also offers 24-hour delivery channels, including internet and telephone banking, and through an affiliation with Raymond James Financial Services, provides insurance agent and investment brokerage services.

Financial Condition

Consolidated assets totaled $393,470,994 at September 30, 2006, up $4,779,822 from year-end 2005. Asset growth was concentrated in the loan portfolio, particularly real estate construction balances. Specifically, loans grew $15,192,326 or 6.92%; investment securities declined $3,839,183 and federal funds sold declined $4,058,000. Loans comprised approximately 65%, investment securities, 32%, and federal funds sold, 3%, of earning assets at September 30, 2006 versus 63%, 33%, and 4% at December 31, 2005. Overall, earning assets approximated 91% of total assets at September 30, 2006. During the year-earlier period, total assets declined $23,084,034 or 5.76%. A decline in federal funds sold was the main factor in the 2005 results. Refer to the Liquidity section of this Analysis for details on deposits and other funding sources.

Investment Securities

On a carrying value basis, investment securities declined $3,839,183 or 3.27% since December 31, 2005. Purchases of securities during the nine-month period, including short-term securities with original maturities of 90 days or less, approximated $46,703,000, and redemptions, $50,496,000. The effective repricing of redeemed securities impacts current and future earnings results; refer to the Interest Rate and Market Risk/Interest Rate Sensitivity and Operations sections of this Analysis for more details. In conjunction with asset/liability management, the Company continues to increase its proportionate holdings of mortgage-backed securities, corporates, and municipals when feasible to reduce its exposure to Agency securities with call features. At September 30, 2006, mortgage-backed securities, corporates, and municipals comprised 21%, 8%, and 29% of the portfolio. Overall, securities comprised 32% of earning assets at September 30, 2006, down from 33% at year-end 2005. The portfolio yield approximated 4.87% during the first nine months of 2006.

Management believes the credit quality of the investment portfolio remains sound, with 62.66% of the carrying value of debt securities being backed by the U.S. Treasury or other U.S. Government-sponsored agencies at September 30, 2006. The weighted average life of the portfolio approximated 3 years at September 30, 2006. The amortized cost and estimated fair value of investment securities are delineated in the table below:

Investment Securities by Category

September 30, 2006 (In thousands)	*Amortized Cost*	*Unrealized Gains*	*Unrealized Losses*	*Fair Value*
Available-for-sale:				
U. S. Government agencies	**$ 48,000**	$ 54	$ 625	**$ 47,429**
Mortgage-backed securities	**24,408**	32	727	**23,713**
Corporates	**9,131**	344	52	**9,423**
	81,539	430	1,404	**80,565**
Held-to-maturity:				
States and political subdivisions	**32,972**	734	171	**33,535**
Total investment securities	**$ 114,511**	$ 1,164	$ 1,575	**$ 114,100**

As shown, the market value of the securities portfolio reflected $411,143 in net unrealized losses at September 30, 2006; refer to the Capital Adequacy section of this Analysis for more details on investment securities and related fair value. The Company does not have a concentration in the obligations of any issuer other than the U.S. Government and its agencies.

Loans

Loans, net of unearned income, grew 6.76% or $15,126,073 since year-end 2005. The net loans to deposits ratio aggregated 72.10% at September 30, 2006 versus 68.06% at December 31, 2005, and 68.99% a year ago. A $12,831,282 or 10.45% increase in real estate construction and residential mortgage loans, particularly construction loans, was the primary factor in the 2006 results. The majority of the growth within the construction portfolio was residential in nature and concentrated in the Company s coastal markets. Most of the loans in the real estate - construction portfolio are preparatory to customers attainment of permanent financing or developer s sale and are, by nature, short-term and somewhat cyclical; swings in these account balances are normal and to be expected. Although the Company, like peer institutions of similar size, originates permanent mortgages for new construction, it traditionally does not hold or service long-term mortgage loans for its own portfolio. Rather, permanent mortgages are typically brokered through a mortgage underwriter or government agency. The Company receives mortgage origination fees for its participation in these origination transactions; refer to the disclosures provided under Results of Operations for more details. Reversing 2005 declines, consumer loans grew $2,344,926 at September 30, 2006 compared to year-end 2005; these loans comprised 7% of the total portfolio at September 30, 2006. Overall, the commercial portfolio fell a nominal $81,906 at September 30, 2006 compared to December 31, 2005. Nonfarm real estate and governmental loans within the commercial portfolio grew $3,483,792 and $704,891; other commercial/industrial and agricultural loans fell $4,003,635 and $266,954. Commercial balances are projected to improve during the fourth quarter of 2006.

Despite economic uncertainties within the Company s markets, management is optimistic that loan volumes will continue to grow the remainder of 2006. Managerial strategies to increase loan production include continuing competitive pricing on loan products, development of additional loan relationships, and purchase of loan participations from correspondent banks, all without compromising portfolio quality. Additionally, real estate financing in the Company s coastal markets is expected to remain strong. During the same period in 2005, net loans declined a negligible $268,549. Loans outstanding are presented by type in the table on the next page.

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Loans by Category

(In thousands)	September 30, 2006	December 31, 2005	September 30, 2005
Commercial, financial, and agricultural[1]	**$ 86,174**	$ 86,256	$ 82,953
Real estate construction[3]	**96,807**	64,549	60,452
Real estate residential mortgage[2,3]	**38,789**	58,215	59,813
Consumer, including credit cards	**17,272**	14,927	15,185
Loans, gross	**239,042**	223,947	218,403
Unearned income	**124**	156	167
Loans, net	**$ 238,918**	$ 223,791	$ 218,236

[1] Includes obligations of states and political subdivisions.

[2] Typically have final maturities of 15 years or less.

[3] To comply with 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-construction loans are residential in nature.

Although the Company s loan portfolio is diversified, significant portions of its loans are collateralized by real estate. At September 30, 2006, real estate loans exceeded $190,387,000, and commitments to extend credit on such loans approximated $37,535,000. As required by policy, real estate loans are collateralized based on certain loan-to-appraised value ratios. A geographic concentration in loans arises given the Company s operations within a regional area of southeast Georgia and northeast Florida. On an aggregate basis, commitments to extend credit and standby letters of credit approximated $56,943,000 at September 30, 2006; because a substantial amount of these contracts expire without being drawn upon, total contractual amounts do not represent future credit exposure or liquidity requirements. The Company has not funded or incurred any losses on letters of credit in 2006 year-to-date.

Nonperforming Assets

Nonperforming assets consist of nonaccrual loans, restructured loans, and foreclosed real estate and other assets. Overall, nonperforming assets aggregated $1,377,507 at September 30, 2006, down $116,324 or 7.79% from year-end 2005. As a percent of total assets, nonperforming assets totaled 0.35% at September 30, 2006 versus 0.38% at year-end 2005 and 0.36% at September 30, 2005. Other than the addition of a $108,000 commercial loan, no material credits have been transferred or removed from nonaccrual status during 2006 year-to-date. Industry or individual concentrations within nonaccrual balances at September 30, 2006 included:

a) Industry concentrations: Approximately 17% or $178,000 of nonaccrual balances at September 30, 2006 pertained to the shrimping industry. Collateral held varies but includes real estate and commercial fishing vessels. Management considers the allowance sufficient to absorb any additional losses that may result from these loans.

b) Individual concentrations: At September 30, 2006, nonaccrual balances also included loans to two other borrowers averaging $96,000 each. Due to the underlying collateral coverage, no significant losses, if any, are expected on this balance.

Refer to the subsection entitled Policy Note for criteria used by management in classifying loans as nonaccrual. The allowance for loan losses approximated 4.01X the nonperforming loans balance at September 30, 2006 versus 3.35X at year-end 2005 and 3.65X a year ago. Significant activity within foreclosed real estate balances included foreclosure of one borrower s residential real estate valued at approximately $130,000. Management is unaware of any other material developments in nonperforming assets at September 30, 2006 that should be presented or otherwise discussed.

Loans past due 90 days or more approximated $476,000, or less than 1% of net loans, at September 30, 2006. Management is unaware of any material concentrations within these past due balances. The table below provides further information about nonperforming assets and loans past due 90 plus days:

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Nonperforming Assets

(In thousands)	September 30, 2006	December 31, 2005	September 30, 2005
Nonaccrual loans:			
Commercial, financial, and agricultural	**$ 250**	$ 327	$ 302
Real estate construction[3]	**126**	33	28
Real estate mortgage[3]	**347**	818	726
Consumer, including credit cards	**336**	107	120
Total nonaccrual loans	**1,059**	$ 1,285	1,176
Restructured loans[1]			
Total nonperforming loans	**1,059**	$ 1,285	1,176
Foreclosed real estate[2]	**293**	187	170
Other repossessed assets	**26**	22	27
Total nonperforming assets	**$ 1,378**	$ 1,494	$ 1,373
Accruing loans past due 90 days or more	**$ 476**	$ 579	$ 809
Ratios:			
Nonperforming loans to net loans	**0.44%**	0.57%	0.54%
Nonperforming assets to net loans plus foreclosed/repossessed assets	**0.58%**	0.67%	0.63%

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

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

3 To comply with 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-construction loans are residential in nature.

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

Allowance for Loan Losses

The Company continuously reviews its loan portfolio and maintains an allowance for loan losses available to absorb losses inherent in the portfolio. The nine-month provision for loan losses at September 30, 2006 totaled $59,500, and net charge-offs, $125,753. The comparable provision and charge-off amounts at September 30, 2005 were $258,833 and $102,144. Net charge-offs represented 0.07% of average loans at September 30, 2006 compared to 0.06% at September 30, 2005 and 0.22% in 2004. No single charge-off exceeded $65,000 at September 30, 2006. The Company is committed to the early recognition of problem loans and to an appropriate and adequate level of allowance. The adequacy

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of the allowance is further discussed in the next subsection of this Analysis. Activity in the allowance is presented in the table below:

Allowance for Loan Losses

Nine Months Ended September 30,

(Dollars in thousands)	**2006**	**2005**	**2004**
Allowance for loan losses at beginning of year	**$ 4,311**	$ 4,134	$ 3,833
Provision for loan losses	**60**	259	612
Charge-offs:			
Commercial, financial, and agricultural	**80**	113	197
Real estate construction	**1**		12
Real estate mortgage	**23**	35	48
Consumer, including credit cards	**152**	155	256
Total charge-offs	**256**	303	513
Recoveries:			
Commercial, financial, and agricultural	**15**	70	5
Real estate construction			
Real estate mortgage	**12**	13	32
Consumer, including credit cards	**103**	118	135
Total recoveries	**130**	201	172
Net charge-offs	**126**	102	341
Allowance for loan losses at end of period	**$ 4,245**	$ 4,291	$ 4,104
Net loans outstanding[1] at end of period	**$ 238,918**	$ 218,236	$ 219,771
Average net loans outstanding[1] at end of period	**$ 234,098**	$ 217,817	$ 208,063
Ratios:			
Allowance to net loans	**1.78%**	1.97%	1.87%
Net charge-offs to average loans[2]	**0.07%**	0.06%	0.22%
Provision to average loans[2]	**0.03%**	0.16%	0.39%
Recoveries to total charge-offs	**50.78%**	66.34%	33.53%

1 Net of unearned income

2 Annualized.

The Company prepares a comprehensive analysis of the allowance for loan losses at least quarterly. SEB s Board of Directors is responsible for affirming the allowance methodology and assessing the general and specific allowance factors in relation to estimated and actual net charge-off trends. The allowance for loan losses consists of three elements: a) specific allowances for individual loans; b) general allowances for loan pools based on historical loan loss experience and current trends; and c) allowances based on economic conditions and other risk factors in the Company s markets. The specific allowance is based on a regular analysis of classified loans where the internal risk ratings are below a predetermined classification. The specific allowance established for these classified loans is based on a careful analysis of probable and potential sources of repayment, including cash flow, collateral value, and guarantor capacity. The general allowance is determined by the mix of loan products within the portfolio, an internal loan grading process, and associated allowance factors. These general allowance factors are updated at least annually and are based on a statistical loss analysis and current loan charge-off trends. The loss analysis examines loss experience for loan portfolio segments in relation to internal loan grades. Charge-off trends are analyzed for homogeneous loan categories (e.g., residential real

estate, consumer loans, etc.). While formal loss and charge-off trend analyses are conducted annually, the Company continually monitors credit quality in all portfolio segments and revises the general allowance factors whenever necessary in order to address improving or deteriorating credit quality trends or specific risks associated with a given loan category. The third element, comprised of economic conditions,

concentrations, and other risk factors, is based on marketplace conditions and/or events that may affect loan repayment in the near-term. This element requires a high degree of managerial judgment to anticipate the impact that economic trends, legislative or governmental actions, or other unique market and/or portfolio issues will have on credit losses. Consideration of other risk factors typically includes such issues as recent loss experience in specific portfolio segments, trends in loan quality, changes in market focus, and concentrations of credit. These factors are based on the influence of current external variables on portfolio risk, so there will typically be some movement between this element and the specific allowance component during various stages of the economic cycle. Because of their subjective nature, these risk factors are carefully reviewed by management and revised as conditions indicate. Based on its analyses, management believes the allowance was adequate at September 30, 2006.

Other Commitments

Other than a) construction of a permanent branch building to replace the temporary facility at Scranton Road in Brunswick, Georgia, b) preparation of leased space at Southport, also in Brunswick, to open as a new branch by year-end 2006, c) renovation of other SEB offices, and d) the purchase of new core banking software, the Company had no material plans or commitments for capital expenditures as of September 30, 2006. Estimated remaining costs associated with new construction and renovations in progress at September 30, 2006 were $3,100,000; remaining costs associated with the new operating system, which will include both teller and deposit platforms, approximate $350,000.

Liquidity

Liquidity is managed to ensure sufficient cash flow to satisfy demands for credit, deposit withdrawals, and other corporate needs. The Company s sources of funds include a large, stable deposit base and secured advances from the Federal Home Loan Bank. Additional liquidity is provided by payments and maturities, including both principal and interest, of the loan and investment securities portfolios. At September 30, 2006, loans[1] and investment securities with carrying values exceeding $119,776,000 and $15,348,000 were scheduled to mature in one year or less. The investment portfolio has also been structured to meet liquidity needs prior to asset maturity when necessary. The Company s liquidity position is further strengthened by its access, on both a short- and long-term basis, to other local and regional funding sources.

Funding sources primarily comprise customer-based core deposits but also include borrowed funds and cash flows from operations. Customer-based core deposits, the Company s largest and most cost-effective source of funding, comprised 90% of the funding base at September 30, 2006, virtually unchanged from 2005 levels. Borrowed funds, which variously encompass U.S. Treasury demand notes, federal funds purchased, and FHLB advances, totaled $6,771,002 at September 30, 2006 versus $6,355,559 at year-end 2005. More specifically, the maximum amount of U.S. Treasury demand notes available to the Company at September 30, 2006 totaled $3,000,000, of which $1,771,002 was outstanding. Unused borrowings under unsecured federal funds lines of credit from other banks, each with varying terms and expiration dates, totaled $23,000,000. Additionally, under a credit facility with the FHLB, the Company can borrow up to 16% of SEB s total assets; at September 30, 2006, unused borrowings approximated $57,720,000. Refer to the subsection entitled FHLB Advances for details on the Company s outstanding balance with the FHLB. Cash flows from operations also constitute a significant source of liquidity. Net cash from operations derives primarily from net income adjusted for noncash items such as depreciation and amortization, accretion, and the provision for loan losses.

Management believes the Company has the funding capacity, from operating activities or otherwise, to meet its financial commitments in 2006. Refer to the Capital Adequacy section of this Analysis for details on treasury stock purchases and intercompany dividend policy and the Financial Condition section for details on unfunded loan commitments.

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

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Deposits

Deposits grew $2,572,456 or 0.78% since year-end 2005. Noninterest-bearing deposits increased $4,251,308 or 5.33%, while interest-bearing deposits fell $1,678,852. The decline in interest-bearing balances was reflected in two categories, NOW/money market and savings. The NOW/money market decline was due to seasonal variation in local government and commercial balances; the savings decline, mostly in the SmartSaver product, resulted from customers taking advantage of higher market rates for CDs and other investment opportunities in the present rate environment. Overall, interest-bearing deposits comprised 74.65%, and noninterest bearing deposits, 25.35%, of total deposits at September 30, 2006. The distribution of interest-bearing balances at September 30, 2006 and certain comparable quarter-end dates is shown in the table below:

Deposits	**September 30, 2006**		**December 31, 2005**		**September 30, 2005**	
(Dollars in thousands)	*Balances*	*Percent of Total*	*Balances*	*Percent of Total*	*Balances*	*Percent of Total*
Interest-bearing demand deposits[1]	**$ 88,447**	**35.75%**	$ 93,954	37.72%	$ 77,548	32.44%
Savings	**72,915**	**29.48%**	82,107	32.97%	88,902	37.19%
Time certificates < $100,000	**51,888**	**20.98%**	46,891	18.83%	46,282	19.36%
Time certificates >= $100,000	**34,122**	**13.79%**	26,098	10.48%	26,303	11.01%
Total interest-bearing deposits	**$ 247,372**	**100.00%**	$ 249,050	100.00%	$ 239,035	100.00%

1 NOW and money market accounts.

Deposits of one local governmental body comprised approximately $25,528,000 and $31,527,000 of the overall deposit base at September 30, 2006 and December 31, 2005. The Company had no brokered deposits at September 30, 2006.

Approximately 83% of time certificates at September 30, 2006 were scheduled to mature within the next twelve months. The composition of average deposits and the fluctuations therein at September 30 for the last two years is shown in the Average Balances table included in the Operations section of this Analysis.

FHLB Advances

Advances outstanding with the FHLB totaled $5,000,000 at September 30, 2006, unchanged from year-end 2005. The outstanding advance, which matures March 17, 2010, accrues interest at an effective rate of 6.00%, payable quarterly. The advance is convertible into a three-month Libor-based floating rate anytime at the option of the FHLB. Year-to-date, interest expense on the advance approximated $224,000. Mortgage-backed securities were pledged to collateralize advances under this line of credit.

Interest Rate and Market Risk/Interest Rate Sensitivity

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

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An indicator of interest rate sensitivity is the difference between interest rate sensitive assets and interest rate sensitive liabilities; this difference is known as the interest rate sensitivity gap. In an asset sensitive, or positive, gap position, the amount of interest-earning assets maturing or repricing within a given period exceeds the amount of interest-bearing liabilities maturing or repricing within that same period. Conversely, in a liability sensitive, or negative, gap position, the amount of interest-bearing liabilities maturing or repricing within a given period exceeds the amount of interest-earning assets maturing or repricing within that time period. During a period of rising rates, a negative gap would tend to affect net interest income adversely, while a positive gap would theoretically result in increased net interest income. In a falling rate environment, a negative gap would tend to result in increased net interest income, while a positive gap would affect net interest income adversely. The gap analysis below provides a snapshot of the Company s interest rate sensitivity position at September 30, 2006:

Interest Rate Sensitivity

September 30, 2006

(Dollars in thousands)	*Repricing Within* *0 - 3 Months*	*4 - 12 Months*	*One - Five Years*	*More Than Five Years*	*Total*
Interest Rate Sensitive Assets					
Federal funds sold	**$ 10,945**				**$ 10,945**
Securities[1]	**2,186**	**$ 15,188**	**$ 69,002**	**$ 28,135**	**114,511**
Loans, gross[2]	**137,818**	**20,725**	**77,475**	**1,965**	**237,983**
Other assets	**1,088**				**1,088**
Total interest rate sensitive assets	**152,037**	**35,913**	**146,477**	**30,100**	**364,527**
Interest Rate Sensitive Liabilities					
Deposits[3]	**$ 174,026**	**59,054**	**14,282**	**10**	**247,372**
U.S. Treasury demand note	**1,771**				**1,771**
Federal Home Loan Bank advances			**5,000**		**5,000**
Total interest rate sensitive liabilities	**175,797**	**59,054**	**19,282**	**10**	**254,143**
Interest rate sensitivity gap	**$ (23,760)**	**$ (23,141)**	**$ 127,195**	**$ 30,090**	**$ 110,384**
Cumulative gap	**$ (23,760)**	**$ (46,901)**	**$ 80,294**	**$ 110,384**	
Ratio of cumulative gap to total rate sensitive assets	**(6.52)%**	**(12.87)%**	**22.03%**	**30.28%**	
Ratio of cumulative rate sensitive assets to rate sensitive liabilities	**86.48%**	**80.03%**	**131.60%**	**143.43%**	
Cumulative gap at December 31, 2005	**$ (50,409)**	**$ (59,043)**	**$ 71,366**	**$ 101,779**	
Cumulative gap at September 30, 2005	**$ (53,074)**	**$ (73,722)**	**$ 67,354**	**$ 99,399**	

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

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

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

As shown in the preceding table, the Company s gap position ($ in thousands) remained negative through the short-term repricing intervals at September 30, 2006, totaling $(23,760) at three months and $(46,901) through one-year. Excluding traditionally nonvolatile NOW balances from the gap calculation, the cumulative gap at September 30, 2006 totaled $54,107 at three months and $30,966 at twelve months. The narrowing of the short-term gap position at September 30, 2006 versus year-end 2005 was primarily attributable to an increase in variable rate loans tied to prime. No significant changes are anticipated in the gap position the remainder of 2006. Shortcomings are inherent in any gap analysis since certain

assets and liabilities may not move proportionally as rates change. For example, the gap analysis presumes that all loans[2] and securities[1] will perform according to their contractual maturities when, in many cases, actual loan terms are much shorter than the original terms and securities are subject to early redemption.

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

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

Impact of Inflation

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

Capital Adequacy

Federal banking regulators have established certain capital adequacy standards required to be maintained by banks and bank holding companies. These regulations define capital as either Tier 1 (primarily shareholders equity) or Tier 2 (certain debt instruments and a portion of the allowance for loan losses). The Company and SEB are subject to a minimum Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) of 4%, total capital ratio (Tier 1 plus Tier 2 to risk-weighted assets) of 8%, and Tier 1 leverage ratio (Tier 1 to average quarterly assets) of 4%. To be considered a well-capitalized institution, the Tier 1 capital, total capital, and Tier 1 leverage ratios must equal or exceed 6%, 10%, and 5%, respectively. Banks and bank holding companies are prohibited from including unrealized gains and losses on debt securities in the calculation of risk-based capital but are permitted to include up to 45 percent of net unrealized pre-tax holding gains on equity securities in Tier 2 capital. The Company did not have any unrealized gains on equity securities includible in the risk-based capital calculations for any of the periods presented. The Company is committed to maintaining its well-capitalized status.

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

Capital Ratios

(Dollars in thousands)	September 30, 2006	December 31, 2005	September 30, 2005
Tier 1 capital:			
Realized shareholders equity	**$ 53,192**	$ 50,089	$ 51,945
Intangible assets and other adjustments	**(521)**	(565)	(579)
Total Tier 1 capital	**52,671**	49,524	51,366
Tier 2 capital:			
Portion of allowance for loan losses	**3,463**	3,152	3,067
Allowable long-term debt			
Total Tier 2 capital	**3,463**	3,152	3,067
Total risk-based capital	**$ 56,134**	$ 52,676	$ 54,433
Risk-weighted assets	**$ 276,286**	$ 251,024	$ 244,337
Risk-based ratios:			
Tier 1 capital	**19.06%**	19.73%	21.02%
Total risk-based capital	**20.32%**	20.98%	22.28%
Tier 1 leverage ratio	**13.67%**	13.10%	13.39%
Realized shareholders equity to assets	**13.50%**	12.86%	13.75%

Book value per share grew $1.07 or 6.91% during the first nine months of 2006 to $16.55 at September 30, 2006. Dividends declared totaled $0.405, up 3.85% or $0.015 from 2005. For more specifics on the Company s dividend policy, refer to the subsection immediately following. Accumulated other comprehensive loss, which measures net fluctuations in the fair values of investment securities, fell $45,446 at September 30, 2006 compared to year-end 2005. Movement in interest rates remained a dominant factor in the fair value results. Further details on investment securities and associated fair values are contained in the Financial Condition section of this Analysis.

Under existing authorization, the Company can purchase up to $10,000,000 in treasury stock. From 2000 2005, the Company repurchased 345,795 shares on the open market and through private transactions at an average price of $19.54 per share. During the nine months of 2006, the Company purchased an additional 21,402 shares at an aggregate purchase price of $599,256 or $28.00 per share. The maximum consideration available for additional purchases, at prices to be determined in the future, is $2,643,671. Any acquisition of additional shares will be dictated by market conditions. There is no expiration date for the treasury authorization.

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

Dividend Policy

The Parent Company is a legal entity separate and distinct from its subsidiaries, and its revenues and liquidity position depend primarily on the payment of dividends from its subsidiaries. State banking regulations limit the amount of dividends SEB may pay without prior approval of the regulatory agencies. Year-to-date, SEB has paid 75% or $2,434,530 of the $3,246,040 in cash dividends available to the Company in 2006 without such prior approval. The Company uses regular dividends paid by SEB in order to pay quarterly dividends to its own shareholders. Management anticipates that the Company will continue to pay cash dividends on a recurring basis.

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Results of Operations

Net income for the 2006 third quarter totaled $1,646,369, down a marginal $55,114 or 3.24% from September 30, 2005 and down 4.86% from June 30, 2006. On a per share basis, quarterly earnings totaled $0.51 at September 30, 2006 versus $0.52 at September 30, 2005 and $0.54 at June 30, 2006. Year-to-date, net income grew $363,894 to $5,006,857 at September 30, 2006 from $4,642,963 in 2005. Similarly, per share income for the nine-month period improved $0.14 to $1.55 at September 30, 2006 from $1.41 in 2005. The return on beginning equity for the nine-month period totaled 13.33% at September 30, 2006 versus 12.66% in 2005. Variations in net interest income and noninterest income/expense are further discussed within the next two subsections of this Analysis; the provision for loan losses is separately discussed within the Financial Condition section.

Net Interest Income

Net interest income increased $147,838 or 3.11% during the third quarter of 2006 compared to 2005. For the year-to-date period, net interest income grew $898,470 or 6.49% from 2005. The net interest margin approximated 5.73% at September 30, 2006 versus 5.32% a year ago; the interest rate spread, 4.97% versus 4.89%. Interest earnings on loans and other earning assets improved $2,901,076 and $11,897, while earnings on investments and federal funds sold declined $209,337 and $175,923 from same period results in 2005. Overall improvements in asset yields precipitated the 2006 results. Asset yields averaged 7.50% at September 30, 2006 versus 6.46% in 2005; see the interest differential table on page 20 for more details on changes in interest income attributable to volume and rates at September 30, 2006 versus 2005. Interest expense on deposits and other borrowed funds increased $702,043 or 65.26% during the 2006 third quarter versus 2005 and $1,629,243 year-to-date. Cost of funds increased 96 basis points from 2005 levels, totaling 2.53% at September 30, 2006 versus 1.57% at September 30, 2005. The jump in cost of funds resulted from higher rates on all deposit types at September 30, 2006 compared to 2005. Given the rate environment currently propelled by the Federal Reserve, management expects costs of funds and corresponding interest expense to continue increasing as deposits and other funds reprice at higher levels. Anticipated loan growth in Brunswick and other markets are expected to alleviate projected declines in margins and spreads. Additionally, because most of the loans in the variable portfolio are tied to prime and similar indexes, the portfolio is positioned to take advantage of rate hikes promulgated by the Federal Reserve in 2006; variable loans comprised approximately 54% of total loans at September 30, 2006.

The intense competition for loans and deposits continues in 2006 and shows no sign of abating. The high number of new and existing financial institutions in the Company s market areas essentially guarantees downward pressure on net interest spreads and margins as all participants struggle to amass and grow market share. Volume of assets and deposits will become even more important as margins decline. Strategies implemented by management to increase average loans outstanding emphasize competitive pricing on loan products and development of additional loan relationships, all without compromising portfolio quality. Management s strategy for deposits is to closely manage anticipated market increases and maintain a competitive position with respect to pricing and products. Comparative details about average balances, income/expense, and average yields earned and rates paid on interest-earning assets and liabilities for the last two years are provided in the table below:

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

Average Balances[6]	2006			2005		
Nine Months Ended September 30,						
(Dollars in thousands)	*Average Balances*	*Income/ Expense*	*Yields/ Rates*	*Average Balances*	*Income/ Expense*	*Yields/ Rates*
Assets						
Interest-earning assets:						
Loans, net[1,2,4]	**$ 234,098**	**$ 15,517**	**8.86%**	$ 217,817	$ 12,616	7.72%
Federal funds sold	**5,373**	**192**	**4.78%**	17,796	368	2.76%
Taxable investment securities[3]	**86,094**	**2,783**	**4.32%**	92,036	2,849	4.13%
Tax-exempt investment securities[3,4]	**30,313**	**1,476**	**6.51%**	33,887	1,697	6.68%
Other assets	**1,105**	**49**	**5.93%**	1,157	37	4.26%
Total interest-earning assets	**$ 356,983**	**$ 20,017**	**7.50%**	$ 362,693	$ 17,567	6.46%
Liabilities						
Interest-bearing liabilities:						
Interest-bearing demand deposits[5]	**$ 86,066**	**$ 1,340**	**2.08%**	$ 88,392	$ 914	1.38%
Savings	**77,451**	**890**	**1.54%**	93,147	615	0.88%
Time deposits	**79,871**	**2,229**	**3.73%**	75,748	1,328	2.34%
Federal funds purchased	**486**	**20**	**5.50%**	105	3	3.81%
U. S. Treasury demand note	**646**	**23**	**4.76%**	567	12	2.82%
Federal Home Loan Bank advances	**5,000**	**224**	**6.00%**	5,000	224	6.00%
Total interest-bearing liabilities	**$ 249,520**	**$ 4,726**	**2.53%**	$ 262,959	$ 3,096	1.57%
Excess of interest-earning assets over interest-bearing liabilities	**$ 107,463**			$ 99,734		
Interest rate spread			**4.97%**			4.89%
Net interest income		**$ 15,291**			$ 14,471	
Net interest margin			**5.73%**			5.32%

1 Average loans are shown net of unearned income. Nonperforming loans are included.
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 nine months ended September 30, 2006 and 2005. The table on the next page summarizes the changes in interest income and interest expense attributable to volume and rates during this period.

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Interest Differential[1] *Nine Months Ended September 30,* *(In thousands)*	**2006 Compared to 2005 Increase (Decrease) Due to** Volume	Rate	Net
Interest income			
Loans[2,3]	$ 989	$ 1,912	$ 2,901
Federal funds sold	(348)	172	(176)
Taxable investment securities	(189)	123	(66)
Tax-exempt investment securities[3]	(175)	(46)	(221)
Other interest-earning assets	(2)	14	12
Total interest income	275	2,175	2,450
Interest expense			
Interest-bearing demand deposits[4]	(25)	451	426
Savings	(118)	393	275
Time deposits	76	825	901
Federal funds purchased[5]	15	2	17
U.S. Treasury demand note	2	9	11
Federal Home Loan Bank advances			
Total interest expense	(50)	1,680	1,630
Net change in net interest income	$ 325	$ 495	$ 820

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

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

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

4 Now and money market accounts.

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

Noninterest Income and Expense

Noninterest income declined $21,031 or 2.16% during the third quarter of 2006 compared to 2005 but grew $75,268 year-to-date. A decline in commissions on sales of insurance and investment products through our Raymond James affiliation was the predominant factor in the quarterly results. Year-to-date, an $82,810 or 4.79% increase in service charges on deposit accounts was the main factor. The 2006 improvement in service charges was primarily attributable to higher volume of NSF fees. The other operating portion of noninterest income declined $7,542 or 0.78% year-to-date. By type and amount, the chief components of other operating income at September 30, 2006 were mortgage origination fees, $325,569; income on sale of check products, $123,961; surcharge fees ATM, $113,781; commissions on the sale of credit life insurance, $79,705; and safe deposit box rentals, $54,421. Together, these five income items comprised 72.92% of other operating income at September 30, 2006. In 2005, these same five income components comprised 78.32% of other operating income. Overall, noninterest expense increased $516,981 or 5.41% in 2006 year-to-date. Personnel costs accounted for $255,314 or 49% of the increase. The vast majority, or 84%, of employee expenses remained concentrated in salaries and other direct compensation, including related payroll taxes, at September 30, 2006. Profit-sharing accruals and other fringe benefits constituted the remaining 6% and 10% of employee expenses. The division of employee expenses between compensation, profit sharing, and other fringe benefits remained consistent with historical norms in 2006. When compared to the prior year, net occupancy and equipment expense increased $148,548 or 7.84% during the first nine months of 2006 compared to 2005. Costs associated with renovations at four branch facilities comprised the majority of the 2006 increase. Other operating expenses increased $113,119 or 6.03% at September 30, 2006 compared to 2005; increases in advertising and various legal and accounting expenses were the primary variables. Besides advertising expense, which approximated $245,000 in 2006 and $187,000 in 2005, no individual component of other operating expenses aggregated or exceeded 10% of the total in 2006 or 2005.

Critical Accounting Policies

The Company s consolidated financial statements are prepared applying certain critical accounting policies. Critical accounting policies affect accounts such as the allowance for loan losses, income taxes,

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investment securities, and goodwill and other intangibles and require numerous estimates and strategic or economic assumptions that may prove inaccurate or subject to variations and may significantly affect the Company s reported results and financial position for the period or in future periods. Changes in underlying factors, assumptions, or estimates in any of these areas could have a material impact on the Company s future financial condition and results of operations. The Company s critical accounting policies are further discussed in the 2005 Form 10-K. There have been no material changes in the Company s critical accounting policies since December 31, 2005.

Recent Accounting Pronouncements

Recent accounting pronouncements affecting the Company are discussed in the 2005 Form 10-K previously filed with the Securities and Exchange Commission.

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

Forward-Looking Statements

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

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

- Competitive pressures between depository and other financial institutions may increase significantly.
- Changes in the interest rate environment may reduce margins and impact funding sources.
- General economic or business conditions in the geographic regions and industry in which the Company operates may lead to a deterioration in credit quality or a reduced demand for credit.
- Legislative or regulatory changes, including changes in accounting standards, monetary policies, and taxation requirements, may adversely affect the Company s business.

Other factors include:

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

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

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

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

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The discussion on market risk is included in the Interest Rate and Market Risk/Interest Rate Sensitivity section of Part I, Item 2.

Item 4. Controls and Procedures.

The Company s management, with the participation of the Company s Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO or Treasurer), has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) or 15(d)-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, the CEO and Treasurer have concluded that the Company s current disclosure controls and procedures, as designed and implemented, were effective.

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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 nine months of 2006, but the Company did add an additional factor:

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

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

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

Not Applicable

Item 3. Defaults Upon Senior Securities.

Not Applicable

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

Not Applicable

Item 5. Other Information.

Not Applicable

Item 6. Exhibits.

(a) Index to Exhibits:

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

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Signatures

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

SOUTHEASTERN BANKING CORPORATION

(Registrant)

By: /s/ ALYSON G. BEASLEY
Alyson G. Beasley, Vice President & Treasurer
(Chief Accounting Officer)

Date: November 14, 2006