SOUTHEASTERN BANKING CORP
Form 10-Q
May 15, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2003

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______

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 STREET, 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 ¨

As of April 30, 2003, 3,333,139 shares of the registrant s common stock, par value $1.25 per share, were outstanding.

Southeastern Banking Corporation

Consolidated Balance Sheets

	March 31, 2003	December 31, 2002
	(Unaudited)	
Assets		
Cash and due from banks	**$ 18,530,895**	$ 16,824,550
Federal funds sold	**20,989,000**	22,811,000
Cash and cash equivalents	**39,519,895**	39,635,550
Investment securities		
Held-to-maturity (market value of approximately $39,990,000 and $39,764,000 at March 31, 2003 and December 31, 2002)	**37,682,877**	37,697,612
Available-for-sale, at market value	**114,721,526**	115,625,072
Total investment securities	**152,404,403**	153,322,684
Loans, gross	**177,686,054**	175,314,077
Unearned income	**(299,307)**	(333,133)
Allowance for loan losses	**(3,596,879)**	(3,600,833)
Loans, net	**173,789,868**	171,380,111
Premises and equipment, net	**8,031,476**	8,140,885
Intangible assets	**816,375**	854,234
Other assets	**4,499,312**	4,806,165
Total Assets	**$ 379,061,329**	$ 378,139,629
Liabilities and Shareholders Equity		
Liabilities		
Noninterest-bearing deposits	**$ 61,932,181**	$ 57,694,311
Interest-bearing deposits	**261,013,401**	260,153,716
Total deposits	**322,945,582**	317,848,027
U. S. Treasury demand note	**933,542**	3,028,187
Federal Home Loan Bank advances	**5,000,000**	5,000,000
Other liabilities	**2,295,987**	4,734,245
Total liabilities	**331,175,111**	330,610,459
Shareholders Equity		
Common stock ($1.25 par value; 10,000,000 shares authorized; 3,580,797 shares issued; 3,333,139 shares outstanding)	**4,475,996**	4,475,996
Additional paid-in-capital	**1,391,723**	1,391,723
Retained earnings	**44,270,969**	43,449,597
Treasury stock, at cost (247,658 shares)	**(4,124,263)**	(4,124,263)

Realized shareholders equity	**46,014,425**	45,193,053
Accumulated other comprehensive income unrealized gains on available-for-sale securities, net of tax	**1,871,793**	2,336,117
Total shareholders equity	**47,886,218**	47,529,170
Total Liabilities and Shareholders Equity	**$ 379,061,329**	$ 378,139,629

See accompanying notes to consolidated financial statements.

1

Southeastern Banking Corporation

Consolidated Statement of Income

(Unaudited)

	Three Months Ended March 31,	
	2003	**2002**
Interest income		
Loans, including fees	**$ 3,580,509**	$ 3,703,337
Federal funds sold	**50,969**	57,802
Investment securities		
Taxable	**1,312,892**	1,652,414
Tax-exempt	**400,020**	374,252
Other assets	**12,524**	15,505
Total interest income	**5,356,914**	5,803,310
Interest expense		
Deposits	**1,334,445**	1,975,794
U. S. Treasury demand note	**2,234**	4,218
Federal Home Loan Bank advances	**74,000**	74,000
Total interest expense	**1,410,679**	2,054,012
Net interest income	**3,946,235**	3,749,298
Provision for loan losses	**234,000**	300,000
Net interest income after provision for loan losses	**3,712,235**	3,449,298
Noninterest income		
Service charges on deposit accounts	**650,400**	566,936
Investment securities gains, net	**7,534**	2,000
Other operating income	**342,258**	369,544
Total noninterest income	**1,000,192**	938,480
Noninterest expense		
Salaries and employee benefits	**1,692,802**	1,645,498
Occupancy and equipment, net	**610,133**	564,552
Other operating expense	**702,748**	671,899
Total noninterest expense	**3,005,683**	2,881,949
Income before income taxes	**1,706,744**	1,505,829
Income tax expense	**485,394**	418,647
Net income	**$ 1,221,350**	$ 1,087,182

Net income per average share basic	**$ 0.37**	$ 0.32
Average common shares basic	**3,333,139**	3,385,470

See accompanying notes to consolidated financial statements.

Southeastern Banking Corporation

Consolidated Statements of Shareholders Equity

(Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2001	$ 4,475,996	$ 1,391,723	$ 42,035,982	$ (3,247,718)	$ 941,344	$ 45,597,327
Comprehensive income:						
Net income			1,087,182			1,087,182
Other comprehensive income, net of tax effect of $321,980:						
Change in unrealized gains on available-for-sale securities					(625,020)	(625,020)
Comprehensive income						462,162
Cash dividends declared ($0.11 1/2 per share)			(389,329)			(389,329)
Balance, March 31, 2002	$ 4,475,996	$ 1,391,723	$ 42,733,835	$ (3,247,718)	$ 316,324	$ 45,670,160
Balance, December 31, 2002	$ 4,475,996	$ 1,391,723	$ 43,449,597	$ (4,124,263)	$ 2,336,117	$ 47,529,170
Comprehensive income:						
Net income			**1,221,350**			**1,221,350**
Other comprehensive income, net of tax effect of $239,197:						
Change in unrealized gains on available-for-sale securities					**(464,324)**	**(464,324)**
Comprehensive income						**757,026**
Cash dividends declared ($0.12 per share)			**(399,978)**			**(399,978)**
Balance, March 31, 2003	**$ 4,475,996**	**$ 1,391,723**	**$ 44,270,969**	**$ (4,124,263)**	**$ 1,871,793**	**$ 47,886,218**

See accompanying notes to consolidated financial statements.

Southeastern Banking Corporation

Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended March 31,	
	2003	**2002**
Operating activities		
Net income	**$ 1,221,350**	$ 1,087,182
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**234,000**	300,000
Depreciation	**220,224**	201,024
Amortization and accretion, net	**301,145**	152,086
Investment securities gains, net	**(7,534)**	(2,000)
Net losses on other real estate	**8,888**	26,215
Changes in assets and liabilities:		
Decrease in other assets	**313,677**	346,927
Decrease in other liabilities	**(415,831)**	(635,460)
Net cash provided by operating activities	**1,875,919**	1,475,974
Investing activities		
Principal collections and maturities of investment securities:		
Held-to-maturity	**170,000**	1,262,000
Available-for-sale	**21,172,929**	13,243,162
Proceeds from sales of investment securities held-to-maturity	**310,650**	
Purchases of investment securities held-to-maturity	**(490,406)**	(1,311,111)
Purchases of investment securities available-for-sale	**(21,204,165)**	(9,509,076)
Net increase in loans	**(2,694,801)**	(1,072,933)
Proceeds from sales of other real estate	**35,331**	41,429
Net funds paid in purchase of branch		(7,748,200)
Capital expenditures, net	**(110,815)**	(360,587)
Net cash used in investing activities	**(2,811,277)**	(5,455,316)
Financing activities		
Net increase in deposits	**5,097,555**	13,892,917
Net (decrease) increase in U. S. Treasury demand note	**(2,094,645)**	1,374,224
Dividends paid	**(2,183,207)**	(2,268,265)
Net cash provided by financing activities	**819,703**	12,998,876
Net (decrease) increase in cash and cash equivalents	**(115,655)**	9,019,534
Cash and cash equivalents at beginning of year	**39,635,550**	24,367,021
Cash and cash equivalents at March 31	**$ 39,519,895**	$ 33,386,555
Supplemental disclosure		
Cash paid during the period		
Interest	**$ 1,745,635**	$ 2,416,494

Noncash investing and financing activities				
Real estate acquired through foreclosure	**$**	**51,044**	$	92,441
Loans made in connection with sales of foreclosed real estate			$	41,175

See accompanying notes to consolidated financial statements.

4

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 (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 ended March 31, 2003 are not necessarily indicative of trends or results to be expected for the year ended December 31, 2003. For further information, refer to the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2002.

2. Reclassifications

Certain prior year amounts have been restated to conform with the current year financial statement presentation.

3. Recent Accounting Standards

Accounting for Costs Associated with Exit or Disposal Activities

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This statement provides guidance on the recognition and measurement of liabilities for costs associated with exit or disposal activities. Generally, SFAS No. 146 stipulates that defined exit costs, including restructuring and employee termination costs, are to be recorded on an incurred rather than commitment basis. The Company adopted SFAS 146 effective January 1, 2003. SFAS 146 did not have a material impact on the consolidated financial statements.

Guarantor s Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others

In November 2002, the FASB issued Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. This interpretation clarifies that a guarantor is required to recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantee. The Company has identified standby letters of credit as guarantees under FIN No. 45 and adopted FIN 45, in entirety, effective January 1, 2003. Adoption of FIN No. 45 did not have a material impact on the Company s financial position or results of operations.

Amendment of Statement 133 on Derivative Instruments and Hedging Activities

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial accounting and

Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. Generally, this standard is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 will not have a current impact on the Company s consolidated financial statements.

4. Acquisition

On January 31, 2002, the Company acquired the Richmond Hill office of Valdosta, Georgia-based Park Avenue Bank. The Company received certain loans, property and equipment, and other assets with fair values of approximately $12,201,000, while assuming deposits and other liabilities totaling approximately $4,270,000. Cash balances applied towards the purchase approximated $8,000,000. A deposit premium of $100,000 was recorded in conjunction with the transaction.

Southeastern Banking Corporation

Management s Discussion and Analysis

This Analysis should be read in conjunction with the 2002 Annual Report on Form 10-K and the consolidated financial statements & related notes on pages 1 6 of this quarterly filing.

Description of Business

Southeastern Banking Corporation (the Company), with assets exceeding $379,061,000, 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 fifteen 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. The Company s insurance subsidiary, SBC Financial Services, Inc. (SBCF), provides insurance agent and investment brokerage services with an emphasis on financial planning. In addition to traditional insurance, products offered include fixed and indexed annuities, mutual funds, retirement plans, and long-term care policies. SBCF had a nominal impact on the Company s financial condition and results of operations at March 31, 2003 and 2002.

Acquisition

On January 31, 2002, the Company acquired the Richmond Hill office of Valdosta, Georgia-based Park Avenue Bank. The Company received certain loans, property and equipment, and other assets with fair values of approximately $12,201,000, while assuming deposits and other liabilities totaling $4,270,000. Cash balances applied towards the purchase approximated $8,000,000. A deposit premium of $100,000 was recorded in conjunction with the transaction. Operating results for Richmond Hill are included from the date of acquisition.

Financial Condition

Consolidated assets totaled $379,061,329 at March 31, 2003, up $921,700 or 0.24% from year-end 2002 and $6,750,862 or 1.81% from March 31, 2002. Virtually all of the 2003 growth year-to-date occurred in the loan portfolio. Offsetting a $1,822,000 reduction in federal funds sold, loan balances grew $2,409,757. Loans comprised 51%, investment securities, 43%, and federal funds sold, 6%, of earning assets at March 31, 2003 versus 49%, 44%, and 7% at December 31, 2002. Overall, earning assets aggregated 92% of total assets at March 31, 2003 and year-end 2002. During the year-earlier period, total assets increased $17,095,652 or 4.81%. The acquisition of the Richmond Hill branch and deposit growth at other SEB locations were the primary factors in the 2002 increase. Refer to the Liquidity section of this Analysis for additional details on deposits and other funding sources.

Investment Securities

On a carrying value basis, investment securities declined $918,281, or less than 1%, since December 31, 2002. Purchases of securities during the three-month period approximated $21,695,000, and redemptions, $21,646,000. Approximately 84% of securities transactions year-to-date were attributable to various issuers exercise of call options and other prepayments as a result of the current low-rate interest environment. The effective repricing of securities at lower rates 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. Although no significant changes occurred in the investment securities mix during 2003 year-to-date, the Company continues to increase its holdings of mortgage-backed securities, corporates, and municipals to reduce its exposure to Agency securities with call features. At March 31, 2003, mortgage-backed securities, corporates, and municipals comprised 27%,

Southeastern Banking Corporation

Management s Discussion and Analysis

12%, and 25% of the portfolio. Overall, securities comprised 43% of earning assets at March 31, 2003 versus 44% at year-end 2002.

Management believes the credit quality of the investment portfolio remains sound, with 62.31% of the carrying value of debt securities being backed by the U.S. Treasury or other U.S. Government-sponsored agencies at March 31, 2003. All of the Company s corporate bonds were rated A or higher by at least one nationally recognized rating agency at March 31, 2003. The amortized cost and estimated fair value of investment securities are delineated in the table below:

Investment Securities by Category

March 31, 2003	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
		(In thousands)		
Available-for-sale:				
U. S. Government agencies	**$ 53,958**	$ 1,157	$ 4	**$ 55,111**
Mortgage-backed securities	**40,567**	744	19	**41,292**
Corporates	**17,361**	958		**18,319**
	111,886	2,859	23	**114,722**
Held-to-maturity:				
States and political subdivisions	**37,683**	2,318	11	**39,990**
Total investment securities	**$ 149,569**	$ 5,177	$ 34	**$ 154,712**

As shown, the carrying value of the securities portfolio reflected $5,143,000 in net unrealized gains at March 31, 2003; 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 1.37% or $2,405,803 at March 31, 2003 compared to year-end 2002. Reflecting higher deposit balances, the net loans to deposits ratio dropped 12 basis points to 54.93% at March 31, 2003 from 55.05% at year-end 2002 and 21 basis points from 55.14% a year ago. Growth in the commercial and real estate mortgage/construction portfolios fueled the 2003 balance improvement year-to-date. More specifically, gross commercial loans increased $3,152,286 or 4.06% at March 31, 2003 compared to December 31, 2002. Nonfarm real estate and agricultural loans within the commercial portfolio grew $3,651,303 and $2,024,725; governmental and other commercial/industrial loans fell $565,513 and $1,958,229. On a combined basis, real estate mortgage and construction loans grew a modest 1.73% or $1,265,815 in 2003 year-to-date. The majority, or 74%, of the growth within these real estate loans was concentrated in the residential mortgage sector. Although construction balances were virtually unchanged at March 31, 2003 versus year-end 2002, 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. While the Company, like peer institutions of similar size, originates permanent residential mortgages for new construction, it traditionally does not hold or service mortgage loans with maturities greater than fifteen years for its own portfolio. Rather, permanent residential 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. Consumer loans declined $2,046,124 or 8.30% during the first quarter of 2003 compared to year-end 2002. Reduced demand was the chief element in the 2003 results. Consumer loans remain the Company s highest-yielding interest-earning asset, and the Company is committed to reversing the decline in this portfolio.

Southeastern Banking Corporation

Management s Discussion and Analysis

Despite the current economic slowdown within the Company s markets, management is optimistic that overall loan volumes will remain higher in 2003 than 2002. Strategies implemented by management 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, in February 2003, the Company opened a loan production office in Brunswick, Georgia, providing the Company with a foothold in one of the fastest-growing and more populous markets in southeast Georgia. The loan production office is expected to increase origination volume in 2003. During the same period last year, net loans grew 6.96% or $11,364,490. More than 90%, or $10,300,000, of the 2002 improvement was attributable to the Richmond Hill acquisition. Loans outstanding are presented by type in the table below:

Loans by Category	**March 31, 2003**	**December 31, 2002**	**March 31, 2002**
		(In thousands)	
Commercial, financial, and agricultural[1]	**$ 80,832**	$ 77,680	**$ 68,923**
Real estate construction[3]	**17,695**	17,371	**6,318**
Real estate residential mortgage[2,3]	**56,556**	55,614	**68,507**
Consumer, including credit cards	**22,603**	24,649	**31,362**
Loans, gross	**177,686**	175,314	**175,110**
Unearned income	**299**	333	**397**
Loans, net	**$ 177,387**		