SOUTHEASTERN BANKING CORP
Form 10-Q
August 14, 2002

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 June 30, 2002

OR

o **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 (State or other jurisdiction of incorporation or organization)	**58-1423423** (IRS Employer Identification No.)
P.O. BOX 455, 1010 NORTHWAY STREET, DARIEN, GEORGIA (Address of principal executive offices)	**31305** (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 o

As of July 31, 2002, 3,333,139 shares of the Registrant s common stock, par value $1.25 per share, were outstanding.

Southeastern Banking Corporation

Consolidated Balance Sheets

	(Unaudited) June 30, 2002	December 31, 2001
Assets		
Cash and due from banks	$ 16,697,957	$ 16,787,021
Federal funds sold	13,691,000	7,580,000
Cash and cash equivalents	30,388,957	24,367,021
Investment securities		
Held-to-maturity (market value of approximately $38,021,000 and $35,451,000 at June 30, 2002 and December 31, 2001)	36,818,476	35,090,649
Available-for-sale, at market value	110,403,881	122,529,275
Total investment securities	147,222,357	157,619,924
Loans, gross	177,272,369	163,805,412
Unearned income	(410,732)	(457,087)
Allowance for loan losses	(3,502,858)	(3,134,594)
Loans, net	173,358,779	160,213,731
Premises and equipment, net	8,262,127	6,675,354
Intangible assets	929,952	904,836
Other assets	5,144,152	5,433,949
Total Assets	$ 365,306,324	$ 355,214,815
Liabilities and Shareholders Equity		
Liabilities		
Noninterest-bearing deposits	$ 59,706,907	$ 57,826,266
Interest-bearing deposits	248,802,142	240,880,561
Total deposits	308,509,049	298,706,827
U. S. Treasury demand note	1,081,958	493,153
Federal Home Loan Bank advances	5,000,000	5,000,000
Other liabilities	2,815,645	5,417,508

Total liabilities	317,406,652	309,617,488
Shareholders Equity		
Common stock ($1.25 par value; 10,000,000 shares authorized; 3,580,797 shares issued 3,385,470 shares outstanding)	4,475,996	4,475,996
Additional paid-in-capital	1,391,723	1,391,723
Retained earnings	43,544,193	42,035,982
Treasury stock, at cost (195,327 shares)	(3,247,718)	(3,247,718)
Realized shareholders equity	46,164,194	44,655,983
Accumulated other comprehensive income - unrealized gains on available-for-sale securities, net of tax	1,735,478	941,344
Total shareholders equity	47,899,672	45,597,327
Total Liabilities and Shareholders Equity	$ 365,306,324	$ 355,214,815

See accompanying notes to consolidated financial statements.

Southeastern Banking Corporation

Consolidated Statements of Income
(Unaudited)

	Quarter		*Six Months*	
Period Ended June 30,	**2002**	**2001**	**2002**	**2001**
Interest income				
Loans, including fees	$ **3,821,697**	$ 4,150,589	$ **7,525,034**	$ 8,469,798
Federal funds sold	**66,894**	308,139	**124,696**	628,251
Investment securities				
Taxable	**1,554,960**	1,817,743	**3,207,374**	3,591,764
Tax-exempt	**388,318**	325,196	**762,570**	631,049
Other assets	**14,495**	22,978	**30,000**	42,315
Total interest income	**5,846,364**	6,624,645	**11,649,674**	13,363,177
Interest expense				
Deposits	**1,868,606**	2,849,289	**3,844,400**	5,785,802
U. S. Treasury demand note	**1,659**	7,928	**5,877**	18,293
Federal Home Loan Bank advances	**74,822**	74,822	**148,822**	148,822
Total interest expense	**1,945,087**	2,932,039	**3,999,099**	5,952,917
Net interest income	**3,901,277**	3,692,606	**7,650,575**	7,410,260
Provision for loan losses	**282,500**	300,000	**582,500**	600,000
Net interest income after provision for loan losses	**3,618,777**	3,392,606	**7,068,075**	6,810,260
Noninterest income				
Service charges on deposit accounts	**634,661**	579,416	**1,201,597**	1,162,104
Investment securities gains, net	**2,374**		**4,374**	
Other operating income	**248,016**	250,641	**617,560**	542,025
Total noninterest income	**885,051**	830,057	**1,823,531**	1,704,129
Noninterest expense				
Salaries and employee benefits	**1,601,369**	1,545,720	**3,246,867**	3,113,525
Occupancy and equipment, net	**557,075**	496,566	**1,091,294**	1,025,297

Other operating expense	**673,123**	776,138	**1,375,355**	1,541,149
Total noninterest expense	**2,831,567**	2,818,424	**5,713,516**	5,679,971
Income before income taxes	**1,672,261**	1,404,239	**3,178,090**	2,834,418
Income tax expense	**472,573**	396,071	**891,220**	814,346
Net income	$ **1,199,688**	$ 1,008,168	$ **2,286,870**	$ 2,020,072
Net income per share basic	$ **0.35**	$ 0.29	$ **0.68**	$ 0.59
Weighted average common shares outstanding	**3,385,470**	3,399,030	**3,385,470**	3,406,394

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, 2000	$ 4,475,996	$ 1,391,723	$ 41,327,784	$ (2,485,742)	$ (369,586)	$ 44,340,175
Comprehensive income:						
Net income			2,020,072			2,020,072
Other comprehensive income, net of tax effect of $424,556:						
Change in unrealized gains (losses) on available - for - sale securities					824,139	824,139
Comprehensive income						2,844,211
Cash dividends declared ($ 0.22 per share)			(747,684)			(747,684)
Acquisition of treasury stock				(650,708)		(650,708)
Balance, June 30, 2001	$ 4,475,996	$ 1,391,723	$ 42,600,172	$ (3,136,450)	$ 454,553	$ 45,785,994
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			2,286,870			2,286,870
Other comprehensive income, net of tax effect of $409,099:						
Change in unrealized gains (losses) on available - for - sale securities					794,134	794,134
Comprehensive income						3,081,004
Cash dividends declared ($0.23 per share)			(778,659)			(778,659)
Balance, June 30, 2002	$ 4,475,996	$ 1,391,723	$ 43,544,193	$ (3,247,718)	$ 1,735,478	$ 47,899,672

See accompanying notes to consolidated financial statements.

Southeastern Banking Corporation

Consolidated Statements of Cash Flows
(Unaudited)

Six Months Ended June 30,	2002	2001
Operating activities		
Net income	$ **2,286,870**	$ 2,020,072
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**582,500**	600,000
Depreciation	**406,147**	384,461
Amortization and accretion, net	**302,744**	(103,893)
Investment securities gains, net	**(4,374)**	
Net losses on other real estater	**11,012**	66,648
Changes in assets and liabilities:		
(Increase) decrease in other assets	**(54,110)**	393,718
Decrease in other liabilities	**(938,132)**	(45,736)
Net cash provided by operating activities	**2,592,657**	3,315,270
Investing activities		
Principal collections and maturities of investment securities:		
Held-to-maturity	**1,282,000**	966,300
Available-for-sale	**31,014,760**	64,051,788
Purchases of investment securities held-to-maturity	**(3,055,210)**	(4,466,838)
Purchases of investment securities available-for-sale	**(17,864,235)**	(61,453,442)
Net (increase) decrease in loans	**(3,333,452)**	7,303,407
Proceeds from sales of other real estate	**154,121**	75,743
Net funds paid in purchase of branch	**(7,748,200)**	
Capital expenditures, net	**(489,555)**	(198,272)
Net cash (used in) provided by investing activities	**(39,771)**	6,278,686
Financing activities		
Net increase in deposits	**5,537,840**	8,196,597
Net increase in U. S. Treasury demand note	**588,805**	955,554
Purchase of treasury stock		(650,708)
Dividends paid	**(2,657,595)**	(1,096,153)
Net cash provided by financing activities	**3,469,050**	7,405,290
Net increase in cash and cash equivalents	**6,021,936**	16,999,246
Cash and cash equivalents at beginning of period	**24,367,021**	19,062,283
Cash and cash equivalents at end of period	$ **30,388,957**	$ 36,061,529

Supplemental disclosure				
Cash paid during the period				
Interest	$	**4,592,537**	$	6,015,867
Income taxes	$	**985,000**	$	770,000
Noncash investing and financing activities				
Real estate acquired through foreclosure	$	**92,441**	$	2,283,941
Loans made in connection with sales of foreclosed real estate	$	**112,074**	$	32,500

See accompanying notes to consolidated financial statements.

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 generally accepted accounting principles 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 six months ended June 30, 2002 are not necessarily indicative of trends or results to be expected for the year ended December 31, 2002. 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, 2001.

2. Recent Accounting Pronouncements

Business Combinations/Goodwill and Other Intangible Assets

In July 2001, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 addresses the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination, and SFAS No. 142 addresses the initial recognition and measurement of intangible assets acquired outside of a business combination whether acquired individually or with a group of other assets. These standards require all future business combinations to be accounted for using the purchase method of accounting. With the adoption of these standards, goodwill is no longer amortized but instead is subject to impairment tests at least annually. The Company adopted SFAS 141 and 142, in entirety, effective January 1, 2002. Adoption of these standards did not have a material impact on the Company s financial position or results of operations.

Accounting for the Impairment or Disposal of Long-Lived Assets

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supercedes both SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, which previously governed impairment of long-lived assets, and APB Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, which addressed the disposal of a business segment. This standard improves financial reporting by requiring one accounting model be used for long-lived assets to be disposed by sale and by broadening the presentation of discontinued operations to include more disposal transactions. The Company adopted SFAS 144 effective January 1, 2002. SFAS 144 did not have a material impact on the consolidated financial statements.

Rescission of SFAS No. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections

In April 2002, the FASB issued SFAS No. 145, Rescission of SFAS No. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections. SFAS No. 4, which was amended by SFAS No. 64,

Southeastern Banking Corporation

Notes to Consolidated Financial Statements
(Unaudited)

required all gains and losses from the extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. With the elimination of SFAS No. 4, the criteria in Opinion 30 will now be used to classify those gains and losses. SFAS No. 13 was amended to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects similar to sale-leaseback transactions. The adoption of SFAS No. 145 will not have a current impact on the Company s consolidated financial statements

.Accounting for Costs Associated with Exit or Disposal Activities

In July 2002, the FASB issued SFAS No. 146, Accounting 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. This standard is effective for exit or disposal activities initiated after December 31, 2002. Adoption of SFAS No. 146 is not expected to have a significant impact on the consolidated financial statements.

3. 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.

4. Treasury Stock

In March 2000, the Board of Directors authorized the purchase of up to $7,000,000 in Company common stock. In 2000 and 2001, the Company purchased 195,327 shares on the open market and through private transactions at an average purchase price of $16.63 per share. Subsequent to June 30, 2002, the Company purchased an additional 52,331 shares at a purchase price of $16.75. The maximum consideration available for additional treasury purchases, at prices to be determined in the future, is $2,875,738. Any acquisition of additional shares will be dictated by market conditions.

Southeastern Banking Corporation

Management s Discussion and Analysis

This Analysis should be read in conjunction with the 2001 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 of $365 million, 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, including its new Richmond Hill office, 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 June 30, 2002 and 2001.

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 $12.2 million, while assuming deposits and other liabilities totaling approximately $4.27 million. Cash balances applied towards the purchase approximated $8 million. A deposit premium of $100,000 was recorded in conjunction with the transaction. More details on the Richmond Hill acquisition are provided in later sections of this Analysis.

Financial Condition

Consolidated assets exceeded $365 million at June 30, 2002, growing $10,091,509 or 2.84% from year-end 2001 and $5,524,007 or 1.54% from June 30, 2001. The acquisition of the Richmond Hill branch and deposit growth at other SEB locations were the primary factors in the year-to-date increase. Approximately $13.1 million of the 2002 growth year-to-date occurred in the loan portfolio. Offsetting moderate reductions in investment securities, the remainder of the growth was concentrated in federal funds sold. Federal funds sold balances are expected to decline during the second half of 2002 as funds are reallocated to other earning assets. Loans comprised 52%, investment securities, 44%, and federal funds sold, 4%, of earning assets at June 30, 2002 versus 50%, 48%, and 2% at December 31, 2001. Overall, earning assets aggregated 92% of total assets at June 30, 2002 and year-end 2001. During the year-earlier period, total assets increased $10,203,765 or 2.92%. Increased deposits funded t he 2001 growth. 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 $10,397,567 or 6.60% since December 31, 2001. Purchases of securities during the three month period approximated $20,919,000, and redemptions, $32,292,000. Approximately 65% of securities transactions year-to-date were attributable to various issuers exercise of call options and other prepayments as a result of interest rate reductions during the last twelve months. 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 the first half of 2002, during the preceding twelve months the Company increased its holdings of mortgage-backed securities, corporates, and municipals to reduce its exposure

Southeastern Banking Corporation

Management s Discussion and Analysis
June 30, 2002

to Agency securities with call features. At June 30, 2002, mortgage-backed securities, corporates, and municipals comprised 26%, 7%, and 25% of the portfolio. Overall, securities aggregated 44% of earning assets at June 30, 2002, down 400 basis points from year-end 2001 levels. The amortized cost and estimated fair value of investment securities are delineated in the table below:

Investment Securities by Category June 30, 2002	***Amortized Cost***	*Unrealized Gains*	*Unrealized Losses*	***Fair Value***
(In thousands)				
Available-for-sale:				
U. S. Government agencies	$ **58,851**	$ 1,270	$ 8	$ **60,113**
Mortgage-backed securities	**38,192**	925	6	**39,111**
Corporates	**10,732**	448		**11,180**
	107,775	2,643	14	**110,404**
Held-to-maturity:				
States and political subdivisions	**36,818**	1,279	76	**38,021**
Total investment securities	$ **144,593**	$ 3,922	$ 90	$ **148,425**

As shown, the market value of the securities portfolio exceeded the cost basis at June 30, 2002; 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 8.27% or $13,513,312 since year-end 2001 to exceed $176 million at June 30, 2002. As a percent of deposits, net loans aggregated 57.33% at June 30, 2002 versus 54.69% at December 31, 2001 and 53.75% at June 30, 2001. More than 75%, or $10.3 million, of the 2002 improvement was attributable to the Richmond Hill acquisition. The remaining increase resulted from loan origination at other SEB locations. The commercial portfolio grew $20,341,823, offsetting overall declines of 6.38% in the consumer and real estate mortgage/construction portfolios. Within the commercial portfolio, nonfarm real estate, agricultural, and other commercial/industrial loans grew $16,158,401, $3,471,533, and $1,231,201; governmental loans fell $519,312. Consumer loans declined $4,408,523 or 14.49% during the first half of 2002 compared to year-end 2001. A softening of consumer demand in the Company s trade areas was the chief element in the 2002 results. Consumer loans remain the Company s highest-yielding interest-earning asset, and the Company is committed to reversing the decline in this portfolio. On a combined basis, real estate mortgage and construction loans fell $2,466,343 or 3.19% in 2002 year-to-date. Although down from year-end 2001 levels, real estate mortgage and construction loans increased $2,631,000 or 3.64% since June 30, 2001. The growth within these real estate loans has been concentrated in the construction sector. 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 residential mortgages for new construction, it traditionally does not hold or service mortgage loans with maturities greater than 15 years for its own portfolio. Rather, permanent residential mor tgages 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.

Despite the current economic slowdown within our markets, management is optimistic that overall loan volumes will remain higher in 2002 than 2001. Strategies implemented by management to increase loan

Southeastern Banking Corporation

Management s Discussion and Analysis

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. During the same period last year, net loans declined 6.00% or $10,431,536. Declines within the commercial portfolio were the primary factors in the 2001 results. Loans outstanding are presented by type in the table below:

Loans by Category	***June 30, 2002***	*December 31, 2001*	*June 30, 2001*
(In thousands)			
Commercial, financial, and agricultural1	$ **76,407**	$ 56,065	$ 59,585
Real estate construction(3)	**14,489**	6,959	6,634
Real estate - residential mortgage(2, 3)	**60,363**	70,361	65,587
Consumer, including credit cards	**26,013**	30,420	32,158
Loans, gross	**177,272**	163,805	163,964
Unearned income	**411**	457	593
Loans, net	$ **176,861**	$ 163,348	$ 163,371

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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-construction loans are residential in nature.

The Company had no concentration of loans to borrowers engaged in any single industry that exceeded 10% of total loans for any of the periods presented. Although the Company s loan portfolio is diversified, significant portions of its loans are collateralized by real estate. At June 30, 2002 and December 31, 2001, gross loans secured by real estate approximated $126,618,000 and $109,842,000. 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. Commitments to extend credit and standby letters of credit approximated $21,223,000 at mid-year 2002; because a substantial amount of these contracts expire without being drawn upon, total contractual amounts do not represent future credit exposure or liquidity requirements.

Nonperforming Assets

Nonperforming assets consist of nonaccrual loans, restructured loans, and foreclosed real estate balances. Overall, nonperforming assets approximated $1,942,000 at June 30, 2002, down $256,000 or 11.65% from year-end 2001 and more significantly, down 48.72% or $1,845,000 from June 30, 2001. As a percent of total assets, nonperforming assets totaled 0.53% at June 30, 2002 versus 0.62% at December 31, 2001 and 1.05% at June 30, 2001. The fluctuation in nonperforming asset balances at June 30, 2002 versus 2001 resulted predominantly from a single commercial real estate loan. Specifically, foreclosed real estate balances at mid-year 2001 included $1,975,000 pertaining to an impaired real estate loan. This loan, secured by a first lien on income-producing commercial real estate, was initially charged-off by $400,000 in December 2000 and prior to foreclosure in February 2001, an additional $300,000. Impairment of the loan was based on the fair value of the underlying collateral, less estimated selling expenses, as determined by a third party appraisal. This property was sold to a third party in August 2001. Pending furtherance of various legal proceedings, management is optimistic that various costs associated with the property may ultimately be recovered.

Included in nonaccrual balances is a single cred