putting the pieces together

2007 Annual Report

putting the pieces together

In 2005, Coastal Banking Company Inc. brought together two companies in a merger of equals and began the process of putting the pieces together to integrate the personnel, systems, processes and functions of the separate companies. After completing this vital integration work, 2007 has been a defining year for Coastal, as it has continued to assemble the specific strategic elements necessary to build itself into an income-generating financial services company. In combination, these pieces have positioned the company for higher income growth in 2008 and beyond.

About the Company

Coastal Banking Company Inc. is the $431.6 million-asset bank holding company of Lowcountry National Bank (LNB) in Beaufort, S.C., and First National Bank (FNB) of Nassau County in Fernandina Beach, Fla. LNB serves coastal South Carolina through full-service banking offices in Beaufort, Hilton Head and Port Royal, and a commercial loan production office in Charleston. FNB operates full-service branches in Fernandina Beach and Meigs, Ga., the latter under the name The Georgia Bank, as well as a wholesale lending division based in Atlanta and two commercial loan production offices in Jacksonville, Fla., and Savannah, Ga. The company's common stock is publicly traded on the OTC Bulletin Board under the symbol CBCO. For more information, please visit www.coastalbanking.com.

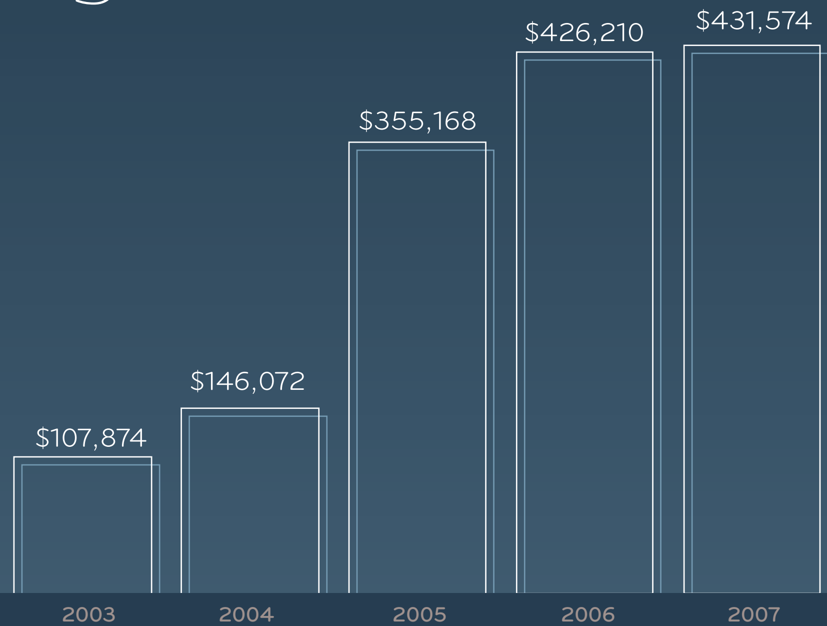
financial highlights 2

letter to shareholders 4

putting the pieces together 6

board of directors 16

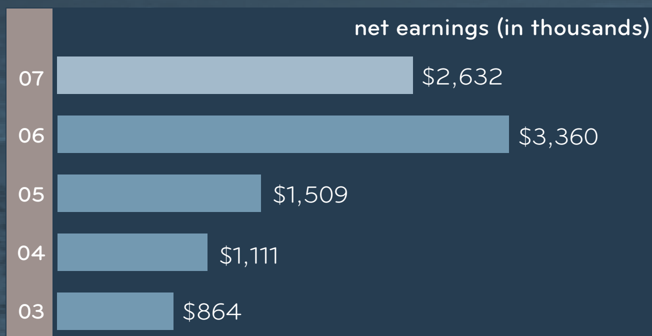
financial highlights

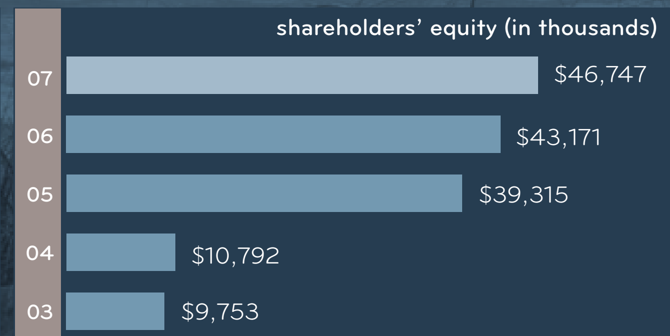


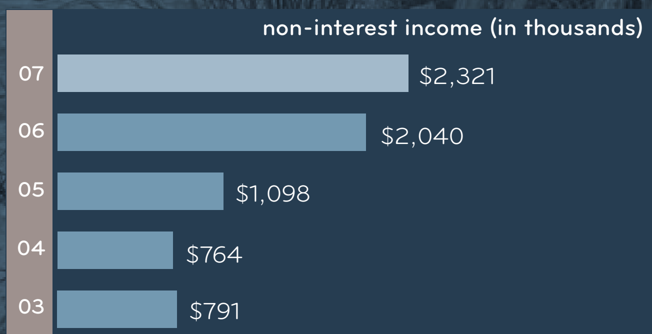
Growing Assets

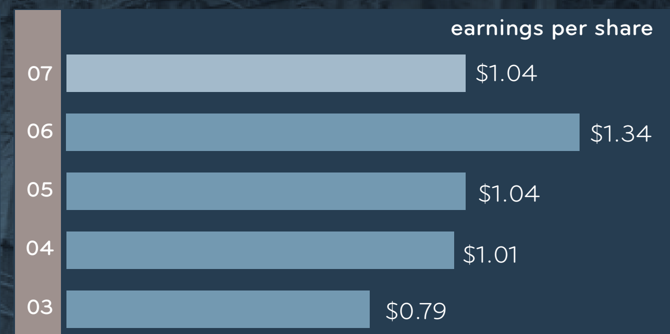
The opening of our new bank branch in Port Royal, S.C., and the addition of our wholesale lending unit contributed to Coastal's record assets.

assets (in thousands)









Focused on long-term growth

a challenging year

Coastal Banking Company performed admirably in one of the most difficult banking markets in memory. Despite the housing market slump, mortgage crisis and slowing economic activity in 2007, we maintained a solid level of credit quality and ample capital reserves, while generating a substantial increase in fee income.

Our credit quality remained favorable compared to our peers in 2007. We ended the year with net charge-offs as a percentage of total loans of 0.05 percent, allowance for loan losses of $3.7 million, or 1.30 percent of loans outstanding, and nonaccrual loans as a percentage of total loans of 0.72 percent.

The increase in noninterest income was driven by our wholesale mortgage division, which funded $53.8 million in loans available for sale during the last four months of 2007. The lending unit, which opened its doors in September 2007, began 2008 with a pipeline of loans in process of nearly $23.0 million. It originates predominantly full-documentation, conforming mortgage loans that are pre-sold into the secondary market.

These accomplishments are a direct result of our long-term strategy for growth, fiscal discipline and financial strength, all of which will bolster our company as we continue to weather the storms of 2008.

to our shareholders:

It was a momentous year for Coastal Banking Company, one in which we put together the vital pieces necessary to grow our franchise. These pieces are part of a strategic plan that positions our company to more assertively expand our presence in our high-growth coastal footprint, from South Carolina to Florida, as well as deliver income in a challenging industry environment.

In 2007, we opened a new full-service banking branch, created a wholesale mortgage division and strengthened our management team. As we look to 2008 and beyond, we will continue to add pieces that will enhance our ability to grow and deliver on our commitment to customers and shareholders.

2007 Financial Performance

Our financial results in 2007 reflect our choice to shoulder the short-term expenses of investments that promise long-term gain, as well as the effects from the downturn in the housing market and credit crunch that led to softening loan demand.

For the year, our financial performance included:

- Net income totaling $2.6 million;
- Earnings per share of $1.04 (diluted EPS of $0.97);
- Total assets of $431.6 million;
- Noninterest income of $2.3 million;
- Net charge-offs as a percentage of total loans of 0.05 percent, and allowance for loan losses of $3.7 million, or 1.30 percent of loans outstanding.

Despite the economic and market challenges, we ended the year with asset quality that compared favorably to our peers, lower net charge-offs and minimal loan concerns. As such, we are well-positioned to weather any storms the banking market may experience in 2008.

Market Expansion & Wholesale Mortgage Operations

One of the first pieces of our new growth strategy in 2007 was the expansion of our presence in the Beaufort, S.C., market, where we opened a full-service Lowcountry National Bank branch in Port Royal. The Beaufort market has a projected population growth rate of more than 15 percent between 2006 and 2011, and our new banking office will allow us to take advantage of this growth.

Another important piece we added is the wholesale mortgage division, formed in September. Based in Atlanta as a unit of First National Bank, the office serves the Atlanta and Charlotte markets (both ranked in the top 5 nationally in residential price gains).

Randolph C. Kohn, President
Suellen Rodeffer Garner, Chairman of the Board
Michael G. Sanchez, Chief Executive Officer

We are well-positioned to weather any storms the banking market may experience in 2008.

Our plans are to expand service to North Florida and, later, to other markets both in and adjacent to our 3-state footprint.

While it may seem counter-intuitive that a bank would choose to enter the mortgage business at a time when housing sales are stagnating and loan defaults are rising, rest assured that we carefully deliberated before making this decision. We found ourselves in the unique position of being able to enter the wholesale market with little risk exposure and at a relatively modest cost.

First, we started from a position of strength in terms of our credit quality and clean balance sheet. Next, we implemented a conservative, risk-averse approach through which we are originating primarily full-documentation, conforming mortgage loans that carry none of the hazards of subprime loans. Also, we are preselling the loans into the secondary market to eliminate nearly all interest-rate risk.

Finally, we named two industry veterans, Charles Wagner and Steve Ralys, to lead the wholesale mortgage division. Both have extensive experience and valuable broker relationships, especially in the Atlanta and Charlotte markets, and they are well-suited to grow the business in the rest of our footprint and beyond.

As a result, we now have a fairly reliable, low-risk and low-cost source of noninterest income that will help fund the growth of our operations.

Management Strength

Perhaps the keystone piece to our growth strategy was the strengthening of our management team in 2007. In addition to bringing aboard Charles and Steve, Paul Garrigues joined us as Chief Financial Officer of the holding company and the banking subsidiaries. Paul has 30 years of financial, accounting and banking experience at companies large and small, and he has particular knowledge of the fiscal and regulatory requirements for growing a banking franchise.

Also, our Board of Directors named Mike Sanchez as Chief Executive Officer and Randy Kohn as President of the holding company, to better take advantage of each executive's management strengths. This was an evolutionary step in the process that began with our merger of equals two years ago, and it best positions us to continue on our new growth path.

Shaping Our Future

With these important pieces in place, we have formed the core of what will be the company's revenue engine for the next several years. Just as important, the costs of these investments are largely behind us. Our Port Royal bank branch and wholesale mortgage operations should generate income and contribute positively to earnings in 2008.

Also, we opened an SBA lending office in Charleston, S.C., in early 2008, and we have plans for a new full-service bank branch in Savannah, where we currently have a loan production office. Savannah is a dynamic banking market located just south of our operations in Beaufort, and has a projected population growth rate of 13% from 2000-2010.

We will look for other opportunities to bring our relationship-based community banking approach to markets along the coasts of South Carolina, Georgia and Florida. The structure of our bank charters gives us the flexibility to expand through acquisition, de novo branching and loan production offices – in short, by whatever means is most favorable in any given market.

While much of our focus is on growth, our most important near-term priorities are stringent adherence to our sound credit management policies, controlling any past-due loans, quickly resolving credit issues and remaining adequately capitalized so that we preserve our favorable credit quality.

Our confidence and optimism about the future stem from our belief that we have assembled the right combination of sound credit culture and essential growth pieces necessary for lasting success as a company and as an investment.

As always, we are grateful for your continued support.

Sincerely,

Michael G. Sanchez, Chief Executive Officer
Randolph C. Kohn, President
Suellen Rodeffer Garner, Chairman of the Board

Growing Our Franchise

Coastal Banking's future is a picture of planned growth, composed of several important pieces that we put into place in 2007.

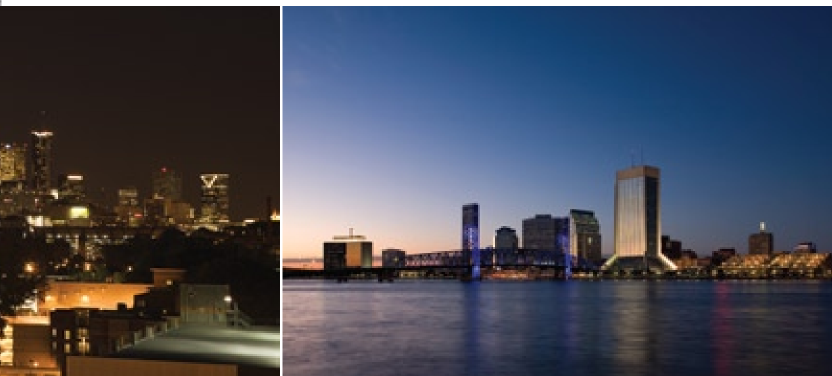
Together, the interconnecting pieces form a strategy to grow our franchise – based on sound management decisions, expansion in key markets along our coastal footprint, and the creation of a vital stream of fee income to help fund our growth initiatives.

statement of strategy

Corner Pieces

The corner pieces of our strategy – a seasoned management team with a talent for strategic decision-making – anchor this picture. As you will read in the following pages, we took deliberate steps in 2007 to strengthen our management team, adding expertise and aligning our talent to refine and best execute our plan to grow more assertively in the coming years.

With these pieces in place, we have an experienced group of banking executives leading the charge, supported at the local market level by talented bankers who are well-known and respected in their communities.



Atlanta & Jacksonville skylines

Our management has the wisdom and vision to guide the company through any short-term industry difficulties to a successful future, as illustrated in our disciplined adherence to conservative underwriting practices and sensible lending limits; in forgoing the seemingly easy path to profitability in the guise of subprime loans and large, speculative loan participations; and in the continuous review of our loan portfolio and market conditions to ensure that we limit our risk exposure and maintain an appropriate level of capital reserves.

Core Approach

At the core of the Coastal growth picture is our strategy to expand our retail market presence. When we combined Lowcountry National Bank and First National Bank to form Coastal Banking Company Inc., creating the poles of our company in Beaufort, S.C., and Fernandina Beach, Fla., the coastal markets in between became our logical targets.

And not just because they would nicely fill in the geographic space between our two banks. More importantly, and strategically, the coastal communities from South Carolina to Florida are vibrant, thriving markets. They represent exactly the combination of economic diversity and strength – with stable permanent residency bases, growing retirement and second-home markets, flourishing tourism and other industry – that both our home markets feature.

Moreover, meeting the unique full-service banking needs of coastal communities is what we do best. With our bank charters, we can expand either through acquisition, creating loan production offices or by establishing de novo full-service branches in any market along the South Carolina, Georgia and Florida coastline.

Support and Strength

Given the clear signs pointing to a slow-growth economy in the near term, we knew we needed to add pieces that would reinforce and strengthen this picture. To do just that, we formed a new wholesale mortgage division in September 2007. Based in Atlanta, this unit provides a source of fee income that is helping fuel our operations and growth initiatives while we manage through tough economic conditions.

We have also used the strategic equivalent of wading into new markets through the formation of loan production offices, which allow us to get established in the community, begin building customer relationships, and pave the way for full-service branches in the future.

Not only do these types of operations help bind together the pieces of our larger picture, they also offer another way we can deepen and strengthen our customer relationships, especially as we extend service to markets throughout our banking footprint.

"...Beaufort is a fully realized and eclectic small town."

– *The New York Times*, Dec. 21, 2007

Located in southeast South Carolina, 70 miles south of Charleston and 40 miles north of Savannah, Beaufort is known as the "Queen of the Carolina Sea Islands" for the alluring beauty of its waterfront, its picturesque village and historic antebellum homes.

A growing second-home and retiree destination, Beaufort experienced a nearly 30 percent gain in population during the 1990s, and its projected population growth rate between 2006 and 2011 is more than 15 percent.

With the charming fishing village of Port Royal nearby, the area also draws many boating and other outdoor enthusiasts. In fact, *Field and Stream* magazine recently named Beaufort as a top 20 fishing destination in the U.S., based on the quality of fishing, the city's attractions and affordability.

This combination of scenic splendor and sporting amenities led *The New York Times* to say, "Today, despite and perhaps because of its growing pains, Beaufort is a fully realized and eclectic small town."

Vibrant Coastal Markets

Leading up to 2007, we laid the groundwork to begin our retail expansion. We added loan production offices in Savannah and Jacksonville, Fla., and we acquired the Meigs, Ga., operations of Cairo Banking Company, establishing full-service banking operations as The Georgia Bank in October 2006.

retail & lending expansion

The Georgia Bank, a unit of First National Bank of Nassau County, provides the underlying state bank charter that will allow our company to build de-novo branches in any Georgia coastal community. 2007 represented the first full year of operations for The Georgia Bank.

Another significant piece of our retail expansion strategy was put in place in the first quarter of 2007 in Port Royal, S.C., where we opened our second de novo branch of Lowcountry National Bank. The new Port Royal branch filled our need for an expanded retail presence in the burgeoning Beaufort market, projected to grow more than 15 percent in population from 2006 to 2011.

Debbie Myers manages the Port Royal Branch of Lowcountry National Bank

Port Royal itself is experiencing significant growth, including the revitalization of the town's traditional mixed-use core, the renovation of historic homes, and residential infill in and around downtown. The town also is home to two military installations: Naval Hospital, Beaufort, and the Marine Corps Recruit Depot at Parris Island.

While retail expansion is a primary element of our growth strategy, the pieces can't be put into place without adequate funding. To bolster our income and increase our capital for growth, we also added lending capacity in 2007. And, while the coastal region is our bread and butter for retail growth, we looked to the centerpiece of growth in the Southeast – Atlanta – to locate the new lending unit we added this year.

In September, we took advantage of a strategic opportunity in the mortgage market to add a new wholesale mortgage division to the company. At the height of the sub-prime mortgage crisis and housing downturn, this seemingly odd time to enter this business was actually a fortuitous opportunity for us. Because many mortgage lenders were exiting the business, we were able to add a seasoned staff and management team with extensive industry contacts and relationships. (You can read more about our new wholesale management team elsewhere in this section.)

We entered the business with nominal incremental operational costs and free of the risk exposure currently troubling the industry. Unlike so many other banks, we had no sub-prime or off-balance sheet exposure whatsoever. Originating predominantly full-documentation, conforming mortgage loans, which are pre-sold into the secondary market, our new wholesale mortgage division produces a nearly risk-free source of noninterest income. The fee income will help fund the company's organic growth during a likely period of slowing growth rates for banks.

Looking ahead to 2008, we plan to add another significant piece to the retail franchise by building our first de novo branch in Georgia, in the Savannah market. Slated for the fourth quarter, the full-service branch will allow us to take advantage of the tremendous growth opportunities in another extremely strong and diverse coastal market. Savannah's port is the nation's fastest growing, its tourism industry is robust and, like our Beaufort market, it is home to major military installations.

atlanta

"Metro Atlanta led the nation in total housing permits each year from 1991 through 2006."

Metro Atlanta is well known for its dynamic growth. The Atlanta Metropolitan Statistical Area (MSA) now boasts more than 5 million residents, and its population growth rate of 20 percent from 2000 to 2006 is the largest increase in the country.

Atlanta has generated significant business and job growth as well. The MSA gained more than 60,000 jobs in 2006, and economists forecast that it will create 1.8 million new jobs by 2025.

This influx of people, business and jobs has led to robust banking and real estate markets. Atlanta's total bank deposits in 2006 reached $117 billion, nearly double the $60 billion on deposit in 2000.

And though Atlanta has not been immune to the recent downturn in the housing market, the MSA led the nation in total housing permits each year from 1991 through 2006, including nearly 70,000 new housing starts in 2006 alone.

savannah

"The Port of Savannah is the fastest growing port in the country."

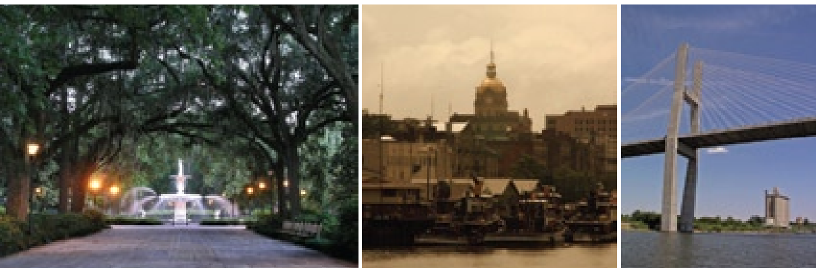
Savannah is a city steeped in history and Southern folklore. It is the home of the country's largest National Historic Landmark District, brimming with famous squares, fountains and historic homes surrounded by oak trees draped in Spanish moss. Indeed, it is listed as one of the country's top 10 cities for walking tours.

Savannah also is home to the fastest growing port in the country and the fourth busiest in the nation as ranked by containers handled and total tonnage. In fact, the number of containers handled at the Port of Savannah has increased by 235 percent in the last 10 years.

The city's diverse economy is also driven by substantial manufacturing and healthcare sectors, in addition to the Hunter Army Airfield and Fort Stewart military bases that, combined, employ more than 42,000 people and generate an annual direct federal expenditure of $1.4 billion.

When we decided to take a more assertive approach toward growing our company, one of the first steps we took was to strengthen our management teams at the executive and business line levels.

executive management changes



Savannah is a city steeped in history and Southern folklore.

On the executive front, we realigned our management structure in August to take advantage of our key executives' primary talents. Mike Sanchez's 30-plus years of experience leading growth initiatives at community and regional banks in Georgia, South Carolina and Florida made him the ideal choice for the role of Chief Executive Officer.

Similarly, Randy Kohn's management and personnel skills were critical to the success of the integration of Lowcountry National Bank and First National Bank of Nassau County, and his abilities as President will be just as vital as the company looks to continue adding new operations to its ranks.

Knowing that appreciable growth brings with it added regulatory requirements and financial complexity, we set out to find a veteran executive with extensive experience in these areas to serve as our new Chief Financial Officer. We were successful in bringing Paul Garrigues on board as CFO in September. Paul is a 30-year veteran who came to us from one of the largest publicly traded community banks in Florida.

Just as important as ensuring that our executive management is as deep and talented as possible, we sought to bolster the strength of our business-unit management in 2007 as well. The goal for our wholesale mortgage division was to find experienced professionals who could grow the business while adhering to our strict guidelines for credit quality.

We tapped Charles Wagner and Steve Ralys, senior vice presidents of First National Bank of Nassau County, to lead the new wholesale mortgage unit, which we launched in September. Both are mortgage industry veterans who have a great deal of expertise and valuable broker relationships. Charles and Steve have worked extensively in Atlanta and Charlotte – the two markets where we initially are focusing our wholesale lending efforts. Later, they will oversee the division's expansion in other areas across our footprint.

Knowledge and experience also were key factors in our search for management of our Lowcountry National Bank branch in Port Royal, S.C., which opened in early 2007. We were able to attract several veteran bankers of larger regional banks who were interested in working in a true community-oriented environment focused on serving customers. Leading the Port Royal team is Debbie Myers, the branch manager.

Paul Garrigues—Chief Financial Officer

Steve Ralys and Charles Wagner lead the wholesale mortgage unit.

Coastal Banking Company, Inc.

directors

Ron Anderson
Managing General Partner, Marel Enterprises

Christina H. Bryan
Co-Owner of various businesses

Suellen Rodeffer Garner, Chairman
Orthodontist; Co-Owner Suellen Rodeffer and David Garner D.D.S., P.A.

Dennis O. Green, CPA
Managing Member, Celadon, LLC

James W. Holden, Jr., DVM, Secretary
Owner, Director of Holly Hall Animal Hospital

Ladson F. Howell, Vice Chairman
Retired Attorney, Howell, Gibson & Hughes, P.A.

James C. Key
Partner, Shenandoah Group, LLP

Randolph C. Kohn
President of Coastal Banking Company, Inc., and President & CEO of Lowcountry National Bank

Robert B. Pinkerton
President & CEO, Athena Corporation

Michael G. Sanchez
CEO of Coastal Banking Company, Inc., and President & CEO of First National Bank of Nassau County

Edward E. Wilson
Licensed Insurance Agent

Marshall E. Wood, P.A.
Attorney

committees

Audit and Compliance

Dennis O. Green, CPA, Chairman
Christina H. Bryan
James C. Key
Robert B. Pinkerton
Marshall E. Wood, P.A.

Corporate Governance and Nominating

James C. Key, Chairman
Ron Anderson
Suellen Rodeffer Garner
Dennis O. Green, CPA
James W. Holden, Jr., DVM
Ladson F. Howell
Edward E. Wilson

Executive Compensation and Management Resources

Edward E. Wilson, Chairman
Ron Anderson
Christina H. Bryan
Suellen Rodeffer Garner
James W. Holden, Jr., DVM
Robert B. Pinkerton

Selected Financial Data, Management's Discussion and Analysis, and Audited Financial Statements for the Year Ended December 31, 2007

COASTAL BANKING COMPANY, INC.

SELECTED FINANCIAL DATA

	2007	2006	2005	2004	2003
FOR THE YEAR *					
Net interest income	$ 12,182,599	$ 12,588,634	$ 6,777,223	$ 4,474,894	$ 3,328,024
Provision for loan losses	310,500	726,700	380,000	463,200	253,500
Non-interest income	2,321,013	2,039,795	1,097,561	764,426	790,667
Non-interest expense	10,455,841	8,895,160	5,189,353	3,269,332	2,541,808
Income taxes	1,105,445	1,647,032	796,060	396,186	458,933
Net earnings	$ 2,631,826	$ 3,359,537	$ 1,509,370	$ 1,110,602	$ 864,450
PER COMMON SHARE					
Basic earnings	$ 1.04	$ 1.34	$ 1.04	$ 1.01	$ 0.79
Diluted earnings	0.97	1.24	0.92	0.94	0.78
Book value-tangible	$ 13.96	$ 12.77	$ 11.45	$ 9.69	$ 8.89
AT YEAR END					
Loans, net	$ 277,637,628	$ 288,345,306	$ 239,505,778	$ 100,397,246	$ 67,488,128
Earning assets	399,473,096	391,362,794	309,765,812	137,904,751	104,034,196
Goodwill and other intangibles	10,871,058	10,955,680	10,855,970	—	—
Assets	431,574,410	426,210,069	355,168,137	146,071,670	107,874,055
Deposits	345,847,116	340,058,621	286,395,980	129,431,713	96,435,587
Shareholders' equity	$ 46,746,752	$ 43,171,486	$ 39,315,168	$ 10,792,050	$ 9,753,467
Common shares outstanding	2,570,560	2,522,723	2,487,726	1,113,942	1,097,754
AVERAGE BALANCES *					
Loans	$ 282,182,122	$ 273,022,109	$ 141,988,973	$ 86,580,511	$ 60,860,974
Assets	424,861,819	392,112,100	203,287,131	128,884,584	91,417,046
Deposits	343,699,455	314,836,821	170,982,888	116,757,374	81,427,295
Shareholders' equity	$ 44,959,118	$ 40,362,959	$ 17,245,815	$ 10,239,847	$ 9,375,405
Weighted average shares outstanding	2,540,401	2,496,839	1,460,288	1,106,836	1,097,754
KEY PERFORMANCE RATIOS					
Return on average assets	0.64 %	0.88 %	0.75 %	0.86 %	0.95 %
Return on average shareholders' equity-tangible	7.72 %	11.51 %	8.75 %	10.85 %	9.22 %
Net interest margin	3.19 %	3.54 %	3.66 %	3.65 %	3.79 %
Average tangible equity to average tangible assets	8.24 %	7.22 %	8.61 %	7.94 %	10.26 %
Non performing loans to total loans	0.72 %	0.03 %	0.05 %	0.31 %	0.55 %
Net charge-offs to average total loans	0.05 %	0.05 %	0.03 %	0.22 %	0.02 %

* Earnings and Balance sheet data from the merger with First Capital Bank Holding Corporation are included in totals beginning 4th quarter, 2005.

Management's Discussion and Analysis of Plan of Operation

General

Coastal Banking Company, Inc. (in this Item 6, the "Company") is a bank holding company headquartered in Beaufort, South Carolina organized to own all of the common stock of its subsidiaries, Lowcountry National Bank (in this Item 6, "Lowcountry") and First National Bank of Nassau County, Florida (in this Item 6, "First National"). The principal activity of the Banks is to provide banking services for their domestic markets. Lowcountry's primary market is Beaufort County, South Carolina. First National's primary market is Nassau County, Florida. The Banks are primarily regulated by the Office of the Comptroller of the Currency ("OCC") and undergo periodic examinations by this regulatory agency. The holding company is regulated by the Federal Reserve Board of Governors and also is subject to periodic examinations. Lowcountry opened for business on May 10, 2000 at 36 Sea Island Parkway, Beaufort, South Carolina 29907. First National opened for business July 26, 1999 and was acquired by Coastal through the merger with its holding company, First Capital Bank Holding Corporation ("First Capital") on October 1, 2005. On October 27, 2006 Coastal acquired our Meigs, Georgia office through the merger of Cairo Banking Company, a Georgia state bank with and into First National. The Company also has an investment in Coastal Banking Company Statutory Trust I ("Trust I") and Coastal Banking Company Trust II ("Trust II"). Both trusts are special purpose subsidiaries organized for the sole purpose of issuing trust preferred securities.

In the merger with First Capital, each outstanding share of First Capital common stock was converted into 1.054 shares of Coastal stock at the time of the merger. Each outstanding share of Coastal common stock prior to the merger remained outstanding as a share of common stock after the merger.

The following discussion describes our results of operations for 2007 as compared to 2006 and also analyzes our financial condition as of December 31, 2007 as compared to December 31, 2006. Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

We have included a number of tables to assist in our description of these measures. For example, the "Average Balances" table shows the average balance during 2007 and 2006 of each category of our assets and liabilities, as well as the yield we earned or the rate we paid with respect to each category. A review of this table shows that our loans typically provide higher interest yields than do other types of interest earning assets, which is why we intend to continue to direct a substantial percentage of our earning assets into our loan portfolio. Similarly, the "Rate/Volume Analysis" table helps demonstrate the impact of changing interest rates and changing volume of assets and liabilities during the years shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included a "Sensitivity Analysis Table" to help explain this. Finally, we have included a number of tables that provide detail about our investment securities, our loans, and our deposits.

Of course, there are risks inherent in all loans, so we maintain an allowance for loan losses to absorb possible losses on existing loans that may become uncollectible. We establish and maintain this allowance by charging a provision for loan losses against our operating earnings. In the following section we have included a detailed discussion of this process, as well as several tables describing our allowance for loan losses. See comments in the section entitled "Provision and Allowance for Loan Losses."

In addition to earning interest on our loans and investments, we earn income through fees, cash surrender value of life insurance and other service charges to our customers. We describe the various components of this non-interest income, as well as our non-interest expense, in the following discussion.

The following discussion and analysis also identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with the financial statements and the related notes and the other statistical information also included in this report.

Forward-Looking Statements

This report contains "forward-looking statements" relating to, without limitation, future economic performance, plans and objectives of management for future operations, and projections of revenues and other financial items that are based on the beliefs of management, as well as assumptions made by and information currently available to management. The words "may," "will," "anticipate," "should," "would," "believe," "contemplate," "expect," "estimate," "continue," "may," and "intend," as well as other similar words and expressions of the future, are intended to identify forward-looking statements. Potential risks and uncertainties include, but are not limited to those described under the heading "Risk Factors" in our Form 10-K for the year ended December 31, 2007.

Critical Accounting Policies

We have adopted various accounting policies, which govern the application of accounting principles generally accepted in the United States of America in the preparation of our financial statements. Our significant accounting policies are described in Note 1 in the footnotes to the consolidated financial statements at December 31, 2007 included elsewhere in this annual report.

We believe that the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of our consolidated financial statements. Please refer to the portion of management's discussion and analysis of financial condition and results of operations that addresses the allowance for loan losses for a description of our processes and methodology for determining the allowance for loan losses.

Intangible assets, included in Other Assets on the Consolidated Balance Sheets, include goodwill and other identifiable assets, such as core deposits, resulting from acquisitions. Goodwill, in this context, is the excess of the purchase price in an acquisition transaction over the fair market value of the net assets acquired. Core deposit intangibles are amortized on a straight-line basis over such assets' estimated expected life. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill is not amortized but is tested annually for impairment or at any time an event occurs, or circumstances change, that may trigger a decline in the value of the reporting unit. Such impairment testing calculations include estimates. Furthermore, the determination of which intangible assets have finite lives is subjective as is the determination of the amortization period for such intangible assets. The Company tests for goodwill impairment by determining the fair market value for each reporting unit and comparing the fair market value to the carrying amount of the applicable reporting unit. If the carrying amount exceeds fair market value the potential for the impairment exists, and a second step of impairment testing is performed. In the second step, the fair market value of the reporting units' goodwill is determined by allocating the reporting unit's fair market value to all of its assets (recognized and unrecognized) and liabilities as if the reporting unit had been acquired in a business combination at the date of the impairment test. If the implied fair market value of reporting unit goodwill is less than its carrying amount, goodwill is impaired and is written-down to its fair market value. The loss recognized is limited to the carrying amount of goodwill. Once an impairment loss is recognized, future increases in fair market value will not result in the reversal of previously recognized losses. The Company performed its annual test of impairment in the fourth quarter and determined that there was no impairment in the carrying value of goodwill as of October 1, 2007.

Results of Operations

Overview

Net income for 2007 was $2,632,000 or $1.04 per basic common share compared to $3,360,000 or $1.34 per basic common share, in 2006. In total, our operational results depend to a large degree on net interest income, which is the difference between the interest income received from our investments, such as loans, investment securities, and federal funds sold, and interest expense, paid on deposit liabilities and other borrowings. Net interest income was $12,183,000 for the year ended December 31, 2007 compared to net interest income of $12,589,000 for the year ended December 31, 2006.

The provision for loan losses in 2007 was $310,500 compared to $726,700 in 2006. The decrease in the provision for loan losses was attributable to management's assessment of credit quality, stabilized loan growth, and other economic factors. The provision for loan losses continues to reflect our estimate of potential losses inherent in the loan portfolio and the creation of an allowance for loan losses adequate to absorb such losses.

Noninterest income for the year ended December 31, 2007 totaled $2,321,000, representing a $281,000 increase from December 31, 2006. This increase was associated with an increase in mortgage loan fees and gain on sale of loans of $246,000, a gain on sale of securities of $121,000, and an increase in service charges on deposits and other service charges, commissions and fees of $162,000, offset by a gain on sale of real estate in 2006 of $321,000. Non-interest expenses in 2007 were $10,456,000; a $1,561,000 increase compared to the 2006 amounts, primarily due to the costs associated with the opening of locations in Port Royal, South Carolina and Atlanta, Georgia. The Company's efficiency ratio, which is a measure of total non-interest expenses as a percentage of net interest income and non-interest income, increased to 72.88% in 2007 from 62.55% in 2006 due in large part to the previously described increase in noninterest expenses.

In 2007, we recognized $1,105,000 of income tax expense compared to an income tax expense of $1,647,000 in 2006. Our effective tax rate was 29.6% in 2007 and 32.9% in 2006. This decrease is due to nontaxable income on municipal securities increasing slightly during 2007 compared to 2006, while total net income decreased during 2007 compared to 2006.

Net Interest Income

For the year ended December 31, 2007, net interest income totaled $12,183,000, as compared to $12,589,000 for the same period in 2006. Interest income from loans, including fees, increased $1,213,000 to $23,160,000 for the year ended December 31, 2007. The average balance of loans was $282,182,000 in 2007 compared to $273,022,000 in 2006. The weighted average rate earned on loans was 8.21% for 2007 compared to 8.04% in 2006. Interest income from securities increased $1,246,000 on a tax equivalent basis. The average balance of investments was $95,715,000 in 2007 compared to $75,310,000 in 2006. The weighted average rate earned on investments was 5.16% for 2007 compared to 4.90% in 2006. This increase in income was offset by increased interest expense, which totaled $16,293,000 for the year ended December 31, 2007, compared to $13,461,000 in 2006. The net interest margin realized on earning assets and the interest rate spread were 3.19% and 2.75%, respectively, for the year ended December 31, 2007. For the year ended December 31, 2006, the net interest margin was 3.54% and the interest rate spread was 3.10%. Yields on interest earning assets increased during the year by nine basis points compared to an increase in rates on interest bearing liabilities of 44 basis points during the year.

Average Balances and Interest Rates

The table below shows the average balance outstanding for each category of interest-earning assets and interest-bearing liabilities for 2007 and 2006, and the average rate of interest earned or paid thereon. Average balances have been derived from the daily balances throughout the period indicated.

	For the Years Ended December 31,					
	2007			2006		
(In Thousands)	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Assets:						
Interest-earning assets:						
Loans (including loan fees)	$ 282,182	$ 23,160	8.21 %	$ 273,022	$ 21,947	8.04 %
Taxable investments	79,476	4,022	5.06 %	65,924	3,054	4.63 %
Tax-free investments	16,239	914	5.63 %	9,386	636	6.78 %
Interest-bearing deposits in other banks	1,667	89	5.34 %	1,755	92	5.24 %
Federal funds sold	11,716	602	5.14 %	11,333	537	4.74 %
Total interest-earning assets	391,283	28,786	7.36 %	361,420	26,266	7.27 %
Other non-interest earning assets	33,579			30,692		
Total assets	$ 424,862			$ 392,112		
Liabilities and shareholders' equity:						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand and savings	$ 123,922	4,467	3.44 %	$ 122,167	4,204	3.44 %
Time	194,987	10,012	5.13 %	167,451	7,641	4.56 %
Other	34,832	1,814	5.21 %	33,217	1,616	4.86 %
Total interest-bearing liabilities	353,741	16,293	4.61 %	322,835	13,461	4.17 %
Other non-interest bearing liabilities	26,162			28,914		
Shareholders' equity	44,959			40,363		
Total liabilities and shareholders' equity	$ 424,862			$ 392,112		
Excess of interest-earning assets over interest bearing liabilities	$ 37,542			$ 38,585		
Ratio of interest-earning assets to interest-bearing liabilities	111 %			112 %		
Tax equivalent adjustment		(311)			(216)	
Net interest income		$ 12,183			$ 12,589	
Net interest spread			2.75 %			3.10 %
Net interest margin			3.19 %			3.54 %

Non-accrual loans and the interest income which was recorded on these loans, if any, are included in the yield calculation for loans in all periods reported.

Amounts are presented on a tax equivalent basis.

Volume/Rate Analysis

Net interest income can also be analyzed in terms of the impact of changing rates and changing volume. The following table describes the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. The effect of a change in average balance has been determined by applying the average rate in the earlier year to the change in average balance in the later year, as compared with the earlier year. The effect of a change in the average rate has been determined by applying the average balance in the earlier year to the change in the average rate in the later year, as compared with the earlier year.

	2007 Compared to 2006 Increase (decrease) due to changes in		
(In Thousands)	**Volume**	**Rate**	**Net Change**
Interest income on:			
Loans (including loan fees)	$ 764	$ 191	$ 955
Taxable investments	668	300	968
Non-taxable investments	401	(123)	278
Interest bearing deposits in other banks	(5)	2	(3)
Federal funds sold	19	45	64
Total interest income (tax equivalent basis)	1,847	415	2,262
Interest expense on:			
Interest-bearing demand and savings	61	202	263
Time	1,346	1,025	2,371
Other	81	117	198
Total interest expense	1,488	1,344	2,832
Net interest income (tax equivalent basis)	$ 359	$ (929)	$ (570)

Interest Rate Sensitivity and Asset Liability Management

Interest rate sensitivity measures the timing and magnitude of the repricing of assets compared with the repricing of liabilities and is an important part of asset liability management of a financial institution. The objective of interest rate sensitivity management is to generate stable growth in net interest income, and to control the risks associated with interest rate movements. Management constantly reviews interest rate risk exposure and the expected interest rate environment so that adjustments in interest rate sensitivity can be timely made. Since the assets and liabilities of a bank are primarily monetary in nature (payable in fixed, determinable amounts), the performance of a bank is affected more by changes in interest rates than by inflation. Interest rates generally increase as the rate of inflation increases, but the magnitude of the change in rates may not be the same.

Net interest income is the primary component of net income for financial institutions. The timing and magnitude of repricing as well as the mix of interest sensitive and non-interest sensitive assets and liabilities affect net interest income. “Gap” is a static measurement of the difference between the contractual maturities or repricing dates of interest sensitive assets and interest sensitive liabilities within the following twelve months. Gap is an attempt to predict the behavior of our net interest income in general terms during periods of movement in interest rates. In general, if we are asset sensitive, more of our interest sensitive assets are expected to reprice within twelve months than our interest sensitive liabilities over the same period. In a rising interest rate environment, assets repricing more quickly are expected to enhance net interest income. Alternatively, decreasing interest rates would be expected to have the opposite effect on net interest income since assets would theoretically be repricing at lower interest rates more quickly than interest sensitive liabilities. Although it can be used as a general predictor, gap as a predictor of movements in net interest income has limitations due to the static nature of its definition and due to its inherent assumption that all assets will reprice immediately and fully at the contractually designated time. At December 31, 2007, the Company, as measured by gap, is asset sensitive at three months or less and liability sensitive cumulatively at one year. Management has several tools available to it to evaluate and affect interest rate risk, including deposit pricing policies and changes in the mix of various types of assets and liabilities.

The following table summarizes the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2007, that are expected to mature, prepay, or reprice in each of the future time periods shown. Except as stated below, the amount of assets or liabilities that mature or reprice during a particular period was determined in accordance with the contractual terms of the asset or liability. Adjustable rate loans are included in the period in which interest rates are next scheduled to adjust rather than in the period in which they are due, and fixed-rate loans and mortgage-backed securities are included in the periods in which they are anticipated to be repaid based on scheduled maturities. The Banks' savings accounts and interest-bearing demand accounts (NOW and money market deposit accounts) that are not contractually tied to an adjusting index are grouped into categories based on the company's historical repricing practices. Money market accounts which are contractually tied to repricing indexes reprice monthly and are grouped in the three month or less category. Many of these money market accounts are tied to a Treasury index.

At December 31, 2007
Maturing or Repricing in

(In Thousands)	3 Months or Less	4 Months to 12 Months	1 to 5 Years	Over 5 Years	Total
Interest-earning assets:					
Federal funds sold	$ 4,710	$ —	$ —	$ —	$ 4,710
Deposits in other banks	1,564	500	—	—	2,064
Investment securities	997	2,995	8,677	78,185	90,854
Loans held for sale	20,553	—	—	—	20,553
Loans	134,478	28,089	75,345	43,379	281,291
Total interest-earning assets	162,302	31,584	84,022	121,564	399,472
Interest-bearing liabilities:					
Deposits:					
Savings and demand	105,626	—	—	—	105,626
Time deposits	14,072	171,080	29,921	—	215,073
Securities sold under agreements to repurchase	2,000	—	—	—	2,000
FHLB advances	4,300	1,500	20,973	—	26,773
Junior subordinated debentures	3,093	—	4,124	—	7,217
Total interest-bearing liabilities	129,091	172,580	55,018	—	356,689
Interest sensitive difference per period	$ 33,211	$ (140,996)	$ 29,004	$ 121,564	$ 42,783
Cumulative interest sensitivity difference	$ 33,211	$ (107,785)	$ (78,781)	$ 42,783	
Cumulative difference to total interest-earning assets	8.3 %	(27.0)%	(19.7)%	10.7 %	

At December 31, 2007, the Company had $33,211,000 more assets than liabilities repricing or maturing within three months, which indicates that the Company is asset sensitive over this time horizon. When extended out to one year, the Company had $107,785,000 more liabilities than assets repricing or maturing, indicating the Company is liability sensitive over a one-year time period

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may reflect changes in market interest rates differently. Additionally, certain assets, such as adjustable-rate mortgages, have features that restrict changes in interest rates, both on a short-term basis and over the life of the asset. Other factors which may affect the assumptions made in the table, include options to call a security or borrowing, pre-payment rates, early withdrawal levels, and the ability of borrowers to service their debt. Management uses modeling techniques which attempt to quantify the impacts of interest rates on margin changes. These modeling techniques reflect the effects of these cited shortcomings including the effects of maturity changes that occur as a result of changes in interest rates. These modeling tools indicate that net interest margin would be slightly negatively impacted at twelve months given a 1% decrease in interest rates.

Mortgage Banking Activities

In the third quarter of 2007, First National Bank of Nassau County opened a wholesale residential mortgage lending division headquartered in Atlanta, Georgia to complement the existing retail residential mortgage lending activity conducted through other branch locations. This division originates and funds residential mortgage loans submitted by mortgage brokers and then sells these mortgage loans in the secondary market. This new lending channel subjects us to various risks, including credit, liquidity and interest rate risks. We reduce unwanted credit and liquidity risks by selling virtually all of the mortgage loans originated through this division. From time to time, we may decide to hold loans originated through this division as additions to our residential real estate loan portfolio. We determine whether the loans will be held in our portfolio or sold in the secondary market at the time of origination. We may subsequently change our intent to hold loans in portfolio and subsequently sell some or all of these wholesale loans from our portfolio as part of our corporate asset/liability management strategy.

While credit and liquidity risks have historically been relatively low for mortgage banking activities, interest rate risk can be substantial. Changes in interest rates will impact the value of mortgages held for sale (MHFS) which are carried at the lower of cost or market value (LOCOM), as well as the associated income and loss reflected in mortgage banking noninterest income, the income and expense associated with instruments (economic hedges) used to hedge changes in the LOCOM value of MHFS, and the value of derivative loan commitments extended to mortgage applicants.

Interest rates impact the amount and timing of loan origination activity because consumer demand for new mortgages and the level of refinancing activity are sensitive to changes in mortgage interest rates. Typically, a decline in mortgage interest rates will lead to an increase in mortgage origination activity. Given the time it takes for consumer behavior to fully react to interest rate changes, as well as the time required for processing a new application, providing the commitment, and selling the loan, interest rate changes will impact loan origination activity with a lag. The amount and timing of the impact on loan origination activity will depend on the magnitude, speed and duration of the change in interest rates.

As part of our mortgage banking activities, we enter into commitments to fund residential mortgage loans at specified times in the future. A mortgage loan commitment is an interest rate lock that binds us to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock, subject to the loan applicant satisfying the underwriting conditions required for approval of their loan application. These loan commitments are derivative loan commitments if the loans that will result from the exercise of the commitments will be held for sale. These derivative loan commitments are recognized at fair value in the balance sheet with changes in their fair values recorded as part of mortgage banking noninterest income. We record no value for the loan commitment at inception. Subsequent to inception, we recognize the fair value of the derivative loan commitment based on estimated changes in the fair value of the underlying loan that would result from the exercise of that commitment and on changes in the probability that the loan will fund within the terms of the commitment (referred to as a pull through rate). The value of the underlying loan is affected primarily by changes in interest rates and the passage of time.

Outstanding derivative loan commitments expose us to the risk that the value of the loans underlying the commitments might decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. To effectively hedge this risk, we enter into best efforts, forward sale flow contracts with secondary market investors to sell these loans. These forward sales contracts are entered into concurrently with issuance of the derivative loan commitment and carry terms that match the terms of the underlying loan commitments. As a result, these forward sales commitments will experience changes in fair value that will fully offset the changes in fair value of the derivative loan commitments.

As our wholesale lending volume increases, we anticipate changes to our loan sales strategy from a best efforts, flow delivery to mandatory flow deliveries, mini bulk sales, and forward MBS deliveries. These alternative loan sales strategies are expected to result in improved execution and thereby increased gain on sale of loans.

Changes in our sales strategy will necessitate a change in our hedging strategy from best efforts concurrent flow forward sales commitments to the use of Treasury forwards and options to hedge our interest rate risk. These other hedging strategies tend not to be as effective in hedging the interest rate risk as the concurrent flow forward sales commitments, however the improved execution on the loan sales is expected to more than compensate for the slight increase in interest rate risk from using less effective hedging techniques.

Impaired Loans

A loan is considered to be impaired when, in management's judgment based on current information and events, it is probable that the loan's principal or interest is not collectible in accordance with the terms of the original loan agreement. Impaired loans, when not material, will be carried in the balance sheet at a value not to exceed their observable market price or the fair value of the collateral if the repayment of the loan is expected to be provided solely by the underlying collateral. The carrying values of any materially impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, which is the contractual interest rate adjusted for any deferred loan fees or costs, premium or discount existing at the inception or acquisition of the loan.

Loans which management identifies as impaired generally will be non-performing loans. Non-performing loans include non-accrual loans or loans which are 90 days or more delinquent as to principal or interest payments. At December 31, 2007, the Company had $2,018,100 of loans that were impaired and non-performing. At December 31, 2006, the Company had $85,519 of impaired and non-performing loans.

The accrual of interest is discontinued on non-accrual loans and any previously accrued interest on such loans will be reversed against current income. Any subsequent interest income is recognized on a cash basis when received unless collectibility of a significant amount of principal is in serious doubt. In such cases, collections are credited first to the remaining principal balance on a cost recovery basis. An impaired loan is not returned to accrual status unless principal and interest are current and the borrower has demonstrated the ability to continue making payments as agreed.

Potential Problem Loans

Management identifies and maintains a list of potential problem loans. These are loans that are not included in non-accrual status, or loans that are past due 90 days or more and still accruing interest. A loan is added to the potential problem list when management becomes aware of information about possible credit problems of borrowers that causes serious doubts as to the ability of such borrowers to comply with the current loan repayment terms. These loans are designated as such in order to be monitored more closely than other credits in the Banks' portfolios.

Provision and Allowance for Loan Losses

The provision for loan losses is the charge to operating earnings that management believes is necessary to maintain the allowance for loan losses at an adequate level. The provision charged to expense was $310,500 for the year ended December 31, 2007 as compared to $726,700 for the year ended December 31, 2006. The decrease in the provision for loan losses was attributable to management's assessment of credit quality, stabilized loan growth, and other economic factors. The loan portfolio decreased by approximately $10,529,000 during the year ended December 31, 2007 as compared to growth of $49.5 million in 2006. The allowance for loan losses was 1.30% of gross loans at December 31, 2007 as compared to 1.19% at December 31, 2006. There are risks inherent in making all loans, including risks with respect to the period of time over which loans may be repaid, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers, and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

We have established an allowance for loan losses through a provision for loan losses charged to expense on our statement of earnings. Additions to the allowance for loan losses are made periodically to maintain the allowance at an appropriate level based on management's analysis of the potential risk in the loan portfolio. The allowance for loan losses represents an amount, which we believe will be adequate to absorb probable losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based upon a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our losses will undoubtedly vary from our estimates, and there is a possibility that charge-offs can reduce this allowance. Our determination of the allowance for loan losses is based on evaluations of the collectibility of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of our overall loan portfolio, economic conditions that may affect the borrower's ability to repay, the amount and quality of collateral securing the loans, our historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight, concentrations of credit, and peer group comparisons.

We allocate the allowance for loan losses to specific categories of loans in our portfolio. See the table below for the allocation of loan losses and for a history of charge-offs by loan category, which may or may not be indicative of future charge-offs by category.

Allocation of the Allowance for Loan Losses

	December 31,			
	2007		2006	
(In Thousands)	Amount	% of Loans in Category	Amount	% of Loans in Category
Commercial, Financial and Agricultural	$ 284	4%	$ 107	4%
Real Estate—Construction	1,048	47	1,864	47
Real Estate—Mortgage	1,999	47	1,350	47
Consumer	239	2	62	2
Unallocated	83	—	92	—
Total	$ 3,653	100%	$ 3,475	100%

Our policy has been to review the allowance for loan losses using a reserve factor based on risk-rated categories of loans because there has been relatively little charge-off activity since the Banks' respective inceptions. The overall objective is to apply percentages to the loans based on the relative inherent risk for that loan type and grade. Reserve factors are based on peer group data, information from regulatory agencies, and on the experience of the Banks' lenders. The reserve factors will change depending on trends in national and local economic conditions, the depth of experience of the Banks' lenders, delinquency trends, and other factors. Our general strategy is to maintain a minimum coverage of a certain percentage of gross loans until we have sufficient historical data and trends available. Periodically, we adjust the amount of the allowance based on changing circumstances. We charge recognized losses to the allowance and add subsequent recoveries back to the allowance for loan losses. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period. Thus, there is a risk that substantial additional increases in the allowance for loan losses could be required. Additions to the allowance for loan losses would result in a decrease of our net income and, possibly, our capital.

The following table summarizes information concerning the allowance for loan losses:

	For the Years Ended December 31,	
(In Thousands)	2007	2006
Loans outstanding, end of year	$ 281,291	$ 291,820
Average loans outstanding	$ 282,182	$ 271,414
Allowance, beginning of year	3,475	2,863
Charge-offs:		
Commercial, financial and industrial	73	95
Real estate—construction	1	—
Real estate—mortgage	54	—
Consumer	25	27
Total charge-offs	153	122
Recoveries:		
Commercial, financial and industrial	19	—
Real estate—construction	—	—
Real estate—mortgage	—	—
Consumer	2	7
Total recoveries	21	7
Net charge-offs	132	115
Additions charged to operations	310	727
Allowance, end of year	$ 3,653	$ 3,475
Ratio of net charge-offs during the period to average loans outstanding during the period	0.05 %	0.04 %
Allowance for loan losses to loans, end of year	1.30 %	1.19 %

The following table summarizes past due and non-accrual loans, other real estate and repossessions, and income that would have been reported on non-accrual loans as of December 31, 2007 and 2006 (amounts are presented in thousands):

(In Thousands)	December 31, 2007	December 31, 2006
Other real estate and repossessions	$ 340	$ —
Accruing loans 90 days or more past due	69	10
Non-accrual loans	2,018	86
Interest on non-accrual loans which would have been reported	104	13

Noninterest Income and Expense

Noninterest income for the year ended December 31, 2007 totaled $2,321,000 as compared to $2,040,000 for the year ended December 31, 2006. Gain on sale of loans totaled $1,157,000 and $911,000 in 2007 and 2006, respectively. The increase resulted from the addition of a wholesale mortgage origination office in Atlanta, Georgia which contributed $317,000 in gain on sale of mortgage loans. Both Banks own bank-owned life insurance policies covering certain of our executives and directors. The cash value of these policies increases over time and, accordingly, we recognized $287,000 in income related to these policies in 2007. We recognized net gains on the sale of certain investment securities available for sale totaling $121,000 during the year ended December 31, 2007 as compared to losses of $13,000 in 2006. In 2006, we recognized a gain on sale of real estate of $321,000.

Total noninterest expense for the year ended December 31, 2007 was $10,456,000 as compared to $8,895,000 for 2006. Salaries and benefits, the largest component of non-interest expense, totaled $5,916,000 for the year ended December 31, 2007, compared to $4,718,000 for the same period a year ago for an increase of $1,198,000. The increase in salaries and benefits is due to the opening of locations in Port Royal, South Carolina and Atlanta, Georgia. Other operating expenses, excluding salaries and benefits, were $4,540,000 for the year ended December 31, 2007 as compared to $4,178,000 for the year ended December 31, 2006. Of the total increase in other operating expenses of $362,000, $256,000 is attributable to occupancy and equipment expense as a result of opening one new full service branch, one commercial loan production office and the wholesale lending office in 2007.

Financial Condition

Total assets increased from $426,210,000 at December 31, 2006 to $431,574,000 at December 31, 2007. The primary source of growth in assets was loans held for sale, which increased $19,513,000 during 2007. Investment securities increased $9,800,000, while loans decreased $10,529,000. Total deposits increased $5,788,000 from the December 31, 2006 balance of $340,059,000 to $345,847,000 at December 31, 2007.

Interest-Earning Assets

Loans

Gross loans totaled $281,291,000 at December 31, 2007, a decrease of $10,529,000 or 3.6%, since December 31, 2006. At year-end 2007 the mix of the loan portfolio remained approximately consistent with the mix at the end of 2006. In absolute dollars, the largest decrease in loans was in real estate—construction loans, which decreased $8,434,000, or 6%, to $129,607,000 at December 31, 2007. Real estate—mortgage loans increased $812,000 or 1%, during 2007. Balances and percentages within the major loans receivable categories are as follows:

	December 31,			
(In Thousands)	2007		2006	
Real estate—construction	$ 129,607	46 %	$ 138,041	47 %
Real estate—mortgage	137,147	48 %	136,335	47 %
Commercial, financial and industrial	10,235	4 %	13,053	4 %
Consumer and other	4,302	2 %	4,391	2 %
	$ 281,291		$ 291,820	

As of December 31, 2007, maturities of loans in the indicated classifications were as follows:

(In Thousands)	Commercial	Real Estate Construction	Total
Maturity			
Within 1 year	$ 6,884	$ 105,914	$ 112,798
1 to 5 years	2,297	17,894	20,191
Over 5 years	1,054	5,799	6,853
Totals	$ 10,235	$ 129,607	$ 139,842

As of December 31, 2007, the interest terms of loans in the indicated classification for the indicated maturity ranges are as follows:

(In Thousands)	Fixed Interest Rates	Variable Interest Rates	Total
Commercial			
Within 1 year	$ 991	$ 5,893	$ 6,884
1 to 5 years	2,102	195	2,297
Over 5 years	1,054	—	1,054
Real estate—construction			
Within 1 year	8,994	96,920	105,914
1 to 5 years	15,264	2,630	17,894
Over 5 years	5,799	—	5,799
	$ 34,204	$ 105,638	$ 139,842

Investment Securities

Investment securities increased to $87,171,000 at December 31, 2007 from $77,371,000 at December 31, 2006.

The following table presents the investments by category:

	December 31,			
	2007		2006	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(In Thousands)				
Available for sale				
U.S. Government and federal agencies	$ 2,998	$ 2,995	$ 5,483	$ 5,396
Government sponsored enterprises	6,496	6,507	17,275	17,143
State and municipal securities	16,786	16,618	3,302	3,274
Mortgage-backed securities	60,925	61,051	34,844	34,560
	$ 87,205	$ 87,171	$ 60,904	$ 60,373
Held to Maturity				
State and municipal securities	$ —	$ —	$ 8,825	$ 8,773
Mortgage-backed securities	—	—	8,173	8,085
Totals	$ —	$ —	$ 16,998	$ 16,858

The following table presents the maturities of investment securities at carrying value and the weighted average yields for each range of maturities presented. Yields are based on amortized cost of securities. (Amounts are presented in thousands)

Maturities at December 31, 2007	Federal Agencies and Government Sponsored Enterprises	Weighted Average Yields	State and Municipal Securities	Weighted Average Yields	Mortgage-backed Securities	Weighte d Average Yields
Within 1 year	$ 3,991,697	3.81%	$ —	—	$ —	—
After 1 through 5 years	2,999,468	4.01%	1,946,895	3.26%	3,730,985	4.16%
After 5 through 10 years	495,310	5.05%	4,149,287	3.60%	2,420,425	4.63%
After 10 years	2,015,730	6.00%	10,522,212	4.03%	54,899,406	5.34%
Totals	$ 9,502,205	4.40%	$ 16,618,394	3.83%	$ 61,050,817	5.24%

Mortgage-backed securities are included in the maturities categories in which they are anticipated to be repaid based on scheduled maturities.

Deposits

Total deposits increased by $5,788,000, or 1.70%, to a total of $345,817,000 at December 31, 2007 from $340,059,000 at December 31, 2006. Non-interest-bearing demand deposits increased $781,000, or 3.20%, while interest-bearing deposits increased $5,008,000, or 1.59%.

Balances and percentages within the major deposit categories are as follows:

	December 31,			
(In Thousands)	2007		2006	
Noninterest-bearing demand	$ 25,147	7 %	$ 24,367	7 %
Interest-bearing demand	102,674	30 %	119,394	35 %
Savings	2,952	1 %	2,977	1 %
Time over $100,000	124,595	36 %	119,007	35 %
Time	90,479	26 %	74,314	22 %
	$ 345,847		$ 340,059	

The average balance of deposits and the average rates paid on such deposits are summarized as follows:

	December 31,			
	2007		2006	
	Amount	Rate	Amount	Rate
(In Thousands)				
Non-interest-bearing demand	$ 24,791	— %	$ 25,219	— %
Interest-bearing demand	120,934	3.80 %	119,589	3.50 %
Savings	2,988	0.71 %	2,578	0.71 %
Time	194,987	5.13 %	167,451	4.56 %
Total	$ 343,700		$ 314,837	

Maturities of time certificates of deposit of $100,000 or more outstanding at December 31, 2007 are summarized as follows:

(In Thousands)	
Within 3 months	$ 23,620
After 3 through 12 months	84,106
1 through 3 years	15,002
After 3 years	1,867
Total	$ 124,595

Junior Subordinated Debentures

In May 2004, Coastal Banking Company Statutory Trust I issued $3.0 million of trust preferred securities with a maturity of May 18, 2034. In accordance with FASB Interpretation Number (“FIN”) 46(R), the Trust has not been consolidated in the Company’s financial statements. The proceeds from the issuance of the trust preferred securities were used by the Trust to purchase $3,093,000 of the Company’s junior subordinated debentures, which pay interest at a floating rate equal to 3 month LIBOR plus 275 basis points. The Company used the proceeds from the sale of the junior subordinated debentures for general purposes, primarily to provide capital to Lowcountry National Bank. The debentures represent the sole asset of the Trust.

In June 2006, Coastal Banking Company Statutory Trust II issued $4.0 million of trust preferred securities with a maturity of September 30, 2036. In accordance with FASB Interpretation Number (“FIN”) 46(R), the Trust has not been consolidated in the Company’s financial statements. The proceeds from the issuance of the trust preferred securities were used by the Trust to purchase $4,124,000 million of the Company’s junior subordinated debentures, which pay interest at a fixed rate of 7.18% until September 30, 2011 and a variable rate thereafter equal to 3 month LIBOR plus 160 basis points. The Company used the proceeds from the sale of the junior subordinated debentures for general purposes, primarily to provide capital to the Banks. The debentures represent the sole asset of the Trust.

Capital Resources

Total shareholders' equity increased from $43,171,000 at December 31, 2006 to $46,747,000 in 2007. Net income for the period added $2,632,000. Comprehensive income of $328,000 resulted from an increase in fair market value of investment securities available for sale during 2007, net of tax.

Bank holding companies, such as ours, and their banking subsidiaries are required by banking regulators to meet particular minimum levels of capital adequacy, which are expressed in the form of certain ratios. Capital is separated into Tier 1 capital (essentially common shareholders' equity and a limited amount of trust preferred securities less intangible assets) and Tier 2 capital (essentially the allowance for loan losses limited to 1.25% of risk-weighted assets). The first two ratios, which are based on the degree of credit risk in our assets, provide the weighting of assets based on assigned risk factors and include off-balance sheet items such as loan commitments and stand-by letters of credit. The ratio of Tier 1 capital to risk-weighted assets must be at least 4.0% and the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8.0%. The capital leverage ratio supplements the risk-based capital guidelines. Banks and bank holding companies are required to maintain a minimum ratio of Tier 1 capital to adjusted quarterly average total assets of 3.0%.

The following table summarizes the Company's capital ratios at December 31, 2007:

Tier 1 capital (to risk-weighted assets)	13.36 %
Total capital (to risk-weighted assets)	14.49 %
Tier 1 capital (to total average assets)	10.41 %

See note 16 of notes to consolidated financial statements for a detail of the Banks and Company.

Liquidity

The Banks must maintain, on a daily basis, sufficient funds to cover the withdrawals from depositors' accounts and to supply new borrowers with funds. To meet these obligations, the Banks keep cash on hand, maintain account balances with their correspondent banks, and purchase and sell federal funds and other short-term investments. Asset and liability maturities are monitored in an attempt to match the maturities to meet liquidity needs. It is the policy of the Banks to monitor their liquidity to meet regulatory requirements and their local funding requirements.

We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments consist of commitments to extend credit, standby letters of credit and loans sold with representations and warranties. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Standby letters of credit are written conditional commitments issued by the Banks to guarantee the performance of a customer to a third party. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. Our exposure to credit loss in the event of non-performance by the other party to the instrument is represented by the contractual notional amount of the instrument.

Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We use the same credit policies in making commitments to extend credit as we do for on-balance sheet instruments. Collateral held for commitments to extend credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

Loans on one-to-four family residential mortgages originated by us are sold to various other financial institutions with representations and warranties that are usual and customary for the industry. These representations and warranties give the purchaser of the loan the right to require that we repurchase a loan if the borrower fails to make any one of the first four loan payments within 30 days of the due date, which is termed an Early Payment Default ("EPD"). Our maximum liquidity need in the event of an EPD claim would be the unpaid principal balance of the loan to be repurchased along with any premium paid by the investor when the loan was purchased and other minor collection cost reimbursements. The Banks have never had to repurchase a loan as the result of an EPD claim by an investor and do not anticipate any material liquidity needs related to future potential EPD claims on loans that have been previously sold and are no longer on the Banks' balance sheets.

In addition to EPD claims, the representations and warranties in our loan sale agreements also provide that we will indemnify the investors for losses or costs on loans we sell under certain limited conditions. Some of these conditions include underwriting errors or omissions, fraud or material misstatements by the borrower in the loan application or invalid market value on the collateral property due to deficiencies in the appraisal. In connection with the start up of the wholesale lending division, the Banks have established a reserve for potential indemnification costs. The balance in this indemnification reserve was $18,000 at December 31, 2007 and there have been no claims or charges against this reserve since it was established in September 2007, accordingly management does not anticipate any material liquidity needs in connection with loan sale indemnification claims.

The following table summarizes our off-balance sheet financial instruments whose contract amounts represent credit risk as of December 31, 2007:

Commitments to extend credit	$ 54,302,000
Standby letters of credit	$ 328,000
Loans sold with representations and warranties	$ 14,360,000

Management is not aware of any significant concentrations of loans to classes of borrowers or industries that would be affected similarly by economic conditions. Although the Banks' loan portfolios are diversified, a substantial portion of their borrowers' ability to honor the terms of their loans is dependent on the economic conditions in Beaufort County, South Carolina; Nassau County, Florida; and Fulton and Thomas Counties, Georgia as well as the surrounding areas. In addition, a substantial portion of our loan portfolio is collateralized by improved and unimproved real estate and is therefore dependent on the local real estate markets.

The Banks maintain relationships with correspondent banks that can provide funds on short notice, if needed. Presently, the Banks have arrangements with commercial banks for short term unsecured advances up to $12,300,000.

Cash and due from banks as of December 31, 2007 totaled $4,998,000, an increase of $224,000 from December 31, 2006. Cash used by operating activities totaled $16,892,000 in 2007, while inflows from financing activities totaled $3,073,000, which was attributable to an increase in deposits of $5,788,000, offset by a net decrease in FHLB advances of $3,200,000.

During 2007, we had a net cash inflow of $14,042,000 from investing activities. Investing activities included net decrease in loans of approximately $10,397,000, proceeds from sales, calls and maturities of securities of $29,059,000, offset by purchases of securities of $38,334,000.

Inflation

Inflation impacts the growth in total assets in the banking industry and causes a need to increase equity capital at higher than normal rates to meet capital adequacy requirements. We cope with the effects of inflation through the management of interest rate sensitivity, by periodically reviewing and adjusting our pricing of services to consider current costs.

Selected Ratios

The following table sets out certain ratios:

	For the Years Ended December 31,	
	2007	2006
Net income to:		
Average shareholders' equity (tangible)	7.72 %	11.51 %
Average assets (tangible)	0.64 %	0.88 %
Dividends to net income	— %	— %
Average equity to average assets (tangible)	8.24 %	7.66 %

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Coastal Banking Company

We have audited the accompanying balance sheets of Coastal Banking Company of December 31, 2007 and 2006, and the related statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the two-year period ended December 31, 2007. Coastal Banking Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Coastal Banking Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

/s/ Mauldin & Jenkins, LLC

Albany, Georgia
March 14, 2008

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31,	
	2007	2006
Assets		
Cash and due from banks	$ 4,997,928	$ 4,774,561
Interest-bearing deposits in banks	2,063,813	1,928,601
Federal funds sold	4,710,397	18,967,745
Securities available for sale, at fair value	87,171,416	60,372,740
Securities held to maturity, at cost	—	16,998,209
Restricted equity securities, at cost	3,683,416	3,710,217
Loans held for sale	20,553,409	1,039,976
Loans, net of unearned income	281,290,645	291,819,946
Less allowance for loan losses	3,653,017	3,474,640
Loans, net	277,637,628	288,345,306
Premises and equipment, net	8,176,488	7,383,595
Cash surrender value of life insurance	6,830,388	6,553,009
Intangible assets	459,144	740,073
Goodwill	10,411,914	10,215,607
Other assets	4,878,469	5,180,430
Total assets	$ 431,574,410	$ 426,210,069
Liabilities and Shareholders' Equity		
Deposits:		
Noninterest-bearing	$ 25,147,412	$ 24,366,771
Interest-bearing	320,699,704	315,691,850
Total deposits	345,847,116	340,058,621
Securities sold under agreements to repurchase	2,000,000	2,000,000
Other borrowings	26,772,798	29,973,051
Junior subordinated debentures	7,217,000	7,217,000
Other liabilities	2,990,744	3,789,911
Total liabilities	384,827,658	383,038,583
Commitments and contingencies		
Shareholders' Equity:		
Preferred stock, $.01 par value; 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, par value $.01; 10,000,000 shares authorized; 2,570,560 and 2,402,594 shares issued and outstanding in 2007 and 2006, respectively	25,708	24,026
Additional paid-in capital	40,280,395	39,661,823
Retained earnings	6,463,087	3,836,130
Accumulated other comprehensive loss	(22,438)	(350,493)
Total shareholders' equity	46,746,752	43,171,486
Total liabilities and shareholders' equity	$ 431,574,410	$ 426,210,069

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Income

	For the years ended December 31,			
		2007		2006
Interest income:				
Interest and fees on loans	$	23,160,169	$	21,946,782
Interest on taxable securities		4,022,456		3,053,776
Interest on nontaxable securities		603,004		420,027
Interest on deposits in other banks		88,516		91,647
Interest on federal funds sold		601,528		537,208
Total interest income		28,475,673		26,049,440
Interest expense:				
Interest on deposits		14,478,538		11,845,450
Interest on junior subordinated debentures		560,194		391,932
Interest on other borrowings		1,254,342		1,223,424
Total interest expense		16,293,074		13,460,806
Net interest income		12,182,599		12,588,634
Provision for loan losses		310,500		726,700
Net interest income after provision for loan losses		11,872,099		11,861,934
Non-interest income:				
Service charges on deposit accounts		508,354		381,098
Other service charges, commissions and fees		225,583		190,450
Gain on sale of SBA loans		558,391		480,176
Gain on sale of mortgage loans		598,617		430,382
Gain on sale of real estate		—		321,038
Gain (loss) on sale of securities available for sale		121,041		(13,460)
Income from investment in life insurance contracts		287,404		239,944
Other income		21,623		10,167
Total other income		2,321,013		2,039,795
Non-interest expenses:				
Salaries and employee benefits		5,916,131		4,717,633
Occupancy and equipment expense		1,077,486		821,727
Advertising fees		277,707		270,773
Amortization of intangible assets		280,929		373,125
Audit fees		322,513		280,424
Data processing fees		817,982		661,301
Director fees		272,674		269,812
Legal and other professional fees		357,150		181,715
Other operating		1,133,269		1,318,650
Total other expenses		10,455,841		8,895,160
Income before income taxes		3,737,271		5,006,569
Income tax expense		1,105,445		1,647,032
Net income	$	2,631,826	$	3,359,537
Basic earnings per share	$	1.04	$	1.34
Diluted earnings per share	$	0.97	$	1.24

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income

	For the years ended December 31,	
	2007	2006
Net income	$ 2,631,826	$ 3,359,537
Other comprehensive income, net of tax:		
Net unrealized holding gains arising during period, net of tax of $210,152 and $73,681	407,942	143,027
Reclassification adjustment for (gains) losses included in net income, net of tax (benefit) of $41,154 and $(4,576)	(79,887)	8,884
Total other comprehensive income	328,055	151,911
Comprehensive income	$ 2,959,881	$ 3,511,448

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity
For the Years Ended December 31, 2007 and 2006

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	
	Shares	Amount	Capital	Earnings	Loss	Total
Balance, December 31, 2005	2,369,263	$ 23,693	$39,317,286	$ 476,593	$ (502,404)	$39,315,168
Net income	—	—	—	3,359,537	—	3,359,537
Proceeds from exercise of stock options	33,331	333	317,466	—	—	317,799
Stock-based compensation expense	—	—	27,071	—	—	27,071
Other comprehensive income	—	—	—	—	151,911	151,911
Balance, December 31, 2006	2,402,594	24,026	39,661,823	3,836,130	(350,493)	43,171,486
Net income	—	—	—	2,631,826	—	2,631,826
Proceeds from exercise of stock options	48,107	481	487,736	—	—	488,217
Stock dividend	120,129	1,201		(1,201)		—
Payment for fractional shares	(270)			(3,668)		(3,668)
Stock-based compensation expense	—	—	130,836	—	—	130,836
Other comprehensive income	—	—	—	—	328,055	328,055
Balance, December 31, 2007	2,570,560	$ 25,708	$40,280,395	$ 6,463,087	$ (22,438)	$46,746,752

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	For the years ended December 31, 2007	2006
Cash flows from operating activities:		
Net income	$ 2,631,826	$ 3,359,537
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation, amortization and accretion	432,905	332,168
Amortization of intangible assets	280,929	373,125
Stock-based compensation expense	130,836	27,071
Provision for loan losses	310,500	726,700
Provision for deferred income taxes	(210,373)	(534,262)
(Gain) loss on sale of securities available for sale	(121,041)	13,460
(Gain) loss on sale of premises and equipment	2,837	(321,038)
Increase in cash value of life insurance	(287,404)	(239,944)
Originations of mortgage loans held for sale	(76,649,707)	(38,356,502)
Proceeds from sales of mortgage loans held for sale	57,136,274	39,766,177
Net (increase) decrease in interest receivable	99,660	(792,124)
Net increase (decrease) in interest payable	(252,781)	257,126
Gain on sale of SBA loans	(558,391)	(480,176)
Gain on sale of mortgage loans	(598,617)	(430,382)
Net other operating activities	760,432	873,821
Net cash provided (used) by operating activities	(16,892,115)	4,574,757
Cash flows from investing activities:		
Net increase in interest-bearing deposits in banks	(135,212)	(341,462)
Net (increase) decrease in federal funds sold	14,257,348	(5,369,310)
Proceeds from maturities of securities available for sale	8,956,642	6,595,285
Proceeds from sale of securities available for sale	20,102,183	2,992,260
Purchases of securities available for sale	(38,333,614)	(23,582,247)
Proceeds from maturities of securities held to maturity	—	1,584,993
Purchases of securities held to maturity	—	(400,000)
Net change in restricted equity securities	26,801	(975,650)
Net (increase) decrease in loans	10,397,178	(48,753,932)
Purchase of life insurance contracts	—	(1,000,000)
Proceeds from sale of premises and equipment	15,900	735,942
Net cash acquired in merger	—	5,384,781
Purchase of premises and equipment	(1,244,788)	(1,408,517)
Net cash provided (used) by investing activities	14,042,438	(64,537,857)
Cash flows from financing activities:		
Net increase in deposits	5,788,495	46,450,557
Increase in securities purchased under agreements to repurchase	—	2,000,000
Proceeds from other borrowings	13,700,000	19,000,000
Repayment of other borrowings	(16,900,000)	(12,000,000)
Proceeds from junior subordinated debt	—	4,124,000
Payment for fractional shares	(3,668)	—
Proceeds from exercise of stock options	488,217	317,799
Net cash provided by financing activities	3,073,044	59,892,536
Net change in cash and due from banks	223,367	(70,744)
Cash and due from banks at beginning of year	4,774,561	4,845,305
Cash and due from banks at end of year	$ 4,997,928	$ 4,774,561
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	$ 16,545,855	$ 13,203,680
Cash paid during the year for income taxes	$ 1,240,021	$ 2,255,903
Noncash Transactions:		
Principal balances of loans transferred to other real estate owned	$ 469,000	$ —
Amortized cost of securities transferred from held to maturity to available for sale	$ 16,998,209	$ —

See accompanying notes to consolidated financial statements.

COASTAL BANKING COMPANY, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Basis of Presentation and Nature of Operations

Coastal Banking Company, Inc. (the "Company") is organized under the laws of the State of South Carolina for the purpose of operating as a bank holding company for Lowcountry National Bank and First National Bank of Nassau County (the "Banks"). Lowcountry National Bank commenced business on May 10, 2000. First National Bank of Nassau County began operations in 1999 and was acquired through merger on October 1, 2005. On October 27, 2006, the Company acquired the Meigs, Georgia office of a bank in Thomas County, Georgia. The Banks provide full commercial banking services to customers throughout Beaufort County, South Carolina; Nassau County, Florida; and Thomas County, Georgia and are subject to regulation by the Office of the Comptroller of the Currency (the "OCC") and the Federal Deposit Insurance Corporation. The Banks also have loan production offices in Savannah, Georgia; Atlanta, Georgia and Jacksonville, Florida, as well as a wholesale mortgage office in Atlanta, Georgia. The Company is subject to regulation by the Federal Reserve Board of Governors. The Company also has an investment in Coastal Banking Company Statutory Trust I ("Trust I") and Coastal Banking Company Trust II ("Trust II"). Both trusts are special-purpose subsidiaries organized for the sole purpose of issuing trust preferred securities.

The consolidated financial statements include the accounts of the Company and the Banks. All significant intercompany transactions have been eliminated in consolidation. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and to general practices in the banking industry.

Accounting Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates.

Segments

The Company, through its subsidiaries, provides a broad range of financial services to individuals and companies. These services include demand, time and savings deposits, lending, and ATM processing and are substantially the same across subsidiaries. While the Company's decision-makers monitor the revenue streams of the various financial products and services by product line and by subsidiary, the operations and the allocation of resources are managed, and financial performance is evaluated, on an organization-wide basis. Accordingly, the Company's banking operation is considered by management to be one reportable operating segment.

Cash, Due from Banks and Cash Flows

For purposes of reporting cash flows, cash and due from banks includes cash on hand, cash items in process of collection and amounts due from banks. Cash flows from loans, federal funds sold, deposits, interest-bearing deposits in banks, restricted equity securities and securities sold under agreements to repurchase are reported net.

The Banks are required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank. The total of those reserve requirements was approximately $982,000 and $955,000 at December 31, 2007 and 2006, respectively.

Securities

The Company classifies its securities as available for sale or held to maturity. Held to maturity securities are those securities for which the Company has the ability and intent to hold until maturity. All securities not included in held to maturity are classified as available for sale.

Available for sale securities are recorded at fair value. Held to maturity securities are recorded at cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on securities available for sale, net of the related tax effect, are excluded from earnings and are reported as a separate component of shareholders' equity until realized.

A decline in the market value of securities below cost that is deemed other than temporary is charged to earnings and establishes a new cost basis for the security.

Premiums and discounts are amortized or accreted over the life of the related securities as adjustments to the yield. Realized gains and losses for securities classified as available for sale and held to maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Other Investments

Other investments include restricted equity securities with no readily determinable fair value. These investments are carried at cost. The Bank, as a member institution, is required to own certain stock investments in the Federal Home Loan Bank of Atlanta ("FHLB") and the Federal Reserve Bank ("FRB"). The stock is generally pledged against any borrowings from these institutions. No ready market exists for the stock and it has no quoted market price. However, redemption of these stocks has historically been at par value.

Loans Held for Sale

Lowcountry National Bank and First National Bank of Nassau County, subsidiaries of the Company (the "Banks"), originate 1-4 family real estate mortgage loans held for sale, which are funded by the Banks with a prior commitment for the loan to be purchased in the secondary market. These loans are generally recorded as an asset of the Banks for less than twenty business days and origination fees and gain on sale generated by these loans is recognized in income on a trade date basis when the loan files are physically delivered to the investor. The Banks also originate 1-4 family real estate mortgage loans that are pre-approved and funded at closing by the secondary market purchaser. The mortgage rate premiums received on secondary mortgage market loans are recognized in income when funds are received from the secondary market investor. Loans held for sale are carried at the lower of cost or fair value. Adjustments to reflect fair value and realized gains and losses upon ultimate sale of the loans are classified as noninterest income in the Consolidated Statements of Income.

Each of the Banks defers recognition of a portion of its mortgage origination fees in accordance with the requirements of FASB Statement No. 91.

The Banks also originate SBA loans, which in some cases are sold on the secondary market. Origination fees associated with these loans are amortized over the life of the loan or until a decision is made to sell. Once the decision is made to sell, adjustments to reflect fair value and realized gains and losses upon ultimate sale of the loans are classified as noninterest income in the Consolidated Statements of Income.

Loans and Allowance for Loan Losses

Loans are stated at principal amount outstanding, net of deferred loan origination fees and costs and the allowance for loan losses. Interest on loans is calculated by using the interest method based upon the principal amount outstanding. Loan origination and commitment fees and direct loan origination costs are deferred and amortized over the contractual life of the related loan or commitments as an adjustment of the related loan yields.

A loan is considered impaired when, based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price, or at the fair value of the collateral of the loan if the loan is collateral dependent. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of interest is doubtful. When the ultimate collectibility of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance represents an amount, which, in management's judgment, will be adequate to absorb probable losses on existing loans that may become uncollectible.

Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, historical losses, high loan concentrations, trends in past dues and non-accrual loans, loan risk ratings, economic conditions, market conditions and other internal and external factors that influence each portfolio segment and review of specific impaired loans. The combination of these results are compared monthly to the recorded allowance for loan losses for reasonableness and material differences are adjusted by increasing or decreasing the provision for loan losses. Management uses an external loan review program to challenge and corroborate the internal loan grading system and provide additional analysis in determining the adequacy of the allowance and the future provisions for estimated loan losses.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Banks' allowance for loan losses. Such agencies may require the Banks to recognize additions to the allowance based on judgments different than those of management.

Non-performing Assets

Loans are placed in a non-accrual status when, in the opinion of management, the collection of additional interest is questionable. Thereafter, no interest is taken into income unless received in cash or until such time as the borrower demonstrates the ability to pay principal and interest.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Costs incurred for maintenance and repairs that do not extend the useful life of the asset are expensed as incurred.

Depreciation expense is computed using the straight-line method over the following estimated useful lives:

Building and improvements	10 - 40 years
Furniture and equipment	3 - 10 years

Goodwill and Intangible Assets

Goodwill represents the excess of cost over the fair value of the net assets purchased in business combinations. Goodwill is required to be tested annually for impairment or whenever events occur that may indicate that the recoverability of the carrying amount is not probable. In the event of an impairment, the amount by which the carrying amount exceeds the fair value is charged to earnings. The Company performed its annual test of impairment in the fourth quarter and determined that there was no impairment in the carrying value of goodwill as of October 1, 2007.

Intangible assets consist of core deposit premiums acquired in connection with business combinations. The core deposit premiums were initially recognized based on valuations performed as of the consummation date. The core deposit premiums are amortized over the average remaining life of the acquired customer deposits. Amortization periods are reviewed annually in connection with the annual impairment testing of goodwill.

Included in the consolidated statements of income for December 31, 2007, and 2006 were charges for amortization of identifiable intangible assets in the amounts of $281,000 and $373,000, respectively.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In the event the future tax consequences of differences between the financial reporting bases and the tax bases of the assets and liabilities result in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such asset is required. A valuation allowance is provided for some portion or all of the deferred tax asset when it is more likely than not that some portion or all of the deferred tax asset will not be realized. In assessing the realizability of the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies.

Stock-Based Compensation

At December 31, 2007, the Company had an Incentive Stock Compensation Plan, which are described more fully in Note 13. On January 1, 2006, Coastal adopted the fair value recognition provisions of FASB Statement No. 123(R), Share-Based Payment ("SFAS 123(R)"), using the modified-prospective-transition method. Under that transition method, compensation cost recognized beginning in 2006 includes: (a) the compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB Statement No. 123, and (b) the compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated.

Earnings Per Share

The Company is required to report earnings per common share with and without the dilutive effects of potential common stock issuances from instruments such as options, convertible securities and warrants on the face of the statements of earnings. Basic earnings per common share are based on the weighted average number of common shares outstanding during the period, which was 2,540,401 in 2007 and 2,496,839 in 2006, while the effects of potential common shares outstanding during the period are included in diluted earnings per share. Additionally, the Company must reconcile the amounts used in the computation of both "basic earnings per share" and "diluted earnings per share". At December 31, 2007, potential common shares of 62,271 were not included in the calculation of diluted earnings per share because the exercise of such shares would be anti-dilutive. There were 27,825 anti-dilutive potential common shares at December 31, 2006. All share amounts have been adjusted for the five percent stock dividend recorded in 2007. Earnings per common share amounts are as follows:

For the year ended December 31, 2007	**Net income (Numerator)**	**Common Share (Denominator)**	**Per Share Amount**
Basic earnings per share	$ 2,631,826	2,540,401	$ 1.04
Effect of dilutive securities—stock options and warrants	—	184,814	(.07)
Diluted earnings per share	$ 2,631,826	2,725,215	$ .97

For the year ended December 31, 2006	**Net income (Numerator)**	**Common Share (Denominator)**	**Per Share Amount**
Basic earnings per share	$ 3,359,537	2,496,839	$ 1.34
Effect of dilutive securities—stock options and warrants	—	213,556	(.10)
Diluted earnings per share	$ 3,359,537	2,710,395	$ 1.24

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements.* The Statement provides guidance for using fair value to measure assets and liabilities. It defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurement. Under the Statement, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. It clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the Statement establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the Statement, fair value measurements would be separately disclosed by level within the fair value hierarchy. Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is not expected to have a material impact on the Company's financial condition or results of operations.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115.* The Statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument (with a few exceptions), is irrevocable (unless a new election date occurs) and is applied only to entire instruments and not to portions of instruments. Most of the provisions in Statement 159 are elective; however, the amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, applies to all entities with available-for-sale and trading securities. Statement No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact of the adoption of this statement.

In December 2007, the FASB issued Statement No. 141 (Revised 2007), *Business Combinations.* The Statement will significantly change the accounting for business combinations, as an acquiring entity will be required to recognize all the assets and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. The Statement changes the accounting treatment for several specific items, such as acquisition costs, noncontrolling interests (formerly referred to as minority interests), contingent liabilities, restructuring costs and changes in deferred tax asset valuation allowances. The Statement also includes a substantial number of new disclosure requirements. Statement No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early adoption is prohibited. The Company is currently evaluating the impact the adoption of this statement will have on the accounting for future acquisitions and business combinations.

In December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51.* The Statement establishes new accounting and reporting standards for the noncontrolling interest (formerly referred to as minority interests) in a subsidiary and for the deconsolidation of a subsidiary. Statement No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 and early adoption is prohibited. The Company is currently evaluating the impact of the adoption of this statement.

Risks and Uncertainties

In the normal course of its business, the Company encounters two significant types of risk: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from borrowers' inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable, the valuation of real estate held by the Company, and the valuation of loans held for sale and mortgage-backed securities available for sale.

The Company is subject to the regulations of various government agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances, and operating restrictions, resulting from the regulators' judgments based on information available to them at the time of their examination.

Concentrations of Credit Risk

The Company, through its subsidiaries, makes loans to individuals and businesses in and around Beaufort County, South Carolina; in and around Fulton, Chatham and Thomas Counties in Georgia; and in and around Duval and Nassau Counties in Florida for various personal and commercial purposes. The Company has a diversified loan portfolio and the borrowers' ability to repay their loans is not dependent upon any specific economic sector.

The Company makes loans to individual and small businesses for various personal and commercial purposes primarily through our full-service offices in Beaufort County, South Carolina and Nassau County, Florida and through our loan production offices in Jacksonville, Florida; Atlanta, Georgia; and Savannah, Georgia. The Company's loan portfolio is not concentrated in loans to any single borrower or in a relatively small number of borrowers. Our loan portfolio has a significant number of construction loans that if subjected to a real estate market down-turn could adversely affect the earnings of the Company.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk that could arise from potential concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral period, loans with initial interest-only payments, etc), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable-rate loans and fixed-rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon-payment loans). These loans are underwritten and monitored to manage the associated risks. Management has determined that there is no concentration of credit risk associated with its lending policies or practices.

The Company's investment portfolio consists principally of obligations of the United States, its agencies or its corporations and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in this investment portfolio. The Company places it deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Note 2. Investment Securities

Investment securities are as follows:

	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Government and federal agencies	$ 2,998,508	$ —	$ (3,701)	$ 2,994,807
Government-sponsored enterprises	6,495,925	19,741	(8,268)	6,507,398
State and municipal securities	16,785,642	67,677	(234,925)	16,618,394
Mortgage-backed securities	60,925,337	403,932	(278,452)	61,050,817
	$ 87,205,412	$ 491,350	$ (525,346)	$ 87,171,416

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Government and federal agencies	$ 5,482,833	$ 3,112	$ (90,232)	$ 5,395,713
Government-sponsored enterprises	17,275,311	31,778	(164,443)	17,142,646
State and municipal securities	3,301,637	5,148	(32,534)	3,274,251
Mortgage-backed securities	34,844,010	191,684	(475,564)	34,560,130
	$ 60,903,791	$ 231,722	$ (762,773)	$ 60,372,740
Held to maturity				
State and municipal securities	$ 8,824,620	$ 23,850	$ (75,146)	$ 8,773,324
Mortgage-backed securities	8,173,589	—	(88,739)	8,084,850
	$ 16,998,209	$ 23,850	$ (163,885)	$ 16,858,174

The following table shows gross unrealized losses and fair value of securities, aggregated by category and length of time that securities have been in a continuous unrealized loss position, at December 31, 2007.

Investment securities available for sale:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and federal agencies	$ —	$ —	$ 2,994,807	$ (3,701)	$ 2,994,807	$ (3,701)
Government-sponsored enterprises	495,310	(3,384)	2,492,648	(4,884)	2,987,958	(8,268)
State and municipal securities	8,311,901	(225,522)	1,235,240	(9,403)	9,547,141	(234,925)
Mortgage-backed securities	18,825,246	(203,102)	6,908,083	(75,350)	25,733,329	(278,452)
Total	$ 27,632,457	$ (432,008)	$ 13,630,778	$ (93,338)	$ 41,263,235	$ (525,346)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Twenty-four (24) individual securities available for sale were in a continuous loss position for twelve months or more. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and not in the credit quality of the issuer. The unrealized losses are considered temporary because each security carries an acceptable investment grade and the repayment sources of principal and interest are government backed. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature.

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2006.

Investment securities available for sale:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and federal agencies	$ —	$ —	$ 135,243	$ (90,232)	$ 135,243	$ (90,232)
Government-sponsored enterprises	1,988,825	(5,592)	14,004,691	(158,851)	15,993,516	(164,443)
State and municipal securities	1,431,861	(13,972)	1,379,901	(18,562)	2,811,762	(32,534)
Mortgage-backed securities	6,693,759	(17,980)	15,284,283	(457,584)	21,978,042	(475,564)
Total	$ 10,114,445	$ (37,544)	$ 30,804,118	$ (725,229)	$ 40,918,563	$ (762,773)

Investment securities held to maturity:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
State and municipal securities	$ 1,768,839	$ (14,164)	$ 3,357,657	$ (60,982)	$ 5,126,496	$ (75,146)
Mortgage-backed securities	—	—	8,084,850	(88,739)	8,084,850	(88,739)
Total	$ 1,768,839	$ (14,164)	$ 11,442,507	$ (149,721)	$13,211,346	$ (163,885)

At December 31, 2006 fifty-one (51) individual securities available for sale were in a continuous loss position for twelve months or more. Fourteen (14) individual securities held to maturity were in a continuous loss position for twelve months or more. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

The amortized cost and estimated fair value of investment securities at December 31, 2007, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Available for sale		
Due in one year or less	$ 3,997,590	$ 3,991,697
Due from one year to five years	8,354,736	8,364,033
Due from five to ten years	9,464,503	9,383,011
Due after ten years	4,463,246	4,381,858
Mortgage-backed securities	60,925,337	61,050,817
	$ 87,205,412	$ 87,171,416

Securities with an amortized cost and fair value pledged to secure public deposits and for other purposes as required by law totaled $21,065,000 and $20,966,000 respectively as of December 31, 2007 and $15,134,000 and $14,752,000 respectively as of December 31, 2006.

Gains and losses on sales of securities available for sale consist of the following:

	For the Years Ended December 31,	
	2007	2006
Gross gains on sales of securities	$ 154,107	$ —
Gross losses on sales of securities	(33,066)	(13,460)
Net realized gains (losses) on sales of securities available for sale	$ 121,041	$ (13,460)

Note 3. Loans and allowance for loan losses

The composition of loans is summarized as follows:

	December 31,	
	2007	2006
Commercial and financial	$ 10,234,984	$ 13,053,338
Agricultural	519,000	54,583
Real estate – construction	129,606,841	138,041,293
Real estate – mortgage, farmland	94,000	13,894
Real estate – mortgage, commercial	68,771,922	64,334,282
Real estate – mortgage, residential	68,280,901	72,000,668
Consumer installment loans	2,625,998	3,339,088
Other	1,156,999	982,800
Gross loans	281,290,645	291,819,946
Less: Allowance for loan losses	3,653,017	3,474,640
Net loans	$ 277,637,628	$ 288,345,306

The Banks grant loans and extensions of credit to individuals and a variety of businesses and corporations located in its general trade areas Beaufort, Beaufort County, South Carolina and adjoining counties, and Nassau County, Florida. Although the Banks have diversified loan portfolios, a substantial portion of the loan portfolios are collateralized by improved and unimproved real estate and are dependent upon the real estate market.

The following is a summary of information pertaining to impaired loans:

	For the Years Ended December 31,	
	2007	2006
Impaired loans without a valuation allowance	$ —	$ —
Impaired loans with a valuation allowance	3,593,673	85,519
Total impaired loans	3,593,673	85,519
Valuation allowance related to impaired loans	248,950	18,144
Average investment in impaired loans	1,604,000	77,000
Interest income recognized on impaired loans	280,805	42,626
Forgone interest income on impaired loans	104,127	13,436

Loans on nonaccrual status amounted to $2,018,100 and $85,519 at December 31, 2007 and 2006, respectively. There were $69,397 of loans past due ninety days or more and still accruing interest at December 31, 2007. There were $10,000 loans past due ninety days or more and still accruing interest at December 31, 2006.

An analysis of the activity in the allowance for loan losses is presented below:

	For the Years Ended December 31,	
	2007	2006
Balance, beginning of year	$ 3,474,640	$ 2,862,992
Provision for loan losses	310,500	726,700
Loans charged off	(152,897)	(122,334)
Recoveries of loans previously charged off	20,774	7,282
Balance, end of year	$ 3,653,017	$ 3,474,640

In the ordinary course of business, the Company has granted loans to certain directors, executive officers and their affiliates. The interest rates on these loans were substantially the same as rates prevailing at the time of the transaction and repayment terms are customary for the type of loan. Changes in related-party loans are summarized as follows:

	For the Years Ended December 31,	
	2007	2006
Balance, beginning of year	$ 4,950,249	$ 5,110,092
Advances	2,817,108	3,896,065
Repayments	(272,760)	(3,232,550)
Transactions due to changes in related parties	(554,600)	(823,358)
Balance, end of year	$ 6,939,997	$ 4,950,249

Note 4. Premises and Equipment

Premises and equipment are summarized as follows:

	December 31,	
	2007	2006
Land	$ 3,648,350	$ 3,288,989
Building	4,275,135	2,854,900
Furniture and equipment	2,726,359	2,264,021
Construction in progress	—	1,054,355
	10,649,844	9,462,265
Less accumulated depreciation	(2,473,356)	(2,078,670)
	$ 8,176,488	$ 7,383,595

Lowcountry National Bank has entered into a non-cancelable operating lease related to land and buildings at its Bluffton branch, which expires in 2008 with options to renew. This lease was modified in 2005 to include additional space to provide for growth.

In 2007, Lowcountry National Bank entered into a non-cancelable lease for office space above the branch building in Port Royal, South Carolina. The lease is for a term of five years that will expire in 2012 with options to renew for subsequent five year periods.

In 2005, First National Bank of Nassau County ("FNB") entered into a three-year lease for rental space for a loan production office in Savannah, Georgia. FNB also has an operating lease for rental space for a loan production office in Jacksonville, Florida. This lease is cancelable at any time with four months notice.

In 2007, FNB entered into a three-year lease for rental space for a loan production office in Atlanta, Georgia. FNB also entered into a three-year lease for rental space for a wholesale mortgage office in Atlanta, Georgia during 2007.

At December 31, 2007, future minimum lease payments under the non-cancelable operating leases with initial or remaining terms of one year or more are as follows:

2008	$	228,908
2009		193,112
2010		127,641
2011		63,876
2012		10,646
	$	624,183

Total rental expense amounted to $246,042 and $125,764 for the years ended December 31, 2007 and 2006, respectively, under these operating leases.

Note 5. Intangible Assets

Following is a summary of information related to acquired intangible assets:

	December 31,			
	2007		2006	
Core deposit premiums				
Gross carrying amount	$	1,212,435	$	1,212,435
Accumulated amortization	$	753,291	$	472,362

The aggregate amortization expense for intangible assets was $281,000 and $373,000 for the years ended December 31, 2007 and 2006, respectively.

The estimated amortization expense for each of the next five years is as follows:

2008	$	198,503
2009		124,160
2010		74,026
2011		39,804
2012 and later		22,651
	$	459,144

Changes in the carrying amount of goodwill are as follows:

	For the years ended December 31,			
	2007		2006	
Beginning balance	$	10,215,607	$	9,722,772
Adjustment of previously acquired goodwill based on final allocations		196,307		(490,568)
Goodwill acquired through purchase of subsidiary Bank		—		983,403
Ending balance	$	10,411,914	$	10,215,607

Note 6. Deposits

The aggregate amount of time deposits in denominations of $100,000 or more at December 31, 2007 and 2006 was $124,594,644 and $119,006,645, respectively. The company had $24,147,572 and $33,555,808 in brokered deposits included in time deposits as of December 31, 2007 and 2006, respectively. The scheduled maturities of time deposits at December 31, 2007 are as follows:

2008	$	185,152,469
2009		15,980,826
2010		10,407,288
2011		923,187
2012		2,609,500
	$	215,073,270

At December 31, 2007 and 2006, overdraft demand deposits reclassified to loans totaled $48,675 and $34,164, respectively.

Note 7. Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements, which are secured borrowings, generally mature within thirty to sixty days from the transaction date. Securities sold under repurchase agreements are reflected at the amount of cash received in connection with the transactions. The Company may be required to provide additional collateral based on the fair value of the underlying securities. The Company monitors the fair value of the underlying securities on a daily basis. Securities sold under repurchase agreements at December 31, 2007 and December 31, 2006 were $2,000,000.

Note 8. Employee Benefit Plans

The Company sponsors the Lowcountry National Bank Retirement Savings Plan and the First National Bank Savings Plan (collectively the "Plans") for the benefit of all eligible employees. All full-time and part-time employees are eligible to participate in these Plans provided they have met the eligibility requirements. Contributions may begin after 30 days of employment. Part-time employees must work a minimum of 1,000 hours per year to be eligible. The Plans allow a participant to defer a portion of his compensation and provides that the Company will match a portion of the deferred compensation. Company matched contributions are vested over a five year period. The Company contributes to the Plans annually upon approval by the Board of Directors. Contributions made to the Plans in 2007 and 2006 amounted to $93,334 and $99,342, respectively.

Note 9. Deferred Compensation Plans

The Company adopted a Director and Executive Officer Deferred Compensation Plan in 2004 that allows directors and executive officers to defer compensation. Interest accrues quarterly on deferred amounts at a rate, which is equal to 75% of the previous quarter's return on equity, not to exceed 12%. Accrued deferred compensation of $67,713 and $47,937 at December 31, 2007 and 2006, respectively, is included in other liabilities.

Note 10. Other Borrowings

Other borrowings consist of the following FHLB advances.

Type advance	Balance	Interest rate	Maturity date	Convertible date
		FHLB Advances Outstanding December 31, 2007		
Fixed rate	$ 1,000,000	5.02 %	February 17, 2009	
Fixed rate	5,000,000	5.65 %	June 1, 2011	
Convertible fixed rate advance	1,500,000	4.05 %	September 7, 2012	September 8, 2008
Convertible fixed rate advance	10,000,000	4.25 %	May 21, 2014	May 21, 2009
Convertible fixed rate advance	5,000,000	3.71 %	June 24, 2015	June 24, 2010
Convertible fixed rate advance	2,000,000	3.69 %	September 7, 2017	March 7, 2008
Variable rate	2,300,000	4.40 %		
Less purchase accounting adjustments	(27,202)			
Total	$ 26,772,798	4.41 %		

Type advance	Balance	Interest rate	Maturity date	Convertible date
		FHLB Advances Outstanding December 31, 2006		
Fixed rate	$ 5,000,000	5.36 %	March 22, 2007	
Fixed rate	5,000,000	5.65 %	June 1, 2011	
Convertible fixed rate advance	5,000,000	4.01 %	August 16, 2010	August 16, 2007
Convertible fixed rate advance	10,000,000	4.25 %	May 21, 2014	May 21, 2009
Convertible fixed rate advance	5,000,000	3.71 %	June 24, 2015	June 24, 2010
Less purchase accounting adjustments	(26,949)			
Total	$ 29,973,051	4.54 %		

At December 31, 2007, the Banks had $12,300,000 of availability on lines of credit to purchase federal funds from unrelated banks. These lines of credit are available on a one to seven day basis for general corporate purposes of the Banks. All of the lenders have reserved the right to withdraw these lines at their option.

Note 11. Income Taxes

The components of income tax expense are as follows:

	For the Years Ended December 31, 2007	2006
Currently payable	$ 1,315,818	$ 2,181,294
Deferred tax benefit	(210,373)	(534,262)
	$ 1,105,445	$ 1,647,032

The Company's income tax expense differs from the amounts computed by applying the federal income tax statutory rates to income before income taxes. A reconciliation of the differences is as follows:

	For the Years Ended December 31, 2007	2006
Tax at federal income tax rate	$ 1,270,672	$ 1,702,200
Increase (decrease) resulting from:		
State income taxes, net of federal benefit	107,302	134,180
Tax exempt interest	(172,017)	(203,142)
Other	(100,512)	13,794
Provision for income taxes	$ 1,105,445	$ 1,647,032

Net deferred tax assets are included in other assets. The components of deferred income taxes are as follows:

	December 31,	
	2007	2006
Deferred income tax assets:		
Loan loss reserves	$ 1,199,933	$ 1,121,742
Deferred compensation	23,021	16,299
Unrealized loss on securities available for sale	11,579	180,557
Other	394,353	428,087
Total deferred tax assets	1,628,886	1,746,685
Deferred income tax liabilities:		
Depreciation and amortization	185,273	208,412
Intangible assets	293,574	419,367
Other	132,377	142,639
Total deferred tax liabilities	$ 611,224	$ 770,418
Net deferred tax asset	$ 1,017,662	$ 976,267

Note 12. Junior Subordinated Debentures

In May 2004, Coastal Banking Company Statutory Trust I (the "Trust") (a non-consolidated subsidiary) issued $3,000,000 of floating rate trust preferred securities with a maturity of May 18, 2034. In accordance with FIN No. 46(R), the trust has not been consolidated in these financial statements. The Company received from the Trust the $3,000,000 million proceeds from the issuance of securities and the $93,000 initial proceeds from the capital investment in the Trust, and accordingly has shown the funds due to the Trust as $3,093,000 junior subordinated debentures.

All of the common securities of the Trust are owned by the Company. The proceeds from the issuance of the trust preferred securities were used by the Trust to purchase $3,093,000 of junior subordinated debentures of the Company, which carry a floating rate equal to the 3-month LIBOR plus 2.75%. At December 31, 2007, this rate was 7.90%. The proceeds received by the Company from the sale of the junior subordinated debentures were used to strengthen the capital position of Lowcountry National Bank and to accommodate current and future growth. The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital, and have been included in the Tier I calculation accordingly. The debentures and related accrued interest represent the sole assets of the Trust.

The trust preferred securities accrue and pay distributions quarterly, equal to 3-month LIBOR plus 2.75% per annum of the stated liquidation value of $1,000 per capital security. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the trust preferred securities; (ii) the redemption price with respect to any trust preferred securities called for redemption by the Trust, and (iii) payments due upon a voluntary or involuntary dissolution, winding up, or liquidation of the Trust.

The trust preferred securities must be redeemed upon maturity of the debentures on May 18, 2034, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust in whole or in part, on or after May 18, 2009. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the unpaid principal amount, plus any accrued unpaid interest.

In June 2006, Coastal Banking Company Statutory Trust II (the "Trust") (a non-consolidated subsidiary) issued $4,000,000 of fixed rate trust preferred securities with a maturity of September 30, 2036. In accordance with FIN No. 46(R), the trust has not been consolidated in these financial statements. The Company received from the Trust the $4,000,000 million proceeds from the issuance of securities and the $124,000 initial proceeds from the capital investment in the Trust, and accordingly has shown the funds due to the Trust as $4,124,000 junior subordinated debentures.

All of the common securities of the Trust are owned by the Company. The proceeds from the issuance of the trust preferred securities were used by the Trust to purchase $4,124,000 of junior subordinated debentures of the Company, which carry a fixed rate of 7.18% until September 30, 2011 and a floating rate equal to the 3-month LIBOR plus 1.60%, adjusted quarterly thereafter. The proceeds received by the Company from the sale of the junior subordinated debentures were used to strengthen the capital position of the Banks and to accommodate current and future growth. The current regulatory rules allow certain amounts of junior subordinated debentures to be included in the calculation of regulatory capital, and have been included in the Tier I calculation accordingly. The debentures and related accrued interest represent the sole assets of the Trust.

The trust preferred securities accrue and pay distributions quarterly at a rate of 7.18% per annum of the stated liquidation value of $1,000 per capital security. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of: (i) accrued and unpaid distributions required to be paid on the trust preferred securities; (ii) the redemption price with respect to any trust preferred securities called for redemption by the Trust, and (iii) payments due upon a voluntary or involuntary dissolution, winding up, or liquidation of the Trust.

The trust preferred securities must be redeemed upon maturity of the debentures on September 30, 2036, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust in whole or in part, on or after September 30, 2011. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the unpaid principal amount, plus any accrued unpaid interest.

Note 13. Stock Option Plans

In connection with the Company's initial public stock offering, the directors received warrants to purchase 222,705 shares of the Company's common stock at a price of $8.65 per share of which 184,595 shares are still outstanding. The warrants vested equally over a three-year period beginning December 2, 1999 and expire on December 2, 2009 or 120 days after the warrant holder ceased to serve as a member of the board of directors. As of December 31, 2007, all of the warrants are exercisable.

The Company adopted a Stock Incentive Plan in 2000 which currently authorizes 385,584 shares of the Company's common stock for issuance under the Plan. The Plan provides that the total number of shares authorized for issuance under the Plan will equal 15% of total outstanding shares. The Plan is administered by the Board of Directors and provides for the granting of options to purchase shares of common stock to officers, directors, employees or consultants of the Company and Banks. The exercise price of each option granted under the Plan will not be less than the fair market value of the shares of common stock subject to the option on the date of grant as determined by the Board of Directors. Options are exercisable in whole or in part upon such terms as may be determined by the Board of Directors, and are exercisable no later than ten years after the date of grant. Options granted under the Plan generally vest over a five-year vesting period. As of December 31, 2007, 177,035 shares were available for grant under this Plan.

Additionally, the Company assumed the outstanding options under the 1999 First Capital Bank Holding Corporation Stock Option Plan (the "First Capital Plan") in connection with the merger of First Capital Bank Holding Company with and into Company on October 1, 2005. As a result of the merger, each outstanding option under the First Capital Plan was converted into an option to purchase Coastal Banking Company, Inc. common stock. Coastal assumed and maintains the First Capital Plan solely to administer the options that were outstanding as of the effective time of the merger. As of the effective time of the merger, the Company elected to discontinue the issuance of options under the First Capital Plan.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for grants in 2007 and 2006. Expected volatilities are based on historical volatility of the Company's stock. The company has not and does not expect to pay a dividend in the near future. Historical data is used to estimate option exercises and employee terminations within the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	For the Years Ended December 31,	
	2007	2006
Weighted average grant date fair value of options granted during the year	$ 6.45	$ 7.90
Assumptions used to estimate fair value:		
Risk-free interest rate	4.630 %	4.875 %
Dividend yield	0 %	0 %
Expected volatility	22 %	19 %
Expected life	7 years	7 years

Information pertaining to options outstanding at December 31, 2007 is as follows:

Options Outstanding			Options Fully Vested and Exercisable		Options Expected to Vest	
Option Shares Outstanding	Average Remaining Life (In Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Number Expected to Vest	Weighted Average Exercise Price
48,199	1.8	$ 8.61	48,199	$ 8.61	—	$ —
54,887	2.4	8.65	54,887	8.65	—	—
9,296	3.4	9.04	9,296	9.04	—	—
11,576	4.0	8.65	11,576	8.65	—	—
9,760	4.4	10.76	9,760	10.76	—	—
15,015	5.1	7.86	15,015	7.86	—	—
4,646	5.2	11.83	3,716	11.83	930	11.83
11,575	5.4	10.65	11,575	10.65	—	—
2,756	7.2	15.19	2,756	15.19	—	—
1,653	7.6	17.91	1,653	17.91	—	—
6,300	8.6	19.81	1,260	19.81	5,040	19.81
19,425	8.9	21.91	3,885	21.91	15,540	21.91
24,399	6.5	19.05	12,201	19.05	12,198	19.05
21,000	9.8	17.27	—	—	21,000	17.27
240,487	4.7	$ 12.16	185,779	$ 10.11	54,708	$$ 19.13

A summary status of the Company's stock option plan as of December 31, 2007 and changes during the year is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding, beginning of year	220,369	$ 10.95	5.0	$ 2,553,434
Granted during the year	45,399	18.23		
Exercised during the year	(23,181)	11.77		
Cancelled during the year	(2,100)	21.91		
Outstanding, end of year	240,487	12.16	4.7	334,049
Options exercisable at year end	185,779	10.11	3.5	639,123

The weighted-average grant-date fair value of options granted during the years 2007 and 2006 was $6.45 and $7.52, respectively. The total intrinsic value of options exercised during the year ended December 31, 2007 was $41,257. The total intrinsic value of options exercised during the year ended December 31, 2006 was $470,813.

It is Coastal's policy to issue new shares for stock option exercises and restricted stock rather than issue treasury shares. Coastal recognizes stock-based compensation expense on a straight-line basis over the options' related vesting term. As of December 31, 2007, there was $372,209 of total unrecognized compensation cost related to nonvested stock-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 3.5 years. The total fair value of shares vested during the years ended December 31, 2007 and 2006 was $130,836 and $27,071, respectively.

On October 1, 2005, the Company acquired First Capital Bank Holding Corporation, the holding company for First National Bank of Nassau County, Florida. First Capital had a Phantom Stock Appreciation Rights ("PSARs") plan. As a result of the merger, the Company acquired a PSARs plan in which the participants were fully vested as a result of the merger. The PSARs Plan authorized 31,955 rights to be granted to certain officers and key employees at the discretion of the Board of Directors of First Capital. The Company does not plan to grant additional PSARs. On June 29, 2007 the PSAR Plan was frozen at current market price of $19.05. Prior to the adoption of SFAS No. 123R, the Company accounted for phantom stock appreciation rights ("PSARs") according to FASB Interpretation No. 28 ("FIN 28"). Under FIN 28, the intrinsic value of the PSARs was reflected as a liability in the balance sheet. The liability was adjusted every quarter based on the intrinsic value as of the reporting date. Upon adoption of SFAS No. 123R, the Company accounts for PSARs using liability accounting. This method requires the Company to record the liability for PSARs at fair value, rather than intrinsic value, in the balance sheet. The Company uses the Black-Scholes model to determine the fair value of PSARs. As a result of freezing the PSAR plan along with falling stock prices in 2007, the company recorded negative PSAR expense during 2007 of approximately $84,000. The expense related to the PSARs plan was approximately $97,000 for the year ended December 31, 2006. The total amount in accrued expenses was approximately $118,000 and $223,000 at December 31, 2007 and 2006, respectively. At December 31, 2007, there were 24,402 PSARS outstanding with a weighted-average exercise price of $15.35. At December 31, 2006, there were 31,955 PSARS outstanding with a weighted-average exercise price of $15.19. The PSARs outstanding are currently exercisable and have an intrinsic value of $90,000 and $235,000 at December 31, 2007 and 2006, respectively.

All share numbers and prices are restated for the effects of a 5% stock dividend paid to shareholders of record on November 30, 2007.

Note 14. Commitments and Contingent Liabilities

Loan Commitments

The Banks are parties to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and loans sold with representations and warranties. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The contractual amounts of those instruments reflect the extent of involvement the Banks have in particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Banks evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. The Banks' loans are primarily collateralized by residential and other real properties, automobiles, savings deposits, accounts receivable, inventory and equipment.

Standby letters of credit are written conditional commitments issued by the Banks to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. Most letters of credit extend for less than one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Loans on one-to-four family residential mortgages originated by us are sold to various other financial institutions with representations and warranties that are usual and customary for the industry. These representations and warranties give the purchaser of the loan the right to require that we repurchase a loan if the borrower fails to make any one of the first four loan payments within 30 days of the due date, which is termed an Early Payment Default ("EPD"). Our maximum exposure to credit loss in the event of an EPD claim would be the unpaid principal balance of the loan to be repurchased along with any premium paid by the investor when the loan was purchased and other minor collection cost reimbursements. The Bank's have never had to repurchase a loan as the result of an EPD claim by an investor and do not anticipate any material credit risk related to future potential EPD claims on loans that have been previously sold and are no longer on the Banks' balance sheets.

In addition to EPD claims, the representations and warranties in our loan sale agreements also provide that we will indemnify the investors for losses or costs on loans we sell under certain limited conditions. Some of these conditions include underwriting errors or omissions, fraud or material misstatements by the borrower in the loan application or invalid market value on the collateral property due to deficiencies in the appraisal. In connection with the start up of the wholesale lending division, the Banks have established a reserve for costs related to potential indemnification costs and EPD claims. The balance in this indemnification reserve was $18,000 at December 31, 2007 and there have been no claims or charges against this reserve since it was established in September 2007, accordingly management does not anticipate any material exposure in connection with loan sale indemnification or EPD claims.

The Banks' exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit, standby letters of credit and loans sold with representations and warranties is represented by the contractual amount of those instruments. The Banks use the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. In most cases, the Banks require collateral to support financial instruments with credit risk.

	December 31,	
	2007	**2006**
Commitments to extend credit	$ 54,302,000	$ 64,381,000
Standby letters of credit	$ 328,000	$ 800,000
Loans sold with representations and warranties	$ 14,360,000	$ 21,796,000

Contingencies

The Company has, from time to time, various lawsuits and claims arising from the conduct of its business. Such items are not expected to have any material adverse effect on the financial position or results of operations of the Company.

Note 15. Concentrations of Credit

The Banks make commercial, residential, construction, agricultural, agribusiness and consumer loans to customers South Carolina, Florida, and Georgia. A substantial portion of the Company's customers' abilities to honor their contracts is dependent on the business economy in the geographical area served by the Banks.

A substantial portion of the Company's loans are secured by real estate in the Company's primary market area. Accordingly, the ultimate collectibility of a substantial portion of the Company's loan portfolio is susceptible to changes in real estate conditions in the Company's primary market area.

Note 16. Regulatory Matters

The Company and the Banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under certain adequacy guidelines and the regulatory framework for prompt corrective action, specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices must be met. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Banks to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 Capital (as defined) to average assets (as defined). Management believes, as of December 31, 2007, that the Company and the Banks meet all capital adequacy requirements to which they are subject.

As of December 31, 2007, the most recent notification from the Federal Deposit Insurance Corporation categorized the Banks as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Banks must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Banks' category. Prompt corrective action provisions are not applicable to bank holding companies.

The actual capital amounts and ratios are also presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2007:						
Total Capital to Risk Weighted Assets						
Consolidated	$ 46,785,780	14.49 %	$ 25,824,288	8.00 %	---N/A---	
Lowcountry National Bank	$ 19,434,686	13.34 %	$ 11,655,440	8.00 %	$ 14,569,300	10.00 %
First National Bank of Nassau County	$ 23,977,702	13.68 %	$ 14,022,800	8.00 %	$ 17,528,500	10.00 %
Tier I Capital to Risk Weighted Assets						
Consolidated	$ 43,115,132	13.36 %	$ 12,912,144	4.00 %	---N/A---	
Lowcountry National Bank	$ 17,775,164	12.20 %	$ 5,827,720	4.00 %	$ 8,741,580	6.00 %
First National Bank of Nassau County	$ 21,966,576	12.53 %	$ 7,011,400	4.00 %	$ 10,517,100	6.00 %
Tier I Capital to Average Assets						
Consolidated	$ 43,115,132	10.41 %	$ 16,559,862	4.00 %	---N/A---	
Lowcountry National Bank	$ 17,775,164	9.30 %	$ 7,647,560	4.00 %	$ 9,559,450	5.00 %
First National Bank of Nassau County	$ 21,966,576	9.91 %	$ 8,869,400	4.00 %	$ 11,086,750	5.00 %

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2006:						
Total Capital to Risk Weighted Assets						
Consolidated	$ 43,471,376	13.06 %	$ 26,632,240	8.00 %	---N/A---	
Lowcountry National Bank	$ 18,066,910	11.88 %	$ 12,167,040	8.00 %	$ 15,208,800	10.00 %
First National Bank of Nassau County	$ 21,876,690	12.19 %	$ 14,355,200	8.00 %	$ 17,944,000	10.00 %
Tier I Capital to Risk Weighted Assets						
Consolidated	$ 39,783,299	11.95 %	$ 13,316,120	4.00 %	---N/A---	
Lowcountry National Bank	$ 16,412,642	10.79 %	$ 6,083,520	4.00 %	$ 9,125,280	6.00 %
First National Bank of Nassau County	$ 19,842,881	11.06 %	$ 7,177,600	4.00 %	$ 10,766,400	6.00 %
Tier I Capital to Average Assets						
Consolidated	$ 39,783,299	10.44 %	$ 15,237,280	4.00 %	---N/A---	
Lowcountry National Bank	$ 16,412,642	8.66 %	$ 7,584,200	4.00 %	$ 9,480,250	5.00 %
First National Bank of Nassau County	$ 19,842,881	9.23 %	$ 8,597,160	4.00 %	$ 10,746,450	5.00 %

There are no current plans to initiate payment of cash dividends and future dividend policy will depend on the Banks' and the Company's earnings, capital requirements, financial condition and other factors considered relevant by the Company's Board of Directors. The Banks are restricted in their ability to pay dividends under national banking laws and regulations of the OCC. Generally, these restrictions require the Banks to pay dividends derived solely from net profits. Moreover, the OCC's prior approval is required if dividends declared by either Bank in any calendar year exceed that Bank's net profit for that year combined with its retained net profits for the preceding two years.

Note 17. Fair Value of Financial Instruments

The fair value of a financial instrument is the current amount that would be exchanged between willing parties. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following disclosures should not be considered as representative of the liquidation value of the Banks, but rather represent a good-faith estimate of the increase or decrease in value of financial instruments held by the Banks since purchase, origination, or issuance. This analysis has not undertaken any steps to value any intangibles, which is permitted by the provisions of SFAS No. 107.

SFAS No. 107, *Disclosures about Fair Value of Financial Instruments,* requires disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheets, for which it is practical to estimate that value. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment and other assets and liabilities.

The following methods and assumptions were used in this analysis in estimating the fair value of financial instruments:

- ***Cash, due from banks, interest-bearing deposits in banks***: The carrying amount of cash, due from banks and interest-bearing deposits in banks approximates fair value.

- ***Securities***: Fair value of securities is based on available quoted market prices. The carrying amount of equity securities with no readily determinable fair value approximates fair value.

- ***Loans***: The carrying amount of variable-rate loans that reprice frequently and have no significant change in credit risk approximates fair value. The fair value of fixed-rate loans is estimated based on discounted contractual cash flows, using interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. The fair value of impaired loans is estimated based on discounted contractual cash flows or underlying collateral values, where applicable.

- ***Deposits***: The carrying amount of demand deposits, savings deposits and variable-rate certificates of deposits approximates fair value. The fair value of fixed-rate certificates of deposit is estimated based on discounted contractual cash flows using interest rates currently being offered for certificates of similar maturities.

- ***Federal funds Sold and Purchased, Repurchase Agreements and Other Borrowings***: The carrying amount of variable rate borrowings, federal funds purchased and securities sold under repurchase agreements approximates fair value. The fair value of fixed rate other borrowings is estimated based on discounted contractual cash flows using the current incremental borrowing rates for similar type borrowing arrangements.

- ***Junior Subordinated Debentures***: The fair value of the Company's fixed rate trust preferred securities is based on available quoted market prices.

- ***Accrued Interest:*** The carrying amount of accrued interest approximates fair value.

- ***Off-Balance-Sheet Instruments***: The carrying amount of commitments to extend credit and standby letters of credit approximates fair value. The carrying amount of the off-balance-sheet financial instruments is based on fees charged to enter into such agreements.

The carrying amount and estimated fair value of the Company's financial instruments are as follows:

	December 31,			
	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash, due from banks, and interest-bearing deposits in banks	$ 7,061,741	7,061,741	$ 6,703,162	6,703,162
Federal funds sold	4,710,397	4,710,397	18,967,745	18,967,745
Securities available for sale	87,171,416	87,171,416	60,372,740	60,732,740
Securities held to maturity	—	—	16,998,209	16,858,174
Restricted equity securities	3,683,416	3,683,416	3,710,217	3,710,217
Loans held for sale	20,553,409	20,553,409	1,039,976	1,039,976
Loans, net	277,637,628	279,855,238	288,345,306	288,580,074
Accrued interest receivable	2,322,912	2,322,912	2,422,575	2,422,575
Financial liabilities:				
Deposits	345,847,116	347,821,220	340,058,621	341,319,966
Securities sold under agreements to repurchase	2,000,000	2,000,000	2,000,000	2,000,000
Other borrowings	26,772,798	26,262,898	29,973,051	28,377,165
Junior subordinated debentures	7,217,000	7,003,992	7,217,000	7,282,039
Accrued interest payable	703,790	703,790	956,571	956,571

Note 18. Condensed Financial Information of Coastal Banking Company (Parent Company Only)

Condensed Balance Sheets

	December 31,	
	2007	2006
Assets		
Cash and due from banks	$ 1,671,457	$ 2,256,398
Investment in Coastal Banking Company Statutory Trust I & II	217,000	217,000
Investment in subsidiary banks	50,590,360	46,860,710
Premises and equipment	1,258,882	—
Other assets	349,723	1,170,358
Total assets	$ 54,087,422	$ 50,504,466
Liabilities		
Junior subordinated debentures	$ 7,217,000	$ 7,217,000
Other liabilities	123,670	115,980
Total liabilities	7,340,670	7,332,980
Shareholders' Equity		
Shareholders' equity	46,746,752	43,171,486
Total liabilities and shareholders' equity	$ 54,087,422	$ 50,504,466

Condensed Statements of Income

	For the years ended December 31,	
	2007	2006
Income		
Interest income	$ 94,506	$ 126,107
Gain on sale of real estate	—	321,038
Other income	45,990	175
Total income	140,496	447,320
Expenses		
Interest expense	560,194	391,932
Other operating expenses	724,309	450,133
Total expense	1,284,503	842,065
Loss before income tax benefits and equity in undistributed earnings of subsidiaries	(1,144,007)	(394,745)
Income tax benefits	374,239	127,716
Loss before equity in undistributed earnings of subsidiaries	(769,768)	(267,029)
Equity in undistributed earnings of subsidiaries	3,401,594	3,626,566
Net income	$ 2,631,826	$ 3,359,537

Condensed Statements of Cash Flows

	For the years ended December 31,	
	2007	2006
Cash flows from operating activities:		
Net income	$ 2,631,826	$ 3,359,537
Adjustments to reconcile net income to net cash used by operating activities:		
Equity in undistributed earnings of Bank	(3,401,594)	(3,626,566)
Depreciation and amortization	20,849	4,500
Stock-based compensation expense	130,836	27,071
Gain on sale of real estate	—	(321,038)
Change in other assets and liabilities	820,156	(1,100,721)
Net cash provided (used) by operating activities	202,073	(1,657,217)
Cash flows from investing activities:		
Purchase of premises and equipment	(1,275,231)	—
Contribution of capital to subsidiary banks	—	(4,000,000)
Investment in Coastal Banking Company Statutory Trust II	—	(124,000)
Proceeds from sale of real estate	—	735,942
Net cash used by investing activities	(1,275,231)	(3,388,058)
Cash flows from financing activities:		
Proceeds from junior subordinated debt	—	4,124,000
Proceeds from exercise of stock options	488,217	317,799
Net cash provided by financing activities	488,217	4,441,779
Net change in cash and due from banks	(584,941)	(603,476)
Cash and due from banks at beginning of year	2,256,398	2,859,874
Cash and due from banks at end of year	$ 1,671,457	$ 2,256,398

Coastal Banking Company, Inc., and Subsidiaries Corporate Data

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Albany, Georgia 31708

Stock Information

The Common Stock of Coastal Banking Company, Inc., is not listed on any exchange. However, the stock is quoted on the NASDAQ OTC Bulletin Board under the symbol "CBCO.OB." There were approximately 670 shareholders of record on December 31, 2007. The following table sets forth the high and low bid prices as quoted on the OTC Bulletin Board during the periods indicated. The quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commissions, and may not represent actual transactions. All prices are adjusted for the stock dividends paid to shareholders of record on December 14, 2007.

	Years Ended December 31,			
	2007		2006	
	High	Low	High	Low
First quarter	$ 22.67	$ 21.30	$ 19.10	$ 18.10
Second quarter	$ 21.57	$ 18.57	$ 18.57	$ 18.05
Third quarter	$ 18.57	$ 16.67	$ 20.76	$ 18.05
Fourth quarter	$ 17.76	$ 12.38	$ 22.77	$ 20.05

Coastal Banking Company, Inc., has never declared or paid a cash dividend and does not expect to do so in the foreseeable future. The ability of Coastal Banking Company, Inc., to pay cash dividends is dependent upon receiving cash dividends from the Banks. However, federal banking regulations restrict the amount of cash dividends that can be paid to Coastal Banking Company, Inc., from the Banks. All of our outstanding shares of common stock are entitled to share equally in dividends from funds legally available when, and if, declared by the board of directors.

Copies of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007, as filed with the Securities and Exchange Commission, will be furnished at no charge to shareholders upon written request to: Paul R. Garrigues, Chief Financial Officer, Coastal Banking Company, Inc., 36 Sea Island Parkway, Beaufort, SC 29907.

This Annual Report serves as the Annual Financial Disclosure Statement furnished pursuant to Part 350 of the Federal Deposit Insurance Corporation's Rules and Regulations. This Statement has not been reviewed or confirmed for accuracy or relevance by the Office of the Comptroller of the Currency.

Coastal Banking Company, Inc.
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