South Atlantic Bancshares, Inc.

2013 ANNUAL REPORT



South Atlantic Bank

South Atlantic Bank was organized in 2007 to meet the unique financial needs of businesses and consumers in the coastal communities we serve. The bank's founders recognized that the growing number of regional banks in the market created an opportunity for a locally owned and operated community bank to succeed. The bank opened its Myrtle Beach office in November 2007, and added locations in Murrells Inlet in December 2008, Pawleys Island in June 2012, and Georgetown in September 2013. Its loan production office in Mount Pleasant opened in October 2013. The bank's product menu includes personal and business checking, savings, and money market accounts, along with mortgages, loans, and lines of credit. The bank offers technologically advanced products including its new mobile banking app, South Atlantic Bank *go*Mobile. We are focused on establishing customer relationships through quality service and convenience with a high level of personal attention. Our bank is a South Carolina chartered bank that is fully insured by the FDIC. Our community banking philosophy strongly emphasizes credit quality, sound banking practices, and exemplary customer service as a model for success.

Mission Statement

To serve, in a fair, balanced, and superior manner, the interest of shareholders, customers, employees, and the public through adherence to high standards of financial soundness, exemplary customer service, employee professionalism, business ethics, corporate citizenship, and profitability.

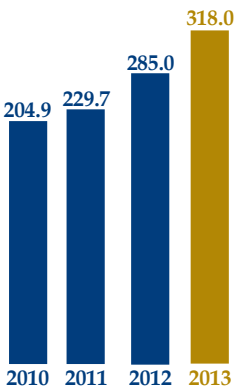
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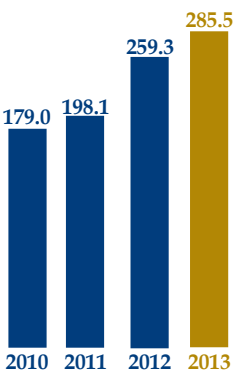
Our front cover features the South Atlantic Bank locations. From left to right are: Myrtle Beach, Murrells Inlet, Pawleys Island, Georgetown, and Mount Pleasant.

Selected Financial Highlights

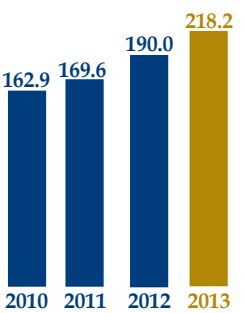
	For the Year Ended 2013	For the Year Ended 2012	For the Year Ended 2011	For the Year Ended 2010
Year End Balances (in thousands)				
Total assets	$ 318,057	284,988	$ 229,725	$ 204,909
Investment securities	73,727	59,455	37,769	22,289
Loans, net of unearned income (total loans)	218,174	189,979	169,638	162,894
Deposits	285,519	259,338	198,086	178,871
Shareholders' equity	24,141	25,359	22,937	20,725
Average Balances (in thousands)				
Total assets	$ 307,746	263,886	$ 227,637	$ 188,535
Earning assets	281,908	243,927	213,033	173,812
Investment securities	69,880	49,505	34,829	21,028
Loans, net of unearned income (total loans)	199,817	173,624	164,188	144,490
Deposits	281,306	238,513	203,909	165,660
Shareholders' equity	24,904	24,092	21,843	21,606
Earnings Breakdown (in thousands)				
Total interest income	$ 11,291	10,002	$ 9,496	$ 7,955
Total interest expense	1,311	1,620	2,144	2,792
Net interest income	9,980	8,382	7,352	5,162
Total noninterest income	1,996	2,632	841	540
Total noninterest expense	9,154	7,991	6,192	5,610
Provision for loan losses	730	1,330	1,310	1,031
Income (loss) before taxes	2,092	1,693	692	(939)
Taxes	447	(869)	(463)	6
Net income (loss)	1,645	2,562	1,155	(945)
Selected % Increases				
Total assets	11.61%	24.06%	12.11%	24.94%
Total interest earning assets	11.93%	25.58%	10.44%	26.78%
Total loans	14.85%	11.99%	4.14%	34.46%
Total deposits	10.10%	30.92%	10.74%	25.89%
Interest income	12.89%	5.33%	19.38%	42.37%
Interest expense	(19.08)%	(24.45)%	(23.22)%	1.56%
Noninterest income	(24.15)%	212.96%	55.84%	3.34%
Noninterest expense	14.55%	29.05%	10.36%	13.73%
Selected Ratios				
Return on average assets	0.54%	0.97%	0.30%	(0.44)%
Return on average equity	6.61%	10.63%	3.17%	(3.72)%
Interest income to total average assets	3.67%	3.79%	4.17%	4.22%
Interest expense to total average assets	0.43%	0.61%	0.94%	1.48%
Net interest income to total average assets	3.24%	3.18%	3.23%	2.74%
Loan loss reserve to total loans	1.10%	1.21%	1.39%	1.21%
Nonperforming assets to total assets	0.13%	0.77%	0.58%	0.32%
Net charge-offs to total average assets	0.21%	0.52%	0.41%	0.35%
Net interest margin	3.54%	3.43%	3.40%	2.88%



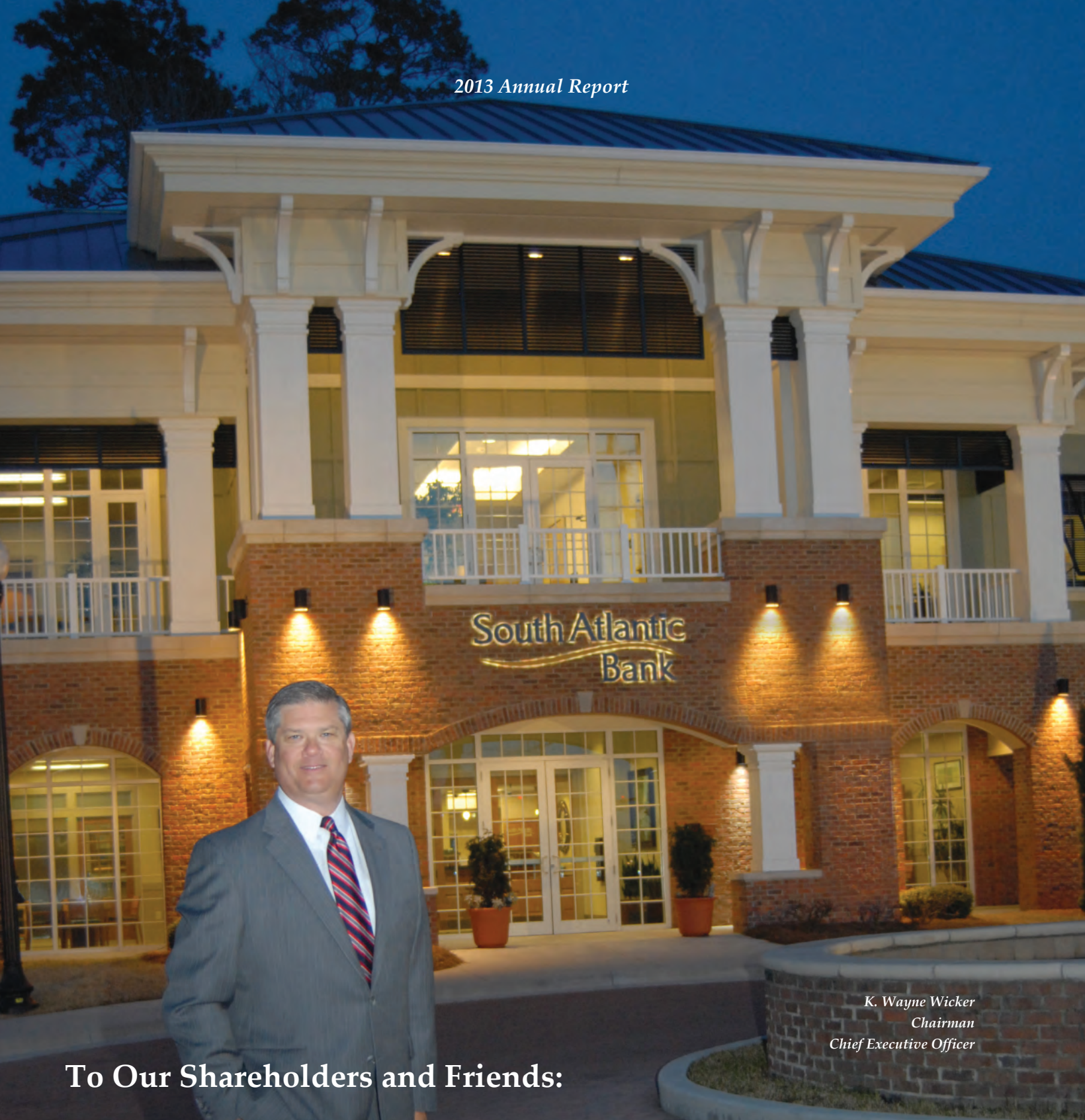
Total Assets
$ in millions



Total Deposits
$ in millions



Total Loans
$ in millions



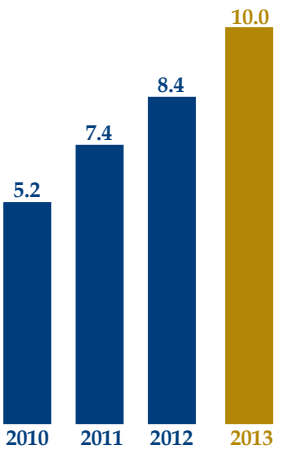
K. Wayne Wicker
Chairman
Chief Executive Officer

To Our Shareholders and Friends:

In a year filled with significant accomplishments including the addition of new locations, mortgage personnel, and innovative products, South Atlantic Bank turned in another strong financial performance. It's an exciting time of growth and expansion at the bank, and I am pleased to share the details with you in our Annual Report.

For the year ended December 31, 2013, the bank had income before taxes of $2,091,823, an increase of 23.5 percent when compared to the $1,693,273 reported for the same period a year ago. The bank became fully taxable in January 2013, after its second full year of profitability. Net income for the year ended December 31, 2013, was $1,644,650 or $0.53 per diluted share, figures that exceeded our budget projections for the year.

We can attribute our successful year to several factors. Our new offices in Georgetown and Mount Pleasant are off to a good start and are already contributing to our bottom line. We have experienced positive growth in the balance sheet. Lines of business including mortgage loans and merchant services are performing well and contributing to our performance. In addition, economic conditions in the markets we serve, particularly in the South Strand and Mount Pleasant areas, are showing signs of improvement.



Net Interest Income
($ in millions)

We experienced strong loan growth of 14.8 percent in 2013, with a good portion of the increase achieved in the fourth quarter. Momentum in the new locations, combined with solid performances from our existing offices, helped to fuel this positive growth. With an improving economy, we have seen an increase in loan demand and our loan officers are working hard every day to capitalize on quality opportunities.

During this period of loan growth, we made impressive gains in credit quality as several important ratios reflected improvement. Nonperforming assets to total average assets declined from 0.77 percent in 2012, to 0.13 percent in 2013. Net charge-offs to total average assets declined 31 basis points to 0.21 percent in 2013, compared to 0.52 percent in 2012. These ratios compare quite favorably to state and national figures and are an excellent indication of the strength of our credit quality.

In 2013, we expanded our geographic footprint southward with two new locations. Our full service office in Georgetown opened in September, followed by our loan production office in Mount Pleasant in October, and the impact of both offices has been felt immediately. Our success in the new markets is due in large part to the teams we assembled to launch our presence. At both offices, we have veteran bankers in place who understand their communities' banking needs and are committed to the South Atlantic Bank way of doing business.


Georgetown Staff


Mount Pleasant LPO Staff

An improving economy and a rebounding housing market provided the impetus to double the size of our mortgage department in 2013. We had the opportunity to add four veteran mortgage professionals to our established team. With the combined team in place, we have been able to offer more products and services, while covering territory from North Myrtle Beach to Charleston. Our mortgage area is well-positioned to help the bank grow this important line of business and we are already seeing results from their efforts.



Mortgage Team

The new locations and additional staffing contributed to a 14.55 percent increase in noninterest expense during 2013, but we are pleased with both the early results and our outlook for 2014. With our staff and locations in place, we are committed to the success of these new endeavors and will work hard to establish and develop our operations before launching any new initiatives.

The maturation of our existing offices also contributed to our financial performance in 2013. Market share data released by the FDIC for June 30, 2013, shows solid gains for South Atlantic Bank. In Horry and Georgetown counties, the bank ranked eighth out of a field of 26 competitors with deposit market share of 4.78 percent. Our bank accomplished this strong showing with just three locations, compared to an average of 13.5 offices for the banks ranked first through seventh. The bank with the fewest locations had three times as many as South Atlantic Bank, with nine. Also significant is that in just one year of banking operations, our Pawleys Island office achieved deposit market share of more than 10%. Our improving market share numbers show the quality of our locations and our people and that our approach to expansion is sound.



Artist's Rendering – New Pawleys Island Office

As its market share indicates, the Pawleys Island office rapidly outgrew its original space at Waverly Place. In late December 2013, the bank purchased 1.15 acres at the corner of Lachicotte Road and Ocean Highway in Pawleys Island with construction on a new building now underway at the site. The building will resemble our Myrtle Beach and Murrells Inlet locations, and is being built by Coastal Structures of Georgetown. Completion is expected in the summer of 2014.

We should not overlook our dedication to providing quality customer service as a driver of our financial performance. A case in point is the data breach that affected consumers who shopped at Target stores across the country in mid December 2013. The breach put millions of debit and credit cardholders at risk of fraud. We knew that the best way to

protect our customers was to stop sales transactions on their present cards and get new cards in their hands as soon as possible. Our customers appreciated our quick action and our efforts to protect their interests. News of our customer service spread quickly in our community, generating a lot of positive feedback about our bank.

The bank continues to receive kudos for its financial performance. For the second consecutive year, South Atlantic Bank was honored as a "Roaring Twenties" winner by SC Biz News. This special program honors the 20 best-performing companies in South Carolina in small and large categories. South Atlantic Bank was again the only Grand Strand-based business to be honored as the majority of companies included hail from Columbia, Charleston, and Greenville. Overall, the bank was the 16th best-performing large company in the state. SC Biz News produces several state-wide business news publications including the *Charleston Regional Business Journal* and the *Columbia Regional Business Report*.

We continue to play an enthusiastic role in a variety of community events that provide local organizations with much needed support. Whether it's a gala fundraiser, a golf tournament, or an 8K race, South Atlantic Bank will be there. In addition to corporate sponsorship, our employees give generously of their time, volunteering at many of these special events. We also work closely with our local schools, providing banking curriculum and guest speakers. The guided tours of our bank for Myrtle Beach Elementary School are highly anticipated by our staff, students, and teachers alike, and demonstrate the partnership that has developed between the bank and the schools. Our bank will continue to have a positive influence on the community for years to come.



Myrtle Beach Elementary School Tours

With a year of solid financial performance and numerous achievements behind us, we have set the stage for a strong 2014. Our community bank is growing and thriving, and I hope you are pleased with the strides we continue to make. We appreciate your investment and your continued support. If you have any questions, please do not hesitate to contact me personally if I can be of service to you.

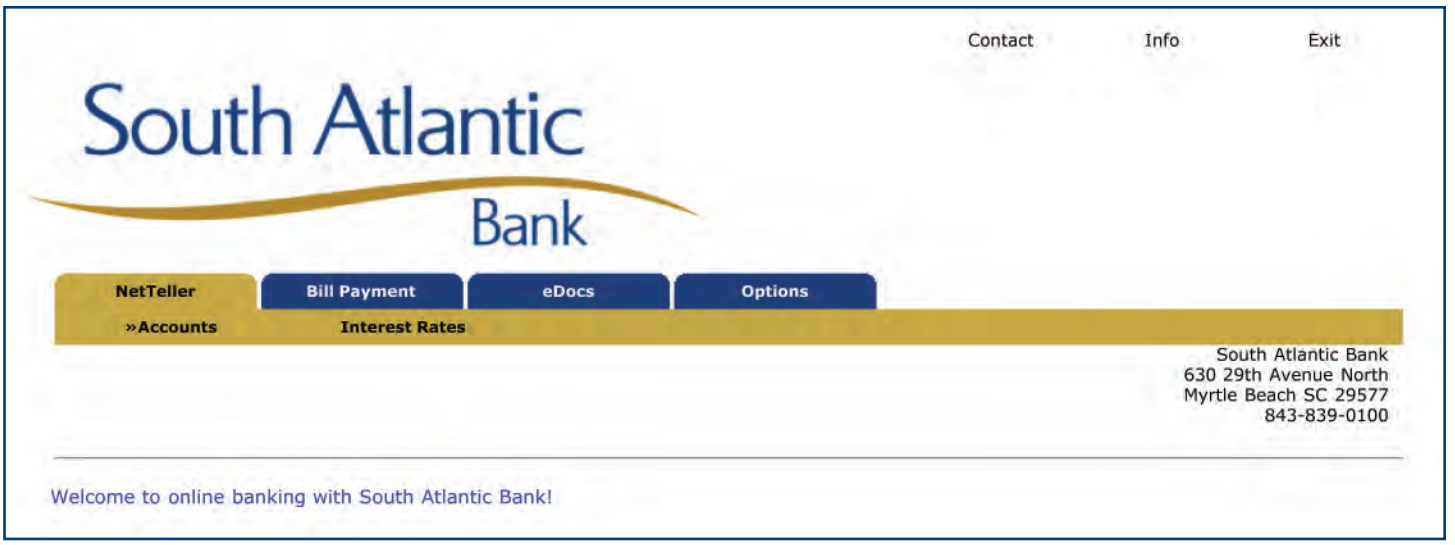
Please make plans to attend our Annual Meeting of Shareholders to take place on Tuesday, April 22, beginning at 5:30 p.m. at the bank's Myrtle Beach headquarters. We look forward to sharing our 2013 results and our plans for the future with you.

K. Wayne Wicker
Chairman
Chief Executive Officer

New Products Emphasize Banking Anytime, Anywhere!

Today's customers require banking products that keep up with their need for speed and convenience. At South Atlantic Bank, we are committed to providing safe and secure banking solutions for the fast-paced world in which we live. From traditional online banking access to mobile banking applications and instant issue debit cards, the tech-savvy customer will be right at home at South Atlantic Bank.

Online Banking, Bill Payer, and e-Docs.



It all began with NetTeller, our online banking and bill payer service. NetTeller has become the customer's passport to all the electronic services we offer. This service is provided free because it is key to solidifying the customer's relationship with us.

A new addition to our online banking product is e-Docs, which allows customers to receive their statements electronically. With e-Docs, the customer receives an e-mail on the day the paper statement would normally be sent, instead of a bulky envelope filled with pages of check images a few days later in the U.S. mail. The e-mail directs the customer to the NetTeller online banking login screen to access the current statement.

e-Docs provides the customer with all the information of the traditional statement in a format that is easy to access, read, and store, while helping the bank to reduce its postage costs.



e-Docs eliminates the need for messy files while saving time and trees.

South Atlantic Bank *go*Mobile.

Our new mobile banking app made its public debut in July 2013 to rave reviews.

This free app allows customers to view transactions, transfer funds, and pay bills with their web-enabled smart phones. Android™ and iPhone™ users can download the app, while users of other cell phones (Blackberry, for example) can easily access *go*Mobile from the URL www.mobile.SouthAtlanticBank.com. We also offer Mobile Text Banking, which allows customers to obtain current balances and view transactions by sending a simple text such as "BAL" or "HIST" to our secure server.

Customers can enroll in South Atlantic Bank *go*Mobile via NetTeller, our online banking service.



It's for banking anytime, anywhere!

Quick Card Debit Cards.



South Atlantic Bank Quick Cards.

New technology has enabled us to get debit cards in our customers' hands within hours of account opening.

With its smooth surface, the Quick Card more closely resembles a hotel room key card. Cards are printed at our Myrtle Beach headquarters using our secure printer technology and then sent via courier to our branches for our customers. The Quick Card greatly reduces the length of time it takes to receive a new card. The risk of fraud also is reduced because the customer selects a Personal Identification Number (PIN) at the branch, eliminating the need for a PIN mailer.

The Quick Card technology enabled us to replace compromised cards within hours, not days during the Target data breach in mid December 2013.

*sms*Guardian® Text Message System.



We enlisted the *sms*Guardian® text message system to help in the battle against debit card fraud. "SMS" stands for "short message service" and allows cardholders to receive and respond to cell phone text message alerts about debit card transactions that meet certain parameters. The cardholder receives an sms within seconds of the card swipe, reviews the alert, and needs to respond only if he or she did not make the transaction in question. The following card activity will trigger an sms: transactions that exceed $100 or three in a 24-hour period, transactions made online, via phone, out-of-state, internationally, or for fuel purchases, and transactions that are declined at the point of sale.

This immediate, two-way communication can help deter fraud as it happens.

smsGuardian uses your cell phone to help fight fraud.

Identity Theft Protection.

Because safety and security is so important to us at South Atlantic Bank, we offer our customers access to premier identity theft solutions from LegalShield℠. Customers can find information about the plans available through a link to LegalShield℠ that is provided on our website, SouthAtlanticBank.com. As bankers, we understand the considerable damage that identity theft can do, and we want our customers to do all they can to protect themselves from harm. LegalShield℠ uses the latest technology in the battle against identity theft in their moderately priced programs.

LegalShield℠
Worry Less, Live More

We firmly believe that our investment in technologically advanced products is in the best interest of our bank and our customers. As further proof of our commitment to these services, we will introduce Mobile Remote Deposit Capture later in 2014.

When customers visit our bank, they will find the level of products usually offered only at much larger financial institutions, delivered with the personal service that has become the hallmark of our bank. It is the best of both worlds, as we use the technology available to build and enhance relationships with our customers.

Independent Auditor's Report

elliott davis

The Board of Directors
South Atlantic Bancshares, Inc. and Subsidiary
Myrtle Beach, South Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of South Atlantic Bancshares, Inc. and its subsidiary, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of South Atlantic Bancshares, Inc. and its subsidiary as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC

Columbia, South Carolina
February 24, 2014

South Atlantic Bancshares, Inc. and Subsidiary
Consolidated Balance Sheets

	December 31, 2013	December 31, 2012
Assets:		
Cash and cash equivalents:		
Cash and due from banks	$ 1,160,068	$ 1,434,580
Federal funds sold and interest-bearing deposits	3,515,627	14,448,738
Total cash and cash equivalents	4,675,695	15,883,318
Investment securities:		
Securities available-for-sale	73,018,770	59,110,256
Nonmarketable equity securities	708,300	344,600
Total investment securities	73,727,070	59,454,856
Mortgage loans held-for-sale	137,281	685,451
Loans receivable	218,036,846	189,293,290
Less allowance for loan losses	2,394,588	2,306,358
Loans, net	215,642,258	186,986,932
Premises, furniture and equipment, net	14,648,103	13,606,853
Bank-owned life insurance	5,370,213	5,195,417
Other real estate owned	40,000	407,825
Accrued interest receivable	1,439,689	948,765
Other assets	2,376,365	1,818,139
Total assets	**$ 318,056,674**	**$ 284,987,556**
Liabilities:		
Deposits:		
Noninterest-bearing transaction accounts	$ 38,396,560	$ 31,009,200
Interest-bearing transaction accounts	20,913,939	14,989,907
Savings and money market accounts	175,318,204	163,623,603
Time deposits $100,000 and over	25,355,877	26,054,248
Other time deposits	25,534,027	23,661,027
Total deposits	285,518,607	259,337,985
Advances from Federal Home Loan Bank	8,140,000	–
Accrued interest payable	14,991	16,489
Other liabilities	242,236	273,980
Total liabilities	**293,915,834**	**259,628,454**
Commitments and contingencies (Notes 12, 14, and 19)		
Shareholders' equity:		
Preferred stock, $1.00 par value per share, 5,000,000 shares authorized; no shares issued and outstanding	–	–
Common stock, $1.00 par value, 25,000,000 shares authorized; 3,037,315 and 3,026,315 shares issued and outstanding at December 31, 2013 and 2012, respectively	3,037,315	3,026,315
Capital surplus	25,597,101	25,507,384
Retained deficit	(1,577,965)	(3,222,615)
Accumulated other comprehensive income (loss)	(2,915,611)	48,018
Total shareholders' equity	24,140,840	25,359,102
Total liabilities and shareholders' equity	**$ 318,056,674**	**$ 284,987,556**

See accompanying *Notes to Consolidated Financial Statements*.

South Atlantic Bancshares, Inc. and Subsidiary
Consolidated Statements of Income

	For the years ended December 31, 2013	2012
Interest income:		
Loans, including fees	$ 10,017,877	$ 9,041,427
Securities available-for-sale	1,236,050	916,850
Federal funds sold and interest-bearing deposits	37,173	43,966
Total	11,291,100	10,002,243
Interest expense:		
Time deposits $100,000 and over	216,669	260,708
Other deposits	1,090,099	1,356,181
Other borrowings	4,015	3,111
Total	1,310,783	1,620,000
Net interest income	**9,980,317**	**8,382,243**
Provision for loan losses	730,000	1,330,000
Net interest income after provision for loan losses	**9,250,317**	**7,052,243**
Noninterest income:		
Mortgage origination income	398,713	411,294
Merchant fee income	332,445	226,422
Service charges on deposit accounts	113,342	102,516
Gain on sale of investment securities	11,060	312,865
Bank-owned life insurance income	174,796	186,228
Gain on sale of loans	592,275	1,110,758
Other fee income	373,079	282,289
Total noninterest income	1,995,710	2,632,372
Noninterest expenses:		
Salaries and employee benefits	5,122,634	4,407,395
Net occupancy	676,202	616,091
Furniture and equipment	340,357	350,173
FDIC banking assessments	227,169	209,977
Advertising	312,631	308,708
Other operating expenses	2,475,211	2,098,998
Total noninterest expenses	9,154,204	7,991,342
Income before income taxes	2,091,823	1,693,273
Income tax expense (benefit)	447,173	(868,834)
Net income	**$ 1,644,650**	**$ 2,562,107**
Income per common share:		
Basic income per common share	$ 0.54	$ 0.85
Average common shares outstanding – basic	3,032,162	3,026,315
Diluted income per common share	$ 0.53	$ 0.85
Average common shares outstanding – diluted	3,075,164	3,026,315

See accompanying *Notes to Consolidated Financial Statements*.

South Atlantic Bancshares, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income (Loss)

	For the years ended 2013	2012
Net Income	**$ 1,644,650**	**$ 2,562,107**
Other comprehensive loss		
Unrealized loss on securities available-for-sale	(3,898,024)	(146,639)
Reclassification adjustment for gains realized in net income	(11,060)	(312,865)
Other comprehensive loss before tax effects	(3,909,084)	(459,504)
Income tax benefit	945,455	156,232
Net-of-tax amount	$ (2,963,629)	$ (303,272)
Comprehensive income (loss)	**$ (1,318,979)**	**$ 2,258,835**

See accompanying *Notes to Consolidated Financial Statements*.

South Atlantic Bancshares, Inc. and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity and Income

Years ended December 31, 2013 and 2012	Common Stock Shares	Common Stock Amount	Capital surplus	Retained deficit	Accumulated other comprehensive income (loss)	Total
Balance, December 31, 2011	**2,751,192**	**$ 2,751,192**	**$25,619,249**	**$ (5,784,722)**	**$ 351,290**	**$ 22,937,009**
Net income				2,562,107		2,562,107
Other comprehensive loss, net of tax benefit of $156,232					(303,272)	(303,272)
Stock option and warrant compensation expense	–	–	163,258	–	–	163,258
Ten percent stock dividend	275,123	275,123	(275,123)			–
Balance, December 31, 2012	**3,026,315**	**$ 3,026,315**	**$ 25,507,384**	**$ (3,222,615)**	**$ 48,018**	**$ 25,359,102**
Net income				1,644,650		1,644,650
Other comprehensive loss, net of tax benefit of $945,455					(2,963,629)	(2,963,629)
Stock option and warrant compensation expense			727			727
Exercise of stock warrants	11,000	11,000	88,990	–	–	99,990
Balance, December 31, 2013	**3,037,315**	**$ 3,037,315**	**$ 25,597,101**	**$ (1,577,965)**	**$ (2,915,611)**	**$ 24,140,840**

See accompanying *Notes to Consolidated Financial Statements*.

South Atlantic Bancshares, Inc. and Subsidiary
Consolidated Statements of Cash Flows

	For the years ended December 31, 2013	2012
Operating activities:		
Net income	**$ 1,644,650**	**$ 2,562,107**
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	730,000	1,330,000
Depreciation expense	516,794	515,829
Discount accretion and premium amortization	1,092,588	650,958
Stock option and warrant compensation expense	727	163,258
Gain on sale of securities	(11,060)	(312,865)
Deferred tax expense (benefit)	594,557	(868,834)
Amortization of deferred loan costs and fees, net	(231,483)	(126,429)
Write downs of other real estate owned	86,979	150,000
Loss on sale of other real estate owned	160,456	1,655
Increase in accrued interest receivable	(490,924)	(53,376)
Decrease in accrued interest payable	(1,498)	(1,429)
(Increase) decrease in other assets	(207,328)	137,368
Increase (decrease) in other liabilities	(31,744)	90,451
Net cash provided by operating activities	**3,852,714**	**4,238,693**
Investing activities:		
Purchase of securities available-for-sale	(55,345,552)	(72,701,579)
Proceeds from sales of securities available-for-sale	28,114,758	32,049,000
Proceeds from maturities, calls, and paydowns of securities available-for-sale	8,331,669	17,981,735
(Purchase) sale of nonmarketable equity securities	(363,700)	187,800
Net increase in loans	(28,905,674)	(22,087,722)
Income from bank-owned life insurance	(174,796)	(186,228)
Purchase of premises, furniture and equipment	(1,600,365)	(263,706)
Proceeds from sale of premises, furniture, and equipment	42,321	—
Proceeds from sale of other real estate owned	420,390	84,027
Net cash used by investing activities	**(49,480,949)**	**(44,936,673)**
Financing activities:		
Increase in noninterest-bearing deposits	7,387,360	14,888,256
Increase in interest-bearing deposits	18,793,262	46,363,330
Net decrease in federal funds purchased	—	(3,500,000)
Proceeds from Federal Home Loan Bank Advances	8,140,000	—
Repayments of Federal Home Loan Bank Advances	—	(5,000,000)
Proceeds from stock warrants exercised	99,990	—
Net cash provided by financing activities	**34,420,612**	**52,751,586**
Net increase (decrease) in cash and cash equivalents	**(11,207,623)**	**12,053,606**
Cash and cash equivalents, beginning of year	**15,883,318**	**3,829,712**
Cash and cash equivalents, end of year	**$4,675,695**	**$ 15,883,318**
Cash paid during the year for:		
Interest	$ 1,312,280	$ 1,621,430
Income taxes	$ 104,331	$ 55,347
Noncash investing and financing activities:		
Unrealized gain (loss) on securities available-for-sale	$ (3,909,084)	$ (459,504)
Transfer of loans to other real estate owned	$ 300,000	$ 487,824

See accompanying *Notes to Consolidated Financial Statements*.

Notes to Consolidated Financial Statements

Note 1: Summary of Significant Accounting Policies

Organization — South Atlantic Bancshares, Inc. and Subsidiary (the "Company") was incorporated to serve as a bank holding company for its subsidiary, South Atlantic Bank (the Bank). South Atlantic Bank commenced business on November 28, 2007. The principal business activity of the Bank is to provide banking services to domestic markets, principally in Horry, Georgetown, and Charleston counties, South Carolina. The Bank is a state-chartered commercial bank, and its deposits are insured by the Federal Deposit Insurance Corporation. The consolidated financial statements include the accounts of the parent company and its wholly-owned subsidiary after elimination of all significant intercompany balances and transactions.

Management's 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 dates of the balance sheets and the statements of income for the periods covered. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, including valuation allowances for impaired loans, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowances for losses on loans and foreclosed real estate may change materially in the near term.

Concentrations of Credit Risk —Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in Horry, Georgetown, and Charleston Counties in South Carolina. Management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

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 from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices. 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. However, to offset this risk, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully amortized (i.e. balloon payment loans usually 5 to 7 years). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Company to unusual credit risk.

The Company's investment portfolio consists principally of obligations of the United States, its agencies or its corporations and general obligation municipals. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its 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.

Securities Available-for-Sale — Securities available-for-sale are carried at amortized cost and adjusted to estimated market value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded in shareholders' equity net of deferred income taxes. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of investments available-for-sale is determined by specific identification and is used in computing the gain or loss upon sale.

Nonmarketable Equity Securities — Nonmarketable equity securities include the cost of the Company's investment in the stock of the Federal Home Loan Bank. The stock has no quoted market value and no ready market exists. Investment in Federal Home Loan Bank stock is a condition of borrowing from the Federal Home Loan Bank. At December 31, 2013 and 2012, the investment in Federal Home Loan Bank stock was $708,300 and $344,600, respectively. Dividends received on the stock are included in the federal funds sold and short-term investments component of interest income.

Loans Held-for-Sale —The Bank's mortgage activities are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgages and selling mortgages to investors under pre-existing commitments. Funded residential mortgages held temporarily for sale to investors are recorded at cost which approximates market value. Application and origination fees collected by the Bank are recognized as income upon sale to the investor.

Loans Receivable — Loans are stated at their unpaid principal balance adjusted for any unamortized deferred fees and costs. Interest income is accrued on the unpaid principal balance using the simple interest method and is recorded in the period earned.

When serious doubt exists as to the collectibility of a loan or when a loan becomes contractually 90 days past due as to principal or interest, interest income is generally discontinued unless the estimated net realizable value of collateral exceeds the principal balance and accrued interest. When interest accruals are discontinued, income earned but not collected is reversed.

Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using a method that approximates a level yield.

The Company identifies impaired loans through its normal internal loan review process. Loans on the Company's problem loan watch list are considered potentially impaired loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered impaired if a minimal payment delay occurs and all amounts due, including accrued interest at the contractual interest rate for the period of delay, are expected to be collected.

Allowance for Loan Losses — The provision for loan losses charged to operating expenses reflects the amount deemed appropriate by management to establish an adequate reserve to meet the probable loan losses present in the current portfolio. Management's judgment is based on periodic and regular evaluation of individual loans, the overall risk characteristics of the various portfolio segments, and prevailing economic conditions. Loans that are determined to be uncollectible are charged against the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance.

While management uses the best information available to make evaluations, future adjustments may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. The allowance for loan losses is subject to periodic evaluation by various regulatory authorities and may be subject to adjustment upon their examination.

Premises, Furniture and Equipment — Premises, furniture and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings and improvements of 40 years, for furniture and equipment of 5 to 10 years and software of 3 years. Leasehold improvements are amortized over the life of each respective lease. The cost of assets sold or otherwise disposed of and the related allowance for depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the income statement when incurred. Maintenance and repairs are charged to current expense. The costs of major renewals and improvements are capitalized.

Other Real Estate Owned — Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is initially recorded at fair value at the date of foreclosure less estimated costs of disposal, which establishes a new cost. After foreclosure, valuations are periodically performed by management and are carried at the lower of cost or fair value less estimated costs of disposal. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for loan losses. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value and valuation allowances to reduce the carrying amount to fair value less estimated costs to dispose are recorded as necessary. Revenue and expense from the operations of foreclosed assets and changes in the valuation allowances are included in net expenses from foreclosed assets in other operating expenses.

Income Taxes — Income taxes are the sum of amounts currently payable to taxing authorities and the net changes in income taxes payable or refundable in future years. Income taxes deferred to future years are determined utilizing a

liability approach. This method gives consideration to the future tax consequences associated with differences between financial accounting and tax bases of certain assets and liabilities which are principally the allowance for loan losses, depreciable premises and equipment, and the net operating loss carryforward.

The Company follows the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 740-10, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The provision also prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise's tax return. No uncertain tax provisions have been taken.

Employee Benefits — The Bank sponsors a defined contribution 401(k) Employee Stock Ownership Plan ("KSOP") covering substantially all full-time employees. Under the plan and present policies, participants are permitted to make contributions up to the deferral limits allowed by the Internal Revenue Service. The Company contributes to the Plan annually upon approval by the Board of Directors. The amount of the contributions made is at the discretion of the Board with vesting of these employer contributions ratably over the next five year period. During the years ended December 31, 2013 and 2012, the Bank recognized $124,778 and $111,138, respectively, in expenses related to this plan.

On January 1, 2013, we converted our defined contribution 401(k) contribution plan into a 401(k) Employee Stock Ownership Plan ("KSOP"), which provides a mechanism for Company employees to invest. Each employee who has attained age twenty-one and has completed at least 1,000 hours of service in a Plan year is eligible to participate in the ESOP. The Company recognizes expense when the contribution is approved by the Board of Directors. There was no expense for the year ended December 31, 2013.

Advertising Expense — Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expended in the period in which the direct mailings are sent.

Income Per Common Share — Basic income per common share represents income available to shareholders divided by the weighted-average number of common shares outstanding during the period. Dilutive income per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. The only potential common share equivalents are those related to stock options and warrants. Stock options and warrants which are anti-dilutive are excluded from the calculation of diluted net income per share. The dilutive effect of options and warrants outstanding under the Company's stock compensation plan is reflected in diluted earnings per share by the application of the treasury stock method. Retroactive recognition has been given for the effects of all stock dividends.

Stock-Based Compensation — The Company accounts for stock options and warrants under the fair value recognition provisions of FASB ASC 718, "Stock Based Compensation." Compensation expense is recognized as salaries and benefits in the consolidated statements of income.

Merchant Fee Income — Merchant fee income represents fees received by the Bank related to credit card processing. These fees are recorded on the accrual basis of accounting.

Comprehensive Income — The Company reports comprehensive income in accordance with ASC 220, "Comprehensive Income." ASC 220 requires that all items that are required to be reported under accounting standards as comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The disclosure requirements have been included in the Company's consolidated statements of comprehensive income.

Statement of Cash Flows — For purposes of reporting cash flows in the financial statements, the Company considers certain highly liquid debt instruments purchased with a original maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, federal funds sold, and interest bearing deposits. Generally, federal funds are sold for one-day periods.

Changes in the valuation account of securities available-for-sale, including the deferred tax effects, are considered non-cash transactions for purposes of the statement of cash flows and are presented in detail in the notes to the consolidated financial statements.

Off-Balance-Sheet Financial Instruments — In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the financial statements when they become payable by the customer.

Recently Issued Accounting Pronouncements — The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders' equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Company January 1, 2012, and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements while the FASB redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments will be effective for the Company on a prospective basis for reporting periods beginning after December 15, 2013. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2013, the FASB issued guidance addressing application of the liquidation basis of accounting. The guidance is intended to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. The amendments will be effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein and those requirements should be applied prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The Company does not expect these amendments to have any effect on its financial statements.

In December 2013, the FASB amended the Master Glossary of the FASB Codification to define "Public Business Entity" to minimize the inconsistency and complexity of having multiple definitions of, or a diversity in practice as to what constitutes, a nonpublic entity and public entity within U.S. GAAP. The amendment does not affect existing requirements, however will be used by the FASB, the Private Company Council ("PCC"), and the Emerging Issues Task Force ("EITF") in specifying the scope of future financial accounting and reporting guidance. The Company does not expect this amendment to have any effect on its financial statements.

In January 2014, the FASB amended the Receivables – Troubled Debt Restructurings by Creditors subtopic of the Codification to address the reclassification of consumer mortgage loans collateralized by residential real estate upon foreclosure. The amendments clarify the criteria for concluding that a substance repossession or foreclosure has occurred, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. The amendments also outline interim and annual disclosure requirements. The amendments will be effective for the Company for interim and annual reporting periods beginning after December 15, 2014. Companies are allowed to use either a modified retrospective transition method or a prospective transition method when adopting this update. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Risks and Uncertainties — In the normal course of its business, the Company encounters two significant types of risks: 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 basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies (regulatory risk). 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 from the regulators' judgments based on information available to them at the time of their examination.

Reclassifications — Certain captions and amounts in the 2012 consolidated financial statements were reclassified to conform with the 2013 presentation.

Note 2: Cash and Due From Banks

The Company is required by regulation to maintain an average cash reserve balance based on a percentage of deposits. The average amount of the required cash reserve balances at December 31, 2013 and 2012 was approximately $517,000 and $969,000, respectively. At December 31, 2013 and 2012, the required cash reserve was satisfied by vault cash.

Note 3: Investment Securities

The amortized cost and estimated fair values of securities available-for-sale were:

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 29,519,015	$ 37,045	$ 1,085,735	$ 28,470,325
Government-sponsored enterprises	1,000,000	–	80,545	919,455
SBA loan pools	17,407,109	4,345	197,083	17,214,371
Obligations of state and local governments	28,928,976	4,308	2,518,665	26,414,619
Total investment securities	**$ 76,855,100**	**$ 45,698**	**$ 3,882,028**	**$ 73,018,770**

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 31,452,981	$ 184,384	$ 65,125	$ 31,572,240
Government-sponsored enterprises	7,504,027	2,962	12,758	7,494,231
SBA Loan Pools	4,730,873	9,908	78,043	4,662,738
Obligations of state and local governments	15,349,621	258,831	227,405	15,381,047
Total investment securities	**$ 59,037,502**	**$ 456,085**	**$ 383,331**	**$ 59,110,256**

The following is a summary of maturities of securities available-for-sale as of December 31, 2013. The amortized cost and estimated fair values are based on the contractual maturity dates except for mortgage-backed securities.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ –	$ –
Due after one year but within five years	5,571,736	5,456,971
Due after five years but within ten years	30,121,799	28,772,443
Due after ten years	11,642,550	10,319,031
Mortgage-backed securities	29,519,015	28,470,325
Total	**$ 76,855,100**	**$ 73,018,770**

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, 2013 and 2012.

	December 31, 2013					
	Less than 12 months		12 months or more		Total	
Available-for-Sale	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government-sponsored enterprises	$ 919,455	$ 80,545	$ –	$ –	$ 919,455	$ 80,545
Mortgage-backed securities	21,970,324	1,085,735	–	–	21,970,324	1,085,735
SBA loan pools	13,859,822	178,406	1,119,312	18,677	14,979,134	197,083
Obligations of state and local governments	22,460,146	2,214,417	2,565,949	304,248	25,026,095	2,518,665
Total	**$59,209,747**	**$3,559,103**	**$ 3,685,261**	**$ 322,925**	**$ 62,895,008**	**$ 3,882,028**

	December 31, 2012					
	Less than 12 months		12 months or more		Total	
Available-for-Sale	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government-sponsored enterprises	$ 1,987,243	$ 12,758	$ —	$ —	$ 1,987,243	$ 12,758
Mortgage-backed securities	13,088,154	65,125	—	—	13,088,154	65,125
SBA loan pools	3,591,176	78,043	—	—	3,591,176	78,043
Obligations of state and local governments	6,745,975	227,405	—	—	6,745,975	227,405
Total	**$ 25,412,548**	**$ 383,331**	**—**	**—**	**$ 25,412,548**	**$ 383,331**

At December 31, 2013, the Bank had four securities which had been in an unrealized loss position for greater than twelve months. There were no investments in an unrealized loss position for greater than twelve months at December 31, 2012.

At December 31, 2013 and 2012, the Bank had 49 and 20 debt securities, respectively, which have been in an unrealized loss position for less than twelve months. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary.

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. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Gross proceeds from the sale of investment securities in 2013 and 2012 totaled $28,114,758 and $32,049,000, respectively. Sales of securities during 2013 resulted in gross realized gains of $161,745 and gross realized losses of $150,685, respectively. Sales of securities during 2012 resulted in gross realized gains of $384,413 and gross realized losses of $71,548, respectively.

At December 31, 2013, securities with book values of $7,482,169 and market values of $7,349,707 were pledged to secure federal funds lines of credit with other financial institutions. At December 31, 2012, securities with book values of $5,554,191 and market values of $5,604,678 were pledged to secure federal funds lines of credit with other financial institutions.

Note 4: Loans Receivable

Following is a summary of loans by major classification as of December 31:

	2013	2012
Commercial	$ 29,593,118	$ 27,962,083
Commercial real estate	130,691,850	122,465,200
Consumer	2,267,739	1,639,577
Consumer real estate	55,715,621	37,352,859
Total gross loans	218,268,328	189,419,719
Less unearned origination fees, net	231,482	126,429
Allowance for loan losses	2,394,588	2,306,358
Loans, net	**$ 215,642,258**	**$ 186,986,932**

The following is a summary of information pertaining to our allowance for loan losses (by purpose code) as of and for the year ending December 31, 2013:

	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Unallocated	Total
Allowance for loan losses:						
Beginning balance	$ 213,665	$ 673,748	$ 21,204	$ 126,151	$ 1,271,590	$ 2,306,358
Charge-offs	(158,597)	(156,892)	(33,259)	(309,034)	—	(657,782)
Recoveries	15,000	—	100	912	—	16,012
Provisions	63,803	(80,947)	33,115	378,153	335,876	730,000
Ending balance	$ 133,871	$ 435,909	$ 21,160	$ 196,182	$ 1,607,466	$ 2,394,588
Ending balances: Individually evaluated for impairment	$ —	$ 400,000	$ —	$ —	$ —	$ 400,000
Collectively evaluated for impairment	$ 133,871	$ 35,909	$ 21,160	$ 196,182	$ 1,607,466	$ 1,994,588
Loans receivable:						
Ending balance — total	$ 29,593,118	$ 130,691,850	$ 2,267,739	$ 55,715,621	$ —	$218,268,328
Ending balances: Individually evaluated for impairment	$ 282,659	$ 2,683,518	$ —	$ 170,332	$ —	$ 3,136,509
Collectively evaluated for impairment	$ 29,310,459	$ 128,008,332	$ 2,267,739	$ 55,545,289	$ —	$215,131,819

The following is a summary of information pertaining to our allowance for loan losses (by purpose code) as of and for the year ending December 31, 2012:

	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Unallocated	Total
Allowance for loan losses:						
Beginning balance	$ 180,356	$ 875,967	$ 10,363	$ 250,185	$ 1,044,801	$ 2,361,672
Charge-offs	(194,401)	(922,089)	(18,170)	(263,110)	—	(1,397,770)
Recoveries	9,780	1,558	1,118	—	—	12,456
Provisions	217,930	718,312	27,893	139,076	226,789	1,330,000
Ending balance	$ 213,665	$ 673,748	$ 21,204	$ 126,151	$ 1,271,590	$ 2,306,358
Ending balances: Individually evaluated for impairment	$ —	$ 400,000	$ —	$ —	$ —	$ 400,000
Collectively evaluated for impairment	$ 213,665	$ 273,748	$ 21,204	$ 126,151	$ 1,271,590	$ 1,906,358
Loans receivable:						
Ending balance — total	$ 27,962,083	$ 122,465,200	$ 1,639,577	$ 37,352,859	$ —	$189,419,719
Ending balances: Individually evaluated for impairment	$ —	$ 3,443,819	$ —	$ 872,146	$ —	$ 4,315,965
Collectively evaluated for impairment	$ 27,962,083	$ 119,021,381	$ 1,639,577	$ 36,480,713	$ —	$185,103,754

Credit Quality Indicators

Loans are categorized into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The following definitions are utilized for risk ratings, which are consistent with the definitions used in supervisory guidance:

Special Mention – Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard – Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss – Loans classified as loss are considered uncollectible.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2013:

	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Total
Grade:					
Pass	$ 29,579,710	$ 123,336,934	$ 2,249,322	$ 55,344,551	$ 210,510,517
Special Mention	–	4,388,739	–	200,738	4,589,477
Substandard	13,408	2,934,942	18,417	170,332	3,137,099
Doubtful	–	31,235	–	–	31,235
Loss	–	–	–	–	–
Total	**$ 29,593,118**	**$ 130,691,850**	**$ 2,267,739**	**$ 55,715,621**	**$ 218,268,328**

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2012:

	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Total
Grade:					
Pass	$ 27,816,895	$ 117,156,149	$ 1,617,015	$ 36,660,950	$ 183,251,009
Special Mention	–	1,447,300	–	201,181	1,648,481
Substandard	145,188	3,831,804	22,562	490,728	4,490,282
Doubtful	–	29,947	–	–	29,947
Loss	–	–	–	–	–
Total	**$ 27,962,083**	**$ 122,465,200**	**$ 1,639,577**	**$ 37,352,859**	**$ 189,419,719**

The following is a past due aging analysis of our loan portfolio at December 31, 2013:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Commercial	$ –	$ –	$ –	$ –	$ 29,593,118	$ 29,593,118	$ –
Commercial RE	–	–	342,764	342,764	130,349,086	130,691,850	–
Consumer	–	–	–	–	2,267,739	2,267,739	–
Consumer RE	76,987	–	–	76,987	55,638,634	55,715,621	–
Total	**$ 76,987**	**$ –**	**$342,764**	**$ 419,751**	**$217,848,577**	**$218,268,328**	$ –

The following is a past due aging analysis of our loan portfolio at December 31, 2012:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Commercial	$ —	$ —	$125,000	$ 125,000	$ 27,837,083	$ 27,962,083	$125,000
Commercial RE	245,733	—	—	245,733	122,219,467	122,465,200	—
Consumer	—	—	—	—	1,639,577	1,639,577	—
Consumer RE	—	—	—	—	37,352,859	37,352,859	—
Total	**$ 245,733**	**$ —**	**$125,000**	**$ 370,733**	**$189,048,986**	**$189,419,719**	**$ 125,000**

The following is an analysis of our impaired loan (including nonaccrual loans) portfolio detailing the related allowance recorded at December 31, 2013:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Commercial	$ 282,659	$ 283,875	$ —	$ 235,629	$ 1,216
Commercial Real Estate	693,127	1,333,158	—	724,778	17,437
Consumer — Other	—	—	—	—	—
Consumer — Real Estate	170,332	170,332	—	185,074	7,151
With an allowance recorded:					
Commercial	$ —	$ —	$ —	$ —	$ —
Commercial Real Estate	1,990,391	1,990,391	400,000	1,997,977	39,365
Consumer — Other	—	—	—	—	—
Consumer — Real Estate	—	—	—	—	—
Total:					
Commercial	$ 282,659	$ 283,875	$ —	$ 235,629	$ 1,216
Commercial Real Estate	2,683,518	3,323,549	400,000	2,722,755	56,802
Consumer — Other	—	—	—	—	—
Consumer — Real Estate	170,332	170,332	—	185,074	7,151
Total Impaired Loans	**$ 3,136,509**	**$ 3,777,756**	**$ 400,000**	**$ 3,143,458**	**$ 65,159**

The following is an analysis of our impaired loan (including nonaccrual loans) portfolio detailing the related allowance recorded at December 31, 2012:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Commercial	$ —	$ —	$ —	$ —	$ —
Commercial Real Estate	1,438,257	1,473,915	—	1,473,915	53,870
Consumer — Other	—	—	—	—	—
Consumer — Real Estate	872,146	836,849	—	836,489	14,720
With an allowance recorded:					
Commercial	$ —	$ —	$ —	$ —	$ —
Commercial Real Estate	2,005,562	1,959,447	400,000	2,003,462	60,557
Consumer — Other	—	—	—	—	—
Consumer — Real Estate	—	—	—	—	—
Total:					
Commercial	$ —	$ —	$ —	$ —	$ —
Commercial Real Estate	3,443,819	3,433,362	400,000	3,477,377	114,427
Consumer — Other	—	—	—	—	—
Consumer — Real Estate	872,146	836,489	—	836,489	14,720
Total Impaired Loans	**$ 4,315,965**	**$ 4,269,851**	**$ 400,000**	**$ 4,313,866**	**$ 129,147**

The following is an analysis of our nonaccrual loan portfolio recorded at December 31, 2013 and 2012:

	2013	2012
Commercial	$ —	$ 97,230
Commercial real estate	625,423	1,130,951
Consumer	—	392,077
Consumer real estate	76,987	—
Total	**$ 704,410**	**$ 1,620,258**

Troubled Debt Restructurings

As a result of adopting the amendments in ASU 2011-02, the Bank reassessed all restructurings that occurred on or after the beginning of the fiscal year of adoption (January 1, 2011) to determine whether they are considered troubled debt restructurings (TDRs) under the amended guidance. The Bank identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance methodology. Upon identifying those loans as TDRs, the Bank identified them as impaired under the guidance in ASC 310-10-35. The amendments in ASU 2011-02 require prospective application of the impairment measurement guidance in ASC 310-10-35 for those loans newly identified as impaired.

The following is an analysis of TDRs identified during 2013:

		For the year ended December 31, 2013	
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	1	$ 283,875	$ 283,875
Commercial real estate	—	—	—
Consumer	—	—	—
Consumer real estate	1	93,345	93,345
Total	**2**	**$ 377,220**	**$ 377,220**

The following is an analysis of TDRs identified during 2012:

Troubled Debt Restructurings	Number of Contracts	For the year ended December 31, 2012 Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	3	$ 2,867,058	$ 2,597,056
Commercial real estate	–	–	–
Consumer	–	–	–
Consumer real estate	1	144,743	98,652
Total	**4**	**$ 3,011,801**	**$ 2,695,708**

In the determination of the allowance for loan losses, management considers troubled debt restructurings and subsequent defaults in these restructurings by market analysis and present value calculations. No loans restructured in the year prior to December 31, 2013 and 2012 went into default during the year. A default is considered to be any loan greater than 90 days past due.

Note 5: Premises, Furniture and Equipment

Premises, furniture and equipment is summarized as follows as of December 31:

	2013	2012
Land	$ 5,427,993	$ 4,518,547
Buildings and leasehold improvements	8,603,158	8,603,158
Furniture and equipment	2,293,260	2,039,387
Software	433,483	331,664
Automobile	44,765	44,765
Construction in progress	302,502	9,596
Total	17,105,161	15,547,117
Less, accumulated depreciation	2,457,058	1,940,264
Premises, furniture and equipment, net	**$ 14,648,103**	**$ 13,606,853**

Depreciation expense for the years ended December 31, 2013 and 2012 was $516,794 and $515,829, respectively. Construction in process relates to improvements to the leased Georgetown branch. Estimated costs to complete the construction are $3,000.

Note 6: Other Real Estate Owned

Activity in other real estate owned is summarized as follows for the year ended December 31:

	2013	2012
Balance, beginning of year	$ 407,825	$ 155,682
Additions	300,000	487,824
Sales	(580,846)	(85,682)
Write downs	(86,979)	(150,000)
Balance, end of year	**$ 40,000**	**$ 407,824**

Note 7: Deposits

At December 31, 2013, the scheduled maturities of time deposit are as follows:

2014	33,251,840
2015	7,183,248
2016	6,025,171
2017	4,429,645
Total	**$ 50,889,904**

The Bank had brokered deposits of $17,613,000 and $9,834,000 as of December 31, 2013 and 2012, respectively.

Note 8: Advances from Federal Home Loan Bank

Advances from the Federal Home Loan Bank (FHLB) consisted of the following at December 31, 2013:

Description	Interest Rate	2013
Fixed rate advances maturing:		
January 13, 2014	0.19%	$ 5,000,000
April 30, 2014	0.27%	3,140,000
Total		**$ 8,140,000**

All FHLB advances outstanding as of December 31, 2013, and totaling $8,140,000, mature in 2014. The Bank had no FHLB advances outstanding as of December 31, 2012.

Pursuant to collateral agreements with the FHLB, advances are secured by stock in the FHLB and by qualifying first mortgage, home equity lines of credit and commercial real estate loans. As of December 31, 2013, the pledged collateral totaled approximately $23 million. Certain advances are subject to prepayment penalties.

Note 9: Stock Compensation Plan

Under the terms of employment agreements with the Company's Chief Executive Officer (CEO), President, and Chief Financial Officer (CFO), stock options were granted to each as part of their compensation and benefits package. Under these agreements, the CEO was granted options to purchase common stock equal to 5% of the shares sold in the offering, or 151,315 options as adjusted for the Company's 2012 stock dividend. The President and CFO were each granted options to purchase common stock equal to 3% of the shares sold in the offering or a total of 90,789 options, as adjusted for the Company's 2012 stock dividend. These options vest ratably over five years. The options have an exercise price of $9.09 per share and terminate ten years after the date of grant.

The Company also established the 2007 Stock Incentive Plan (the Plan) which provides for the granting of options to employees. The Company granted a total of 344,442 stock options, as adjusted for the Company's 2012 stock dividends, to various employees under the Plan, including the options granted above to executive officers. These options have a vesting and expected term of five years and an exercise price of $9.09 per share and terminate ten years after the date of grant. During 2013, the Company granted a total of 13,000 stock options. These options have a vesting and expected term of five years. These options have an exercise price of $10.50 and terminate ten years after the date of the grant.

A summary of the status of the Company's stock options, and changes during the period are presented below:

	2013		2012	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	344,442	$ 9.09	344,442	$ 9.09
Granted	13,000	10.50	–	–
Exercised	–	–	–	–
Forfeited	–	–	–	–
Outstanding at end of year	**357,442**		**344,442**	

The fair value of options is estimated at the date of grant using the Black-Sholes pricing model and expensed over the options' vesting period. The following weighted-average assumptions were used in valuing options issued during 2013.

	Weighted-Average Assumptions
Dividend yield	0.00%
Expected life	5 years
Expected volatility	7.04%
Risk-free interest rate	1.61%

There were 344,442 exercisable options at December 31, 2013 with a weighted average exercise price of $9.09. There was no aggregate intrinsic value of these options at December 31, 2013. Total compensation expense related to stock options was $727 and $114,791 for the years ended December 31, 2013 and 2012, respectively. As of December 31, 2013, there was $16,618 of total unrecognized compensation cost related to nonvested stock options.

The following table summarizes information about stock options outstanding under the Bank's Plan at December 31, 2013 and 2012:

	2013	2012
Number of options	357,442	344,442
Weighted average remaining life	4 years	5 years
Weighted average exercise price	$ 9.14	$ 9.09
High exercise price	$ 10.50	$ 9.09
Low exercise price	$ 10.00	$ 9.09

A summary of the status of the Bank's nonvested shares as of December 31 is presented below:

	2013		2012	
	Shares	Weighted Average Grant-Date Fair Value	Shares	Weighted Average Grant-Date Fair Value
Nonvested at the beginning of the year	–	$ –	68,888	$ 2.59
Granted	13,000	1.12	–	–
Vested	–	–	68,888	2.59
Forfeited	–	–	–	–
Nonvested at end of year	**13,000**		**–**	

Note 10: Stock Warrants

The organizers of the Company received stock warrants giving them the right to purchase one share of common stock for every share they purchased in the initial offering of the Company's common stock up to 11,000 shares at a price of $9.09 per share. The warrants vest ratably over a five year period and terminate ten years after date of grant. Warrants held by directors of the Company will expire 90 days after the director ceases to be a director or officer of the Company (365 days if due to death or disability).

In 2013, no warrants were issued or cancelled, however 11,000 warrants were exercised in 2013, leaving a total of 99,000 outstanding and exercisable as of December 31, 2013. Total compensation expense related to warrants was $0 and $48,467 for the years ended December 31, 2013 and 2012, respectively.

Note 11: Income Taxes

Income tax expense (benefit) is summarized as follows for the years ending December 31:

	2013	2012
Current portion:		
Federal	$ —	$ —
State	96,275	105,180
	96,275	105,180
Deferred income taxes	(594,557)	(1,130,244)
Income tax expense (benefit)	**$ (498,282)**	**$ (1,025,064)**

Income tax expense is allocated as follows for the years ended December 31, 2013 and 2012:

	2013	2012
To continuing operations	$ 447,173	$ (868,834)
To shareholder's equity	(945,455)	156,230
Net tax expense (benefit)	**$ (498,282)**	**$ (712,604)**

The gross amounts of deferred tax assets and deferred tax liabilities are as follows as of December 31, 2013 and 2012:

	2013	2012
Deferred tax assets:		
Allowance for loan losses	$ 498,458	$ 651,206
Net operating loss carryforward	1,508,672	1,689,349
Organization and start-up costs	148,622	165,446
Unrealized loss on securities available-for-sale	920,718	—
Federal and state credits	259,132	171,848
Other	39,425	81,126
Total deferred tax assets	3,375,027	2,758,975
Valuation allowance	(5,233)	(4,165)
Net deferred tax assets	**3,369,794**	**2,754,810**
Deferred tax liabilities:		
Accumulated depreciation	1,235,100	1,209,845
Loan origination costs	54,376	33,237
Prepaid expenses	36,484	37,714
Unrealized gain on securities available-for-sale	—	24,737
Total deferred tax liabilities	1,325,960	1,305,533
Net deferred tax asset	**$ 2,043,834**	**$ 1,449,277**

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. Management's judgment is based on estimates concerning future income earned and positive earnings for the years ended December 31, 2013 and 2012. Management has concluded that sufficient positive evidence exists to overcome any and all negative evidence in order to meet the "more likely than not standard" regarding the realization of the net deferred tax assets. As of December 31, 2013 and 2012, a small valuation allowance in the amount of $5,233 and $4,165, respectively, remains for state holding company losses. Net deferred tax assets are recorded in other assets on the Company's consolidated balance sheet.

The Company has a federal net operating loss carryforward for income tax purposes of $4,415,218 and $4,960,137 as of December 31, 2013 and 2012, respectively. The Company has a state net operating loss carryforward of $124,186 and $87,950 as of December 31, 2013 and 2012, respectively. These net operating loss carryforwards begin to expire in the year 2028.

A reconciliation between the income tax expense and the amount computed by applying the Federal statutory rate of 34% to income before income taxes follows for the years ended December 31, 2013 and 2012:

	2013	2012
Tax expense at statutory rate	$ 711,220	$ 575,713
State income tax, net of federal income tax benefit	63,542	80,905
Change in valuation allowance	1,068	(1,430,231)
Cash surrender value of life insurance	(59,431)	(63,318)
Other municipal income	(216,593)	(76,435)
Other	(52,633)	44,532
Income tax expense (benefit)	**$ 447,173**	**$ (868,834)**

Tax returns for 2010 and subsequent years are subject to examination by taxing authorities.

Note 12: Leases

Operating lease expense totaled $82,122 and $58,487 for the years ended December 31, 2013 and December 31, 2012, respectively. Minimum future rental payments under non-cancelable operating leases having remaining terms in excess of one year, for each of the next five years and thereafter in the aggregate are:

2014	$ 131,929
2015	110,244
2016	68,418
2017	71,418
2018 and thereafter	91,753
Total	**$ 473,762**

The Company is leasing a portion of its Murrells Inlet location to an unrelated tenant. Lease income generated from this tenant totaled $56,998 and $46,957 during the years ended December 31, 2013 and 2012, respectively.

Note 13: Related Party Transactions

Certain parties (principally certain directors and executive officers of the Company, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectibility. As of December 31, 2013 and 2012, the Company had related party loans totaling $9,530,718 and $11,090,058, respectively.

Deposits by directors, including their affiliates and executive officers, were approximately $21,857,225 and $23,359,615 at December 31, 2013 and 2012, respectively.

Note 14: Commitments and Contingencies

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. Management is not aware of any legal proceedings which would have a material adverse effect on the financial position or operating results of the Company.

Note 15: Income Per Common Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common

share equivalents include common shares issuable upon exercise of outstanding stock warrants and stock options. Retroactive recognition has been given for the effects of all stock dividends. The effect from stock options on incremental shares from the assumed conversions for basic earnings per share and diluted earnings per share are presented below:

	2013	2012
Income per common share – basic computation:		
Net income	$ 1,644,650	$ 2,562,107
Average common shares outstanding – basic	3,032,162	3,026,315
Basic income per common share	$ 0.54	$ 0.85
Income per common share – diluted computation:		
Net income	$ 1,644,650	$ 2,562,107
Average common shares outstanding – basic	3,032,162	3,026,315
Incremental shares from assumed conversions:		
Stock options and warrants	43,002	–
Average common shares outstanding – diluted	3,075,164	3,026,315
Diluted income per common share	$ 0.53	$ 0.85

Note 16: Regulatory Matters

The Bank is 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 adverse material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's 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 Bank to maintain minimum ratios of Tier 1 and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk weights ranging from 0% to 100%. Tier 1 capital consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital. The regulatory minimum requirements are 4% for Tier 1 and 8% for total risk-based capital.

The Bank is also required to maintain capital at a minimum level based on total assets, which is known as the leverage ratio. Only the strongest banks are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

As of December 31, 2013, management believes it is categorized as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events that management believes have changed the Bank's category.

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements:

	Actual		For capital adequacy purposes Minimum		To be well-capitalized under prompt corrective action provisions Minimum	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2013						
Total capital (to risk-weighted assets)	$ 29,086,000	11.91%	$ 19,537,040	8.00%	$ 24,421,300	10.00%
Tier 1 capital (to risk-weighted assets)	26,691,000	10.93%	9,768,520	4.00%	14,652,780	6.00%
Tier 1 capital (to average assets)	26,691,000	8.61%	12,402,320	4.00%	15,502,900	5.00%
December 31, 2012						
Total capital (to risk-weighted assets)	$ 27,087,000	12.54%	$ 17,280,383	8.00%	$ 21,600,478	10.00%
Tier 1 capital (to risk-weighted assets)	24,781,000	11.47%	8,642,023	4.00%	12,963,034	6.00%
Tier 1 capital (to average assets)	24,781,000	8.83%	11,225,821	4.00%	14,032,276	5.00%

Note 17: Unused Lines of Credit

As of December 31, 2013, the Company had unused lines of credit to purchase federal funds from unrelated banks totaling $29,700,000. These lines of credit are available on a one to fourteen day basis for general corporate purposes. As of December 31, 2013 and 2012, there were no borrowings on these lines.

The Company also has an additional line of credit with the Federal Home Loan Bank to borrow funds, subject to a pledge of qualified collateral. As of December 31, 2013, the Company borrowed $8,140,000 on this line. The Company had approximately $14,300,000 and $9,800,000 of available funds with the Federal Home Loan Bank as of December 31, 2013 and 2012, respectively. There were no borrowings at December 31, 2012.

On December 20, 2013, the parent company obtained a $4,000,000 line of credit from an unrelated financial institution. The line bears a fixed rate of interest at 5% and matures on January 5, 2016. Once funds are drawn, the repayment schedule will be interest payable quarterly and the balloon payment at maturity. The proceeds of the loan are to be used for general corporate purposes. There were no amounts outstanding for this line of credit at December 31, 2013.

Note 18: Shareholders' Equity

Stock Dividends – In December 2012, the Board of Directors declared a ten percent stock dividend payable on December 18, 2012, to shareholders of record at December 3, 2012. As a result of the stock dividend, 275,123 shares were issued. All share and per share amounts have been adjusted to reflect these dividends.

The ability of South Atlantic Bancshares, Inc. and Subsidiary to pay cash dividends is dependent upon receiving cash in the form of dividends from its banking subsidiary. However, certain restrictions exist regarding the ability of the subsidiary to transfer funds to South Atlantic Bancshares, Inc. and Subsidiary. The approval of the South Carolina Board of Financial Institutions is required to pay dividends in excess of the Bank's net profits (as defined) for the current year plus retained net profits (as defined) for the preceding two years, less any required transfers to surplus. As of December 31, 2013, the Bank had no retained earnings available for cash dividends.

Note 19: Financial Instruments With Off-Balance-Sheet Risk

The Company is a party 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 consist of commitments to extend credit and standby letters of credit. 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. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance 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. The Company uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities.

Collateral held for commitments to extend credit and letters of credit varies but may include accounts receivable, inventory, property, plant, equipment and income-producing commercial properties.

The following table summarizes the Bank's off-balance-sheet financial instruments at December 31, 2013 and 2012 whose contract amounts represent credit risk:

	2013	2012
Commitments to extend credit	$ 27,505,000	$ 14,990,000
Letters of credit	1,737,890	879,986
Total	**$ 29,242,890**	**$ 15,869,986**

Note 20: Fair Value of Financial Instruments

Accounting standards require disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

The accounting standard defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted market prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasuries, and money market funds.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, mortgage-backed securities, municipal bonds, corporate debt securities, and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly-structured or long-term derivative contracts.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis:

Investment Securities Available-for-Sale: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the counter markets and money market funds. Level 2 securities include mortgage backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans: The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2013 and 2012 substantially all of the impaired loans were evaluated based upon the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Other Real Estate Owned: Foreclosed assets are adjusted to fair value upon transfer of the loans to other real estate owned. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable

market price or a current appraised value, the Company recorded the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Mortgage Loans Held-for-Sale: The fair values of mortgages held for sale are derived from an active market of similar loans and as such are classified as Level 2 in the fair value hierarchy.

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy.

	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Government-sponsored enterprises	$ 919,455	$ –	$ 919,455	$ –
Obligations of state and local governments	26,414,619	–	26,414,619	–
Mortgage-backed securities	28,470,325	–	28,470,325	–
SBA pools	17,214,371	–	17,214,371	
Loans held-for-sale	137,281	–	137,281	–
Total	**$ 73,156,051**	**$ –**	**$ 73,156,051**	**$ –**

	December 31, 2012			
	Total	Level 1	Level 2	Level 3
Government-sponsored enterprises	$ 7,494,231	$ –	$ 7,494,231	$ –
Obligations of state and local governments	15,381,047	1,163,040	14,218,007	–
Mortgage-backed securities	31,572,240	–	31,572,240	–
SBA pools	4,662,738	4,662,738	–	
Loans held-for-sale	685,451	–	685,451	–
Total	**$ 59,795,707**	**$ 5,825,778**	**$ 53,969,929**	**$ –**

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of December 31, 2013 and 2012 for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2013 and 2012.

	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Other real estate owned	$ 40,000	$ –	$ 40,000	$ –
Impaired loans:				
Commercial	282,659	–	282,659	–
Commercial real estate	2,283,518	–	2,283,518	–
Consumer real estate	170,332	–	170,332	–
Total impaired loans	2,736,509	–	2,736,509	–
Total	**$ 2,776,509**	**$ –**	**$ 2,776,509**	**$ –**

	December 31, 2012			
	Total	Level 1	Level 2	Level 3
Other real estate owned	$ 407,825	$ –	$ 407,825	$ –
Impaired loans:				
Commercial real estate	3,043,819	–	3,043,819	–
Consumer real estate	872,146	–	872,146	–
Total impaired loans	3,915,965	–	3,915,965	–
Total	**$ 4,323,790**	**$ –**	**$ 4,323,790**	**$ –**

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Due from Banks — The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold and Interest Bearing Deposits — Federal funds are sold for a term of one day, and the carrying amount approximates the fair value.

Securities Available-for-Sale — Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Nonmarketable Equity Securities — The carrying value of these securities approximates the fair value since no ready market exists for the stocks.

Mortgage Loans Held-for-Sale — The carrying value of mortgage loans held-for-sale approximates fair value.

Loans Receivable — For certain categories of loans, such as variable rate loans which are repriced frequently and have no significant change in credit risk, fair values are based on the carrying amounts. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with contractual terms of the loan agreement are considered impaired. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

Bank Owned Life Insurance — The carrying amount is a reasonable estimate of fair value.

Deposits — The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit and other time deposits are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

Federal Funds Purchased — The carrying amount is a reasonable estimate of fair value.

Advances from Federal Home Loan Bank — For disclosure purposes, the fair value of the FHLB fixed rate borrowing is estimated using discounted cash flows, based on the current incremental borrowing rates for similar types of borrowing arrangements. The carrying value of advances from Federal Home Loan Bank approximates fair value.

Accrued Interest Receivable and Payable — The carrying value of these instruments is a reasonable estimate of fair value.

Off-Balance Sheet Financial Instruments — Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the counterparties' credit standing.

The carrying values and estimated fair values of the Company's financial instruments as of December 31, 2013 and 2012 are as follows:

	2013		2012	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and due from banks	$ 1,160,068	$ 1,160,068	$ 1,434,580	$ 1,434,580
Federal funds sold and interest-bearing deposits	3,515,627	3,515,627	14,448,738	14,448,738
Securities available-for-sale	73,018,770	73,018,770	59,110,256	59,110,256
Nonmarketable equity securities	708,300	708,300	344,600	344,600
Loans held-for-sale	137,281	137,281	685,451	685,451
Loans receivable	218,036,846	216,166,672	189,293,290	188,714,911
Bank-owned life insurance	5,370,213	5,370,218	5,195,417	5,195,417
Accrued interest receivable	1,439,689	1,439,689	948,765	948,765
Financial Liabilities:				
Demand deposit, interest-bearing transaction, and savings accounts	234,628,703	234,628,703	209,622,710	209,622,710
Certificates of deposit and other time deposits	50,889,904	43,582,764	49,715,275	47,229,511
Advances from Federal Home Loan Bank	8,140,000	8,112,065	—	—
Accrued interest payable	14,991	14,991	16,489	16,489

	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Off-Balance Sheet Financial Instruments:				
Commitments to extend credit	$ 27,505,000	$ —	$ 14,990,000	$ —
Letters of credit	1,737,890	—	879,986	—

Note 21: Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through February 24, 2014, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

Note 22: South Atlantic Bancshares, Inc. and Subsidiary (Parent Company Only)

Following is condensed financial information of South Atlantic Bancshares, Inc. (parent company only) as of and for the years ended December 31:

Consolidated Balance Sheets

	December 31,	
	2013	2012
Assets:		
Cash	$ 318,498	$ 494,546
Investment in banking subsidiary	23,774,794	24,828,874
Other assets	49,354	37,488
Total assets	**$ 24,142,646**	**$ 25,360,908**
Liabilities and shareholders' equity:		
Accrued expenses	$ 1,807	$ 1,806
Shareholders' equity	24,140,840	25,359,102
Total liabilities and shareholders' equity	**$ 24,142,646**	**$ 25,360,908**

Consolidated Statements of Income

	2013	2012
Income:	$ –	$ –
Expenses:		
Salaries and benefits	15,727	163,258
Other	17,343	29,069
Total	33,070	192,327
Loss before income taxes and equity in undistributed income of banking subsidiary:	(33,070)	(192,327)
Income tax benefit	18,171	30,376
Equity in undistributed income of banking subsidiary	1,659,549	2,724,058
Net income	**$ 1,644,650**	**$ 2,562,107**

Condensed Statements of Cash Flows

	2013	2012
Operating activities:		
Net income	$ 1,644,650	$ 2,562,107
Adjustments to reconcile net income to net cash used by operating activities:		
Equity in undistributed income of banking subsidiary	(1,659,549)	(2,724,058)
Stock and warrant compensation expense	727	163,258
Proceeds from exercise of warrants	99,990	–
Increase in investment in bank	(250,000)	–
Increase in other assets	(11,866)	(18,141)
Net cash used by operating activities	(176,048)	(16,834)
Net decrease in cash and cash equivalents	(176,048)	(16,834)
Cash and due from banks, beginning of year	**494,546**	**511,380**
Cash and due from banks, end of year	**$ 318,498**	**$ 494,546**

South Atlantic Bancshares, Inc. Corporate Information

Annual Meeting

The Annual Meeting of Shareholders of South Atlantic Bancshares, Inc. will take place on Tuesday, April 22, 2014, at 5:30 p.m. at the bank's headquarters at 630 29th Avenue North, Myrtle Beach, South Carolina, 29577.

Stock Information

The common stock of South Atlantic Bancshares, Inc. is privately held and is not listed on any exchange. Limited trades were conducted in 2013. As of December 31, 2013, there were 384 shareholders of record.

The ability of South Atlantic Bancshares, Inc. to pay cash dividends is dependent upon receiving cash in the form of dividends from South Atlantic Bank. However, certain restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends. All of the Bank's dividends to the Company are payable only from the undivided profits of the Bank.

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Toll-free: 1.855.449.0975

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Corporate Counsel

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Greenville, SC 29601-2122

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Executive Officers
K. Wayne Wicker
Chairman
Chief Executive Officer

R. Scott Plyler
President

Richard N. Burch
Executive Vice President
Chief Financial Officer

Accounting
Melissa K. Downs-High
Vice President
Comptroller

Kathy M. Doane
Banking Officer
Senior Financial Accountant

Administration
Candace L. Cherry
Vice President
Corporate Assistant

Deposit Operations
Tiffany P. Suggs
Senior Vice President
Director of Branch and Deposit Operations

Yolonda F. Bryant
Banking Officer
Deposit Operations Specialist

Amy B. Stubbs
Banking Officer
Deposit Operations Specialist

Loan Operations
Anne B. Cote
Senior Vice President
Director of Loan Operations

Karen M. Atwood
Vice President
Loan Documentation Manager

Deborah B. Atkins
Assistant Vice President
Loan Administration Specialist

Shirley Y. Kulcsar
Assistant Vice President
Loan Documentation Specialist

Margaret J. Shaffer
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Loan Administration Specialist

Marketing
Barbara W. Marshall
Vice President
Director of Marketing

Merchant Services
Donald G. Kyzer
Senior Vice President
Director of Merchant Card Services

Courtney B. Hicks
Assistant Vice President
Merchant Operations Manager

Mortgage Services
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Senior Vice President
Director of Mortgage Loans

Douglas A. Arseneau
Senior Vice President
Director of Mortgage Loan Operations

Susan O. Burton
Vice President
Mortgage Loan Operations Manager

Adam M. Paskanik
Vice President
Mortgage Loan Officer

Donna L. Spitzer
Assistant Vice President
Mortgage Processor/Underwriter

Branch Personnel
Myrtle Beach
Mary Jo Rogers
Senior Vice President
Chief Lending Officer

Paul E. Peeples
Senior Vice President
Myrtle Beach Regional Executive

Michelle A. Coletta
Vice President
Retail Business Development Officer

Murrells Inlet
W. David Rhodes, IV
Senior Vice President
South Strand Regional Executive

Frances Kopnicky
Vice President
Murrells Inlet Branch Manager

Pawleys Island
Drew S. Johnson
Senior Vice President
Waccamaw Neck Regional Executive

Donna M. Murphy
Vice President
Retail Business Development Officer

Georgetown
Daniel F. Siau
Senior Vice President
Georgetown City Regional Executive

Mary I. Lee
Vice President
Retail Business Development Officer

Yvette F. Morgan
Assistant Vice President
Loan Assistant

Mount Pleasant
Loan Production Office
Kenneth M. Pickens
Senior Vice President
Charleston Regional Executive

Brian J. Michel
Vice President
Commercial Lender

Kurt S. Seguer
Vice President
Commercial Lender

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Trial Lawyer and Partner
The Brittain Law Firm



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Chief Financial Officer
South Atlantic Bank



Tony K. Cox
Executive Vice President, Real Estate
Burroughs and Chapin Company



Miles M. Herring
Franchisee and Operator
Krispy Kreme Doughnuts



Martha S. Lewis
Senior Physical Therapist
NextStep Rehabilitation
An Affiliate of Georgetown Hospital System



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President
South Atlantic Bank



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Co-Owner and President
H.B. Springs Company



Jack L. Springs, Jr.
Owner/Broker
Century 21 Barefoot Realty



Zeb M. Thomas, Jr.
President
The Dayton House

South Atlantic Bank



K. Wayne Wicker
Chairman
Chief Executive Officer
South Atlantic Bank

South Atlantic Bancshares, Inc.



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