

C O A S T A L   B A N K I N G   C O M P A N Y ,   I N C .



*2009 Annual Report*



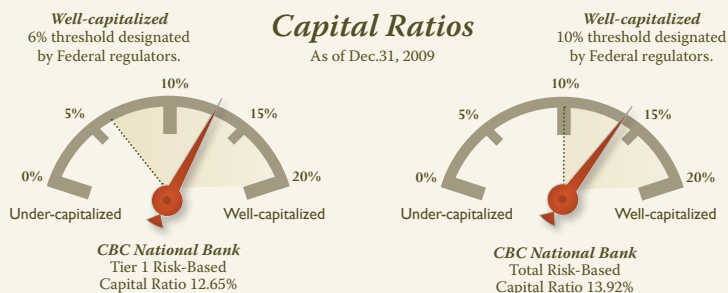
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"Given the doom and gloom news that blankets the banking industry, it is easy to lose perspective, especially when analyzing the prospects of a community bank like ours. The negative headlines focus on the very visible tip of overall financial performance, and lose sight of factors at play below the surface that strongly impact the potential for long-term health and profitability. This annual report dives below the surface to highlight the significant accomplishments that we believe position us to emerge stronger and progress toward sustained profitability."

– Michael G. Sanchez, CEO

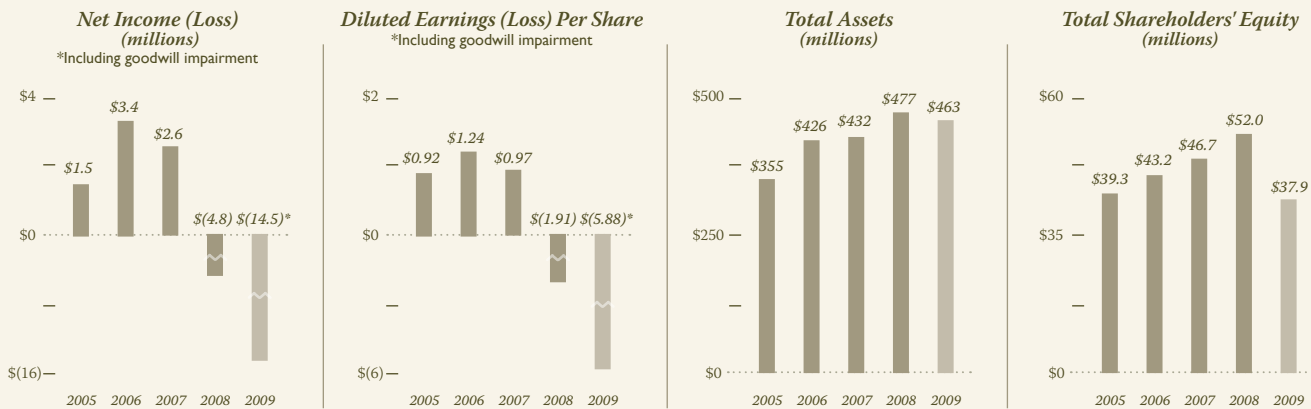
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2009 Financial Highlights



The higher the ratio of capital to risk-weighted assets, the more resources banks have to weather a struggling economy. We ended 2009 well-capitalized and with ample liquidity to meet our needs.

- Net interest income grew 8.9 percent to \$10.9 million from 2008.
- Noninterest income grew 143.5 percent to \$7.7 million.
- Interest expense declined by \$3.6 million.
- One-time goodwill impairment of \$10.4 million.

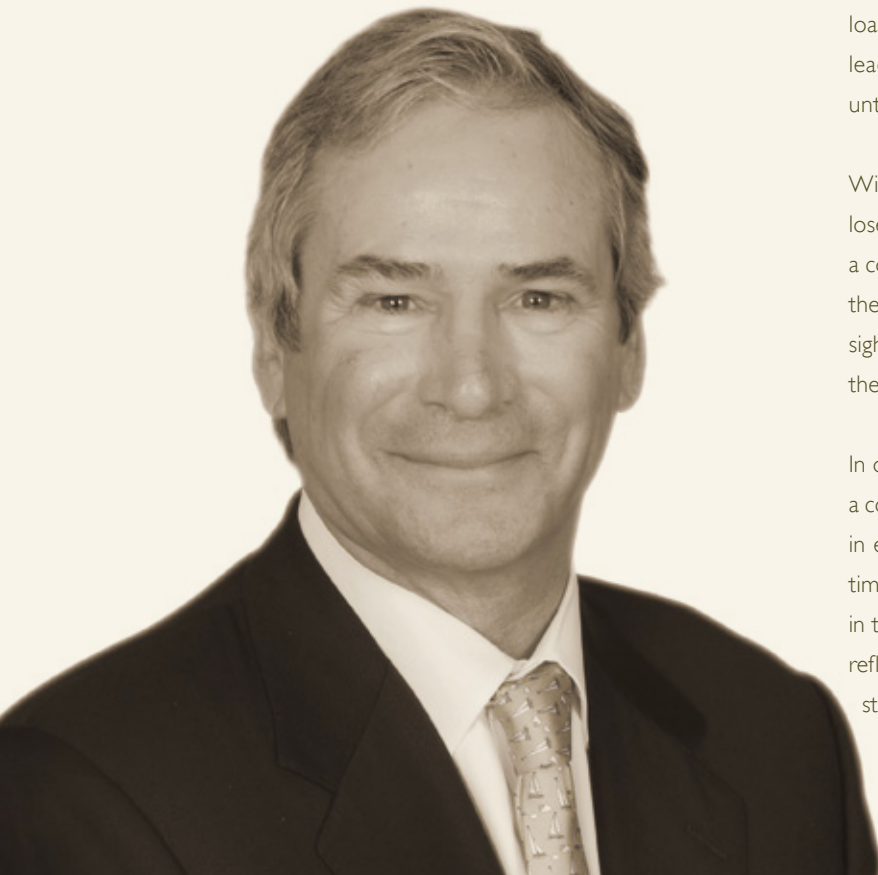




## Letter to Shareholders

*"It is quite a feat to grow operating income in one of the worst economies in a generation. Yet, that is exactly what we did."*

– Michael G. Sanchez, CEO



Dear Shareholders,

It came as no surprise that 2009 was one of the most difficult and challenging years for the banking market in decades. We knew a perfect storm of negative economic trends was brewing for banking. The economy was struggling mightily, the residential real estate market crash hit bottom and unemployment rose sharply, resulting in an increasing number of customers defaulting on their loan obligations.

As a result, bank profits largely disappeared – especially across the Southeast where these trends were most pronounced – and the number of failures rose. The industry still must work through a large number of nonperforming loans in a tough economic and interest-rate environment, leading most analysts to believe that recovery won't come until the end of 2010 at the earliest.

With all this doom and gloom as a backdrop, it is easy to lose perspective, especially when analyzing the prospects of a community bank like ours. The negative headlines focus on the very visible tip of overall financial performance, and lose sight of factors at play below the surface that strongly impact the potential for long-term health and profitability.

In our case, the obvious indicator of the difficulty of operating a community bank during the "Great Recession" is our shortfall in earnings. On paper, this loss was compounded by a one-time, \$10.4 million impairment on goodwill that we recognized in the fourth quarter – a non-cash accounting adjustment that reflects the diminished value the market has placed on our stock, and had no impact on core operating earnings, cash flow, liquidity or risk-based regulatory capital ratios.

If you dive deeper into our financial results, however, you will see that we are much better positioned now than when we began the year. We made a number of achievements in 2009 that were, in some ways, more significant than what we accomplished during previous boom years.

It is much easier to generate profits when the economy is humming along at nearly 3% annual growth in GDP, as it was before the recession took hold. It is quite another feat to grow operating income in one of the worst economies in a generation, while reducing nonperforming assets and building a sizeable reserve to cover potential loan losses.

Yet, that is exactly what we did.

### ***Increasing Core Operating Earnings***

At the start of the economic downturn, we implemented strategic initiatives to reduce nonperforming assets, improve credit quality and boost capital. Our focus was, and continues to be, on the basics of banking – the blocking and tackling of making sound loans and generating core deposits. This approach has proven to be instrumental in seeing us through these trying times.

Throughout 2009, we saw positive trends in key areas of our core business.

- Net interest income grew by \$896,000 over 2008, an 8.9 percent increase.
- Noninterest income grew by \$4.5 million, a 143.5 percent increase.
- Interest expense declined \$3.6 million from 2008.

There are a number of factors that drove these results, including the phenomenal performance of our wholesale mortgage division, our success in lowering deposit costs, and our ability to convert nonperforming assets to earning assets, which continues to be a goal for 2010. We have provided more detail on these areas later in this annual report.

### ***Improving Our Balance Sheet***

We took advantage of this growth to make two difficult, yet necessary, decisions that improved our balance sheet and better positioned our company to manage through the current economic cycle. One was to considerably increase our allowance for loan losses; the other was to aggressively write off our nonperforming loans.

In response to rising past-due loans and

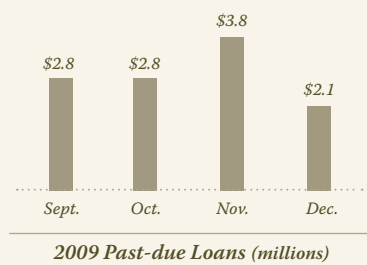
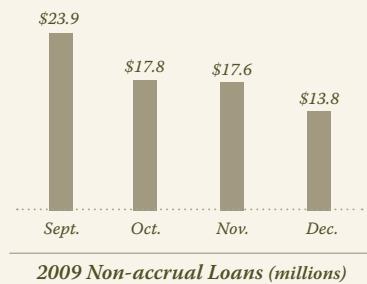
the persistent slump in the real estate market, we began diverting a sizable portion of our income to fortify our allowance for loan losses. Our objective is to build and sustain a reserve to protect the company in case the economy takes another turn for the worse.

At the same time, we began a calculated and intensive effort to reduce our nonperforming assets by transferring non-accrual loans to Other Real Estate Owned (OREO). Doing so enables us to more quickly sell our distressed assets and convert the proceeds to earning assets, providing a positive impact to our income and net interest margin.

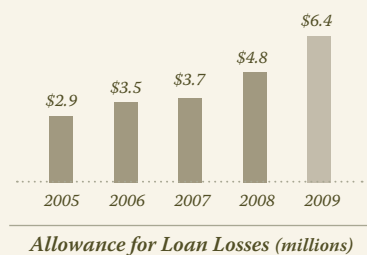
To accomplish this, we set up a Special Assets Group that quickly went to work reducing our total nonperforming assets by more than \$3.2 million in the last four months of 2009 alone. We recovered an average of more than 73 percent of the loan balance on the OREO properties we sold, which is an outstanding result compared to the current industry average.

These strategic balance-sheet-improvement initiatives were done at the expense of our current earnings. It is our firm belief, however, that they were the most prudent use of our resources to best position the company for a return to sustained profitability.

### Serving Our Communities



*Though our total nonperforming assets are still elevated, there was a clear slowing in the number of new loans being added to non-accrual status at the end of 2009, signaling a possible stabilization in our credit quality*



Another below-the-surface item missed by a focus on the headlines is that we have and will continue to go about the normal business of serving the needs of our communities. One of our key missions is to provide vital liquidity to support the recovery and growth of the communities we serve. That is why we are making a concerted effort to offer new lending opportunities to our customers.

To this point, our wholesale mortgage division nearly doubled its production from the prior year, originating \$915.1 million in loans available for sale compared to \$473.2 million in 2008. The wholesale division surpassed the \$1 billion milestone in loan production in June, despite having been in operation only since September 2007.

By the end of 2009, more than half of our wholesale unit's lending volume came from financing home purchases, and nearly one-third from FHA lending. By reducing our concentration of commercial real estate lending, especially construction and development loans, and shifting the mix to relatively less risky residential loans, we were able to improve the quality of loans in our portfolio.

### Other Positive Trends For 2010

Improvement can be seen in several other positive trends, as well. Though our total nonperforming assets are still elevated, there was a clear slowing in the number of new loans being added to non-accrual status at the end of 2009, signaling a possible stabilization in our credit quality.

In the last four months of the year, non-accrual loans dropped from \$23.9 million to \$13.8 million or, as a percentage of capital, from 47.7 percent to 36.3 percent. Total past-due loans 30 days and over, less nonaccrual loans, also fell from \$2.8 million to \$2.1 million, or 33.3 percent to 5.6 percent as a percentage of capital.

If these trends hold, any future recognition of losses likely will come from write-offs of existing real estate-related loans, and not from new lending. Over time, we should reap the benefits from reducing the level of foreclosed properties and other nonperforming assets.

Make no mistake, we will continue to operate cautiously. Although banking experts think loan losses will peak in 2010, their outlook also calls for tepid economic recovery and little, if any, job growth.

That is precisely why we are building up our loan-loss allowance and reducing our nonperforming assets. Along with maintaining strong capital and liquidity reserves, these below-the-surface actions give us ample capacity to carry us through until a more robust recovery takes place. In sum, they give us reason for optimism.

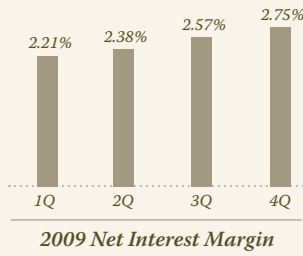
Our goal as we forge ahead is to build on our momentum, progress toward sustained profitability and reward our shareholders for their patience and loyalty.

Sincerely,

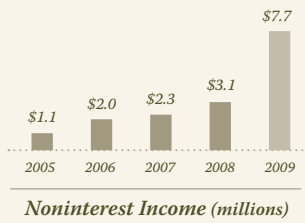
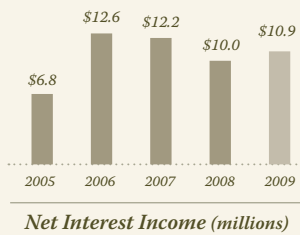
Michael G. Sanchez  
Chief Executive Officer



## Improving Our Balance Sheet



*We took advantage of gains in our operating income and the strength of our capital and liquidity reserves to increase our allowance for loan losses.*



### What's the top priority for community bank CEOs in 2010?

Seventy percent of those polled in a recent survey said it is improving their bank's balance sheet. That is no surprise given the fact that the recession has caused many bank customers to default on their loans, saddling banks with nonperforming assets and losses.

For Coastal Banking Company, our priority is building on the success we achieved in 2009, when we were able to grow our operating income and began to reduce our nonperforming assets – all of which have already strengthened our balance sheet considerably.

As a result, we are entering 2010 with a greater capacity to absorb the ongoing challenges of a fragile economy and to continue serving the needs of our customers and communities.

### Growing Operating Income

The momentum we generated in 2009 can be seen in several positive trends in our core banking business, especially the substantial increase in our net interest income and decrease in our interest expense. Both of these are noteworthy achievements in the current interest-rate environment.

In 2009, we grew net interest income by nearly \$1 million, an 8.9 percent increase over 2008. At the same time, we decreased our interest expense by \$3.6 million.

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*Contributing to the expansion in our net interest margin was our ability to convert nonperforming assets into other real estate owned (OREO). This allows us to sell troubled holdings more quickly and turn them into cash, and is part of our overall strategy to improve asset quality.*

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## **Improving Our Balance Sheet** *(continued)*

Community banks traditionally make the bulk of their profits on the difference between the interest rate borrowers pay on their loans and the interest rate banks pay on deposits. This spread, the net interest margin, has become increasingly thin due to the precipitous drop in the Federal Funds rate, which went from 5.25 percent in June 2006 to a historically low 0–0.25 percent in December 2008, where it has remained.

The impact this rate decline has had on all banks cannot be overstated. Most variable-rate loans are tied to the Prime Rate, and when that rate goes considerably below the market rate paid for deposits, it makes it very difficult for banks to achieve profitability, especially at a time when they have had to dedicate substantial revenue to cover actual and potential loan losses.

Our success in the face of this daunting situation is due, in part, to our ability to replace high-priced CDs that were expiring. We issued new CDs with lower interest rates linked to the current market, which had the effect of averaging down our deposit costs.

While deposit costs shrank, revenue from loan payments stayed level because

we designed most of our variable-rate loans to include a “floor” – a specific interest rate that the loan cannot fall below – a prudent stipulation to have in a low interest-rate environment.

### ***Reducing NPAs and Increasing ALL***

Contributing to the increase in our core operating earnings was our success in converting nonperforming assets into other real estate owned (OREO). This allows us to sell troubled holdings more quickly and turn them into cash, and is part of our overall strategy to improve asset quality.

To that end, in 2008 we established a Special Assets Group that went about the work of moving a substantial amount of problem loans from non-accrual status to OREO. This group made remarkable progress in 2009, especially in the last four months of the year when we reduced non-accrual loans by \$10.1 million and past-due loans by \$700,000. The group will continue its efforts in 2010.

At the same time, we took advantage of gains in our operating income and the strength of our capital and liquidity

reserves to increase our allowance for loan losses. This is money we are setting aside in case current loans go into default in the future.

Given the ongoing strain placed on customers by the ailing economy and high unemployment rate, we boosted our allowance for loan losses nearly \$1.6 million in 2009, to \$6.4 million. This is 2.20 percent of our total loans as of the end of the year, a significant jump from 1.59 percent at the end of 2008.

As we move forward, we will continue to maintain a loan-loss reserve level to cover what we believe we will need. Fortunately, we experienced a slowing in the occurrence of new problem loans at the end of 2009, indicating a possible stabilization in our overall credit quality as we head into 2010.



## Continuing to Serve *Our Customers & Communities*

There was much talk in 2009 about banks not lending money. That absolutely was not the case with our company. Our bankers and lenders went about their work providing our communities the financial services they needed, as well as reaching out to support the efforts of local charitable organizations. Serving the needs of our customers and communities is the absolute core of our business, and last year it remained business as usual.

Indeed, one of our bedrock missions in this struggling economy is to provide much-needed liquidity to support the recovery and growth of the communities we serve. To that end, our wholesale mortgage division funded 82% percent more new residential mortgages during 2009 than in 2008. For all of 2009, the wholesale division funded more than \$922 million in residential mortgages.

CBC National Bank was able to support this significant increase in originations in 2009 by leveraging the funding it received in December 2008 from the Treasury Department's TARP Capital Purchase Program. Residential funding levels at the wholesale division doubled in the six full months following receipt of the TARP proceeds as compared to the

prior six-month period, and maintained those elevated levels through the rest of the year. Our belief is that this is the most effective use of the TARP capital, as improving the housing market is a key to the recovery of the overall economy and of the communities we serve.

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*One of our core missions is to provide much-needed liquidity to support the recovery and growth of our communities.*

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While the initial surge in lending volume early in the year was concentrated more in refinance transactions, loans funded to finance home purchase transactions steadily increased to represent more than half of all loans funded in June of last year. In addition, since obtaining regulatory approval to originate loans insured by the Federal Housing Administration (FHA) in August 2008, FHA lending has grown to represent approximately one-third of all loans funded by our wholesale division.

As a result, we are improving the quality of loans in our portfolio by reducing our concentration of commercial real estate lending, especially construction and development loans, and shifting the mix to relatively less risky residential loans. More than \$7 million in loans originated by the

wholesale division were added to CBC National Bank's portfolio in 2009 as part of this strategy.

The wholesale division, based in Atlanta, reached the \$1 billion milestone in loan production during its second year in business, having begun operations in September 2007. It continues to utilize a conservative, risk-averse business model, originating primarily full-documentation, conforming mortgage loans that are pre-sold into the secondary market to eliminate nearly all interest-rate risk.

Just as we served the overall financial and borrowing needs of our communities in 2009, we also served them through our ongoing outreach to charitable and other civic organizations. Our employees contributed their time and talents, along with the company's financial support, to organizations across the markets we serve. Included among them were: the Communities in Schools Fun Run; the Nassau County Sheriff's Department's Cops & Kids Foundation; and the Beaufort Water Festival, Shrimp Festival and Twilight Run, just to name a few.

Continuing to successfully meet the full range of needs – and support the growth – of our communities. Business as usual.

## Board of Directors

*Back row left to right*

**Mark B. Heles**  
President of H&H Quality Properties, LLC

**James C. Key**  
Partner, Shenandoah Group, LLP

**Michael G. Sanchez**  
President & CEO of Coastal Banking Company,  
and President & CEO of CBC National Bank

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

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

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

**Edward E. Wilson**  
Licensed Insurance Agent

*Front row left to right*

**Robert B. Pinkerton**  
President & CEO, Athena Corporation

**Christina H. Bryan**  
Co-Owner of various businesses

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

**Marshall E. Wood**  
Attorney, Marshall E. Wood, P.A.

## Committees

### *Audit and Compliance*

Dennis O. Green, CPA, Chairman  
Christina H. Bryan  
James C. Key  
Edward E. Wilson  
Marshall E. Wood

### *Corporate Governance and Nominating*

James W. Holden, Jr., DVM, Chairman  
Dennis O. Green, CPA  
Ladson F. Howell  
James C. Key

### *Executive Compensation and Management Resources*

Edward E. Wilson, Chairman  
Christina H. Bryan  
Mark Heles  
Robert B. Pinkerton



## 10K SECTION

Coastal Banking Company Inc. is the \$463.1 million-asset bank holding company of CBC National Bank, which operates as Lowcountry National Bank in Beaufort, S.C., First National Bank of Nassau County in Fernandina Beach, Fla., and The Georgia Bank in Meigs, Ga. CBC National Bank, which is headquartered in Fernandina Beach, provides a full range of consumer and business banking services through full-service banking offices in Beaufort, Fernandina Beach, Meigs, Hilton Head, S.C., and Port Royal, S.C. The company also operates a wholesale lending division based in Atlanta and commercial loan production offices in Jacksonville, Fla., and Savannah, Ga. The company's common stock is publicly traded on the OTC Bulletin Board under the symbol CBCO. For more information, please visit [www.coastalbanking.com](http://www.coastalbanking.com).

