

CAPITAL CITY BANK GROUP INC  
Form 10-Q  
November 09, 2006

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

**For the Quarterly Period Ended September 30, 2006**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 0-13358**

**CAPITAL CITY BANK GROUP, INC.**  
(Exact name of registrant as specified in its charter)

**Florida**  
(State or other jurisdiction of incorporation or  
organization)

**59-2273542**  
(I.R.S. Employer Identification No.)

**217 North Monroe Street, Tallahassee, Florida**  
(Address of principal executive office)

**32301**  
(Zip Code)

**(850) 671-0300**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated

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filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
 No

At October 31, 2006, 18,532,107 shares of the Registrant's Common Stock, \$.01 par value, were outstanding.

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**CAPITAL CITY BANK GROUP, INC.  
QUARTERLY REPORT ON FORM 10-Q  
FOR THE PERIOD ENDED SEPTEMBER 30, 2006**

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**INTRODUCTORY NOTE:  
Caution Concerning Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "target," "goal," and similar expressions are intended to identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements.

Our ability to achieve our financial objectives could be adversely affected by the factors discussed in detail in Part I, Item 2., "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Part II, Item 1A. "Risk Factors" in this Quarterly Report on Form 10-Q, the following sections of our Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 Form 10-K"): (a) "Introductory Note" in Part I, Item 1. "Business"; (b) "Risk Factors" in Part I, Item 1A., as updated in our subsequent quarterly reports filed on Form 10-Q, and (c) "Introduction" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Part II, Item 7. as well as:

• Our ability to integrate the business and operations of companies and banks that we have acquired, and those we may acquire in the future;

• Strength of the United States economy in general and the strength of the local economies in which we conduct operations;

• effects of harsh weather conditions, including hurricanes;

• inflation, interest rate, market and monetary fluctuations;

• effect of changes in the stock market and other capital markets;

• legislative or regulatory changes;

• Willingness of customers to accept third-party products and services for our products and services and vice versa;

• changes in the securities and real estate markets;

• increased competition and its effect on pricing;

• technological changes;

• changes in monetary and fiscal policies of the U.S. government;

• changes in consumer spending and savings habits;

• growth and profitability of our noninterest income;

- changes in accounting principles, policies, practices or guidelines;
- other risks described from time to time in filings with the Securities and Exchange Commission; and
- our ability to manage the risks involved in the foregoing.

However, other factors besides those referenced also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

Table of Contents**PART I.**  
**Item 1.****FINANCIAL INFORMATION**  
**CONSOLIDATED FINANCIAL STATEMENTS****CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE PERIODS ENDED SEPTEMBER 30**  
**(Unaudited)**

|  | Three Months Ended |           | Nine Months Ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | 2006               | 2005      | 2006              | 2005      |
| <i>(Dollars in Thousands, Except Per Share Data)</i> |                    |           |                   |           |
| <b>INTEREST INCOME</b>                               |                    |           |                   |           |
| Interest and Fees on Loans                           | \$ 40,260          | \$ 35,331 | \$ 116,570        | \$ 96,278 |
| Investment Securities:                               |                    |           |                   |           |
| U.S. Treasury  | 132                | 89        | 310               | 347       |
| U.S. Govt. Agencies and Corporations                 | 929                | 788       | 2,672             | 2,442     |
| States and Political Subdivisions                    | 650                | 416       | 1,672             | 1,132     |
| Other Securities                                     | 203                | 144       | 606               | 436       |
| Funds Sold   | 338                | 121       | 1,463             | 638       |
| Total Interest Income                                | 42,512             | 36,889    | 123,293           | 101,273   |
| <b>INTEREST EXPENSE</b>                              |                    |           |                   |           |
| Deposits   | 9,985              | 5,480     | 26,423            | 14,407    |
| Short-Term Borrowings                                | 753                | 691       | 2,352             | 1,875     |
| Subordinated Notes Payable                           | 936                | 931       | 2,789             | 2,039     |
| Other Long-Term Borrowings                           | 615                | 783       | 2,189             | 2,272     |
| Total Interest Expense                               | 12,289             | 7,885     | 33,753            | 20,593    |
| <b>NET INTEREST INCOME</b>                           |                    |           |                   |           |
|  | 30,223             | 29,004    | 89,540            | 80,680    |
| Provision for Loan Losses                            | 711                | 376       | 1,499             | 1,174     |
| Net Interest Income After Provision For Loan Losses  | 29,512             | 28,628    | 88,041            | 79,506    |
| <b>NONINTEREST INCOME</b>                            |                    |           |                   |           |
| Service Charges on Deposit Accounts                  | 6,450              | 5,635     | 18,226            | 15,018    |
| Data Processing                                      | 673                | 660       | 2,014             | 1,917     |
| Asset Management Fees                                | 1,215              | 1,050     | 3,420             | 3,175     |
| Securities Transactions                              | 0                  | 9         | (4)               | 9         |
| Mortgage Banking Revenues                            | 824                | 1,317     | 2,448             | 3,116     |
| Other  | 4,982              | 4,452     | 15,089            | 12,989    |
| Total Noninterest Income                             | 14,144             | 13,123    | 41,193            | 36,224    |
| <b>NONINTEREST EXPENSE</b>                           |                    |           |                   |           |
| Salaries and Associate Benefits                      | 15,277             | 14,046    | 45,912            | 39,793    |
| Occupancy, Net                                       | 2,354              | 2,119     | 6,935             | 6,091     |

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|                           |        |        |        |        |
|---------------------------|--------|--------|--------|--------|
| Furniture and Equipment   | 2,492  | 2,285  | 7,652  | 6,589  |
| Intangible Amortization   | 1,536  | 1,430  | 4,601  | 3,922  |
| Merger Expense            | -      | 180    | -      | 414    |
| Other                     | 8,763  | 8,549  | 26,484 | 23,663 |
| Total Noninterest Expense | 30,422 | 28,609 | 91,584 | 80,472 |

**INCOME BEFORE INCOME**

|              |        |        |        |        |
|--------------|--------|--------|--------|--------|
| <b>TAXES</b> | 13,234 | 13,142 | 37,650 | 35,258 |
| Income Taxes | 4,554  | 4,565  | 13,234 | 12,436 |

|                              |          |          |           |           |
|------------------------------|----------|----------|-----------|-----------|
| <b>NET INCOME</b>            | \$ 8,680 | \$ 8,577 | \$ 24,416 | \$ 22,822 |
| Basic Net Income Per Share   | \$ .47   | \$ .46   | \$ 1.31   | \$ 1.26   |
| Diluted Net Income Per Share | \$ .47   | \$ .46   | \$ 1.31   | \$ 1.26   |

|                                    |            |            |            |            |
|------------------------------------|------------|------------|------------|------------|
| Average Basic Shares Outstanding   | 18,529,926 | 18,623,037 | 18,604,488 | 18,142,502 |
| Average Diluted Shares Outstanding | 18,564,932 | 18,648,504 | 18,627,167 | 18,156,764 |

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

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**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**AS OF SEPTEMBER 30, 2006 AND DECEMBER 31, 2005**  
**(Unaudited)**

| <i>(Dollars In Thousands, Except Share Data)</i>   | <b>September 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|-------------------------------|------------------------------|
| <b>ASSETS</b>  |                               |                              |
| Cash and Due From Banks  | \$ 100,781                    | \$ 105,195                   |
| Funds Sold and Interest Bearing Deposits   | 35,631                        | 61,164                       |
| Total Cash and Cash Equivalents  | 136,412                       | 166,359                      |
| Investment Securities, Available-for-Sale  | 190,617                       | 171,019                      |
| Loans, Net of Unearned Interest  | 2,009,459                     | 2,067,494                    |
| Allowance for Loan Losses  | (17,311)                      | (17,410)                     |
| Loans, Net   | 1,992,148                     | 2,050,084                    |
| Premises and Equipment, Net  | 84,915                        | 73,818                       |
| Goodwill   | 84,810                        | 84,829                       |
| Other Intangible Assets  | 21,076                        | 25,622                       |
| Other Assets   | 48,895                        | 53,731                       |
| Total Assets   | \$ 2,558,873                  | \$ 2,625,462                 |
| <b>LIABILITIES</b>   |                               |                              |
| Deposits:  |                               |                              |
| Noninterest Bearing Deposits   | \$ 506,331                    | \$ 559,492                   |
| Interest Bearing Deposits  | 1,542,908                     | 1,519,854                    |
| Total Deposits   | 2,049,239                     | 2,079,346                    |
| Short-Term Borrowings  | 54,171                        | 82,973                       |
| Subordinated Notes Payable   | 62,887                        | 62,887                       |
| Other Long-Term Borrowings   | 43,701                        | 69,630                       |
| Other Liabilities  | 29,833                        | 24,850                       |
| Total Liabilities  | 2,239,831                     | 2,319,686                    |
| <b>SHAREOWNERS' EQUITY</b>   |                               |                              |
| Preferred Stock, \$.01 par value, 3,000,000 shares authorized;<br>no shares outstanding  | -                             | -                            |
| Common Stock, \$.01 par value, 90,000,000 shares authorized; 18,532,104<br>and 18,631,706 shares issued and outstanding at September 30, 2006 and<br>December 31, 2005, respectively | 185                           | 186                          |
| Additional Paid-In Capital   | 80,938                        | 83,304                       |
| Retained Earnings  | 238,870                       | 223,532                      |
| Accumulated Other Comprehensive Loss, Net of Tax   | (951)                         | (1,246)                      |
| Total Shareowners' Equity  | 319,042                       | 305,776                      |
| Total Liabilities and Shareowners' Equity  | \$ 2,558,873                  | \$ 2,625,462                 |

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*





Table of Contents**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY***(Dollars in Thousands, Except Per Share Data)*

|   | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss, Net of<br>Taxes | Total      |
|---|-----------------|----------------------------------|----------------------|--|------------|
| <b>Balance, December 31, 2005</b>                                 | \$ 186          | \$ 83,304                        | \$ 223,532           | \$ (1,246)   | \$ 305,776 |
| Comprehensive Income:   |                 |                                  |                      |  |            |
| Net Income  | -               | -                                | 24,416               | -  |            |
| Net Change in Unrealized Loss<br>On Available-for-Sale Securities | -               | -                                | -                    | 295  |            |
| <b>Total Comprehensive Income</b>                                 | -               | -                                | -                    | -  | 24,711     |
| Cash Dividends (\$.4875 per share)                                | -               | -                                | (9,078)              | -  | (9,078)    |
| Stock Performance Plan Compensation                               | -               | 1,504                            | -                    | -  | 1,504      |
| Issuance of Common Stock  | 1               | 969                              | -                    | -  | 970        |
| Repurchase of Common Stock  | (2)             | (4,839)                          | -                    | -  | (4,841)    |
| <b>Balance, September 30, 2006</b>                                | \$ 185          | \$ 80,938                        | \$ 238,870           | \$ (951)   | \$ 319,042 |

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

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**CAPITAL CITY BANK GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE MONTH PERIODS ENDED SEPTEMBER 30**  
**(Unaudited)**

| <i>(Dollars in Thousands)</i>  | <b>2006</b>     | <b>2005</b>     |
|--|-----------------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                      |                 |                 |
| Net Income   | \$ 24,416       | \$ 22,822       |
| Adjustments to Reconcile Net Income to<br>Cash Provided by Operating Activities: |                 |                 |
| Provision for Loan Losses  | 1,499           | 1,174           |
| Depreciation   | 5,251           | 4,324           |
| Net Securities Amortization  | 480             | 1,133           |
| Amortization of Intangible Assets  | 4,601           | 3,922           |
| Loss (Gain) on Sale of Investment Securities                                     | 4               | (9)             |
| Origination of Loans Held-for-Sale   | (144,719)       | (167,172)       |
| Proceeds From Sales of Loans Held-for-Sale                                       | 148,330         | 170,667         |
| Net Gain From Sales of Loans Held-for-Sale                                       | (2,448)         | (3,116)         |
| Non-Cash Compensation  | 1,504           | 1,083           |
| Deferred Income Taxes  | 3,704           | 1,450           |
| Net Decrease (Increase) in Other Assets  | 4,225           | (3,447)         |
| Net Increase in Other Liabilities  | 2,359           | 10,974          |
| Net Cash Provided By Operating Activities  | 49,206          | 43,805          |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                      |                 |                 |
| Securities Available-for-Sale:   |                 |                 |
| Purchases  | (95,807)        | (78,748)        |
| Sales  | 283             | 35,142          |
| Payments, Maturities, and Calls  | 75,872          | 94,723          |
| Net Decrease (Increase) in Loans   | 54,636          | (107,237)       |
| Net Cash Acquired in Acquisition   | -               | 37,412          |
| Purchase of Premises & Equipment   | (16,634)        | (13,264)        |
| Proceeds From Sales of Premises & Equipment                                      | 286             | 175             |
| Net Cash Provided By (Used In) Investing Activities                              | 18,636          | (31,797)        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                      |                 |                 |
| Net Decrease in Deposits   | (30,108)        | (70,983)        |
| Net Decrease in Short-Term Borrowings  | (42,271)        | (88,311)        |
| Proceeds from Subordinated Note Payable  | -               | 31,959          |
| Increase in Other Long-Term Borrowings   | 3,250           | 88,116          |
| Repayment of Other Long-Term Borrowings  | (15,711)        | -               |
| Dividends Paid   | (9,078)         | (8,371)         |
| Repurchase of Common Stock   | (4,841)         | -               |
| Issuance of Common Stock   | 969             | 785             |
| Net Cash Used In Financing Activities  | (97,790)        | (46,805)        |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>                                   | <b>(29,948)</b> | <b>(35,316)</b> |
| Cash and Cash Equivalents at Beginning of Period                                 | 166,359         | 161,545         |

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|  |    |         |    |         |
|--|----|---------|----|---------|
| Cash and Cash Equivalents at End of Period                                   | \$ | 136,412 | \$ | 126,229 |
| Supplemental Disclosure:   |    |         |    |         |
| Interest Paid on Deposits  | \$ | 26,051  | \$ | 13,685  |
| Interest Paid on Debt  |    | 7,523   |    | 6,034   |
| Taxes Paid   |    | 11,530  |    | 11,129  |
| Loans Transferred to Other Real Estate                                       |    | 638     |    | 2,391   |
| Issuance of Common Stock as Non-Cash Compensation                            |    | 1,504   |    | 339     |
| Transfer of Current Portion of Long-Term Borrowings to Short-Term Borrowings |    | 13,061  |    | 42,649  |

*The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.*

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 1 - MANAGEMENT'S OPINION AND ACCOUNTING POLICES****Basis of Presentation**

The consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, including Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. Prior period financial statements have been reformatted and/or amounts reclassified, as necessary, to conform with the current presentation.

In the opinion of management, the consolidated financial statements contain all adjustments, which are those of a recurring nature, and disclosures necessary to present fairly the financial position of the Company as of September 30, 2006 and December 31, 2005, the results of operations for the three and nine month periods ended September 30, 2006 and 2005, and cash flows for the nine month periods ended September 30, 2006 and 2005.

The Company and its subsidiary follow accounting principles generally accepted in the United States of America and reporting practices applicable to the banking industry. The principles that materially affect its financial position, results of operations and cash flows are set forth in the Notes to Consolidated Financial Statements which are included in the Company's 2005 Annual Report on Form 10-K.

**Stock-based Compensation**

On January 1, 2006, the Company changed its accounting policy related to stock-based compensation in connection with the adoption of Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment (Revised 2004)" ("SFAS 123R"). See Note 7 - Stock-Based Compensation for additional information.

**NOTE 2 - INVESTMENT SECURITIES**

The amortized cost and related market value of investment securities available-for-sale were as follows:

| <i>(Dollars in Thousands)</i>             | Amortized Cost | <b>September 30, 2006</b> |                   | Market Value |
|---|----------------|---------------------------|-------------------|--------------|
|   |                | Unrealized Gains          | Unrealized Losses |              |
| U.S. Treasury                             | \$ 12,083      | \$ 29                     | \$ 33             | \$ 12,079    |
| U.S. Government Agencies and Corporations | 60,043         | 47                        | 669               | 59,421       |
| States and Political Subdivisions         | 83,007         | 19                        | 485               | 82,541       |
| Mortgage-Backed Securities                | 24,358         | 31                        | 461               | 23,928       |
| Other Securities <sup>(1)</sup>           | 12,648         | -                         | -                 | 12,648       |
| Total Investment Securities               | \$ 192,139     | \$ 126                    | \$ 1,648          | \$ 190,617   |

| <i>(Dollars in Thousands)</i> | Amortized Cost | <b>December 31, 2005</b> |                   | Market Value |
|-------------------------------|----------------|--------------------------|-------------------|--------------|
|                               |                | Unrealized Gains         | Unrealized Losses |              |
| U.S. Treasury                 | \$ 9,065       | \$ -                     | \$ 50             | \$ 9,015     |

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|   |            |       |          |            |
|---|------------|-------|----------|------------|
| U.S. Government Agencies and Corporations | 75,233     | -     | 1,017    | 74,216     |
| States and Political Subdivisions         | 53,611     | 44    | 512      | 53,143     |
| Mortgage-Backed Securities                | 20,948     | 35    | 452      | 20,531     |
| Other Securities <sup>(1)</sup>           | 14,114     | -     | -        | 14,114     |
| Total Investment Securities               | \$ 172,971 | \$ 79 | \$ 2,031 | \$ 171,019 |

(1) FHLB and FRB stock recorded at cost.

Table of Contents**NOTE 3 - LOANS**

The composition of the Company's loan portfolio was as follows:

| <i>(Dollars in Thousands)</i>          | <b>September 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|-------------------------------|------------------------------|
| Commercial, Financial and Agricultural | \$ 218,442                    | \$ 218,434                   |
| Real Estate-Construction               | 183,237                       | 160,914                      |
| Real Estate-Commercial                 | 647,302                       | 718,741                      |
| Real Estate-Residential                | 539,828                       | 553,124                      |
| Real Estate-Home Equity                | 174,577                       | 165,337                      |
| Real Estate-Loans Held-for-Sale        | 3,780                         | 4,875                        |
| Consumer                               | 242,293                       | 246,069                      |
| Loans, Net of Unearned Interest        | \$ 2,009,459                  | \$ 2,067,494                 |

**NOTE 4 - ALLOWANCE FOR LOAN LOSSES**

An analysis of the changes in the allowance for loan losses for the nine month periods ended September 30 was as follows:

| <i>(Dollars in Thousands)</i>              | <b>2006</b> | <b>2005</b> |
|--|-------------|-------------|
| Balance, Beginning of Period               | \$ 17,410   | \$ 16,037   |
| Acquired Reserves                          | -           | 1,385       |
| Provision for Loan Losses                  | 1,499       | 1,174       |
| Recoveries on Loans Previously Charged-Off | 1,309       | 1,361       |
| Loans Charged-Off                          | (2,907)     | (2,533)     |
| Balance, End of Period                     | \$ 17,311   | \$ 17,424   |

Impaired loans are primarily defined as all nonaccruing loans for the loan categories which are included within the scope of SFAS No. 114, "Accounting by Creditors for Impairment of a Loan." Selected information pertaining to impaired loans is depicted in the table below:

|                                     | <b>September 30, 2006</b> |          | <b>December 31, 2005</b> |          |
|-------------------------------------|---------------------------|----------|--------------------------|----------|
| Impaired Loans:                     |                           |          |                          |          |
| With Related Valuation Allowance    | \$ 5,554                  | \$ 2,143 | \$ 5,612                 | \$ 2,915 |
| Without Related Valuation Allowance | 3,455                     | -        | 1,658                    | -        |

**NOTE 5 - INTANGIBLE ASSETS**

The Company had intangible assets of \$105.9 million and \$110.5 million at September, 2006 and December 31, 2005, respectively. Intangible assets were as follows:

| <i>(Dollars in Thousands)</i> | <b>September 30, 2006</b> |                             | <b>December 31, 2005</b> |                             |
|-------------------------------|---------------------------|-----------------------------|--------------------------|-----------------------------|
|                               | Gross<br>Amount           | Accumulated<br>Amortization | Gross<br>Amount          | Accumulated<br>Amortization |
| Core Deposit Intangibles      | \$ 47,176                 | \$ 27,544                   | \$ 47,176                | \$ 23,312                   |
| Goodwill                      | 88,596                    | 3,786                       | 88,615                   | 3,786                       |

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|                                  |            |           |            |           |
|----------------------------------|------------|-----------|------------|-----------|
| Customer Relationship Intangible | 1,867      | 449       | 1,867      | 305       |
| Non-Compete Agreement            | 539        | 513       | 483        | 287       |
| Total Intangible Assets          | \$ 138,178 | \$ 32,292 | \$ 138,141 | \$ 27,690 |

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*Net Core Deposit Intangibles:* As of September 30, 2006 and December 31, 2005, the Company had net core deposit intangibles of \$19.6 million and \$23.9 million, respectively. Amortization expense for the first nine months of 2006 and 2005 was \$4.2 million and \$3.6 million, respectively. Estimated annual amortization expense is \$5.6 million.

*Goodwill:* As of September 30, 2006 and December 31, 2005, the Company had goodwill, net of accumulated amortization, of \$84.8 million. Goodwill is the Company's only intangible asset that is no longer subject to amortization under the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets."

*Other:* As of September 30, 2006 and December 31, 2005, the Company had a customer relationship intangible, net of accumulated amortization, of \$1.4 million and \$1.6 million, respectively. This intangible was recorded as a result of the March 2004 acquisition of trust customer relationships from Synovus Trust Company. Amortization expense for the first nine months of 2006 and 2005 was \$144,000. Estimated annual amortization expense is \$191,000 based on use of a 10-year useful life.

As of September 30, 2006 and December 31, 2005, the Company also had a non-compete intangible, net of accumulated amortization, of \$26,000 and \$196,000, respectively. This intangible was recorded as a result of the October 2004 acquisition of Farmers and Merchants Bank of Dublin, Georgia. Amortization expense for the first nine months of 2006 and 2005 was \$226,000 and \$178,000, respectively. Estimated amortization expense for the remainder of 2006 is \$26,000.

**NOTE 6 - DEPOSITS**

The composition of the Company's interest bearing deposits at September 30, 2006 and December 31, 2005 was as follows:

| <i>(Dollars in Thousands)</i>   | <b>September 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|---------------------------------|-------------------------------|------------------------------|
| NOW Accounts                    | \$ 533,549                    | \$ 520,878                   |
| Money Market Accounts           | 387,906                       | 331,094                      |
| Savings Deposits                | 129,884                       | 144,296                      |
| Other Time Deposits             | 491,569                       | 523,586                      |
| Total Interest Bearing Deposits | \$ 1,542,908                  | \$ 1,519,854                 |

**NOTE 7 - STOCK-BASED COMPENSATION**

In accordance with the Company's adoption of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), in the first quarter of 2003, the cost related to stock-based associate compensation included in net income has been accounted for under the fair value method in all reported periods.

On January 1, 2006, the Company adopted SFAS 123R. The Company continues to include the cost of its share-based compensation plans in net income under the fair value method.

As of September 30, 2006, the Company had three stock-based compensation plans, consisting of the 2005 Associate Incentive Plan ("AIP"), the 2005 Associate Stock Purchase Plan ("ASPP"), and the 2005 Director Stock Purchase Plan ("DSPP"). Total compensation expense associated with these plans for the nine months ended September 30, 2006 and 2005, was approximately \$1.5 million and \$1.1 million, respectively.

*AIP.* The Company's AIP allows the Company's Board of Directors to award key associates various forms of equity-based incentive compensation. Under the AIP, the Company has adopted the Stock-Based Incentive Plan (the "Incentive Plan"), effective January 1, 2006, which is a performance-based equity bonus plan for selected members of management, including all executive officers. Under the Incentive Plan, all participants are eligible to earn an equity award, consisting of performance shares, in each year of the five-year period ending December 31, 2010. Annual awards are tied to the annual earnings progression necessary to achieve the Project 2010 goal of \$50.0 million in annual net income. The grant-date fair value of an annual compensation award is approximately \$1.5 million. A total of 43,437 shares are eligible for issuance annually.

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At the end of each calendar year, the Compensation Committee of the Company's Board of Directors will confirm whether the performance goals have been met prior to the payout of any awards. Any performance shares earned under the Incentive Plan will be issued in the calendar quarter following the calendar year in which the shares were earned.

In accordance with the provisions of SFAS 123R, the Company recognized expense of approximately \$1.1 million for the first nine months of 2006 related to the Incentive Plan. Under a substantially similar predecessor plan, the Company recognized expense of \$581,000 for the first nine months of 2005. A total of 875,000 shares of common stock have been reserved for issuance under the AIP. To date, the Company has issued 28,093 shares of common stock.

*Executive Stock Option Agreement.* In 2006, under the provisions of the AIP, the Company's Board of Directors approved a stock option agreement for a key executive officer (William G. Smith, Jr. - Chairman, President and CEO, CCBG). Similar stock option agreements were approved in 2003-2005. These agreements grant a non-qualified stock option award upon achieving certain annual earnings per share conditions set by the Board, subject to certain vesting requirements. The options granted under the agreements have a term of ten years and vest at a rate of one-third on each of the first, second, and third anniversaries of the date of grant. Under the 2004 and 2003 agreements, 37,246 and 23,138 options, respectively, were issued, none of which have been exercised. The fair value of a 2004 option was \$13.42, and the fair value of a 2003 option was \$11.64. The exercise prices for the 2004 and 2003 options are \$32.69 and \$32.96, respectively. Under the 2005 agreement, the earnings per share conditions were not met; therefore, no economic value was earned by the executive. In accordance with the provisions of SFAS 123R and SFAS 123, the Company recognized expense of approximately \$146,000 and \$145,000 for the first nine months of 2006 and 2005, respectively, related to the aforementioned agreements.

A summary of the status of the Company's option shares as of September 30, 2006 is presented below:

| Options                           | Shares | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Term | Aggregate<br>Intrinsic Value |
|-----------------------------------|--------|------------------------------------|---------------------------------------|------------------------------|
| Outstanding at January 1, 2006    | 60,384 | \$ 32.79                           | 8.3                                   | \$ 88,161                    |
| Granted                           | -      | -                                  | -                                     | -                            |
| Exercised                         | -      | -                                  | -                                     | -                            |
| Forfeited or expired              | -      | -                                  | -                                     | -                            |
| Outstanding at September 30, 2006 | 60,384 | \$ 32.79                           | 7.8                                   | \$ -                         |
| Exercisable at September 30, 2006 | 35,977 | \$ 32.79                           | 7.8                                   | \$ -                         |

As of September 30, 2006, there was \$173,000 of total unrecognized compensation cost related to the nonvested option shares granted under the agreements. That cost is expected to be recognized over a remaining weighted-average period of 10 months.

*DSPP.* The Company's DSPP allows the directors to purchase the Company's common stock at a price equal to 90% of the closing price on the date of purchase. Stock purchases under the DSPP are limited to the amount of the directors' annual retainer and meeting fees. The DSPP has 93,750 shares reserved for issuance. A total of 16,733 shares have been issued since the inception of the DSPP. For the first nine months of 2006, the Company issued 10,144 shares under the DSPP and recognized \$31,000 in expense related to this plan. For the first nine months of 2005, the Company issued 5,418 shares and recognized \$21,000 in expense related to the DSPP.

*ASPP.* Under the Company's ASPP, substantially all associates may purchase the Company's common stock through payroll deductions at a price equal to 90% of the lower of the fair market value at the beginning or end of each

six-month offering period. Stock purchases under the ASPP are limited to 10% of an associate's eligible compensation, up to a maximum of \$25,000 (fair market value on each enrollment date) in any plan year. Shares are issued at the beginning of the quarter following each six-month offering period. The ASPP has 593,750 shares of common stock reserved for issuance. A total of 36,281 shares have been issued since inception of the ASPP. For the first nine months of 2006, the Company issued 9,343 shares under the ASPP and recognized \$67,000 in expense related to this plan. For the first nine months of 2005, the Company issued 8,928 shares and recognized \$66,000 in expense related to the ASPP.

Based on the Black-Scholes option pricing model, the weighted average estimated fair value of the purchase rights granted under the ASPP Plan was \$6.22 for the first nine months of 2006. For the first nine months of 2005, the weighted average fair value of the purchase rights granted was \$6.48. In calculating compensation, the fair value of each stock purchase right was estimated on the date of grant using the following weighted average assumptions:

|                          | <b>Nine Months Ended September 30,</b> |             |
|--------------------------|--|-------------|
|                          | <b>2006</b>                            | <b>2005</b> |
| Dividend yield           | 1.95%                                  | 1.9%        |
| Expected volatility      | 23.5%                                  | 28.0%       |
| Risk-free interest rate  | 4.5%                                   | 2.6%        |
| Expected life (in years) | 0.5                                    | 0.5         |

Table of Contents**NOTE 8 - EMPLOYEE BENEFIT PLANS**

The components of the net periodic benefit costs for the Company's qualified benefit pension plan were as follows:

| <i>(Dollars in Thousands)</i>      | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------------------|---|-------------|--|-------------|
|                                    | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| Discount Rate                      | 5.75%                                       | 6.00%       | 5.75%                                      | 6.00%       |
| Long-Term Rate of Return on Assets | 8.00%                                       | 8.00%       | 8.00%                                      | 8.00%       |
| Service Cost                       | \$ 1,250                                    | \$ 1,183    | \$ 3,750                                   | \$ 3,263    |
| Interest Cost                      | 875   | 838         | 2,625                                      | 2,438       |
| Expected Return on Plan Assets     | (975)                                       | (782)       | (2,925)                                    | (2,378)     |
| Prior Service Cost Amortization    | 50  | 55          | 150  | 165         |
| Net Loss Amortization              | 375   | 400         | 1,125                                      | 990         |
| Net Periodic Benefit Cost          | \$ 1,575                                    | \$ 1,694    | \$ 4,725                                   | \$ 4,478    |

The components of the net periodic benefit costs for the Company's Supplemental Executive Retirement Plan ("SERP") were as follows:

| <i>(Dollars in Thousands)</i>      | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------------------|---|-------------|--|-------------|
|                                    | <b>2006</b>                                 | <b>2005</b> | <b>2006</b>                                | <b>2005</b> |
| Discount Rate                      | 5.75%                                       | 6.00%       | 5.75%                                      | 6.00%       |
| Long-Term Rate Of Return On Assets | N/A   | N/A         | N/A  | N/A         |
| Service Cost                       | \$ 30                                       | \$ 35       | \$ 90                                      | \$ 105      |
| Interest Cost                      | 56  | 54          | 168  | 162         |
| Expected Return On Plan Assets     | N/A   | N/A         | N/A  | N/A         |
| Prior Service Cost Amortization    | 15  | 15          | 45   | 45          |
| Net Loss Amortization              | 19  | 21          | 57   | 63          |
| Net Periodic Benefit Cost          | \$ 120                                      | \$ 125      | \$ 360                                     | \$ 375      |

**NOTE 9 - COMMITMENTS AND CONTINGENCIES**

*Lending Commitments.* The Company is a party to financial instruments with off-balance sheet risks 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.

The Company's maximum exposure to credit loss under standby letters of credit and commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in establishing commitments and issuing letters of credit as it does for on-balance sheet instruments. As of September 30, 2006, the amounts associated with the Company's off-balance sheet obligations were as follows:

| <i>(Dollars in Millions)</i>                | <b>Amount</b> |
|---|---------------|
| Commitments to Extend Credit <sup>(1)</sup> | \$ 443.3      |
| Standby Letters of Credit                   | \$ 17.8       |

<sup>(1)</sup> Commitments include unfunded loans, revolving lines of credit, and other unused commitments.

Commitments to extend credit are agreements to lend to a customer so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

*Contingencies.* The Company is a party to lawsuits and claims arising out of the normal course of business. In management's opinion, there are no known pending claims or litigation, the outcome of which would, individually or in the aggregate, have a material effect on the consolidated results of operations, financial position, or cash flows of the Company.

#### **NOTE 10 - COMPREHENSIVE INCOME**

SFAS No. 130, "Reporting Comprehensive Income," requires that certain transactions and other economic events that bypass the income statement be displayed as other comprehensive income (loss). Comprehensive income totaled \$9.6 million and \$24.7 million, respectively, for the three and nine months ended September 30, 2006, and \$8.4 million and \$22.3 million, respectively, for the comparable periods in 2005. The Company's comprehensive income consists of net income and changes in unrealized gains (losses) on securities available-for-sale, net of income taxes. Changes in unrealized gains (losses), net of taxes, on securities totaled \$963,000 and \$295,000, respectively, for the three and nine months ended September, 2006, and \$(195,000) and \$(540,000), respectively, for the three and nine months ended September 30, 2005. Reclassification adjustments consist only of realized gains and losses on sales of investment securities and were not material for the nine months ended September 30, 2006 and 2005.

Table of Contents**QUARTERLY FINANCIAL DATA (UNAUDITED)**

|  | 2006      |           |           |           | 2005      |           |           |           | 2004 |
|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|------|
| <i>(Dollars in Thousands, Except Per Share Data)</i> | Third     | Second    | First     | Fourth    | Third     | Second    | First     | Fourth    |      |
| Summary of Operations:                               |           |           |           |           |           |           |           |           |      |
| Interest Income                                      | \$ 42,512 | \$ 41,369 | \$ 39,412 | \$ 38,780 | \$ 36,889 | \$ 33,910 | \$ 30,474 | \$ 29,910 |      |
| Interest Expense                                     | 12,289    | 11,182    | 10,282    | 9,470     | 7,885     | 6,788     | 5,920     | 5,600     |      |
| Net Interest Income                                  | 30,223    | 30,187    | 29,130    | 29,310    | 29,004    | 27,122    | 24,554    | 24,310    |      |
| Provision for Loan Losses                            | 711       | 121       | 667       | 1,333     | 376       | 388       | 410       | 300       |      |
| Net Interest Income After Provision for Loan Losses  | 29,512    | 30,066    | 28,463    | 27,977    | 28,628    | 26,734    | 24,144    | 23,990    |      |
| Gain on Sale of Credit Card Portfolios               | -         | -         | -         | -         | -         | -         | -         | 300       |      |
| Noninterest Income                                   | 14,144    | 14,003    | 13,045    | 12,974    | 13,123    | 12,041    | 11,060    | 11,500    |      |
| Conversion/Merger Expense                            | -         | -         | -         | 24        | 180       | 234       | -         | 400       |      |
| Noninterest Expense                                  | 30,422    | 31,070    | 30,092    | 29,318    | 28,429    | 26,362    | 25,267    | 24,400    |      |
| Income Before Provision for Income Taxes             | 13,234    | 12,999    | 11,416    | 11,609    | 13,142    | 12,179    | 9,937     | 10,900    |      |
| Provision for Income Taxes                           | 4,554     | 4,684     | 3,995     | 4,150     | 4,565     | 4,311     | 3,560     | 3,700     |      |
| Net Income   | \$ 8,680  | \$ 8,315  | \$ 7,421  | \$ 7,459  | \$ 8,577  | \$ 7,868  | \$ 6,377  | \$ 7,200  |      |
| Net Interest Income (FTE)                            | \$ 30,745 | \$ 30,591 | \$ 29,461 | \$ 29,652 | \$ 29,329 | \$ 27,396 | \$ 24,835 | \$ 24,610 |      |
| Per Common Share:                                    |           |           |           |           |           |           |           |           |      |
| Net Income Basic                                     | \$ .47    | \$ .44    | \$ .40    | \$ .40    | \$ .46    | \$ .44    | \$ .36    | \$ .36    |      |
| Net Income Diluted                                   | .47       | .44       | .40       | .40       | .46       | .44       | .36       | .36       |      |
| Dividends Declared                                   | .163      | .163      | .163      | .163      | .152      | .152      | .152      | .152      |      |
| Diluted Book Value                                   | 17.18     | 16.81     | 16.65     | 16.39     | 16.17     | 15.87     | 14.69     | 14.69     |      |
| Market Price:  |           |           |           |           |           |           |           |           |      |
| High   | 33.25     | 35.39     | 37.97     | 39.33     | 38.72     | 33.46     | 33.60     | 36.00     |      |
| Low  | 29.87     | 29.51     | 33.79     | 33.21     | 31.78     | 28.02     | 29.30     | 30.00     |      |
| Close  | 31.10     | 30.20     | 35.55     | 34.29     | 37.71     | 32.32     | 32.41     | 33.00     |      |

## Selected Average

## Balances:

|                |              |              |              |              |              |              |              |            |
|----------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|------------|
| Loans          | \$ 2,025,112 | \$ 2,040,656 | \$ 2,048,642 | \$ 2,062,775 | \$ 2,046,968 | \$ 1,932,637 | \$ 1,827,327 | \$ 1,779,7 |
| Earning Assets | 2,241,158    | 2,278,817    | 2,275,667    | 2,279,010    | 2,250,902    | 2,170,483    | 2,047,049    | 2,066,1    |
| Assets         | 2,560,155    | 2,603,090    | 2,604,458    | 2,607,597    | 2,569,524    | 2,458,788    | 2,306,807    | 2,322,8    |
| Deposits       | 2,023,523    | 2,047,755    | 2,040,248    | 2,027,017    | 2,013,427    | 1,932,144    | 1,847,378    | 1,853,5    |

## Shareowners'

|        |         |         |         |         |         |         |         |       |
|--------|---------|---------|---------|---------|---------|---------|---------|-------|
| Equity | 318,041 | 315,794 | 311,461 | 306,208 | 300,931 | 278,107 | 260,946 | 248,7 |
|--------|---------|---------|---------|---------|---------|---------|---------|-------|

## Common

## Equivalent

## Average Shares:

|         |        |        |        |        |        |        |        |      |
|---------|--------|--------|--------|--------|--------|--------|--------|------|
| Basic   | 18,530 | 18,633 | 18,652 | 18,624 | 18,623 | 18,094 | 17,700 | 17,4 |
| Diluted | 18,565 | 18,653 | 18,665 | 18,654 | 18,649 | 18,102 | 17,708 | 17,4 |

## Ratios:

|     |       |       |       |       |       |       |       |   |
|-----|-------|-------|-------|-------|-------|-------|-------|---|
| ROA | 1.35% | 1.28% | 1.16% | 1.14% | 1.32% | 1.28% | 1.12% | 1 |
|-----|-------|-------|-------|-------|-------|-------|-------|---|

|     |        |        |       |       |        |        |       |    |
|-----|--------|--------|-------|-------|--------|--------|-------|----|
| ROE | 10.83% | 10.56% | 9.66% | 9.67% | 11.31% | 11.35% | 9.91% | 11 |
|-----|--------|--------|-------|-------|--------|--------|-------|----|

## Net Interest

|              |       |       |       |       |       |       |       |   |
|--------------|-------|-------|-------|-------|-------|-------|-------|---|
| Margin (FTE) | 5.45% | 5.38% | 5.25% | 5.16% | 5.17% | 5.07% | 4.92% | 4 |
|--------------|-------|-------|-------|-------|-------|-------|-------|---|

|                  |        |        |        |        |        |        |        |    |
|------------------|--------|--------|--------|--------|--------|--------|--------|----|
| Efficiency Ratio | 64.35% | 66.23% | 67.20% | 65.22% | 63.60% | 63.56% | 67.06% | 63 |
|------------------|--------|--------|--------|--------|--------|--------|--------|----|



Table of Contents**Item MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
2. OF OPERATIONS**

Management's discussion and analysis ("MD&A") provides supplemental information, which sets forth the major factors that have affected our financial condition and results of operations and should be read in conjunction with the Consolidated Financial Statements and related notes. The MD&A is divided into subsections entitled "Business Overview," "Financial Overview," "Results of Operations," "Financial Condition," "Liquidity and Capital Resources," "Off-Balance Sheet Arrangements," and "Accounting Policies." Information therein should facilitate a better understanding of the major factors and trends that affect our earnings performance and financial condition, and how our performance during 2006 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and its subsidiary, collectively, are referred to as "CCBG," "Company," "we," "us," or "our."

The period-to-date averages used in this report are based on daily balances for each respective period. In certain circumstances, comparing average balances for the comparable quarters of consecutive years may be more meaningful than simply analyzing year-to-date averages. Therefore, where appropriate, quarterly averages have been presented for analysis and have been noted as such. See Table I for average balances and interest rates presented on a quarterly basis.

In this MD&A, we present an operating efficiency ratio and an operating net noninterest expense as a percent of average assets, both of which are not calculated based on accounting principles generally accepted in the United States ("GAAP"), but that we believe provide important information regarding our results of operations. Our calculation of the operating efficiency ratio is computed by dividing non-interest expense less intangible amortization and one-time merger expenses, by the sum of tax equivalent net interest income and noninterest income. We calculate our operating net noninterest expense as a percent of average assets by subtracting noninterest expense excluding intangible amortization and one-time merger expenses from noninterest income. Management uses these non-GAAP measures as part of its assessment of its performance in managing non-interest expenses. We believe that excluding intangible amortization and one-time merger expenses in our calculations better reflect our periodic expenses and is more reflective of normalized operations.

Although we believe the above-mentioned non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP. In addition, there are material limitations associated with the use of these non-GAAP financial measures such as the risks that readers of our financial statements may disagree as to the appropriateness of items included or excluded in these measures and that our measures may not be directly comparable to other companies that calculate these measures differently. Our management compensates for these limitations by providing detailed reconciliations between GAAP information and the non-GAAP financial measure as detailed below.

Reconciliation of operating efficiency ratio to efficiency ratio -

|  | <b>Nine Months Ended September 30</b> |             |
|--|---------------------------------------|-------------|
|  | <b>2006</b>                           | <b>2005</b> |
| Efficiency ratio   | 69.39%                                | 68.32%      |
| Effect of intangible amortization and one-time merger expenses | (3.49)%                               | (3.68)%     |
| Operating efficiency ratio                                     | 65.90%                                | 64.64%      |

Reconciliation of operating net noninterest expense to net noninterest expense -

**Nine Months Ended September 30**

|  | <b>2006</b> | <b>2005</b> |
|--|-------------|-------------|
| Net noninterest expense as a percent of average assets           | 2.60%       | 2.42%       |
| Effect of intangible amortization and one-time merger expenses   | (0.24)%     | (0.24)%     |
| Operating net noninterest expense as a percent of average assets | 2.36%       | 2.18%       |

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The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included in this Quarterly Report on Form 10-Q.

**CAUTION CONCERNING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q, including this MD&A section, contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "target," "goal," and similar expressions are intended to identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. Please see the Introductory Note and Item 1A. Risk Factors of our Annual Report on Form 10-K, as updated in our subsequent quarterly reports filed on Form 10-Q, and in our other filings made from time to time with the SEC after the date of this report.

However, other factors besides those listed above, in our Quarterly Report or in our Annual Report also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

**BUSINESS OVERVIEW**

We are a financial holding company headquartered in Tallahassee, Florida and are the parent of our wholly-owned subsidiary, Capital City Bank (the "Bank" or "CCB"). The Bank offers a broad array of products and services through a total of 69 full-service offices located in Florida, Georgia, and Alabama. The Bank also has mortgage lending offices in three additional Florida communities, and one Georgia community. The Bank offers commercial and retail banking services, as well as trust and asset management, merchant services, securities brokerage and data processing services.

Our profitability, like most financial institutions, is dependent to a large extent upon net interest income, which is the difference between the interest received on earning assets, such as loans and securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. Results of operations are also affected by the provision for loan losses, operating expenses such as salaries and employee benefits, occupancy and other operating expenses including income taxes, and non-interest income such as service charges on deposit accounts, asset management and trust fees, mortgage banking revenues, merchant service fees, brokerage and data processing revenues.

Our philosophy is to grow and prosper, building long-term relationships based on quality service, high ethical standards, and safe and sound banking practices. We are a super-community bank in the relationship banking business with a locally oriented, community-based focus, which is augmented by experienced, centralized support in select specialized areas. Our local market orientation is reflected in our network of banking office locations, experienced community executives, and community advisory boards which support our focus on responding to local banking needs. We strive to offer a broad array of sophisticated products and to provide quality service by empowering associates to make decisions in their local markets.

Pursuant to our long-term strategic initiative, "Project 2010", we have continued our expansion, emphasizing a combination of growth in existing markets and acquisitions. Acquisitions will continue to be focused on a three state

area including Florida, Georgia, and Alabama with a particular focus on financial institutions, which are \$100 million to \$400 million in asset size and generally located on the outskirts of major metropolitan areas. We continue to evaluate de novo expansion opportunities in attractive new markets in the event that acquisition opportunities are not feasible. Other expansion opportunities that will be evaluated include asset management, insurance, and mortgage banking.

*Recent Acquisition.* On May 20, 2005, we completed our merger with First Alachua Banking Corporation ("FABC"), headquartered in Alachua, Florida. We issued approximately 906,000 shares of common stock and paid approximately \$29.0 million in cash for a total purchase price of \$58.0 million. FABC's wholly-owned subsidiary, First National Bank of Alachua, had \$228.3 million in assets at closing with seven offices in Alachua County and an eighth office in Hastings, Florida, which is in St. Johns County.

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**FINANCIAL OVERVIEW**

A summary overview of our financial performance for 2006 versus 2005 is provided below.

*2006 Financial Performance Highlights -*

Earnings of \$8.7 million, up 1.2% and \$24.4 million, up 7.0% for the three and nine months ended September 30, 2006 as compared to the same periods in 2005.

Diluted earnings per share of \$.47 for the third quarter of 2006 compared to \$.46 for the comparable period in 2005. Earnings per diluted share for the nine months ended September 30, 2006 of \$1.31 represents a 4.0% increase over the same period in 2005.

Growth in earnings was attributable to improvement in operating revenues of 5.3% and 11.8% for the three and nine month periods, respectively, driven primarily by higher net interest income and noninterest income.

Taxable equivalent net interest income grew 4.8% and 11.3% for the three and nine month periods, respectively, due to an improved net interest margin.

Net interest margin percentage improved 28 basis points and 31 basis points for the three and nine month periods, respectively, driven by favorable re-pricing spread and higher yield on new loan production.

Noninterest income grew 7.8% and 13.7% for the three and nine month periods, respectively, due primarily to higher deposit fees, asset management fees, retail brokerage fees, and card processing fees.

Continued strong credit quality as reflected by a nonperforming asset ratio of .34% and an annualized net charge-off ratio of .13% for the third quarter of 2006 compared to .08% for the same period in 2005. At quarter-end the allowance for loan losses was .86% of outstanding loans and provided coverage of 269% of nonperforming loans compared to .85% and 343%, respectively, for the same period in 2005.

We remain well-capitalized with a risk based capital ratio of 14.72%.

Table of Contents**RESULTS OF OPERATIONS****Net Income**

Earnings for the three and nine months ended September 30, 2006 were \$8.7 million, or \$.47 per diluted share, and \$24.4 million, or \$1.31 per diluted share, respectively. This compared to \$8.6 million, or \$.46 per diluted share and \$22.8 million, or \$1.26 per diluted share in 2005. Results include the impact of the acquisition of FABC in May 2005.

The growth in earnings for the third quarter of 2006 was primarily attributable to an increase in operating revenues (defined as net interest income plus noninterest income) of \$2.2 million, partially offset by increases in noninterest expense of \$1.8 million and loan loss provision of \$335,000. The increase in operating revenues is reflective of a 4.2% increase in net interest income and a 7.8% increase in noninterest income.

The growth in earnings for the nine month period of \$1.6 million, or 7.0% was primarily attributable to an increase in operating revenues of \$13.8 million, or 11.8%, partially offset by an increase in noninterest expense of \$11.1 million, or 13.8%, and income taxes of \$797,000, or 6.4%. The increase in operating revenue reflects an 11.0% increase in net interest income and a 13.7% increase in noninterest income.

A condensed earnings summary is presented below:

| <i>(Dollars in Thousands)</i>                | <b>Three Months Ended September</b> |             | <b>Nine Months Ended September</b> |             |
|--|-------------------------------------|-------------|------------------------------------|-------------|
|  | <b>2006</b>                         | <b>2005</b> | <b>2006</b>                        | <b>2005</b> |
| Interest Income                              | \$ 42,512                           | \$ 36,889   | \$ 123,293                         | \$ 101,273  |
| Taxable Equivalent Adjustment <sup>(1)</sup> | 522                                 | 325         | 1,256                              | 879         |
| Interest Income (FTE)                        | 43,034                              | 37,214      | 124,549                            | 102,152     |
| Interest Expense                             | (12,289)                            | (7,885)     | (33,753)                           | (20,593)    |
| Net Interest Income (FTE)                    | 30,745                              | 29,329      | 90,796                             | 81,559      |
| Provision for Loan Losses                    | (711)                               | (376)       | (1,499)                            | (1,174)     |
| Taxable Equivalent Adjustment                | (522)                               | (325)       | (1,256)                            | (879)       |
| Net Interest Income After Provision          | 29,512                              | 28,628      | 88,041                             | 79,506      |
| Noninterest Income                           | 14,144                              | 13,123      | 41,193                             | 36,224      |
| Merger Expense                               | -                                   | (180)       | -                                  | (414)       |
| Noninterest Expense                          | (30,422)                            | (28,429)    | (91,584)                           | (80,058)    |
| Income Before Income Taxes                   | 13,234                              | 13,142      | 37,650                             | 35,258      |
| Income Taxes                                 | (4,554)                             | (4,565)     | (13,234)                           | (12,436)    |
| Net Income                                   | \$ 8,680                            | \$ 8,577    | \$ 24,416                          | \$ 22,822   |
| Percent Change                               | 1.20%                               | (20.72)%    | 6.98%                              | 3.22%       |
| Return on Average Assets <sup>(2)</sup>      | 1.35%                               | 1.32%       | 1.26%                              | 1.25%       |
| Return on Average Equity <sup>(2)</sup>      | 10.83%                              | 11.31%      | 10.36%                             | 10.89%      |

(1) Computed using a statutory tax rate of 35%

(2) Annualized

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**Net Interest Income**

Net interest income represents our single largest source of earnings and is equal to interest income and fees generated by earning assets, less interest expense paid on interest bearing liabilities. Third quarter of 2006 taxable-equivalent net interest income increased \$1.4 million, or 4.8%, over the comparable quarter in 2005. During the first nine months of 2006, taxable-equivalent net interest income increased \$9.3 million, or 11.3%, respectively, over the first nine months of 2005. This increase was caused by the effect of our acquisition of FABC, higher earning asset yields and a slight improvement in earning asset mix, partially offset by higher funding costs and a change in deposit mix. The increase in yields and funding costs are a result of the higher interest rate environment. The combination of these factors resulted in a 28 basis point improvement in the net interest margin as compared to the third quarter of 2005. Table I provides a comparative analysis of our average balances and interest rates.

For the three month period ended September 30, 2006, taxable-equivalent interest income increased \$5.8 million or 15.6%, over the comparable period in 2005. During the first nine months of 2006, taxable-equivalent interest income improved \$22.4 million, or 21.9%, respectively, over the comparable period in 2005. The increase was attributable to a change in earning asset mix and higher yields on earning assets. Earning asset yields improved 106 basis points to 7.62% in the third quarter of 2006 from 6.56% in the third quarter of 2005 and 7.35% in the prior quarter, primarily attributable to the higher interest rate environment. Relative to the third quarter, we anticipate income on earning assets will remain down slightly for the fourth quarter resulting from a slight decline in the net interest margin and an anticipated lower level of earning assets.

Interest expense for the three and nine month periods ended September 30, 2006 increased \$4.4 million, or 55.9% and \$13.2 million, or 63.9%, respectively, from the comparable prior year periods. The increased expense is attributable to higher rates paid on all interest bearing liabilities and an increase in long-term debt costs resulting from debt secured to fund the FABC acquisition. The average rate paid on interest bearing liabilities of 2.84% in the third quarter of 2006 represents an increase of 98 and 26 basis points, respectively, over the third quarter of 2005 and second quarter of 2006. We anticipate that our interest expense will continue to increase in the fourth quarter due to continued upward pressure on our funding costs driven by the higher rate environment, shifting deposit mix, and increased competition for deposits.

Our interest rate spread (defined as the average federal taxable-equivalent yield on earning assets less the average rate paid on interest bearing liabilities) increased from 4.60% for the first nine months of 2005 to 4.75% for the comparable period in 2006.

Our net interest margin (defined as federal taxable-equivalent net interest income divided by average earning assets) was 5.45% and 5.36%, respectively, for the three and nine month periods of 2006, versus 5.17% and 5.05%, respectively, for the comparable periods in 2005. The increase in margin reflects higher asset yields driven by rising interest rates. The net interest margin is expected to decline during the fourth quarter, which is attributable to factors noted above.

**Provision for Loan Losses**

The provision for loan losses was \$711,000 and \$1.5 million, respectively, for the three and nine month periods ended September 30, 2006, compared to \$376,000 and \$1.2 million for the same periods in 2005. The increase in the provision for both periods was due to a higher level of required reserves.

Net charge-offs totaled \$664,000, or .13% of average loans for the third quarter of 2006 compared to \$403,000, or .08% for the third quarter of 2005. For the nine-month period ended September 30, 2006, net charge-offs totaled \$1.6

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million, or .10% of average loans compared to \$1.2 million, or .08% of average loans for the comparable period in 2005. At quarter-end the allowance for loan losses was .86% of outstanding loans and provided coverage of 269% of nonperforming loans.

Charge-off activity for the respective periods is set forth below:

| <i>(Dollars in Thousands)</i>   | <b>Three Months Ended September</b> |               | <b>Nine Months Ended September</b> |                 |
|---|-------------------------------------|---------------|------------------------------------|-----------------|
|   | <b>2006</b>                         | <b>2005</b>   | <b>2006</b>                        | <b>2005</b>     |
| <b>CHARGE-OFFS</b>  |                                     |               |                                    |                 |
| Commercial, Financial and Agricultural  | \$ 294                              | \$ 151        | \$ 760                             | \$ 541          |
| Real Estate - Construction  | -                                   | -             | -                                  | -               |
| Real Estate - Commercial  | -                                   | 4             | 291                                | 10              |
| Real Estate - Residential   | 81                                  | 115           | 127                                | 177             |
| Consumer  | 690                                 | 551           | 1,729                              | 1,805           |
| <b>Total Charge-offs</b>  | <b>1,065</b>                        | <b>821</b>    | <b>2,907</b>                       | <b>2,533</b>    |
| <b>RECOVERIES</b>   |                                     |               |                                    |                 |
| Commercial, Financial and Agricultural  | 43                                  | 43            | 168                                | 150             |
| Real Estate - Construction  | -                                   | -             | -                                  | -               |
| Real Estate - Commercial  | 4                                   | 1             | 9                                  | 1               |
| Real Estate - Residential   | 2                                   | 20            | 11                                 | 36              |
| Consumer  | 352                                 | 354           | 1,121                              | 1,174           |
| <b>Total Recoveries</b>   | <b>401</b>                          | <b>418</b>    | <b>1,309</b>                       | <b>1,361</b>    |
| <b>Net Charge-offs</b>  | <b>\$ 664</b>                       | <b>\$ 403</b> | <b>\$ 1,598</b>                    | <b>\$ 1,172</b> |
| <b>Net Charge-offs (Annualized) as a Percent of Average Loans Outstanding, Net of Unearned Interest</b> | <b>.13%</b>                         | <b>.08%</b>   | <b>.10%</b>                        | <b>.08%</b>     |

**Noninterest Income**

Noninterest income increased \$1.0 million, or 7.8%, and \$5.0 million, or 13.7%, respectively, over the comparable three and nine month periods in 2005. The increase in both periods was primarily due to higher deposit fees, asset management fees, retail brokerage fees, and card processing fees. The increase in deposit fees is due to the growth in deposit accounts reflective of strong deposit growth that has resulted from our "Absolutely Free" checking products. Asset management fees increased due to growth in new business. The improvement in retail brokerage fees is due to an increase in the sales force, which has increased production. Card processing fees were driven higher by increased transaction volume for merchant services and increased bank card activity. Noninterest income represented 31.9% and 31.5%, respectively, of operating revenue for the three and nine month periods of 2006 compared to 31.2% and 31.0%, respectively, for the same periods in 2005.

The table below reflects the major components of noninterest income.

| <i>(Dollars in Thousands)</i> | <b>Three Months Ended September</b> |             | <b>Nine Months Ended September</b> |             |
|-------------------------------|-------------------------------------|-------------|------------------------------------|-------------|
|                               | <b>2006</b>                         | <b>2005</b> | <b>2006</b>                        | <b>2005</b> |



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Noninterest Income:

|                                     |           |               |           |               |           |               |           |               |
|-------------------------------------|-----------|---------------|-----------|---------------|-----------|---------------|-----------|---------------|
| Service Charges on Deposit Accounts | \$        | 6,450         | \$        | 5,635         | \$        | 18,226        | \$        | 15,018        |
| Data Processing                     |           | 674           |           | 660           |           | 2,014         |           | 1,917         |
| Asset Management Fees               |           | 1,215         |           | 1,050         |           | 3,420         |           | 3,175         |
| Retail Brokerage Fees               |           | 520           |           | 305           |           | 1,505         |           | 917           |
| Mortgage Banking Revenues           |           | 824           |           | 1,317         |           | 2,448         |           | 3,116         |
| Merchant Service Fees               |           | 1,766         |           | 1,556         |           | 5,284         |           | 4,652         |
| Interchange Fees                    |           | 797           |           | 582           |           | 2,261         |           | 1,608         |
| ATM/Debit Card Fees                 |           | 635           |           | 550           |           | 1,861         |           | 1,624         |
| Other                               |           | 1,263         |           | 1,468         |           | 4,174         |           | 4,197         |
| <b>Total Noninterest Income</b>     | <b>\$</b> | <b>14,144</b> | <b>\$</b> | <b>13,123</b> | <b>\$</b> | <b>41,193</b> | <b>\$</b> | <b>36,224</b> |

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Various significant components of noninterest income are discussed in more detail below.

*Service Charges on Deposit Accounts.* Deposit service charge fees increased \$815,000, or 14.5%, and \$3.2 million, or 21.4%, respectively, over the comparable three and nine month periods in 2005. The increase reflects higher overdraft and nonsufficient funds fees due primarily to growth in deposit accounts attributable to an increase in free checking accounts and improved fee collection efforts.

*Asset Management Fees.* Income from asset management activities increased \$165,000, or 15.7%, and \$245,000, or 7.7%, respectively, over the comparable three and nine month periods in 2005. The improvement for both periods is primarily due to growth in new business within existing and new markets. At September 30, 2006, assets under management totaled \$713.0 million, representing an increase of \$32.0 million, or 4.7% from the comparable period in 2005.

*Mortgage Banking Revenues.* Mortgage banking revenues decreased \$493,000, or 37.4%, and \$668,000, or 21.5%, respectively, from the comparable three and nine month periods in 2005. The decrease reflects the local and national trend of a slower housing market and a decreased level of refinance activity.

*Card Fees.* Card processing fees (including merchant services fees, interchange fees, and ATM/debit card fees) increased \$510,000, or 19.0%, and \$1.5 million, or 19.3%, respectively, over the comparable three and nine periods in 2005. The increase in merchant service fees is primarily due to higher transaction volume reflective of growth in merchant accounts. Higher interchange fees and ATM/debit card fees reflect an increase in our active card base primarily associated with growth in deposit accounts.

*Other.* Other income decreased \$205,000, or 13.9%, and \$23,000, or 0.5%, respectively, over the comparable three and nine month periods in 2005 due primarily to lower miscellaneous loan fees and miscellaneous recoveries.

**Noninterest Expense**

Noninterest expense increased \$1.8 million, or 6.3%, and \$11.1 million, or 13.8%, respectively, over the comparable three and nine month periods in 2005. Higher expense for compensation and occupancy were the primary reasons for the increase in the third quarter. Increases in compensation, occupancy, and other expense drove the increase for the nine month period. Management has recently taken steps to strengthen our expense control procedures, including enhancement of current expense policies, creation of an expense control committee, which will focus on identifying cost savings strategies, and implementation of a new software system to improve accountability for expense management across our various divisions.

The table below reflects the major components of noninterest expense.

| (Dollars in Thousands) | Three Months Ended September |             | Nine Months Ended September |             |
|------------------------|------------------------------|-------------|-----------------------------|-------------|
|                        | 2006                         | 30,<br>2005 | 2006                        | 30,<br>2005 |
| Noninterest Expense:   |                              |             |                             |             |
| Salaries               | \$ 11,709                    | \$ 10,662   | \$ 34,868                   | \$ 30,300   |
| Associate Benefits     | 3,568                        | 3,384       | 11,044                      | 9,493       |
| Total Compensation     | 15,277                       | 14,046      | 45,912                      | 39,793      |
| Premises               | 2,354                        | 2,119       | 6,935                       | 6,091       |
| Equipment              | 2,492                        | 2,285       | 7,652                       | 6,589       |

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|                           |           |           |           |           |
|---------------------------|-----------|-----------|-----------|-----------|
| Total Occupancy           | 4,846     | 4,404     | 14,587    | 12,680    |
| Legal Fees                | 323       | 546       | 1,285     | 1,358     |
| Professional Fees         | 851       | 903       | 2,470     | 2,477     |
| Processing Services       | 490       | 352       | 1,344     | 1,100     |
| Advertising               | 1,036     | 1,131     | 3,288     | 3,079     |
| Travel and Entertainment  | 413       | 346       | 1,284     | 950       |
| Printing and Supplies     | 601       | 673       | 1,878     | 1,790     |
| Telephone                 | 559       | 693       | 1,769     | 1,771     |
| Postage                   | 257       | 279       | 859       | 895       |
| Intangible Amortization   | 1,536     | 1,430     | 4,601     | 3,922     |
| Interchange Fees          | 1,531     | 1,367     | 4,571     | 4,057     |
| Courier Service           | 327       | 355       | 985       | 997       |
| Miscellaneous             | 2,374     | 2,084     | 6,751     | 5,603     |
| Total Noninterest Expense | \$ 30,422 | \$ 28,609 | \$ 91,584 | \$ 80,472 |

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Various significant components of noninterest expense are discussed in more detail below.

*Compensation.* Salaries and associate benefits expense increased \$1.2 million, or 8.8%, and \$6.1 million, or 15.4% over the comparable three and nine month periods in 2005. For the first nine months of the year, we experienced increases in associate salaries of \$4.4 million, payroll tax expense of \$252,000, associate insurance expense of \$350,000, pension plan expense of \$250,000, and stock-based compensation of \$788,000. The increase in associate salaries and payroll tax expense reflects the addition of FABC associates, annual merit/market based raises for associates, and lower realized loan cost. Realized loan cost reflects the impact of SFAS No. 91 "Accounting for Nonrefundable Fees and Costs Associated with Acquiring Loans", which requires deferral and amortization of loan costs that are accounted for as a credit offset to salary expense. The decrease in the number of loans originated for the first nine months of the year reduced the amount of this offset as compared to the first nine months of 2005. The increase in expense for insurance and pension benefits is reflective of an increase in eligible participants. The higher pension expense is also due to a lower discount rate used for the 2006 expense projection. Higher stock based compensation reflects an increase in plan participants and higher target awards due to the adoption of our new Incentive Plan.

*Occupancy.* Occupancy expense (including premises and equipment) increased \$441,000, or 10.0%, and \$1.9 million, or 15.0%, respectively over the comparable three and nine month periods in 2005. For the quarter, we realized increases in depreciation of \$157,000, utilities of \$101,000, and maintenance agreements (FF&E) of \$73,000. The increase in depreciation is primarily due to the addition of one new office in late 2005, and two replacement offices and office renovations that were completed in 2006. Utility expense increased primarily due to a mid-year rate hike. Higher expense for maintenance agreements (FF&E) was primarily due to an increase in core processing system and networking costs. For the first nine months of the year, we experienced increases in depreciation of \$927,000, maintenance and repairs (building and FF&E) of \$310,000, utilities of \$275,000, maintenance agreements (FF&E) of \$371,000, and building insurance of \$105,000 from the comparable period in 2005. The increase in depreciation is related to the addition of FABC offices and the aforementioned office additions/renovations. An increase in general maintenance service expense associated with new and existing banking offices, core processing/networking systems and ATM's drove the increase in maintenance and repairs. Utility expense increased due to the aforementioned mid-year rate hike and the addition of FABC offices. The increase in expense for maintenance agreements (FF&E) is primarily due to an increase in core processing and networking costs partially attributable to enhancement of the company's back-up and recovery capabilities. The addition of new/replacement and banking office renovations and an insurance premium increase drove the increase in building insurance.

*Other.* Other noninterest expense increased \$141,000, or 1.4%, and \$3.1 million, or 11.0%, respectively over the three and nine month periods in 2005. For the first nine months of the year, the increase was primarily attributable to higher expense for the following categories: 1) advertising - \$209,000, 2) travel and entertainment - \$334,000, 3) intangible amortization - \$679,000, 4) interchange fees - \$514,000, and 5) miscellaneous - \$1.3 million. The increase in advertising expense is due to an increase in promotional expenses associated with the addition of new banking offices in late 2005 and an expansion in our line of free checking products. The higher expense for travel and entertainment is linked primarily to an increase in associate training and company events during the year. The increase in intangible amortization reflects new core deposit amortization from the FABC acquisition. The increase in interchange fees is due to increased merchant card transaction volume. Miscellaneous expense grew due to increases in other losses, ATM/debit card production, associate hiring expense, and associate training expense.

Operating net noninterest expense (noninterest income minus noninterest expense, excluding intangible amortization and one-time merger expenses) as a percent of average assets was 2.36% for the first nine months of 2006 compared to 2.18% for the same period in 2005. Our operating efficiency ratio (noninterest expense, excluding intangible amortization and one-time merger expenses, expressed as a percent of the sum of taxable-equivalent net interest income plus noninterest income) was 65.90% for the first nine months of 2006 compared to 64.64% for the same

period in 2005 due to expense growth as discussed above.

### **Income Taxes**

There was no material variance in the tax provision between the third quarter of 2006 and 2005. The provision for income taxes increased \$797,000, or 6.4% during the first nine months of 2006, reflecting higher taxable income. Our effective tax rate for the three and nine-months ended September 30, 2006 was 34.41% and 35.15% compared to 34.74% and 35.39% for the same periods in 2005.

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**FINANCIAL CONDITION**

Average assets decreased \$47.4 million, or 1.82%, to \$2.560 billion for the quarter-ended September 30, 2006 from \$2.608 billion in the fourth quarter of 2005. Average earning assets of \$2.241 billion decreased \$37.9 million, or 1.66%, from the fourth quarter of 2005. A decrease in average loans of \$37.7 million and a \$6.7 million decrease in average short term investments was partially offset by a \$6.5 million increase in investment securities. These variances are discussed in more detail below.

**Funds Sold**

We ended the third quarter with approximately \$9.8 million in average net overnight funds sold, compared to \$5.7 million net overnight funds purchased in the fourth quarter of 2005. The improvement reflects the increase in non-maturity deposits that is discussed in further detail below (*Deposits*). Growth in non-maturity deposits and an overall reduction in the loan portfolio during the first nine months of the year has reduced the Bank's position in overnight funds purchased.

**Investment Securities**

Our investment portfolio is a significant component of our operations and, as such, it functions as a key element of liquidity and asset/liability management. As of September 30, 2006, the average investment portfolio increased \$6.5 million, or 3.6%, from the fourth quarter of 2005. We will continue to evaluate the need to purchase securities for the investment portfolio for the remainder of 2006, taking into consideration the Bank's overall liquidity position and pledging requirements.

Securities classified as available-for-sale are recorded at fair value and unrealized gains and losses associated with these securities are recorded, net of tax, as a separate component of shareowners' equity. At September 30, 2006 and December 31, 2005, shareowners' equity included a net unrealized loss of \$1.0 million and \$1.2 million, respectively.

**Loans**

Average loans for the third quarter decreased \$37.7 million, or 1.83%, from the fourth quarter, due to an overall slowdown in loan activity and higher than expected principal pay-downs and pay-offs.

Our nonperforming loans were \$6.4 million at September 30, 2006 compared to \$5.3 million at December 31, 2005. As a percent of nonperforming loans, the allowance for loan losses represented 269% at September 30, 2006 and 331% at December 31, 2005. Nonperforming loans include nonaccruing and restructured loans. The increase in nonperforming loans during the quarter reflects the addition of several small balance commercial loans that had previously been identified as potential problem loans. Other real estate, which includes property acquired either through foreclosure or by receiving a deed in lieu of foreclosure, was \$0.4 million at September 30, 2006 versus \$0.3 million at December 31, 2005. The ratio of nonperforming assets as a percent of loans plus other real estate was .34% at September 30, 2006, compared to .27% at December 31, 2005.

We strive to maintain an allowance for loan losses at a level sufficient to provide for the estimated credit losses inherent in the loan portfolio as of the balance sheet date. Credit losses arise from borrowers' inability or unwillingness to repay, and from other risks inherent in the lending process, including collateral risk, operations risk, concentration risk and economic risk. All related risks of lending are considered when assessing the adequacy of the loan loss reserve. The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when management believes collection of the principal is unlikely. The allowance for loan losses is based on management's judgment of overall loan quality. This is a significant estimate based on a detailed analysis

of the loan portfolio. The balance can and will change based on changes in the assessment of the portfolio's overall credit quality. We evaluate the adequacy of the allowance for loan losses on a quarterly basis.

The allowance for loan losses at September 30, 2006 was \$17.3 million, compared to \$17.4 million at December 31, 2005. At September 30, 2006 the allowance represented 0.86% of total loans compared to 0.84% at December 31, 2005. While there can be no assurance that we will not sustain loan losses in a particular period that are substantial in relation to the size of the allowance, our assessment of the loan portfolio does not indicate a likelihood of this occurrence. It is management's opinion that the allowance at September 30, 2006 is adequate to absorb losses inherent in the loan portfolio at quarter-end.

### **Deposits**

Average deposits for the third quarter of 2006 decreased \$.5 million, or .02%, from the fourth quarter of 2005. The reduction reflects a decline in savings accounts (\$17.0 million), certificates of deposit (\$35.6 million), and DDA accounts (\$49.1 million) partially offset by increases in NOW account (\$27.5 million) and money market account (\$73.7 million) balances.

The ratio of average noninterest bearing deposits to total deposits was 24.4% for the third quarter of 2006, compared to 27.9% for the fourth quarter of 2005. For the same period, the ratio of average interest bearing liabilities to average earning assets was 75.6% and 73.1%, respectively.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES****Liquidity**

*General.* Liquidity for a banking institution is the availability of funds to meet increased loan demand, excessive deposit withdrawals, and the payment of other contractual cash obligations. Management monitors our financial position in an effort to ensure we have ready access to sufficient liquid funds to meet normal transaction requirements and take advantage of investment opportunities and cover unforeseen liquidity demands. In addition to core deposit growth, sources of funds available to meet liquidity demands include cash received through ordinary business activities (i.e., collection of interest and fees), federal funds sold, loan and investment maturities, our bank lines of credit, approved lines for the purchase of federal funds by CCB and Federal Home Loan Bank ("FHLB") advances.

Average liquidity (defined as funds sold and interest bearing deposits with other banks) for the third quarter of 2006 was \$25.5 million compared to \$32.3 million in the fourth quarter of 2005. The decrease is primarily reflective of the pay-off of two large FHLB advances during the third quarter. Liquidity levels are anticipated to decline slightly during the fourth quarter.

*Borrowings.* We have the ability to draw on a \$25.0 million revolving credit note, due on October 15, 2007. Interest is payable quarterly at LIBOR plus an applicable margin on advances. The revolving credit note is unsecured. The existing loan agreement contains certain financial covenants that we must maintain. At September 30, 2006, we were in compliance with all of the terms of the agreement and had \$25.0 million available under the credit facility.

For the first nine months of the year, the Bank made FHLB advance payments totaling approximately \$45.7 million and obtained one new FHLB advance for \$3.2 million.

We issued a \$32.0 million junior subordinated deferrable interest note in May 2005 to a wholly owned Delaware statutory trust, Capital City Bank Group Capital Trust II ("CCBG Capital Trust II"). Interest payments are due quarterly at a fixed rate of 6.07% for the first five years, then adjust annually thereafter based on the three month LIBOR plus a margin of 1.80%. The note matures on June 15, 2035. The proceeds of the borrowing were used to fund the cash portion of the FABC purchase price.

*Contractual Cash Obligations.* We maintain certain contractual arrangements to make future cash payments. The table below details those future cash payment obligations as of September 30, 2006. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts.

| <i>(Dollars in Thousands)</i>      | <b>Payments Due By Period</b> |                    |                    |                      |            | <b>Total</b> |
|------------------------------------|-------------------------------|--------------------|--------------------|----------------------|------------|--------------|
|                                    | <b>1 Year or Less</b>         | <b>1 - 3 Years</b> | <b>4 - 5 Years</b> | <b>After 5 Years</b> |            |              |
| Federal Home Loan Bank Advances    | \$ 640                        | \$ 30,413          | \$ 5,690           | \$ 19,361            | \$ 56,104  |              |
| Subordinated Notes Payable         | -                             | -                  | -                  | 62,887               | 62,887     |              |
| Operating Lease Obligations        | 368                           | 2,712              | 2,211              | 7,080                | 12,371     |              |
| Total Contractual Cash Obligations | \$ 1,008                      | \$ 33,125          | \$ 7,901           | \$ 89,328            | \$ 131,362 |              |

**Capital**

Equity capital was \$319.0 million as of September 30, 2006 compared to \$305.8 million as of December 31, 2005. Management continues to monitor our capital position in relation to our level of assets with the objective of maintaining a strong capital position. The leverage ratio was 11.26% at September 30, 2006 compared to 10.27% at



December 31, 2005. Further, the risk-adjusted capital ratio of 14.72% at September 30, 2006 exceeds the 8.0% minimum requirement under the risk-based regulatory guidelines. As allowed by the Federal Reserve Board capital guidelines the trust preferred securities issued by Capital City Bank Group Capital Trust I and CCBG Capital Trust II are included as Tier 1 capital in our capital calculations.

Adequate capital and financial strength is paramount to the stability of CCBG and the Bank. Cash dividends declared and paid should not place unnecessary strain on our capital levels. Although a consistent dividend payment is believed to be favorably viewed by the financial markets and shareowners, the Board of Directors will declare dividends only if we are considered to have adequate capital. Future capital requirements and corporate plans are considered when the Board considers a dividend payment. Dividends declared and paid during the third quarter of 2006 totaled \$.1625 per share compared to \$.1520 per share for the third quarter of 2005, an increase of 6.9%. The dividend payout ratios for the third quarter ended 2006 and 2005 were 34.9% and 33.3%, respectively.

State and federal regulations as well as our long-term debt agreements place certain restrictions on the payment of dividends by both CCBG and the Bank. At September 30, 2006, these regulations and covenants did not impair CCBG or the Bank's ability to declare and pay dividends or to meet other existing obligations in the normal course of business.

During the first nine months of 2006, shareowners' equity increased \$13.3 million, or 5.8%, on an annualized basis. Growth in equity during the first nine months of the year was positively impacted by net income of \$24.4 million, a decrease in the net unrealized loss on available-for-sale securities of \$0.3 million, the issuance of common stock of \$1.6 million and, and stock-based compensation accretion of \$0.9 million. Equity was reduced by dividends paid during the first nine months of the year by \$9.1 million, or \$.4875 per share and the repurchase of common stock of \$4.8 million. At September 30, 2006, our common stock had a book value of \$17.18 per diluted share compared to \$16.39 at December 31, 2005.

Our Board of Directors has authorized the repurchase of up to 1,171,875 shares of our outstanding common stock. The purchases are made in the open market or in privately negotiated transactions. To date, we have repurchased a total of 864,760 shares at an average purchase price of \$18.28 per share. We repurchased 148,876 shares of our common stock in the second quarter of 2006 at an average purchase price of \$32.41 per share.

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**OFF-BALANCE SHEET ARRANGEMENTS**

We do not currently engage in the use of derivative instruments to hedge interest rate risks. However, we are a party to financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of our clients.

At September 30, 2006, we had \$443.3 million in commitments to extend credit and \$17.8 million in standby letters of credit. Commitments to extend credit are agreements to lend to a client so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a client to a third party. We use the same credit policies in establishing commitments and issuing letters of credit as we do for on-balance sheet instruments.

If commitments arising from these financial instruments continue to require funding at historical levels, management does not anticipate that such funding will adversely impact its ability to meet on-going obligations. In the event these commitments require funding in excess of historical levels, management believes current liquidity, available lines of credit from the FHLB, investment security maturities and our revolving credit facility provide a sufficient source of funds to meet these commitments.

**ACCOUNTING POLICIES**

**Critical Accounting Policies**

The consolidated financial statements and accompanying Notes to Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require us to make various estimates and assumptions (see Note 1 in the Notes to Consolidated Financial Statements). We believe that, of our significant accounting policies, the following may involve a higher degree of judgment and complexity.

*Allowance for Loan Losses.* The allowance for loan losses is established through a charge to the provision for loan losses. Provisions are made to reserve for estimated losses in loan balances. The allowance for loan losses is a significant estimate and is evaluated quarterly by us for adequacy. The use of different estimates or assumptions could produce a different required allowance, and thereby a larger or smaller provision recognized as expense in any given reporting period. A further discussion of the allowance for loan losses can be found in the section entitled "Allowance for Loan Losses" and Note 1 in the Notes to Consolidated Financial Statements in our 2005 Annual Report on Form 10-K.

*Intangible Assets.* Intangible assets consist primarily of goodwill, core deposit assets, and other identifiable intangibles that were recognized in connection with various acquisitions. Goodwill represents the excess of the cost of acquired businesses over the fair market value of their identifiable net assets. We perform an impairment review on an annual basis to determine if there has been impairment of our goodwill. We have determined that no impairment existed at December 31, 2005. Impairment testing requires management to make significant judgments and estimates relating to the fair value of its identified reporting units. Significant changes to these estimates may have a material impact on our reported results.

Core deposit assets represent the premium we paid for core deposits. Core deposit intangibles are amortized on the straight-line method over various periods ranging from 5-10 years. Generally, core deposits refer to nonpublic, non-maturing deposits including noninterest-bearing deposits, NOW, money market and savings. We make certain

estimates relating to the useful life of these assets, and rate of run-off based on the nature of the specific assets and the client bases acquired. If there is a reason to believe there has been a permanent loss in value, management will assess these assets for impairment. Any changes in the original estimates may materially affect reported earnings.

*Pension Assumptions.* We have a defined benefit pension plan for the benefit of substantially all of our associates. Our funding policy with respect to the pension plan is to contribute amounts to the plan sufficient to meet minimum funding requirements as set by law. Pension expense, reflected in the Consolidated Statements of Income in noninterest expense as "Salaries and Associate Benefits," is determined by an external actuarial valuation based on assumptions that are evaluated annually as of December 31, the measurement date for the pension obligation. The Consolidated Statements of Financial Condition reflect an accrued pension benefit cost due to funding levels and unrecognized actuarial amounts. The most significant assumptions used in calculating the pension obligation are the weighted-average discount rate used to determine the present value of the pension obligation, the weighted-average expected long-term rate of return on plan assets, and the assumed rate of annual compensation increases. These assumptions are re-evaluated annually with the external actuaries, taking into consideration both current market conditions and anticipated long-term market conditions.

The weighted-average discount rate is determined by matching anticipated Retirement Plan cash flows for a 30-year period to long-term corporate Aa-rated bonds and solving for the underlying rate of return, which investing in such securities would generate. This methodology is applied consistently from year-to-year. We anticipate using a 5.75% discount rate for 2006.

The weighted-average expected long-term rate of return on plan assets is determined based on the current and anticipated future mix of assets in the plan. The assets currently consist of equity securities, U.S. Government and Government agency debt securities, and other securities (typically temporary liquid funds awaiting investment). We anticipate using a rate of return on plan assets of 8.0% for 2006.

The assumed rate of annual compensation increases of 5.50% for 2006 is based on expected trends in salaries and the employee base. This assumption is not expected to change materially in 2006.

Information on components of our net periodic benefit cost is provided in Note 8 of the Notes to Consolidated Financial Statements included herein and Note 12 of the Notes to Consolidated Financial Statements in our 2005 Annual Report on Form 10-K.

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**Recent Accounting Pronouncements**

*Statement of Financial Accounting Standards*

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments." SFAS 155 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS 155 (i) permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (v) amends SFAS 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for us on January 1, 2007, and is not expected to have a significant impact on our financial statements.

SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for us on January 1, 2008 and is not expected to have a significant impact on the our financial statements.

SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88 106, and 132(R)." SFAS 158 requires an employer to recognize the over-funded or under-funded status of defined benefit postretirement plans as an asset or a liability in its statement of financial position. The funded status is measured as the difference between plan assets at fair value and the benefit obligation (the projected benefit obligation for pension plans or the accumulated benefit obligation for other postretirement benefit plans). An employer is also required to measure the funded status of a plan as of the date of its year-end statement of financial position with changes in the funded status recognized through comprehensive income. SFAS 158 also requires certain disclosures regarding the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of gains or losses, prior service costs or credits, and the transition asset or obligation. We will be required to recognize the funded status of our defined benefit pension plan in our financial statements for the year ended December 31, 2006. The requirement to measure plan assets and benefit obligations as of the date of the year-end statement of financial position is effective for our financial statements beginning with the year ended after December 31, 2008. We are currently evaluating the potential impact of SFAS 158 on our consolidated financial statements.

*Financial Accounting Standards Board Interpretations*

In July 2006, the FASB issued FASB Interpretation 48, "Accounting for Income Tax Uncertainties" ("FIN 48"). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are currently evaluating the potential impact of FIN 48 on our consolidated financial statements.

*SEC Staff Accounting Bulletins*

Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of a Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements." SAB 108 addresses how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. The effects of prior year uncorrected errors include the potential accumulation of improper amounts that may result in a material misstatement on the balance sheet or the reversal of prior period errors in the current period that result in a material misstatement of the current period income statement amounts. Adjustments to current or prior period financial statements would be required in the event that after application of various approaches for assessing materiality of a misstatement in current period financial statements and consideration of all relevant quantitative and qualitative factors, a misstatement is determined to be material. SAB 108 is applicable to all financial statements issued by us after November 15, 2006. We are currently evaluating the potential impact of SAB 108 on our consolidated financial statements.

Table of Contents**TABLE I  
AVERAGE BALANCES & INTEREST RATES***(Taxable Equivalent Basis - Dollars in Thousands)*

|   | Three Months Ended September 30, |           |       |                     |           |       | Nine Months Ended September 30, |            |       |                     |           |       |
|---|----------------------------------|-----------|-------|---------------------|-----------|-------|---------------------------------|------------|-------|---------------------|-----------|-------|
|   | 2006                             |           |       | 2005                |           |       | 2006                            |            |       | 2005                |           |       |
|   | Balance                          | Interest  | Rate  | Balance             | Interest  | Rate  | Balance                         | Interest   | Rate  | Balance             | Interest  | Rate  |
| <b>ASSETS</b>                                     |                                  |           |       |                     |           |       |                                 |            |       |                     |           |       |
| Loans, Net of Unearned Interest <sup>(1)(2)</sup> | \$ 2,025,112                     | \$ 40,433 | 7.92% | \$ 2,046,968        | \$ 35,433 | 6.87% | \$ 2,038,050                    | \$ 116,931 | 7.67% | \$ 1,936,448        | \$ 35,433 | 6.87% |
| Taxable Investment Securities                     | 109,097                          | 1,264     | 4.62% | 137,970             | 1,022     | 2.95% | 113,859                         | 3,588      | 4.19% | 147,099             | 1,022     | 2.95% |
| Tax-Exempt Investment Securities <sup>(2)</sup>   | 81,409                           | 998       | 4.90% | 56,079              | 638       | 4.55% | 71,960                          | 2,568      | 4.76% | 47,153              | 638       | 4.55% |
| Funds Sold  | 25,540                           | 339       | 5.19% | 9,885               | 121       | 4.79% | 41,219                          | 1,463      | 4.72% | 26,191              | 121       | 4.79% |
| Total Earning Assets                              | 2,241,158                        | 43,034    | 7.62% | 2,250,902           | 37,214    | 6.56% | 2,265,088                       | 124,550    | 7.35% | 2,156,891           | 37,214    | 6.56% |
| Cash & Due From Banks                             | 96,969                           |           |       | 106,638             |           |       | 102,188                         |            |       | 102,800             |           |       |
| Allowance for Loan Losses                         | (17,420)                         |           |       | (17,570)            |           |       | (17,481)                        |            |       | (16,917)            |           |       |
| Other Assets                                      | 239,448                          |           |       | 229,554             |           |       | 239,277                         |            |       | 203,228             |           |       |
| <b>TOTAL ASSETS</b>                               | <b>\$ 2,560,155</b>              |           |       | <b>\$ 2,569,524</b> |           |       | <b>\$ 2,589,072</b>             |            |       | <b>\$ 2,446,002</b> |           |       |
| <b>LIABILITIES</b>                                |                                  |           |       |                     |           |       |                                 |            |       |                     |           |       |
| NOW Accounts                                      | \$ 511,299                       | \$ 2,026  | 1.57% | \$ 463,936          | \$ 773    | .66%  | \$ 510,556                      | \$ 5,136   | 1.34% | \$ 412,679          | \$ 773    | .66%  |
| Money Market Accounts                             | 381,628                          | 3,259     | 3.39% | 272,724             | 1,062     | 1.54% | 363,150                         | 8,199      | 3.02% | 264,999             | 1,062     | 1.54% |
| Savings Accounts                                  | 132,421                          | 72        | 0.22% | 159,080             | 75        | 0.19% | 136,058                         | 202        | 0.20% | 154,056             | 75        | 0.19% |
| Other Time Deposits                               | 504,121                          | 4,627     | 3.64% | 563,595             | 3,570     | 2.51% | 514,857                         | 12,886     | 3.35% | 554,570             | 3,570     | 2.51% |
| Total Int. Bearing Deposits                       | 1,529,469                        | 9,984     | 2.59% | 1,459,335           | 5,480     | 1.49% | 1,524,621                       | 26,423     | 2.32% | 1,386,304           | 5,480     | 1.49% |
| Short-Term Borrowings                             | 73,078                           | 753       | 4.07% | 89,483              | 691       | 3.07% | 83,187                          | 2,352      | 3.77% | 92,561              | 691       | 3.07% |
| Subordinated Notes Payable                        | 62,887                           | 936       | 5.91% | 62,887              | 931       | 5.87% | 62,887                          | 2,789      | 5.93% | 46,616              | 931       | 5.87% |
| Other Long-Term Borrowings                        | 52,367                           | 615       | 4.66% | 72,408              | 783       | 4.29% | 61,912                          | 2,189      | 4.73% | 69,876              | 783       | 4.29% |
| Total Int. Bearing Liabilities                    | 1,717,801                        | 12,288    | 2.84% | 1,684,113           | 7,885     | 1.86% | 1,732,607                       | 33,753     | 2.60% | 1,595,357           | 7,885     | 1.86% |
| Noninterest Bearing Deposits                      | 494,054                          |           |       | 554,092             |           |       | 512,493                         |            |       | 545,287             |           |       |
| Other Liabilities                                 | 30,259                           |           |       | 30,388              |           |       | 28,849                          |            |       | 25,217              |           |       |
| <b>TOTAL LIABILITIES</b>                          | <b>2,242,114</b>                 |           |       | <b>2,268,593</b>    |           |       | <b>2,273,949</b>                |            |       | <b>2,165,861</b>    |           |       |

**SHAREOWNERS'  
EQUITY**

|                                 |         |         |         |         |
|---------------------------------|---------|---------|---------|---------|
| TOTAL<br>SHAREOWNERS'<br>EQUITY | 318,041 | 300,931 | 315,123 | 280,141 |
|---------------------------------|---------|---------|---------|---------|

**TOTAL  
LIABILITIES &  
EQUITY**

|  |              |              |              |              |
|--|--------------|--------------|--------------|--------------|
|  | \$ 2,560,155 | \$ 2,569,524 | \$ 2,589,072 | \$ 2,446,002 |
|--|--------------|--------------|--------------|--------------|

|                                       |           |           |           |       |
|---------------------------------------|-----------|-----------|-----------|-------|
| Interest Rate Spread                  |           | 4.78%     | 4.70%     | 4.75% |
| Net Interest Income                   | \$ 30,746 | \$ 29,329 | \$ 90,797 | \$    |
| Net Interest<br>Margin <sup>(3)</sup> |           | 5.45%     | 5.17%     | 5.36% |

(1) Average balances include nonaccrual loans. Interest income includes fees on loans of \$979,000 and \$2.9 million, for the three and nine months ended September 30, 2006, versus \$898,000 and \$2.2 million for the comparable periods ended September 30, 2005.

(2) Interest income includes the effects of taxable equivalent adjustments using a 35% tax rate.

(3) Taxable equivalent net interest income divided by average earning assets.

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**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Overview**

Market risk management arises from changes in interest rates, exchange rates, commodity prices, and equity prices. We have risk management policies to monitor and limit exposure to market risk and do not participate in activities that give rise to significant market risk involving exchange rates, commodity prices, or equity prices. In asset and liability management activities, policies are in place that are designed to minimize structural interest rate risk.

**Interest Rate Risk Management**

The normal course of business activity exposes us to interest rate risk. Fluctuations in interest rates may result in changes in the fair market value of our financial instruments, cash flows and net interest income. We seek to avoid fluctuations in our net interest margin and to maximize net interest income within acceptable levels of risk through periods of changing interest rates. Accordingly, our interest rate sensitivity and liquidity are monitored on an ongoing basis by our Asset and Liability Committee ("ALCO"), which oversees market risk management and establishes risk measures, limits and policy guidelines for managing the amount of interest rate risk and its effects on net interest income and capital. A variety of measures are used to provide for a comprehensive view of the magnitude of interest rate risk, the distribution of risk, the level of risk over time and the exposure to changes in certain interest rate relationships.

ALCO continuously monitors and manages the balance between interest rate-sensitive assets and liabilities. ALCO's objective is to manage the impact of fluctuating market rates on net interest income within acceptable levels. In order to meet this objective, management may adjust the rates charged/paid on loans/deposits or may shorten/lengthen the duration of assets or liabilities within the parameters set by ALCO.

Our financial assets and liabilities are classified as other-than-trading. An analysis of the other-than-trading financial components, including the fair values, are presented in Table II. This table presents our consolidated interest rate sensitivity position as of September 30, 2006 based upon certain assumptions as set forth in the Notes to the Table. The objective of interest rate sensitivity analysis is to measure the impact on our net interest income due to fluctuations in interest rates. The asset and liability values presented in Table II may not necessarily be indicative of our interest rate sensitivity over an extended period of time.

We expect rising rates to have a favorable impact on the net interest margin, subject to the magnitude and timeframe over which the rate changes occur. However, as general interest rates rise or fall, other factors such as current market conditions and competition may impact how we respond to changing rates and thus impact the magnitude of change in net interest income. Non-maturity deposits offer management greater discretion as to the direction, timing, and magnitude of interest rate changes and can have a material impact on our interest rate sensitivity. In addition, the relative level of interest rates as compared to the current yields/rates of existing assets/liabilities can impact both the direction and magnitude of the change in net interest margin as rates rise and fall from one period to the next.

**Inflation**

The impact of inflation on the banking industry differs significantly from that of other industries in which a large portion of total resources are invested in fixed assets such as property, plant and equipment.

Assets and liabilities of financial institutions are virtually all monetary in nature, and therefore are primarily impacted by interest rates rather than changing prices. While the general level of inflation underlies most interest rates, interest



rates react more to changes in the expected rate of inflation and to changes in monetary and fiscal policy. Net interest income and the interest rate spread are good measures of our ability to react to changing interest rates and are discussed in further detail in the section entitled "Results of Operations."

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**Table II**  
**FINANCIAL ASSETS AND LIABILITIES MARKET RISK ANALYSIS<sup>(1)</sup>**  
(Other Than Trading Portfolio)

|  | As of September 30, 2006 |            |            |           |           |           |              |              |
|--|--------------------------|------------|------------|-----------|-----------|-----------|--------------|--------------|
| (Dollars in Thousands)                     | Year 1                   | Year 2     | Year 3     | Year 4    | Year 5    | Beyond    | Total        | Fair Value   |
| <b>Loans</b>                               |                          |            |            |           |           |           |              |              |
| Fixed Rate                                 | \$ 311,323               | \$ 153,135 | \$ 102,449 | \$ 49,751 | \$ 25,179 | \$ 18,762 | \$ 660,599   | \$ 662,057   |
| Average Interest Rate                      | 6.40%                    | 7.59%      | 7.81%      | 7.68%     | 7.39%     | 6.60%     | 7.03%        |              |
| Floating Rate <sup>(2)</sup>               | 1,076,304                | 151,808    | 97,439     | 7,852     | 6,152     | 9,305     | 1,348,860    | 1,352,111    |
| Average Interest Rate                      | 6.95%                    | 6.82%      | 7.49%      | 7.54%     | 7.65%     | 8.09%     | 6.99%        |              |
| <b>Investment Securities<sup>(3)</sup></b> |                          |            |            |           |           |           |              |              |
| Fixed Rate                                 | 51,485                   | 58,445     | 51,361     | 7,923     | 4,864     | 15,503    | 189,581      | 189,581      |
| Average Interest Rate                      | 3.79%                    | 4.07%      | 4.09%      | 4.05%     | 4.21%     | 5.49%     | 4.12%        |              |
| Floating Rate                              | 1,036                    | -          | -          | -         | -         | -         | 1,036        | 1,036        |
| Average Interest Rate                      | 5.18%                    | -          | -          | -         | -         | -         | 5.18%        |              |
| <b>Other Earning Assets</b>                |                          |            |            |           |           |           |              |              |
| Floating Rate                              | 35,631                   | -          | -          | -         | -         | -         | 35,631       | 35,631       |
| Average Interest Rate                      | 5.27%                    | -          | -          | -         | -         | -         | 5.27%        |              |
| <b>Total Financial Assets</b>              |                          |            |            |           |           |           |              |              |
|  | \$ 1,475,779             | \$ 363,388 | \$ 251,249 | \$ 65,526 | \$ 36,195 | \$ 43,570 | \$ 2,235,707 | \$ 2,240,416 |
| Average Interest Rate                      | 6.68%                    | 6.71%      | 6.93%      | 7.22%     | 7.01%     | 6.52%     | 6.73%        |              |
| <b>Deposits<sup>(4)</sup></b>              |                          |            |            |           |           |           |              |              |
| <b>Fixed Rate</b>                          |                          |            |            |           |           |           |              |              |
| Deposits                                   | \$ 402,953               | \$ 60,510  | \$ 19,392  | \$ 6,451  | \$ 2,982  | \$ 260    | \$ 492,548   | \$ 468,351   |
| Average Interest Rate                      | 3.78%                    | 3.91%      | 4.11%      | 3.86%     | 4.18%     | 4.92%     | 3.81%        |              |
| <b>Floating Rate</b>                       |                          |            |            |           |           |           |              |              |
| Deposits                                   | 1,050,360                | -          | -          | -         | -         | -         | 1,050,360    | 998,915      |
| Average Interest Rate                      | 2.18%                    | -          | -          | -         | -         | -         | 2.18%        |              |
| <b>Other Interest Bearing Liabilities</b>  |                          |            |            |           |           |           |              |              |
| Fixed Rate Debt                            | 4,223                    | 13,976     | 3,375      | 2,921     | 2,927     | 16,279    | 43,701       | 42,822       |
| Average Interest Rate                      | 4.66%                    | 4.41%      | 4.79%      | 4.90%     | 4.95%     | 4.98%     | 4.74%        |              |
| Floating Rate Debt                         | 54,171                   | -          | -          | 30,928    | 31,959    | -         | 117,058      | 117,124      |

|                             |              |           |           |           |           |           |              |              |
|-----------------------------|--------------|-----------|-----------|-----------|-----------|-----------|--------------|--------------|
| Average Interest Rate       | 4.19%        | -         | -         | 5.71%     | 6.07%     | -         | 5.10%        |              |
| Total Financial Liabilities | \$ 1,511,707 | \$ 74,486 | \$ 22,767 | \$ 40,300 | \$ 37,868 | \$ 16,539 | \$ 1,703,667 | \$ 1,627,212 |
| Average interest Rate       | 2.69%        | 4.01%     | 4.21%     | 5.67%     | 4.56%     | 4.98%     | 2.92%        |              |

- (1) Based upon expected cashflows, unless otherwise indicated.
- (2) Based upon a combination of expected maturities and repricing opportunities.
- (3) Based upon contractual maturity, except for callable and floating rate securities, which are based on expected maturity and weighted average life, respectively.
- (4) Savings, NOW and money market accounts can be repriced at any time, therefore, all such balances are included as floating rate deposits in Year 1. Other time deposit balances are classified according to maturity.

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**Item 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of September 30, 2006, the end of the period covered by this Form 10-Q, our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer each concluded that as of September 30, 2006, the end of the period covered by this Form 10-Q, we maintained effective disclosure controls and procedures.

**Changes in Internal Control over Financial Reporting**

Our management, including the Chief Executive Officer and Chief Financial Officer, has reviewed our internal control. There have been no significant changes in our internal control during our most recently completed fiscal quarter, nor subsequent to the date of their evaluation, that could significantly affect our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are party to lawsuits and claims arising out of the normal course of business. In management's opinion, there are no known pending claims or litigation, the outcome of which would, individually or in the aggregate, have a material effect on our consolidated results of operations, financial position, or cash flows.

**Item 1.A. Risk Factors**

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6.**

**Exhibits**

(A) Exhibits

31.1 Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

31.2 Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

32.1 Certification of William G. Smith, Jr., Chairman, President and Chief Executive Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.

32.2 Certification of J. Kimbrough Davis, Executive Vice President and Chief Financial Officer of Capital City Bank Group, Inc., Pursuant to 18 U.S.C. Section 1350.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned Chief Financial Officer hereunto duly authorized.

CAPITAL CITY BANK GROUP, INC.  
(Registrant)

/s/ J. Kimbrough Davis  
J. Kimbrough Davis  
Executive Vice President and Chief Financial Officer

Date: November 9, 2006