

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

REGENCY AFFILIATES INC  
Form 10KSB  
April 15, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

-----  
FORM 10-KSB

ANNUAL REPORT

Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2004

REGENCY AFFILIATES, INC.  
-----

(Name of Small Business Issuer in Its Charter)

Delaware

1-7949

72-0888772

-----  
(State or other jurisdiction  
of incorporation)

-----  
(Commission File No.)

-----  
(IRS Employer  
Identification No.)

610 Jensen Beach Boulevard  
Jensen Beach, Florida 34957

-----  
(Address of Principal Executive Offices)

(772) 334-8181

-----  
Issuer's Telephone Number, Including Area Code

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock, par value \$0.01 share

Check whether the issuer (1) has filed all reports required to be filed by  
Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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

Mark if disclosure of delinquent filers in response to Item 405 of Regulation  
S-B is not contained in this form, and no disclosure will be contained, to the  
best of registrant's knowledge, in definitive proxy or information statements  
incorporated by reference in Part III of this Form 10-KSB or any amendment to  
this Form 10-KSB.

State issuer's revenues for its most recent fiscal year: \$0.00

The number of shares outstanding of the registrant's \$.01 Par Value Common Stock  
issued as of April 8, 2005, was 3,021,412 and the aggregate market value of  
voting stock held by non-affiliates of the registrant was approximately  
\$9,619,250.

Transitional Small Business Disclosure: Yes  No

# Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Documents incorporated by reference: None

## TABLE OF CONTENTS

	Page
	----
PART I	
ITEM 1. DESCRIPTION OF BUSINESS.....	1
ITEM 2. DESCRIPTION OF PROPERTY.....	6
ITEM 3. LEGAL PROCEEDINGS.....	6
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.....	7
PART II	
ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDERS MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES.....	8
ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.....	9
ITEM 7. CONSOLIDATED FINANCIAL STATEMENTS.....	11
ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.....	11
ITEM 8A. CONTROLS AND PROCEDURES.....	11
ITEM 8b. OTHER INFORMATION.....	11
PART III	
ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.....	11
ITEM 10. EXECUTIVE COMPENSATION.....	12
ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.....	14
ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.....	16
PART IV	
ITEM 13. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K.....	16
ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.....	21
SIGNATURES	
EXHIBIT INDEX	

## PART 1

### ITEM 1. DESCRIPTION OF BUSINESS

This filing contains statements which, to the extent they are not recitations of historical fact, constitute "forward looking statements" under federal securities laws. All such statements are intended to be subject to the safe harbor protection provided by applicable securities laws. For discussions identifying some important factors that could cause actual Regency Affiliates, Inc. ("Regency" or the "Company" or "we" or the "Registrant") results to differ materially from those anticipated in the forward looking statements contained in this filing, see Regency's "Narrative Description of Business," "Management's Discussion and Analysis," and "Notes to Consolidated Financial Statements." Readers are cautioned not to place undue reliance on these forward looking statements, which reflect management's analysis only as of the date hereof. The Company undertakes no obligation to publicly revise these forward looking

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

statements to reflect events or circumstances that arise after the date hereof. Readers should carefully review the risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-QSB to be filed by the Company subsequent to this Annual Report on Form 10-KSB and any Current Reports on Form 8-K filed by the Company.

### GENERAL DEVELOPMENT OF BUSINESS

The Company, formerly TransContinental Energy Corporation, was organized as a Delaware corporation in 1980 to be the successor to TransContinental Oil Corporation, which existed since 1947.

In July 1993 we acquired an 80% interest in National Resource Development Corporation ("NRDC"). At the time, NRDC's principal asset consisted of previously quarried and stockpiled rock ("Aggregate") inventory located at a mine site in Michigan. The remaining 20% interest in NRDC is owned by Statesman Group, Inc. ("Statesman"), a former shareholder of Regency. In December 2001, the Aggregate inventory was sold to Iron Mountain Resources, Inc. ("Iron Mountain"), our 75% owned subsidiary, in exchange for an \$18,200,000 note. After defaulting on the note, Iron Mountain reconveyed the Aggregate to NRDC in lieu of foreclosure and the note was deemed satisfied. See "NARRATIVE DESCRIPTION OF BUSINESS - National Resource Development Corporation; Iron Mountain Resources, Inc."

On November 18, 1994, we acquired a limited partnership interest in Security Land and Development Company Limited Partnership ("Security Land" or the "Partnership") for an equity investment of \$350,000. Security Land owns an office building complex in Woodlawn, Maryland, which is leased to the United States Social Security Administration. In June 2003, Security Land refinanced the existing indebtedness on the property resulting in a distribution of refinancing proceeds to Regency of approximately \$41,000,000, approximately \$14,125,000 of which was used by the Company to repay existing indebtedness to KBC Bank. See "NARRATIVE DESCRIPTION OF BUSINESS - Security Land and Development Company Limited Partnership". The remaining net proceeds of the Security Land distribution were available for general corporate purposes.

On March 17, 1997, Regency, through Rustic Crafts International, Inc. ("Rustic Crafts"), a wholly-owned subsidiary, acquired the assets and assumed certain liabilities of Rustic Crafts, Co., Inc., a manufacturer of wood and cast marble decorative electric fireplaces and related accessories. On September 30, 2002, Rustic Crafts sold all of its operating assets to RCI Wood Products Inc. ("RCI"), a third party controlled by the former President of Rustic Crafts, in exchange for two promissory notes totaling \$1,107,000 and \$200,000 cash. See "NARRATIVE DESCRIPTION OF BUSINESS - Rustic Crafts International, Inc."

On October 16, 2002, Regency redeemed all of the shares of our common stock owned by Statesman pursuant to the terms of a Redemption Agreement, dated October 16, 2002, between Regency and Statesman. We funded the redemption from the proceeds of an aggregate of \$4,750,000 borrowed from Royalty Holdings LLC ("Royalty"), an affiliate of current management, in exchange for two notes - a \$3,500,000 5% Convertible Promissory Note due October 16, 2012 and a \$1,250,000 9% Promissory Note due October 16, 2007. Both notes allowed interest to accrue without current payment. The principal and interest under the Convertible Promissory Note were convertible into shares of our common stock at a conversion rate of \$2.00 per shares. On November 7, 2002, Royalty converted \$1,495,902 of the principal amount of the Convertible Promissory Note plus accrued interest into 750,000 shares of our common stock. On July 3, 2003, Royalty converted the remaining principal amount of the note and the \$71,378 of accrued and unpaid interest thereon into 1,037,738 shares of our common stock. On the same date, the Company prepaid the full \$1,250,000 principal amount of, and all accrued and unpaid interest under, the 9% Promissory Note in accordance with the mandatory

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

prepayment provisions of such note. Also on July 3, 2003, the Company repaid all amounts outstanding under a \$300,000 working capital loan facility from Royalty established in March 2003, and terminated such facility. The payment amount consisted of \$180,000 of principal and \$2,910 of accrued and unpaid interest.

In connection with the redemption of our common stock owned by Statesman, we acquired from Statesman a three year option to purchase the 20% stock interest in NRDC held by Statesman. To exercise the option, we must deliver to Statesman for cancellation a \$2.44 million note issued to Regency by Statesman in October 2001. As consideration for the option, we (i) paid Statesman \$250,000, (ii) amended the note and related pledge agreement to limit our recourse under the note and (iii) transferred to Statesman certain office furniture and equipment that we owned. As part of the redemption, we also entered into an agreement with Statesman providing for (i) an amendment to the Certificate of Designations of the Series C Preferred Stock for Regency and (ii) certain limitations on the ability of Statesman to issue or transfer shares or other beneficial interests in Statesman or to sell, transfer, purchase or acquire any capital stock of Regency, in each case without first receiving our written confirmation that such issuance or transfer would not adversely affect our ability to utilize our tax loss carryforwards. We paid Statesman an aggregate amount of \$2,730,000 in consideration of the foregoing agreements.

In connection with the redemption of our common stock owned by Statesman, effective October 28, 2002, each of our former directors resigned and the four current directors were appointed to serve as the successor members of the Board of Directors. In addition, simultaneously with the redemption, all of the officers of Regency resigned and were replaced by designees of Royalty. At such time, Regency entered into a Contingent Payment Agreement with William R. Ponsoldt, Sr., the Company's former President and Chief Executive Officer, whereby payment of \$1,508,000 of accrued compensation owed to Mr. Ponsoldt by Regency became subject to the satisfaction of certain conditions precedent. On November 25, 2003, following satisfaction of the relevant conditions, we paid Mr. Ponsoldt \$1,225,234, such amount reflecting a mutually agreed upon discount from the amount owed. The loans, redemption, and other October 2002 transactions described above are collectively referred to herein as the "Restructuring Transactions."

On September 23, 2003, the Company's Board of Directors authorized the repurchase of our common stock in the aggregate amount not to exceed \$1,000,000. The shares may be repurchased from time to time in open market transactions or privately negotiated transactions at the Company's discretion, subject to market conditions and other factors. Under the program, no shares will knowingly be purchased from the Company's officers or directors or from any such person's affiliates. On September 15, 2004 the Company purchased 47,000 shares from an independent, third party at a price per share of \$6.25 (the market price). The total cost, including commission and transfer fees was \$295,635.

On April 30, 2004, the Company through a newly-formed, wholly-owned subsidiary called Regency Power Corporation, a Delaware corporation ("Regency Power"), acquired a 50% membership interest in MESC Capital, LLC, a Delaware limited liability company ("MESC Capital"), from DTE Mobile, LLC ("DTE Mobile"), pursuant to an Assignment and Assumption Agreement dated as of April 30, 2004. The purchase price for the 50% membership interest was \$3,000,000 and was funded from the Company's working capital. DTE Mobile, which is owned by an unregulated subsidiary of a large energy company that has significant experience in owning, managing and operating electric generation and on-site energy facilities, owns the other 50% membership interest in MESC Capital.

MESC Capital was formed to acquire all of the membership interests in Mobile Energy Services Company, LLC, an Alabama limited liability company

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

("Mobile Energy"). Mobile Energy owns an on-site energy facility that supplies steam and electricity to a Kimberly-Clark tissue mill in Mobile, Alabama. The acquisition of Mobile Energy was also consummated on April 30, 2004 pursuant to a Membership Interest Purchase Agreement, dated as of January 30, 2004, between MESC Capital and Mobile Energy Services Holdings, Inc. The purchase price under the Membership Interest Purchase Agreement, after certain pre-closing adjustments, was \$33,600,000. The purchase price and working capital reserves were funded by the issuance of \$28,500,000 of non-recourse debt, a total equity contribution by MESC Capital of \$8,600,290, \$4,300,145 of which was funded by Regency Power and \$4,300,145 of which was funded by DTE Mobile, and a credit of \$1,000,000 on account of existing and continuing tax-exempt indebtedness of Mobile Energy. The \$28,500,000 acquisition indebtedness will be fully amortized over the fifteen year term. Neither Regency Power nor DTE Mobile is obligated to contribute additional capital, or loan or otherwise advance funds, to MESC Capital. See "NARRATIVE DESCRIPTION OF BUSINESS - Regency Power Corporation".

2

### NARRATIVE DESCRIPTION OF BUSINESS.

#### Security Land and Development Company Limited Partnership

On November 18, 1994, we acquired a limited partnership interest in Security Land for an equity investment of \$350,000. We have no obligation to make any further capital contribution to Security Land. Security Land owns the 34.3-acre Security West complex at 1500 Woodlawn Drive, Woodlawn, MD consisting of a two-story office building and a connected six-story office tower occupied by the United States Social Security Administration Office of Disability and International Operations. The buildings have a net rentable area of approximately 717,000 square feet. The construction of the Security West Buildings was completed in 1972 and the Social Security Administration has occupied the building since 1972.

On November 30, 2000, we invested \$10,000 for a 5% Limited Partnership Interest in 1500 Woodlawn Limited Partnership, the General Partner of Security Land.

During 1994, Security Land completed the placement of a \$56,450,000 non-recourse project note, due November 15, 2003. The placement of the project note was undertaken by the issuance of 7.90% certificates of participation and was underwritten by Dillon Read & Co., Inc. The net proceeds received from the sale of the certificates were used to refinance existing debt of Security Land related to the project, to finance certain alterations to the project by Security Land, to fund certain reserves and to pay costs of the project note issue. The project note was a non-recourse obligation of Security Land, interest and principal payments were payable solely from the lease payments from the U.S. Government and the note was self-amortizing.

In March 2003, the General Services Administration agreed to extend the term of its lease at the building owned by Security Land through October 31, 2018. The significant terms of the lease extension include fixed annual gross rent of approximately \$12,754,000 (or approximately \$17.79 per sq. ft.). Security Land is responsible for all operating expenses of the building. Security Land is also responsible for upgrading some of the building's common areas.

On June 24, 2003, US SSA LLC, a single purpose entity owned by Security Land, borrowed \$98,500,000 through a public debt issue underwritten by CTL Capital, LLC. Proceeds of the refinancing were used to repay the outstanding balance of Security Land's 1994 indebtedness, to establish reserves to make

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

capital improvements to the property, to provide reserves required by the new debt, to pay costs and expenses related to issuing the debt, to pay fees related to the lease extension with the General Services Administration and the financing, and to make a distribution to the partners of Security Land. The debt matures October 31, 2018, at which time the loan will have been paid down to a balance of \$10,000,000. Security Land has obtained residual value insurance for approximately \$10,000,000. The interest cost of the financing is 4.63%.

The Company received approximately \$41,000,000 of net refinancing proceeds from the Security Land distribution. In addition, under the terms of the Security Land partnership agreement, as amended in April 2003 in contemplation of the refinancing, the Company is entitled to (i) 95% of Security Land's distributions of cash flow until the Company has received \$2,000,000 of such distributions, and thereafter 50% of such distributions and (ii) once the Company has received \$2,000,000 of cash flow distributions, a \$180,000 annual management fee from Security Land. The foregoing percentages are inclusive of the Company's interest as a limited partner in 1500 Woodlawn, the general partner of Security. In connection with the Security Land refinancing and distribution, the Company was required to repay its KBC Bank loan. The payoff amount was approximately \$14,125,000, which included a release fee and make-whole premium.

Rustic Crafts International, Inc.

Rustic Crafts was until September 30, 2002 a manufacturer of decorative wood and cast marble fireplaces, mantels, shelves, fireplace accessories and other home furnishings. On September 30, 2002, Rustic Crafts sold all of its operating assets to RCI for \$1,307,000 comprised of (i) a \$707,000 note bearing interest at 5% per annum requiring monthly payments of principal and interest of \$13,342 and due September 30, 2007, (ii) a \$400,000 note which, as restructured in August 2003; bears interest at 7% per annum and requires monthly payments of principal and interest of \$5,032 with a balloon payment due September 8, 2006; and (iii) \$200,000 cash (the proceeds of which were from a \$250,000 loan from Regency to the buyer which was satisfied in January 2003). Additionally, the buyer entered into a three-year lease for the land and building in Scranton, PA owned by Rustic Crafts, with rental payments of \$6,500 per month. Payments on the 5% note are contingent upon the quarterly positive net cash flows of the buyer, as defined by generally accepted accounting principles. Prior to the sale of its operating assets, Rustic Crafts had established a \$1,000,000 line of credit with PNC Bank that was guaranteed by Regency and expired on May 18, 2002. In conjunction with the Rustic Crafts asset sale, Rustic Crafts' indebtedness under the line of credit together with its mortgage loan from PNC Bank in respect of the Scranton, PA property and certain other indebtedness to PNC Bank was restructured to replace such indebtedness with five notes totaling \$2,432,782. Each of the restructured notes of which were initially due in June 2004, and a ten year amortization schedule and bore interest at the rate of 10.8% per annum. On June 27, 2003, a payment was made to PNC Bank in the amount of \$2,257,952 in full satisfaction of the restructured notes. On January 12, 2004, Rustic Crafts sold the Scranton, PA property for \$531,500.

3

At March 31, 2004, the Company held notes receivable totaling \$1,127,708, which were deemed uncollectible due to lack of cash flows generated and continual default on payment terms by the issuer. Management determined to record full impairment of the notes and any accrued interest thereon, resulting in an impairment charge of \$1,182,626, which is included in the Selling, General & Administrative caption of the accompanying Statements of Operations. Management intends however, to continue to pursue options available to receive payment on the obligations from debtor.

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

National Resource Development Corporation; Iron Mountain Resources, Inc.

Until December 2001, our 80%-owned subsidiary, NRDC had as its principal asset approximately 70 million short tons of Aggregate located at the site of the Groveland Mine in Dickinson County, Michigan. NRDC never consummated sales of material amounts of Aggregate. In December 2001, the Aggregate was sold to Iron Mountain, a 75% owned subsidiary of Regency. The purchase price was \$18,200,000 and is payable, with interest of 2.46%, in ninety-six equal payments of principal and interest commencing December 2003. The intercompany gain on this transaction has been eliminated in the consolidation process resulting in the Aggregate being carried at its historical cost. Iron Mountain was unsuccessful in its efforts to sell the Aggregate and, in December 2003, defaulted under the note to NRDC. In February 9, 2005, in lieu of foreclosure, Iron Mountain reconveyed the Aggregate to NRDC and the note was deemed satisfied.

Aggregate is primarily sold for railroad ballast, road construction, construction along shorelines and decorative uses. Ownership of the Aggregate is subject to a Royalty Agreement which requires the payment of certain royalties to M.A. Hanna Company, an independent third-party, upon sales of Aggregate. The market for Aggregate stone is highly competitive and, as shipping costs are high, the majority of any sales are likely to be made in the Great Lakes area. Other companies that produce rock and aggregate products are located in the same region as the Groveland Mine and certain of such competitors have greater financial and personnel resources than the Company.

### Regency Power Corporation

On April 30, 2004, we, through our wholly-owned subsidiary Regency Power acquired a 50% membership interest in MESC Capital from DTE Mobile pursuant to an Assignment and Assumption Agreement dated as of April 30, 2004. The purchase price for the 50% membership interest was \$3,000,000 and was funded from Regency's working capital. The terms of the Assignment and Assumption Agreement were negotiated on an arms'-length basis between Regency and DTE Mobile. DTE Mobile, which is owned by an unregulated subsidiary of a large energy company that has significant experience in owning, managing and operating electric generation and on-site energy facilities, owns the other 50% membership interest in MESC Capital. MESC Capital was formed to acquire all of the membership interests in Mobile Energy. Mobile Energy owns an on-site energy facility that supplies steam and electricity to a Kimberly-Clark tissue mill in Mobile, Alabama.

The acquisition of Mobile Energy was also consummated on April 30, 2004 pursuant to a Membership Interest Purchase Agreement, dated as of January 30, 2004, between MESC Capital and Mobile Energy Services Holdings, Inc. The purchase price under the Membership Interest Purchase Agreement, after certain pre-closing adjustments, was \$33,600,000, and is subject to certain post-closing adjustments. The purchase price and working capital reserves were funded by the issuance of \$28,500,000 of non-recourse debt, a total equity contribution by MESC Capital of \$8,600,290, \$4,300,145 of which was funded by Regency Power and \$4,300,145 of which was funded by DTE Mobile, and a credit of \$1,000,000 on account of existing and continuing tax-exempt indebtedness of Mobile Energy.

The terms of the Membership Interest Purchase Agreement were negotiated on an arms'-length basis between MESC Capital and Mobile Energy Services Holdings, Inc. Regency did not participate in negotiations with respect to the Membership Interest Purchase Agreement.

The \$28,500,000 acquisition indebtedness was obtained from Allied Irish Banks, P.L.C., which may assign or participate the loan in accordance with the terms of the loan agreement. The loan will be amortized over the fifteen year

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

term. In connection with the acquisition of the 50% membership interest in MESC Capital, Regency Power and DTE Mobile entered into an Operating Agreement, dated April 30, 2004, which sets forth their respective rights and obligations as members of MESC Capital as well as the duties and authority of DTE Mobile as the managing member of MESC Capital.

Under the Operating Agreement, Regency Power will receive 50% of all distributions, and participate equally in ultimate management authority through equal representation on the MESC Capital Board of Control. DTE Mobile, as managing member, is responsible for day-to-day management of MESC Capital. DTE

4

Mobile will not receive any compensation for serving as managing member, and is subject to removal by the Board of Control with or without cause. Neither Regency Power nor DTE Mobile is obligated to contribute additional capital, or loan or otherwise advance funds, to MESC Capital, and neither member can sell or transfer its interest in MESC Capital without the consent of the other and without first complying with a right of first offer in favor of the non-selling member.

The energy facility is located on approximately 11 acres of land within the Kimberly-Clark tissue mill in Mobile, Alabama. The facility supplies up to 61 megawatts of co-generated steam and electricity for use in the mill's operations, with a power-house fueled by a combination of coal, biomass and natural gas.

In connection with MESC Capital's acquisition of Mobile Energy, Kimberly-Clark entered into a 15-year agreement with Mobile Energy pursuant to which Mobile Energy will be the exclusive steam supplier to the mill and will provide a substantial portion of the mill's electricity requirements. Under the agreement, Kimberly-Clark is obligated to make monthly fixed capacity payments, monthly fixed and variable operations and maintenance payments, and to reimburse Mobile Energy for fuel costs. Early termination of the agreement by Kimberly-Clark obligates Kimberly-Clark to make a termination payment to Mobile Energy in an amount anticipated to be sufficient to retire the acquisition financing obtained by MESC Capital and to provide a return on the MESC equity investment. In addition, in the event of an early termination by Kimberly-Clark and under certain conditions, DTE Mobile has agreed to make a termination payment to Regency Power.

Mobile Energy operated under the protection of Chapter 11 of the United States Bankruptcy Code from January 1999 until late 2003. During such time, the energy facility was operated by an interim operator. MESC Capital was selected through an auction process conducted by Mobile Energy bondholders to be the acquirer of Mobile Energy. In connection with the acquisition, the interim operator was terminated and DTE Mobile and its affiliate will provide operations, management and maintenance services and asset management support for the investment and energy facility pursuant to agreements with MESC Capital and Mobile Energy.

### COMPETITION

Other than as discussed in "ITEM 1. DESCRIPTION OF BUSINESS - NARRATIVE DESCRIPTION OF BUSINESS - National Resource Development Corporation; Iron Mountain Resources, Inc.", our business is not materially subject to competitive forces.

### ENVIRONMENTAL REGULATIONS

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Federal, state and local provisions that regulate the discharge of materials into the environment do not currently materially affect our capital expenditures, earnings or competitive position.

### EMPLOYEES

As of December 31, 2004, Regency and its subsidiaries employed three people.

### SPECIAL INVESTMENT CONSIDERATIONS

The Company's business, financial condition and prospects could be adversely affected by a number of factors that should be considered by stockholders and persons considering investing in Regency. Some of such factors include:

- A default in the lease or sudden catastrophe to property owned by Security Land or the operating facilities owned by Mobile Energy from uninsured acts of God or war could have a materially adverse impact upon our investment in Security Land and Mobile Energy, respectively, and therefore our financial position and results of operations;

- Our subsidiaries currently lack the necessary infrastructure at the site of the Groveland mine in order to permit them to make more than casual sales of the Aggregate located at the Groveland mine;

- We have had significant tax loss and credit carryforwards and no assurance can be provided that the Internal Revenue Service would not attempt to limit or disallow altogether our use, retroactively and/or prospectively, of such carryforwards, due to ownership changes or any other reason. The disallowance of the utilization of our net operating loss would severely impact or financial position and results of operations due to the significant amounts of taxable income that has been, and may in the future be, offset by our net operating loss carryforwards;

5

- Royalty, an affiliate of the Company's management, beneficially owns approximately 60% of our common stock. As a result, Royalty has the ability to control the outcome of all matters requiring shareholder approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets;

- Regency does not expect to pay dividends in the foreseeable future; and

- There are many public and private companies that are also searching for operating businesses and other business opportunities as potential acquisition or merger candidates. The Company will be in direct competition with these other companies in its search for business opportunities. Many of these entities have significantly greater financial and personnel resources than the Company.

### WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission. Our Securities and Exchange Commission filings are available to the public over the Internet at the SEC's web site at <http://www.sec.gov>. You may also read and copy any material we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Public Reference Room by calling the SEC at 1-800-SEC-0330 for further information on the public reference rooms.

The Company's Internet address is [www.regencyaffiliates.com](http://www.regencyaffiliates.com). We make available on our web site, free of charge, our Annual Report on Form 10-KSB, quarterly reports on Form 10-QSB, current reports on Form 8-K, and beneficial ownership reports on Forms 3, 4, and 5 and amendments to those reports as soon as reasonably practicable after this material is electronically filed or furnished to the Securities and Exchange Commission.

### ITEM 2. DESCRIPTION OF PROPERTY

Security Land owns the Security West Building at 1500 Woodlawn Drive, Woodlawn, MD. See "ITEM 1. BUSINESS - NARRATIVE DESCRIPTION OF BUSINESS - Security Land and Development Company Limited Partnership", which is incorporated by reference herein, for more information on this property.

### ITEM 3. LEGAL PROCEEDINGS

On December 14, 2001, we initiated a proceeding in The Circuit Court of the Nineteenth Judicial Circuit in and for Martin County, Florida, case number 01-1087-CA against Larry J. Horbach, individually and L.J. Horbach & Associates. Larry Horbach was a former interim CFO and Board member. We claim that Larry Horbach, without appropriate authority, borrowed \$100,050 from Mid City Bank in the name of Regency. We further claim that Horbach converted all or part of the proceeds from the loan for his benefit and breached his fiduciary duties as an officer and director. Horbach filed a Motion for the Court to determine whether the claims asserted against him were properly brought in Florida, or whether they should have been filed in Nebraska. The matter was fully briefed, and the Florida Court took the matter under advisement. The Florida Court has not yet rendered its decision on this jurisdictional issue.

On February 7, 2002, a complaint naming Regency as defendant was filed in the District Court of Douglas County, Nebraska, case number 1012. The Plaintiffs are Larry J. Horbach, individually and L.J. Horbach & Associates and they are demanding payment on a loan they purchased from Mid City Bank. The plaintiffs are requesting payment of \$82,512.57 plus accrued interest, costs and attorney fees. We are vigorously defending this litigation.

On May 2, 2002, a lawsuit (the "Federal Action") was filed in the Federal District Court for the District of Nebraska (the "Nebraska Court") by two dissident Company shareholders, Edward E. Gatz and Donald D. Graham, captioned Gatz et al. v. Ponsoldt, Sr., et al, against the former officers and directors of the Company, Statesman and, as a nominal defendant only, the Company. In December 2002, plaintiffs filed a seven-count Amended Complaint to add claims against Royalty and Royalty's control persons. All Defendants moved to dismiss all claims against them on jurisdictional and substantive grounds. On July 7, 2003, the Nebraska Court ruled that venue in the District of Nebraska was improper and granted defendants' motions to transfer the case to the District of Delaware. In connection with the transfer of the case to Delaware, the Court denied as moot the other motions pending before it without prejudice to their reassertion in the United States District Court for the District of Delaware (the "Delaware Federal Court"). In September and October 2003, all defendants filed motions to dismiss the Federal Action with the Delaware Federal Court and plaintiffs filed a motion for permission to file an amended and supplemental complaint as well as a preliminary injunction or status quo order seeking, among other things, to prevent the Company from taking any actions outside the ordinary course of business. On December 18, 2003, the Delaware Federal Court issued an opinion and order which, among other things (i) granted defendants'

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

motions to dismiss the amended complaint with respect to certain claims, (ii) denied plaintiffs' motion for leave to file a supplemental and second amended complaint, (iii) denied plaintiffs' request for a preliminary injunction and a status quo order and (iv) dismissed the remainder of the amended complaint for lack of subject matter jurisdiction. As a result of the Delaware Federal Court's opinion and order, the Federal Action was dismissed in its entirety.

On January 20, 2004, a purported derivative and class action lawsuit (the "Delaware State Action") was filed by the same two individual shareholder plaintiffs in the New Castle County Court of Chancery, Delaware (the "Court"), captioned Gatz et al. v. Ponsoldt, Sr., et al, (C.A. No. 174-N) naming as defendants certain current and former directors of the Company, Royalty and certain of its affiliates, Statesman and, nominally, the Company. The complaint alleges, among other things, breaches of fiduciary duties by the former director defendants and Statesman in connection with (i) the exercise by Statesman in 2001 of an option to acquire shares of our common stock, (ii) the 2001 sale of Aggregate by NRDC to Iron Mountain and (iii) the October 2002 Restructuring Transactions. The complaint also alleges breaches of fiduciary duties by the current director defendants in connection with the payment by the Company in 2003 of accrued compensation owed to William R. Ponsoldt, Sr. for periods prior to the October 2002 Restructuring Transactions. The complaint also alleges that Royalty and its affiliates knowingly participated in the breaches of fiduciary duties by the former director defendants relating to the October 2002 Restructuring Transactions. In addition to other damages, plaintiffs seek unspecified compensatory and/or rescissory damages against all defendants, a declaration that all Company stock issued to Statesman, William R. Ponsoldt, Sr., Royalty and any person affiliated with the foregoing is void, an order rescinding any payments in any form made by the Company to William R. Ponsoldt, Sr. or any of his affiliates or family members, an order rescinding the October 2002 Restructuring Transactions, and an order rescinding Statesman's 2001 option exercise and rescinding the option itself.

In November 2004 the Court dismissed all but one claim alleged in the complaint. The Company is not a defendant in the sole surviving claim, which relates to the December 2001 sale of assets from one Regency subsidiary to another Regency subsidiary. In dismissing the claims, the Court determined that all of the claims (other than the claim related to the 2001 asset sale) were derivative in nature and that the claims could therefore not be maintained.

The defendants in the Federal Action and the Delaware State Action, other than Statesman, are entitled to be indemnified by the Company for damages, if any, and expenses, including legal fees, they may incur as a result of the lawsuit, subject to certain circumstances under which such indemnification is not available. In addition, none of the claims contained in the Delaware State Action are covered by insurance, as the Company's carrier has declined coverage on the basis of the "insured vs. insured" exclusion since one of the named plaintiffs, Donald D. Graham, was previously a director of the Company.

On May 10, 2004, Gary Nuttall, a former President of the Company, commenced an arbitration against the Company with respect to certain claims allegedly arising under his 1995 Employment Agreement with the Company. Mr. Nuttall is seeking severance and all other compensation and benefits due him under the 1995 Employment Agreement in an amount in excess of approximately \$1,650,000 (\$1,400,000 of which is a financing bonus), 466,667 unrestricted shares of the Company (pre-split), options to purchase additional stock of the Company, punitive damages, interest, fees and costs associated with the arbitration. The Company believes the claims are without merit and intends to defend them vigorously.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

The following matters were submitted to stockholders at the Company's January 18, 2005 Annual Meeting of Stockholders:

1. To elect four directors of Regency to serve until the next Meeting of Stockholders. The vote for the respective nominees for election as directors was as follows:

DIRECTORS	FOR	AGAINST	ABSTAIN
Laurence S. Levy	1,813,316	0	380
Neil N. Hasson	1,813,316	0	380
Stanley Fleishman	1,813,316	0	380
Errol Glasser	1,813,316	0	380

2. To ratify the appointment of Rosenberg Rich Baker Berman & Company as independent public accountants. The results of the vote to ratify the appointment of Rosenberg Rich Baker Berman & Company as independent public accountants was:

For: 1,813,531	Against: 57	Abstain: 108
----------------	-------------	--------------

7

### PART II

#### ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDERS MATTERS MARKET INFORMATION AND SMALL BUSINESS ISSUER PURCHASE OF EQUITY SECURITIES

Our common stock is traded in the over-the-counter market on the bulletin board. The symbol for the listing is "RAFI.OB". The following table sets forth the high and low bid prices for each calendar quarter during the last two fiscal years of Regency. On April 8, 2005 the closing sale price of our common stock was \$5.25. As of April 8, 2005, there were approximately 2,346 common stockholders of record.

YEAR ENDED DECEMBER 31, 2003	HIGH (\$)	LOW (\$)
First Quarter	4.40	3.35
Second Quarter	8.00	4.20
Third Quarter	6.60	5.80
Fourth Quarter	6.40	5.95
YEAR ENDED DECEMBER 31, 2004		
First Quarter	6.45	6.01
Second Quarter	7.45	6.05
Third Quarter	6.50	6.01
Fourth Quarter	6.02	5.15

#### DIVIDEND POLICY

We have not paid or declared cash dividends on our common stock during the last two fiscal years. We have no present intention to pay cash dividends on our common stock.

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### TRANSFER AGENT

In January 2001, Transfer On-Line, Inc. was named as transfer agent replacing Horbach & Associates. Transfer On-Line, Inc. is located at 317 SW Alder Street, Second Floor, Portland, Oregon 97204. Their telephone number is (503) 227-2950 and their website is www.transferonline.com.

### RECENT SALES OF UNREGISTERED SECURITIES

The Company, awarded 250 restricted shares of common stock to each of Errol Glasser and Stanley Fleishman on each of January 1, 2004, April 1, 2004, July 1, 2004 and October 1, 2004 pursuant to the Company's 2003 Stock Incentive Plan, as amended. Exemption from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), for the issuance of such shares is claimed under Section 4(2) of the Securities Act.

### SMALL BUSINESS ISSUER REPURCHASE OF SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs
September 1, 2004 - September 30, 2004	47,000	\$6.25	47,000

### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Certain statements contained in this Annual Report on Form 10-KSB, including, but not limited to those regarding the Company's financial position, business strategy, acquisition strategy and other plans and objectives for future operations and any other statements that are not historical facts constitute "forward-looking statements" within the meaning of federal securities laws and the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements expressed or implied by such forward-looking statements to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected effect on its business or operations. These forward-looking statements are made based on management's expectations and beliefs concerning future events impacting the Company and are subject to uncertainties and factors (including, but not limited to, those specified below) which are difficult to predict and, in many instances, are beyond the control of the Company. Such factors include:

- A default in the lease or sudden catastrophe to property owned by Security Land or the operating facilities owned by Mobile Energy from uninsured

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

acts of God or war could have a materially adverse impact upon our investment in Security Land and Mobile Energy respectively, and therefore our financial position and results of operations;

- Our subsidiaries currently lack the necessary infrastructure at the site of the Groveland mine in order to permit them to make more than casual sales of the Aggregate located at the Groveland mine;

- We have had significant tax loss and credit carryforwards and no assurance can be provided that the Internal Revenue Service would not attempt to limit or disallow altogether our use, retroactively and/or prospectively, of such carryforwards, due to ownership changes or any other reason. The disallowance of the utilization of our net operating loss would severely impact our financial position and results of operations due to the significant amounts of taxable income that has been, and may in the future be, offset by our net operating loss carryforwards;

- Royalty, an affiliate of the Company's management, beneficially owns approximately 60% of our common stock. As a result, Royalty has the ability to control the outcome of all matters requiring shareholder approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets;

- Regency does not expect to pay dividends in the foreseeable future; and

- There are many public and private companies that are also searching for operating businesses and other business opportunities as potential acquisition or merger candidates. The Company will be in direct competition with these other companies in its search for business opportunities. Many of these entities have significantly greater financial and personnel resources than the Company.

The following discussion and analysis of the financial condition and results of operations of Regency should be read in conjunction with the accompanying financial statements and related notes included in Item 7 of this report.

### GENERAL

The Company is committed to enhancing the value of the Company's Common Stock by seeking opportunities to monetize its existing assets and by seeking new business opportunities on an opportunistic basis. To date, the Company has not entered into any binding agreements regarding any such transaction. The Company does not propose to restrict its search for business opportunities to any particular geographical area or industry, and may, therefore, acquire any business, to the extent of its resources. The Company's discretion in the selection of business opportunities is unrestricted, subject to the availability of such opportunities, economic conditions, and other factors. No assurance can be given that the Company will be successful identifying or securing a desirable business opportunity, and no assurance can be given that any such opportunity that is identified and secured will produce favorable results for the Company and its stockholders.

9

Our Stockholders' Equity at December 31, 2004 was \$18,499,882 as compared to \$20,106,287 on December 31, 2003, a decrease of 7.9%.

### RESULTS OF OPERATIONS

2004 COMPARED TO 2003

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Net sales were \$0 in both 2004 and 2003.

Selling and administrative expenses decreased by \$1,940,005 or 34.1% in 2004 as compared to 2003, primarily due to a reduction in professional fees associated with litigation defense and elimination of costs associated with long term debt.

Income from equity investment in Security Land decreased in 2004 by \$1,326,412 or 38.1% as compared to 2003 due to the increase in interest expenses on the increased principal balance of debt on the Security Land property and an increase in administrative expenses for the maintenance of the Security Land property.

Interest expense decreased by \$714,979 in 2004 over 2003 due to the extinguishment of all long-term debt.

Income tax expense decreased \$29,229 in 2004 from \$70,724 in 2003 due to existing credits from overpayments of state income taxes. We do not expect any Federal tax as a result of current and previous period operating losses.

Net loss decreased by \$994,770 or 42.9% in 2004 over 2003. The decrease was primarily due the increase in selling and administrative expenses.

### 2003 COMPARED TO 2002

Net sales were \$0 in both 2003 and 2002.

Selling and administrative expenses increased by \$3,806,640 or 302.64% in 2003 as compared to 2002. Increases in professional fees, costs related to extinguishment of debt, and impairment of the Scranton property were offset by reduction in executive compensation and related expenses. Sales and administrative expenses in 2002 of the former operating subsidiaries are included in discontinued operations.

Income from equity investment in Partnership decreased in 2003 by \$2,871,297 as compared to 2002 due to the increase in interest expenses on the increased principal balance of debt on the Security Land property and an increase in administrative expenses of Security Land.

Interest expense decreased by \$460,003 in 2003 over 2002 due to the extinguishment of all long-term debt.

Income tax expense increased \$128,789 from 2002 due to an increase in state income taxes and decrease in Federal tax benefits from 2002.

Net income decreased \$5,010,868 or 186.10% in 2003 over 2002. The decrease was primarily due the increase in selling and administrative expenses and reduction in income from our equity investment in Security Land, offset by reductions in interest expense and losses from prior year discontinued operations.

### LIQUIDITY AND CAPITAL RESOURCES

On December 31, 2004, Regency had current assets of \$10,850,748 and Shareholders' Equity of \$18,449,882. On December 31, 2004, Regency had \$10,461,610 in cash and marketable securities, total assets of \$19,693,531 and total liabilities of \$690,827.

On June 24, 2003, US SSA LLC, a single purpose entity owned by Security Land, borrowed \$98,500,000 through a public debt issue underwritten by CTL Capital, LLC. Proceeds of the refinancing were used to repay the outstanding balance of Security Land's 1994 indebtedness, to establish reserves to make

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

capital improvements to the property, to provide reserves required by the new debt, to pay costs and expenses related to issuing the debt, to pay fees related to the lease extension with the GSA and the financing, and to make a distribution to the partners of Security Land. The loan matures on October 31, 2018 at which time the loan will have been paid down to a balance of \$10,000,000. Security Land obtained residual value insurance for approximately \$10,000,000. The interest cost of the financing is 4.63%. The financing is non-recourse to the Regency. Regency received approximately \$41,000,000 from the

10

Security Land distribution. In addition, under the terms of the Security partnership agreement, Regency is entitled to (i) 95% of Security Land's distributions of cash flow until Regency has received \$2,000,000 of such distributions, and thereafter 50% of such distributions and (ii) once Regency has received \$2,000,000 of cash flow distributions, a \$180,000 annual management fee from Security Land. The foregoing percentages are inclusive of the Company's interest as a limited partner in 1500 Woodlawn, the general partner of Security. In connection with the Security Land refinancing and distribution, the Company was required to repay its KBC Bank loan. The payoff amount was approximately \$14,125,000, which included a release fee and make-whole premium.

Management believes that the Company's cash balances are adequate to fund the Company's cash requirements for at least the next twelve months.

### ITEM 7. CONSOLIDATED FINANCIAL STATEMENTS

The Financial Statements required by Item 7 of Part II of Form 10-KSB are presented on page F1 and are incorporated herein by reference.

### ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

### ITEM 8A. CONTROLS AND PROCEDURES

In accordance with Exchange Act Rules 13a-15 and 15d-15, the Company carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective, as of the end of the period covered by this report, to provide reasonable assurance that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

No change occurred in the Company's internal controls concerning financial reporting during the fourth quarter of the fiscal year ended December 31, 2004 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

### ITEM 8B. OTHER INFORMATION

None

PART III

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following directors were elected at the annual meeting of the stockholders held January 18, 2005 and will serve until the next meeting of stockholders, upon the election and qualification of their successors. Executive officers are appointed by, and serve at the pleasure of, the Board of Directors. The following lists the name, age and principal occupation of each director and executive officer of the Company.

NAME, AGE	POSITIONS AND OFFICES HELD AND PRINCIPAL OCCUPATION DURING PAST FIVE YEARS
Laurence S. Levy, 48	Mr. Levy is Chairman of the Board of Directors and Chief Executive Officer of the Company. Mr. Levy is the co-founder and managing principal of an investment firm specializing in leveraged buyouts. He is also a principal investor at Hyde Park Holdings, LLC, a private equity financing, acquiring and managing companies operating in manufacturing, infrastructure, parking and subscription services. Mr. Levy is chairman of the board and chief executive officer of Regency Corporation, an OTC bulletin board listed blank check company since 2004.
Neil N. Hasson, 39	Mr. Hasson is a Director and Chief Financial Officer of the Company. In 2005, Mr. Hasson was appointed as a Director of the Company ("CPI"). CPI is an international real estate investment firm. Mr. Hasson was the head of European Real Estate Partners, a \$660 million real estate fund managed by DLJ Jenrette ("DLJ"), where he was involved with transactions throughout the world. Mr. Hasson joined DLJ as a Managing Director in January 1995. Mr. Hasson currently serves as a Director of Sterling Centrecorp, a real estate company listed on the NYSE.
Stanley Fleishman, 53	Mr. Fleishman is a Director of the Company. Since 2005, he has been President and CEO of Jetro Holdings Inc., a wholly owned subsidiary of the Company, which operates perishable retail groceries and food service in the United States.
Errol Glasser, 51	Mr. Glasser is a Director of the Company. Since 2005, he has been President of Triangle Capital, LLC, a private equity investment firm based in New York City. Previously, Mr. Glasser was a Managing Director at Kidder, Peabody & Co. with responsibility for investment banking activity.
Carol Zelinski, 41	Ms. Zelinski is the Secretary of the Company. She is currently an analyst at Hyde Park Holdings, LLC, a private equity investment firm, but is not a Director of the Company.

### Compliance with Section 16(a) of the Exchange Act

Based solely on a review of reports on Form 3 and 4 and amendments thereto furnished to the Regency during its most recent fiscal year, reports on Form 5 and amendments thereto furnished to us with respect to our most recent fiscal

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

year, we believe that no person who, at any time during 2004, was subject to the reporting requirements of Section 16(a) with respect to Regency failed to meet such requirements on a timely basis.

Code of Ethics.

We have adopted a Code of Ethics that applies to the Company's chief executive officer and chief financial officer. A copy of the Code of Ethics will be provided without charge to any person who requests it by writing to the address set forth on the cover page to this Form 10-KSB.

### ITEM 10. EXECUTIVE COMPENSATION

#### SUMMARY COMPENSATION TABLE

The following table sets forth the annual and long-term compensation during the last three years for each of the Company's executive officers.

#### SUMMARY COMPENSATION TABLE

Name and Principal Position -----	Annual Compensation				Restricted Stock Award (#) ---
	Year ----	Salary (\$) ---	Bonus (\$) ---	Other Annual Compensation (\$) ---	
Laurence S. Levy President/CEO	2004	150,000	0	0	0
	2003	181,250	0	0	0
	2002	31,643	0	0	0
Neil N. Hasson CFO	2004	50,000	0	0	0
	2003	56,250	0	0	0
	2002	10,547	0	0	0

12

#### OPTION/SAR GRANTS

The Option/SAR Grants Table below shows the individual grants of stock options (whether or not in tandem with SARS) and freestanding SARS made during the last completed fiscal year to any of the named executive officers.

#### OPTION GRANTS IN LAST FISCAL YEAR

NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED	PERCENT OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE PRICE PER SHARE (\$)	MARKET PRICE DATE OF GRANT (\$)
Laurence S. Levy	50,000	50%	\$2.01	\$6.45
Neil N. Hasson	50,000	50%	\$2.01	\$6.45

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### AGGREGATED OPTION/SAR EXERCISES IN LAST FISCAL YEAR AND FY-END OPTION/SAR VALUE

The Aggregated Option/SAR Exercises in Last Fiscal Year and FY-End Option/SAR Values table shows there were no exercises of stock options (nor tandem SARs) nor freestanding SARs during the last completed fiscal year by any of the named executive officers.

OPTION VALUES AT DECEMBER 31, 2004

NAME	SHARES ACQUIRED ON EXERCISE (# SHARES)	VALUE REALIZED	EXERCISABLE NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 2004 (# OF SHARES)	
			EXERCISABLE	UNEXERCISABLE
Laurence S. Levy	0	0	125,000	0
Neil N. Hasson	0	0	125,000	0

### INCENTIVE STOCK OPTION PLANS

Non Qualified Stock Options.

On August 13, 2004, Messrs. Levy and Hasson were each granted options to purchase 50,000 shares of our common stock at an exercise price of \$2.01 per share under the 2003 Stock Incentive Plan, as amended.

LTIP Awards.

There have been no awards under any long-term Incentive Plan during the last completed fiscal year.

Defined Benefit Plans.

We have no defined benefit or actuarial plans.

### COMPENSATION OF DIRECTORS

Pursuant to our 2003 Stock Incentive Plan adopted in March 2003, non-management directors receive 250 shares of our common stock for every quarter of a year of service completed. In this regard, each of Messrs. Fleishman and Glasser were issued 1,000 shares of our common stock. On August

13, 2004, Messrs. Levy and Hasson were each granted options to purchase 50,000 shares of our common stock at an exercise price of \$2.01 per share under the 2003 Stock Incentive Plan, as amended.

### EMPLOYMENT CONTRACTS, TERMINATION OF EMPLOYMENT AND CHANGE IN CONTROL

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### ARRANGEMENTS

In connection with the Restructuring Transactions described in Item 1, we entered into an Employment Agreement with Laurence S. Levy, our current President and Chief Executive Officer, and with Neil Hasson, our current Chief Financial Officer. Under each employment agreement, the executive's employment commences on the date of the Restructuring Transactions and terminates upon the date on which the executive attains retirement age, provided that the executive may terminate his employment upon 30 days notice to Regency and he may be removed from office upon death or disability or for just cause. The employment agreements provides for a base annual salary of no less than \$150,000 for Mr. Levy and no less than \$50,000 for Mr. Hasson, a discretionary bonus and other customary benefits. The employment agreements also provide for the issuance to each of Messrs. Levy and Hasson, of options to purchase 25,000 shares of our common stock for \$1.35 per share. Those options were issued in April 2003 pursuant to the Company's 2003 Stock Incentive Plan.

### ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

#### Equity Compensation Plan Information.

Plan Category	(a) Number of Securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights
Equity compensation plans approved by security holders	21,000	\$5.31
Equity compensation plans not approved by security holders (1)	285,000	\$1.76
Total	306,000	\$2.00

-----

(1) These options were granted under the Company's 2003 Stock Incentive Plan, as amended. The 2003 Stock Incentive Plan, as amended, is administered by the Company's Board of Directors or by a committee thereof. No grants may be made under the 2003 Stock Incentive Plan, as amended, after the 10-year anniversary of the plan. The 2003 Stock Incentive Plan, as amended, provides for the grant of non-qualified stock options in the sole discretion of the Board or a committee thereof. Stock options may be exercised in cash and/or unless otherwise provided in an applicable stock option agreement, with shares of our common stock upon the terms set forth in the 2003 Stock Incentive Plan, as amended. In addition, each non-employee director of the Company is granted 250 shares of our common stock at the end of each calendar quarter for which he or she has served as a director for such entire calendar quarter. Please see the full terms of the 2003 Stock Incentive Plan, as amended, for more detailed information. The 2003 Stock Incentive Plan, as amended, is attached as an exhibit hereto and is incorporated by reference herein.

#### Security Ownership of Certain Beneficial Owners.

The following table sets forth information regarding ownership of

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

outstanding shares of our common stock as of April 8, 2005 by those individuals or groups who have advised us that they own more than five percent (5%) of such outstanding shares.

14

Name and Address of Beneficial Owner -----	Amount Beneficially Owned -----	Percent of Class -----
Royalty Holdings LLC and Royalty Management, Inc. 450 Park Avenue New York, New York 10022	1,823,738 (1)	60.36%
Raffles Associates, L.P. 450 Seventh Avenue New York, New York 10123	167,567 (2)	5.55%
Laurence S. Levy (1) c/o Hyde Park Holdings, LLC 450 Park Avenue New York, New York 10022.	1,948,738 (1) (3)	61.94%

- 
- (1) Based on information contained in the Amended Statement on Schedule 13D filed by such entities on October 18, 2004.
  - (2) Based on information contained in the amended Statement on Schedule 13G filed by such entity on January 20, 2005.
  - (3) Comprised of (i) the 1,823,738 shares that are beneficially owned by Royalty Management, Inc., of which Mr. Levy is the President, sole director and sole stockholder and (ii) 125,000 shares underlying currently exercisable options granted to Mr. Levy under the Company's 2003 Stock Incentive Plan, as amended.

The following table sets forth certain information as of April 8, 2005 regarding the ownership of Common Stock by (i) each director and nominee for director, (ii) each individual named in the Summary Compensation Table contained herein, and (iii) all current executive officers and directors of the Company as a group. Except as otherwise indicated, each such stockholder has sole voting and investment power with respect to the shares beneficially owned by such stockholder.

Name and Address of Beneficial Owner -----	Amount Beneficially Owned -----	Percent of Class -----
Laurence S. Levy (1)	1,948,738 (2)	61.94%
Neil N. Hasson (1)	125,000 (3)	3.97%
Errol Glasser 280 Madison Avenue Suite 600 New York, New York 10016	18,750 (4)	Less than 1%
Stanley Fleishman c/o Jetro 15-24 132rd Street	14,500 (4)	Less than 1%

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

College Point, New York 10123

Raffles Affiliates, Inc. 450 Seventh Avenue Suite 509 New York, New York 10123	167,567 (5)	5.55%
---	-------------	-------

All current Directors and Executive Officers as a group	2,107,238	63.93%
--	-----------	--------

- 
- (1) The address of such beneficial owner is c/o Hyde Park Holdings, LLC, 450 Park Avenue, New York, New York 10022.
  - (2) Comprised of (i) the 1,823,738 shares that are beneficially owned by Royalty Management, Inc., of which Mr. Levy is the President, sole director and sole stockholder and (ii) 125,000 shares underlying currently exercisable options granted to Mr. Levy under the Company's 2003 Stock Incentive Plan, as amended.

15

- (3) Comprised of 125,000 shares of Common Stock underlying options currently exercisable granted to Mr. Hasson under the Company's 2003 Stock Incentive Plan, as amended.
- (4) Includes 12,500 shares of Common Stock underlying stock options currently exercisable or exercisable within sixty days issued to such individual under the Company's 2003 Stock Incentive Plan, as amended.

### ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

#### Loan Facility

In order to satisfy the Company's working capital needs, in April 2003 the Company obtained a loan facility from Royalty, an affiliate of Messrs. Levy and Hasson, pursuant to which the Company could have borrowed up to an aggregate of \$300,000 from Royalty. Amounts borrowed were evidenced by a demand note bearing interest of 8% per annum. On July 3, 2003, the Company repaid all amounts outstanding under the \$300,000 working capital loan facility from Royalty, and terminated the facility. The payment amount consisted of \$180,000 of principal and \$2,910 of accrued and unpaid interest.

#### License Agreement

Pursuant to a License Agreement entered into in March 2003, Royalty Management, Inc., which is wholly-owned by Laurence S. Levy, the Company's President, Chief Executive Officer and a director, provides New York City office space, office supplies and office services to the Company for \$100,000 per year.

#### Note Conversion

On July 3, 2003 Royalty converted the remaining \$2,004,098 outstanding principal amount of its

Convertible Promissory Note plus accrued interest into 1,037,738 shares of Common Stock. The note had been issued to Royalty as part of the Company's October 2002 recapitalization transactions.

#### Note Repayment

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

On July 3, 2003 the Company repaid the full \$1,250,000 principal amount of, and all accrued and unpaid interest under, the 9% Promissory Note of the Company held by Royalty. The note had been issued to Royalty as part of the Company's October 2002 recapitalization transactions.

### Employment Agreements

See "ITEM 10. EXECUTIVE COMPENSATION - EMPLOYMENT CONTRACTS, TERMINATION OF EMPLOYMENT AND CHANGE IN CONTROL ARRANGEMENTS" which is incorporated herein by reference.

### Other Arrangements

See "ITEM 1. BUSINESS - NARRATIVE DESCRIPTION OF BUSINESS - "National Resource Development Corporation; Iron Mountain Resources, Inc.", which is incorporated by reference herein.

### ITEM 13. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K

a. The following documents are filed as part of this report:

1. Financial Statements:	Page
-----	----
Independent Accountant's Report	F-1
Consolidated Balance Sheets	F-2 - F-3
Consolidated Statements of Operations	F-4
Consolidated Statements of Shareholders' Equity	F-5
Consolidated Statements of Cash Flows	F-6 - F-7
Notes to Consolidated Financial Statements	F-8 - F-29

2. Other Exhibits

Exhibit No.	Description of Document
-----	-----
3.1(i)(a)	Restated Certificate of Incorporation of the Company (filed as exhibit 3.1(i)(a) to the Company's Form 10-Q dated November 19, 2002, and incorporated herein by reference).
3.1(i)(b)	Corrected Certificate of Amendment reflecting amendment to Restated Certificate of Incorporation of the Company (filed as exhibit 3.1(i)(b) to the Company's Form 10-Q, dated November 19, 2002, and incorporated herein by reference).
3.1(i)(c)	Certificate of Amendment to Restated Certificate of Amendment (filed as Exhibit A to the Company's Information Statement on Schedule 14C filed on October 27, 2003).

Exhibit No.	Description of Document
-----	-----

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

- 3.1(i)(d) Certificate of Designation - Series B Preferred Stock, \$10 Stated Value, \$.10 par value (filed as Exhibit to Form 10-K dated June 7, 1993 and incorporated herein by reference).
- 3.1(i)(e) Amended and Restated Certificate of Designation, Series C Preferred Stock, \$100 Stated Value, \$.10 par value (filed as Exhibit 99.4 to the Company's Current Report on Form 8-K filed on October 18, 2002, and incorporated herein by reference).
- 3.1(i)(f) Certificate of Designation - Series D Junior Preferred Stock, \$10 Stated Value, \$.10 par value (filed as Exhibit to Form 10-K dated June 7, 1993 and incorporated herein by reference).
- 3.1(i)(g) Certificate of Designation - Series E Preferred Stock, \$100 Stated Value, \$.10 par value (filed as Exhibit 4.1 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1995 at page E-1, and incorporated herein by reference).
- 3.1(ii)(a) By-laws of the Company (filed as Exhibit 3.4 to the Company's Registration Statement on Form S-1, Registration No. 2-86906, and incorporated herein by reference).
- 3.1(ii)(b) Amendment No. 1 to By-Laws of the Company (filed as exhibit 3.1(ii)(b) to the Company's Form 10-Q dated November 19, 2002, and incorporated herein by reference).
- 10.1 2003 Stock Incentive Plan of the Company (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003 and incorporated herein by reference) \*
- 10.2 Amendment No. 1 to 2003 Stock Incentive Plan (filed as Exhibit 8 to Amendment No. 3 to Schedule 13D filed by Royalty Holdings LLC, Royalty Management, Inc., Laurence Levy and Neil Hasson on October 3, 2003, and incorporated herein by reference.) \*
- 10.3 Amendment No. 2 to 2003 Stock Incentive Plan (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-QSB on August 23, 2004, and incorporated herein by reference.) \*
- 10.4 Stock Option Agreement, dated April 1, 2003, between the Company and Stanley Fleishman (filed as Exhibit 10.2 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). \*
- 10.5 Stock Option Agreement, dated April 1, 2003, between the Company and Errol Glasser (filed as Exhibit 10.3 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). \*

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

17

Exhibit No. -----	Description of Document -----
10.6	Stock Option Agreement, dated April 1, 2003, between the Company and Laurence Levy (filed as Exhibit 10.4 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). *
10.7	Stock Option Agreement, dated April 1, 2003, between the Company and Neil Hasson (filed as Exhibit 10.5 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). *
10.8	Stock Option Agreement, dated October 1, 2003 between the Company and Laurence Levy (filed as Exhibit 11 to Amendment No. 3 to Schedule 13D filed by Royalty Holdings LLC, Royalty Management, Inc., Laurence Levy and Neil Hasson on October 3, 2003, and incorporated herein by reference). *
10.9	Stock Option Agreement, dated October 1, 2003 between the Company and Neil Hasson (filed as Exhibit 12 to Amendment No. 3 to Schedule 13D filed by Royalty Holdings LLC, Royalty Management, Inc., Laurence Levy and Neil Hasson on October 3, 2003, and incorporated herein by reference). *
10.10	Stock Option Agreement, dated October 1, 2003 between the Company and Errol Glasser. *
10.11	Stock Option Agreement, dated October 1, 2003 between the Company and Stanley Fleishman. *
10.12	Stock Option Agreement, dated as of August 13, 2004 between the Company and Laurence Levy (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on August 23, 2004, and incorporated herein by reference). *
10.13	Stock Option Agreement, dated as of August 13, 2004 between the Company and Neil Hasson (filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on August 23, 2004, and incorporated herein by reference). *
10.14	License Agreement, dated March 17, 2003, between the Company and Royalty Management, Inc. (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference).
10.15	Demand Note from the Company in favor of Royalty Holdings LLC (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference).

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

- 10.16 Redemption Agreement, dated October 16, 2002, between the Company and Statesman (filed as exhibit 99.1 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.17 Call Option Agreement, dated October 16, 2002, between the Company and Statesman (filed as exhibit 99.2 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).

18

Exhibit No. -----	Description of Document -----
10.18	Contingent Payment Agreement, dated October 16, 2002, between the Company and William R. Ponsoldt, Sr. (filed as exhibit 99.3 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference). *
10.19	Amended and Restated Certificate of Designations of the Series C Preferred Stock (filed as exhibit 99.4 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
10.20	Note Purchase Agreement, dated October 16, 2002, between the Company Royalty Holdings LLC (filed as exhibit 99.5 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
10.21	5% Convertible Promissory Note of the Company (filed as exhibit 99.6 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
10.22	9% Promissory Note of the Company (filed as exhibit 99.7 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
10.23	Amended and Restated Promissory Note of the Company (filed as exhibit 99.8 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
10.24	Amendment No. 1 to Pledge Agreement (filed as exhibit 99.9 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
10.25	Letter Agreement, dated October 16, 2002, between the Company and Statesman (filed as exhibit 99.10 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
10.26	Employment Agreement, dated October 16, 2002, between Laurence S. Levy and the Company (filed as exhibit 99.11 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference). *

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

10.27                    Employment Agreement, dated October 16, 2002, between Neil N. Hasson and the Company (filed as exhibit 99.12 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference). \*

19

Exhibit No. -----	Description of Document -----
10.28	Employment Agreement dated June 3, 1997, between Regency Affiliates, Inc. and William R. Ponsoldt, Sr., and Agreement dated June 3, 1997, between Regency Affiliates, Inc. and Statesman Group, Inc. (filed as exhibits 10(a) and (b) to the Company's report on Form 8-K dated June 13, 1997, and incorporated herein by reference). *
10.29	Asset Purchase and Sale Agreement dated February 27, 1997, between Rustic Crafts Co., Inc. and certain individuals, as Sellers, and Regency Affiliates, Inc., as Purchaser, and Assignment and Assumption of Purchase Agreement dated March 17, 1997, between Regency Affiliates, Inc., and Rustic Crafts International, Inc. (filed as exhibit 10.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997 at page E-1, and incorporated herein by reference).
10.30	Amended and Restated Agreement between Regency Affiliates, Inc. and the Statesman Group, Inc., dated March 24, 1998 (filed as exhibit 10.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997, at page E-36, and incorporated herein by reference).
10.31	Loan Agreement and Pledge and Security Agreement with KBC Bank N.V., dated June 24, 1998 (filed as exhibits 10.1 and 10.2 to the Company's report on Form 10-Q for the quarter ended June 30, 1998, and incorporated herein by reference).
10.22	Security Land And Development Company Limited Partnership Agreement, as amended by Amendment Nos. 1 through 6 (filed as Exhibit 1(a) to Registrant's Annual Report on Form 10-K for the year ended December 31, 1994, and incorporated herein by reference).
10.33	Seventh Amendment to Partnership Agreement of Security Land and Development Company Limited Partnership dated June 24, 1998 (filed as exhibit 10.3 to the Company's report on Form 10-Q for the quarter ended June 30, 1998, and incorporated herein by reference).
10.34	Eighth Amendment to Partnership Agreement of Security Land and Development Company Limited Partnership, dated April 8, 2003 (filed as Exhibit 10.27 to the Company report on Form 10-KSB for the year ended December 31, 2002, filed on April 15, 2003, and incorporated herein by reference).

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

10.35 Purchase Agreement for a 5% Limited Partnership Interest in 1500 Woodlawn Limited Partnership, the General Partner of Security (filed as exhibit 10.2 to the Company's report on Form 10-K for the year ended December 31, 2001, and incorporated herein by reference).

20

Exhibit No. -----	Description of Document -----
10.36	Glas-Aire Redemption Agreement (incorporated herein by reference to the Company's Current Report on Form 8-K filed on October 16, 2001).
10.37	Statesman exercise agreement (incorporated herein by reference to the Company's Current Report on Form 8-K filed on October 25, 2001).
10.38	Ninth Amendment to Security Land and Development Company Limited Partnership Amended and Restated Limited Partnership Agreement (filed as Exhibit 10.1 to the Company's Form 8-K filed on June 25, 2003, and incorporated herein by reference).
10.39	Seventh Amendment to First Amended and Restated Limited Partnership Agreement of 1500 Woodlawn Limited Partnership (filed as Exhibit 10.2 to the Company's Form 8-K filed on June 25, 2003, and incorporated herein by reference).
10.40	Assignment and Assumption Agreement, dated as of April 30, 2004, between DTE Mobile, LLC and Regency Power Corporation (incorporated by reference from the Company's Current Report on 8-K filed on May 11, 2004).
10.41	Membership Interest Purchase Agreement, dated as of January 30, 2004, between MESC Capital, LLC and Mobile Energy Services Holdings, Inc. (incorporated by reference from the Company's Current Report on 8-K filed on May 11, 2004).
21	Schedule of Subsidiaries
23	Consent Letter from Rosenberg, Rich, Baker, Bermann & Company
31.1	Chief Executive Officer's Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer's Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

of the Sarbanes-Oxley Act of 2002.

99.1 Report of the Special Committee of the Company's Board of Directors, dated May 10, 2003, and adopting resolutions (filed as Exhibit 99.2 to Company's Quarterly Report on Form 10-Q for the period ended March 31, 2003, and incorporated by reference herein).

-----  
 \* Indicates that exhibit is a management contract or compensatory plan or arrangement.

b. The following reports on Form 8-K were filed by the Company during the quarter ended December 31, 2004. No financial statements were filed in any such reports.

Date Filed -----	Item No. -----
November 8, 2004	8.01, 9.01

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the fees billed by the Company's independent auditor, Rosenberg, Rich, Baker, Berman & Company during fiscal years ended December 31, 2004 and December 31, 2003.

	Audit Fees (a)	Audit Related Fees (b)	Tax Fees (c)	All Other Fees (d)
For the period ended December 31, 2004	\$32,513	\$ --	\$18,500	\$ --
For the period ended December 31, 2003	\$57,736	\$ --	\$18,267	\$ --

- 
- (a) Audit fees relate to professional services rendered in connection with the audit of the Company's annual financial statements, quarterly review of financial statements included in the Company's Forms 10-Q, and audit services provided in connection with other statutory and regulatory filings.
  - (b) Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or reviews of financial statements and are not reported under "Audit Fees". These services include consultations concerning financial accounting and reporting standards.
  - (c) Tax fees include professional services related to tax compliance, tax planning and the preparation of federal and state tax returns.
  - (d) Consists of fees for products and services other than the services reported above.

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REGENCY AFFILIATES, INC.

April 14, 2005  
Date

By: /s/ Laurence S. Levy  
-----  
Laurence S. Levy, President and  
Chief Executive Officer

April 14, 2005  
Date

By: /s/ Neil N. Hasson  
-----  
Neil N. Hasson, Chief Financial  
Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

April 14, 2005  
Date

By: /s/ Laurence S. Levy  
-----  
Laurence S. Levy, President,  
Chief Executive Officer and Director

April 14, 2005  
Date

By: /s/ Neil N. Hasson  
-----  
Neil N. Hasson, Chief Financial  
Officer and Director

April 14, 2005  
Date

By: /s/ Errol Glasser  
-----  
Errol Glasser, Director

April 14, 2005  
Date

By: /s/ Stanley Fleishman  
-----  
Stanley Fleishman, Director

22

INDEX TO EXHIBITS

1.	Financial Statements:	Page
	-----	----
	Independent Accountant's Report	F-3
	Consolidated Balance Sheets	F-4 - F-5
	Consolidated Statements of Operations	F-6
	Consolidated Statements of Shareholders' Equity	F-7

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Consolidated Statements of Cash Flows

F-8 - F-9

Notes to Consolidated Financial Statements

F-10 - F-30

2. Other Exhibits

Exhibit No. -----	Description of Document -----
3.1(i)(a)	Restated Certificate of Incorporation of the Company (filed as exhibit 3.1(i)(a) to the Company's Form 10-Q dated November 19, 2002, and incorporated herein by reference).
3.1(i)(b)	Corrected Certificate of Amendment reflecting amendment to Restated Certificate of Incorporation of the Company (filed as exhibit 3.1(i)(b) to the Company's Form 10-Q, dated November 19, 2002, and incorporated herein by reference).
3.1(i)(c)	Certificate of Amendment to Restated Certificate of Amendment (filed as Exhibit A to the Company's Information Statement on Schedule 14C filed on October 27, 2003).
3.1(i)(d)	Certificate of Designation - Series B Preferred Stock, \$10 Stated Value, \$.10 par value (filed as Exhibit to Form 10-K dated June 7, 1993 and incorporated herein by reference).
3.1(i)(e)	Amended and Restated Certificate of Designation, Series C Preferred Stock, \$100 Stated Value, \$.10 par value (filed as Exhibit 99.4 to the Company's Current Report on Form 8-K filed on October 18, 2002, and incorporated herein by reference).

E-1

Exhibit No. -----	Description of Document -----
3.1(i)(f)	Certificate of Designation - Series D Junior Preferred Stock, \$10 Stated Value, \$.10 par value (filed as Exhibit to Form 10-K dated June 7, 1993 and incorporated herein by reference).
3.1(i)(g)	Certificate of Designation - Series E Preferred Stock, \$100 Stated Value, \$.10 par value (filed as Exhibit 4.1 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1995 at page E-1, and incorporated herein by reference).
3.1(ii)(a)	By-laws of the Company (filed as Exhibit 3.4 to the Company's Registration Statement on Form S-1, Registration No. 2-86906, and incorporated herein by reference).
3.1(ii)(b)	Amendment No. 1 to By-Laws of the Company (filed as exhibit 3.1(ii)(b) to the Company's Form 10-Q dated November 19, 2002, and incorporated herein by reference).

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

reference).

- 10.1 2003 Stock Incentive Plan of the Company (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference) \*
- 10.2 Amendment No. 1 to 2003 Stock Incentive Plan (filed as Exhibit 8 to Amendment No. 3 to Schedule 13D filed by Royalty Holdings LLC, Royalty Management, Inc., Laurence Levy and Neil Hasson on October 3, 2003, and incorporated herein by reference.) \*
- 10.3 Amendment No. 2 to 2003 Stock Incentive Plan (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-QSB on August 23, 2004, and incorporated herein by reference.) \*
- 10.4 Stock Option Agreement, dated April 1, 2003, between the Company and Stanley Fleishman (filed as Exhibit 10.2 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). \*
- 10.5 Stock Option Agreement, dated April 1, 2003, between the Company and Errol Glasser (filed as Exhibit 10.3 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). \*
- 10.6 Stock Option Agreement, dated April 1, 2003, between the Company and Laurence Levy (filed as Exhibit 10.4 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). \*
- 10.7 Stock Option Agreement, dated April 1, 2003, between the Company and Neil Hasson (filed as Exhibit 10.5 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference). \*

E-2

Exhibit No. -----	Description of Document -----
10.8	Stock Option Agreement, dated October 1, 2003 between the Company and Laurence Levy (filed as Exhibit 11 to Amendment No. 3 to Schedule 13D filed by Royalty Holdings LLC, Royalty Management, Inc., Laurence Levy and Neil Hasson on October 3, 2003, and incorporated herein by reference). *
10.9	Stock Option Agreement, dated October 1, 2003 between the Company and Neil Hasson (filed as Exhibit 12 to Amendment No. 3 to Schedule 13D filed by Royalty Holdings LLC, Royalty Management, Inc., Laurence Levy and Neil Hasson on October 3, 2003, and incorporated herein by reference). *

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

- 10.10 Stock Option Agreement, dated October 1, 2003 between the Company and Errol Glasser. \*
- 10.11 Stock Option Agreement, dated October 1, 2003 between the Company and Stanley Fleishman. \*
- 10.12 Stock Option Agreement, dated as of August 13, 2004 between the Company and Laurence Levy (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on August 23, 2004, and incorporated herein by reference). \*
- 10.13 Stock Option Agreement, dated as of August 13, 2004 between the Company and Neil Hasson (filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on August 23, 2004, and incorporated herein by reference). \*
- 10.14 License Agreement, dated March 17, 2003, between the Company and Royalty Management, Inc. (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference).
- 10.15 Demand Note from the Company in favor of Royalty Holdings LLC (filed as Exhibit 10.1 to the Company's Annual Report on Form 10-KSB for the year ended 2002 filed on April 15, 2003, and incorporated herein by reference).
- 10.16 Redemption Agreement, dated October 16, 2002, between the Company and Statesman (filed as exhibit 99.1 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.17 Call Option Agreement, dated October 16, 2002, between the Company and Statesman (filed as exhibit 99.2 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.18 Contingent Payment Agreement, dated October 16, 2002, between the Company and William R. Ponsoldt, Sr. (filed as exhibit 99.3 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference). \*
- 10.19 Amended and Restated Certificate of Designations of the Series C Preferred Stock (filed as exhibit 99.4 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).

E-3

Exhibit No.	Description of Document
-----	-----
10.20	Note Purchase Agreement, dated October 16, 2002, between the Company Royalty Holdings LLC (filed as exhibit 99.5 to Company's Current Report on Form 8-K filed October

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

- 18, 2002, and incorporated herein by reference).
- 10.21 5% Convertible Promissory Note of the Company (filed as exhibit 99.6 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.22 9% Promissory Note of the Company (filed as exhibit 99.7 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.23 Amended and Restated Promissory Note of the Company (filed as exhibit 99.8 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.24 Amendment No. 1 to Pledge Agreement (filed as exhibit 99.9 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.25 Letter Agreement, dated October 16, 2002, between the Company and Statesman (filed as exhibit 99.10 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference).
- 10.26 Employment Agreement, dated October 16, 2002, between Laurence S. Levy and the Company (filed as exhibit 99.11 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference). \*
- 10.27 Employment Agreement, dated October 16, 2002, between Neil N. Hasson and the Company (filed as exhibit 99.12 to Company's Current Report on Form 8-K filed October 18, 2002, and incorporated herein by reference). \*
- 10.28 Employment Agreement dated June 3, 1997, between Regency Affiliates, Inc. and William R. Ponsoldt, Sr., and Agreement dated June 3, 1997, between Regency Affiliates, Inc. and Statesman Group, Inc. (filed as exhibits 10(a) and (b) to the Company's report on Form 8-K dated June 13, 1997, and incorporated herein by reference). \*

E-4

Exhibit No. -----	Description of Document -----
10.29	Asset Purchase and Sale Agreement dated February 27, 1997, between Rustic Crafts Co., Inc. and certain individuals, as Sellers, and Regency Affiliates, Inc., as Purchaser, and Assignment and Assumption of Purchase Agreement dated March 17, 1997, between Regency Affiliates, Inc., and Rustic Crafts International, Inc. (filed as exhibit 10.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997 at page E-1, and incorporated herein by reference).
10.30	Amended and Restated Agreement between Regency Affiliates, Inc. and the Statesman Group, Inc., dated March 24, 1998 (filed as exhibit 10.2 to the Company's

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Annual Report on Form 10-K for the year ended December 31, 1997, at page E-36, and incorporated herein by reference).

- 10.31 Loan Agreement and Pledge and Security Agreement with KBC Bank N.V., dated June 24, 1998 (filed as exhibits 10.1 and 10.2 to the Company's report on Form 10-Q for the quarter ended June 30, 1998, and incorporated herein by reference).
- 10.32 Security Land And Development Company Limited Partnership Agreement, as amended by Amendment Nos. 1 through 6 (filed as Exhibit 1(a) to Registrant's Annual Report on Form 10-K for the year ended December 31, 1994, and incorporated herein by reference).
- 10.33 Seventh Amendment to Partnership Agreement of Security Land and Development Company Limited Partnership dated June 24, 1998 (filed as exhibit 10.3 to the Company's report on Form 10-Q for the quarter ended June 30, 1998, and incorporated herein by reference).
- 10.34 Eighth Amendment to Partnership Agreement of Security Land and Development Company Limited Partnership, dated April 8, 2003 (filed as Exhibit 10.27 to the Company report on Form 10-KSB for the year ended December 31, 2002, filed on April 15, 2003, and incorporated herein by reference).
- 10.35 Purchase Agreement for a 5% Limited Partnership Interest in 1500 Woodlawn Limited Partnership, the General Partner of Security (filed as exhibit 10.2 to the Company's report on Form 10-K for the year ended December 31, 2001, and incorporated herein by reference).
- 10.36 Glas-Aire Redemption Agreement (incorporated herein by reference to the Company's Current Report on Form 8-K filed on October 16, 2001).
- 10.37 Statesman exercise agreement (incorporated herein by reference to the Company's Current Report on Form 8-K filed on October 25, 2001).

E-5

Exhibit No.	Description of Document
10.38	Ninth Amendment to Security Land and Development Company Limited Partnership Amended and Restated Limited Partnership Agreement (filed as Exhibit 10.1 to the Company's Form 8-K filed on June 25, 2003, and incorporated herein by reference).
10.39	Seventh Amendment to First Amended and Restated Limited Partnership Agreement of 1500 Woodlawn Limited Partnership (filed as Exhibit 10.2 to the Company's Form 8-K filed on June 25, 2003, and incorporated herein by reference).

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

- 10.40 Assignment and Assumption Agreement, dated as of April 30, 2004, between DTE Mobile, LLC and Regency Power Corporation (incorporated by reference from the Company's Current Report on 8-K filed on May 11, 2004).
- 10.41 Membership Interest Purchase Agreement, dated as of January 30, 2004, between MESC Capital, LLC and Mobile Energy Services Holdings, Inc. (incorporated by reference from the Company's Current Report on 8-K filed on May 11, 2004).
- 21 Schedule of Subsidiaries
- 23 Consent Letter from Rosenberg, Rich, Baker, Bermann & Company
- 31.1 Chief Executive Officer's Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Chief Financial Officer's Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.1 Report of the Special Committee of the Company's Board of Directors, dated May 10, 2003, and adopting resolutions (filed as Exhibit 99.2 to Company's Quarterly Report on Form 10-Q for the period ended March 31, 2003, and incorporated by reference herein).

-----  
\* Indicates that exhibit is a management contract or compensatory plan or arrangement.

E-6

Regency Affiliates, Inc. and Subsidiaries

Consolidated Financial Statements

December 31, 2004 and 2003

Regency Affiliates, Inc. and Subsidiaries  
Index to the Financial Statements

	Page
Independent Registered Public Accounting Firm's Report	F-1
Financial Statements	

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Consolidated Balance Sheets	F-2
Consolidated Statements of Operations	F-4
Consolidated Statements of Shareholders' Equity	F-5
Consolidated Statements of Cash Flows	F-6 - F-7
Notes to Consolidated Financial Statements	F-8 - F-29

Report of Independent Registered Accounting Firm

To the Board of Directors and Stockholders  
of Regency Affiliates, Inc. and Subsidiaries

We have audited the consolidated balance sheets of Regency Affiliates, Inc. and Subsidiaries as of December 31, 2004 and 2003 and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Regency Affiliates, Inc. and Subsidiaries as of December 31, 2004 and 2003 and the results of its consolidated operations, changes in shareholder's equity and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Rosenberg Rich Baker Berman & Company

Bridgewater, New Jersey  
April 13, 2005

F-1

Regency Affiliates, Inc. and Subsidiaries  
Consolidated Balance Sheets

	December 31,	
	----- 2004 -----	----- 2003 -----
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,469,354	\$ 451,249

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Marketable securities	8,992,256	18,495,025
Accounts receivable, net of allowance	--	3,077
Accrued interest receivables	347,242	299,324
Notes receivable - current	--	327,936
Other current assets	41,896	64,294
	-----	-----
Total Current Assets	10,850,748	19,640,905
Notes receivable, net of current portion	--	801,335
Property, plant and equipment, net	1,899	489,972
Investment in partnerships	7,757,157	599,268
Other Assets		
Aggregate inventory	832,427	832,427
Deferred costs	250,000	250,000
Other	1,300	1,300
	-----	-----
Total Other Assets	1,083,727	1,083,727
	-----	-----
Total Assets	\$19,693,531	\$22,615,207
	=====	=====

See notes to the consolidated financial statements.

F-2

Regency Affiliates, Inc. and Subsidiaries  
Consolidated Balance Sheets

	December 31,	
	2004	2003
	-----	-----
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable and accrued expenses	\$ 690,827	\$ 1,000,000
	-----	-----
Total Current Liabilities	690,827	1,000,000
Deferred credit	502,822	1,000,000
Shareholders' equity		
Serial preferred stock not subject to mandatory redemption (Maximum liquidation preference \$24,975,312)	1,052,988	1,000,000
Common stock, par value \$.01; 10,000,000 shares authorized and 3,020,412 shares issued outstanding	30,204	30,204
Additional paid-in capital	8,182,631	8,182,631
Readjustment resulting from quasi-reorganization at December 1987	(1,670,596)	(1,670,596)
Retained earnings	13,640,290	14,640,290
Note receivable - sale of stock	(2,440,000)	(2,440,000)
Treasury stock, 47,000 and 1,160,233 shares in 2004 and 2003, Respectively	(295,635)	(295,635)
	-----	-----

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Total Shareholders' Equity	18,499,882	20,
	-----	-----
	\$ 19,693,531	\$ 22,
	=====	=====

See notes to the consolidated financial statements.

F-3

Regency Affiliates, Inc. and Subsidiaries  
Consolidated Statements of Operations

	December 31,	
	2004	2003
Net Sales	\$ --	\$ --
	-----	-----
Costs and expenses		
General and Administrative expenses	3,710,057	5,685,109
	-----	-----
Loss from operations	(3,710,057)	(5,685,109)
	-----	-----
Other income (expense)		
Income from equity investment in partnerships	2,156,967	3,483,381
Rental income	4,599	95,984
Interest and dividend income	261,948	185,844
Other income, net	4,468	387,263
Interest expense	--	(714,979)
	-----	-----
Net loss before income taxes	(1,282,075)	(2,247,616)
Income tax (expense) benefit	(41,495)	(70,724)
	-----	-----
Net Loss	\$ (1,323,570)	\$ (2,318,340)
	=====	=====
Net loss per common share:		
Basic and diluted	\$ (0.44)	\$ (0.93)
	-----	-----
Weighted average number of shares	3,019,317	2,502,657
	-----	-----

See notes to the consolidated financial statements.

F-4

Regency Affiliates, Inc. and Subsidiaries  
Consolidated Statements of Shareholders' Equity  
Years Ended December 31, 2004 and 2003

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

	Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amount
Balance - January 1, 2003	605,291	\$ 1,052,988	2,024,382	\$ 27
Shares cancelled, returned to treasury			(45,208)	
Common stock issued upon conversion of note payable/accrued interest	--	--	1,037,738	10
Common stock issued for services	--	--	1,500	
Net loss	--	--	--	
Balance - December 31, 2003	605,291	1,052,988	3,018,412	37
Retirement of treasury shares				(7)
Purchase treasury shares note payable/accrued interest	--	--		
Common stock issued for services	--	--	2,000	
Net loss	--	--	--	
Balance - December 31, 2004	605,291	\$ 1,052,988	3,020,412	\$ 30

	Retained Earnings	Note Receivable Sale of Stock	Treasury Stock Shares	
	Balance - January 1, 2003	\$ 17,282,200	\$ (2,440,000)	1,115,025
Shares cancelled, returned to treasury			45,208	
Common stock issued upon conversion of note payable/accrued interest	--	--	--	
Common stock issued for services	--	--	--	
Net loss	(2,318,340)	--	--	
Balance - December 31, 2003	14,963,860	(2,440,000)	1,160,233	
Retirement of treasury shares			(1,160,233)	
Purchase treasury shares note payable/accrued interest	--	--	47,000	
Common stock issued for services	--	--	--	
Net loss	(1,323,570)	--	--	

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Balance - December 31, 2004	\$ 13,640,290	\$ (2,440,000)	47,000	\$
	=====	=====	=====	=====

See notes to the consolidated financial statements.

F-5

Regency Affiliates, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows

	Years Ended December	
	2004	2003
	-----	-----
Cash flows from operating activities		
Net loss	\$ (1,323,570)	\$ (2,440,000)
Adjustments to reconcile net loss to net cash provided (used) by operating activities		
Income from equity investment in partnerships	(2,156,969)	(3,000,000)
Impairment of notes receivable	1,127,708	
Interest accretion on long-term debt	--	
Depreciation and amortization	4,658	
Issuance of common stock in lieu of cash	12,800	
Unrealized gain on marketable securities	(104,242)	
Impairment of property and equipment	--	1,000,000
Changes in assets and liabilities		
Decrease (increase) in accounts receivable	3,077	
Loan receivable - Operating	--	
Decrease (increase) in accrued receivables	(47,918)	
Decrease (increase) in income taxes receivable	--	
Decrease (increase) in other current assets	22,399	
Decrease (increase) in other assets	--	
Increase (decrease) in accounts payable and accrued expenses	(16,047)	(1,000,000)
Net cash (used) by operating activities	(2,478,104)	(5,440,000)
	-----	-----
Cash flows from investing activities		
Cash investments in MESC Capital, LLC	(7,300,145)	
Payments received on notes receivable	1,563	
Distribution of earnings from partnership	1,000,000	41,000,000
Purchases of marketable securities	(129,892,989)	(18,000,000)
Proceeds from sales of marketable securities	139,500,000	
Net proceeds from the sale of property and equipment	483,415	
Net cash provided by investing activities	3,791,844	22,999,000
	-----	-----
Cash flows from financing activities		
Payment of long-term debt	--	(16,000,000)
Repayment of notes payable - bank	--	
Repayment of notes payable - other	--	
Purchase of treasury stock	(295,635)	
Net cash used in financing activities	(295,635)	(16,000,000)
	-----	-----
Net increase in cash and cash equivalents	\$ 1,018,105	\$
Cash and cash equivalents - beginning	451,249	
Cash and cash equivalents - ending	\$ 1,469,354	\$

See notes to the consolidated financial statements.

F-6

Regency Affiliates, Inc. and Subsidiaries  
 Consolidated Statements of Cash Flows (continued)

	Years Ended December 31,	
	2004	2003
Supplemental disclosures of cash flow information:		
Cash paid during the year for		
Interest	\$ --	\$4,393,983
Income taxes	\$ 41,495	\$ 252,371

Supplemental disclosures of noncash investing and financing activities:

During the year ended December 31, 2004, the Company has recorded the retirement of 1,160,233 shares of cancelled treasury stock at a cost of \$18,243 resulting in a reduction of common stock of \$7,549 and additional paid-in capital of \$10,694.

In 2003, \$2,004,098 in convertible notes payable and \$71,377 in accrued interest thereupon were converted into 1,037,738 shares of common stock.

In 2003, the Company reached an agreement to restructure a note receivable, whereby accrued interest receivable of \$23,934 was converted into part of the principal on the new note receivable.

See notes to the consolidated financial statements.

F-7

Regency Affiliates, Inc. and Subsidiaries  
 Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

A. Principles of Consolidation and Nature of Business - The consolidated financial statements include the accounts of Regency Affiliates, Inc. (the "Company"), its wholly owned subsidiary Speed.com, Inc. through March 1, 2003, the date of dissolution, its 75% owned subsidiary, Iron Mountain Resources, Inc. ("IMR") since December 13, 2001, and its 80% owned subsidiaries, National Resource Development Corporation ("NRDC"), RegTransco, Inc. ("RTI") through March 1, 2003, the date of dissolution and Transcontinental Drilling Company ("Drilling") through June 3, 2003, the date of dissolution. All significant intercompany balances and transactions have been eliminated in consolidation.

Regency Affiliates, Inc.'s share of consolidated net assets at December 31, 2004 and 2003 consists principally of cash and cash equivalents of approximately \$144,800 and \$436,000 respectively, marketable securities of approximately \$8,992,000 and \$18,500,000 respectively, investment in partnerships of approximately \$7,760,000 and \$599,000, respectively, property, plant and equipment of approximately \$1,900 and \$6,600, respectively, and liabilities of approximately \$691,000 and \$707,000, respectively.

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

B. Revenue Recognition - The Company's subsidiaries recognize revenue from the sale of goods upon shipment to their respective customers.

C. Earnings Per Share - Basic earnings per share are computed by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share computations assume the conversion of the Series B and Junior Series D preferred stock during the period that the preferred stock issues were outstanding. If the result of these assumed conversions is dilutive, the dividend requirements and periodic accretion for the preferred stock issues are reduced (See Note 11). In addition, diluted per share computations assume conversion of convertible debt and stock options outstanding that are "in the money".

The effect of any conversion has not been included as it would be anti-dilutive.

D. Securities Issued for Services - The Company accounts for stock issued for services under the intrinsic value method. For stock issued for services, the fair market value of the Company's stock on the date of stock issuance is used. The Company has adopted Statement of Financial Accounting Standard (SFAS) No. 123, "Accounting for Stock-Based Compensation". The statement generally suggests, but does not require, stock-based compensation transactions to be accounted for based on the fair value of the services rendered or the fair value of the equity instruments issued, whichever is more reliably measurable. Securities issued for services amounted to \$12,800 in 2004 and \$8,450 in 2003. The underlying fair value of the common shares amounted to \$640 and \$5.63 per share, respectively.

F-8

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies (Continued)

E. Fair Value of Financial Instruments - The fair values of cash, accounts receivable, accounts payable and other short-term obligations approximate their carrying values because of the short maturity of these financial instruments. The carrying values of the Company's long-term obligations approximate their fair value. In accordance with Statement of Financial Accounting Standards No. 107, "Disclosure About Fair Value of Financial Instruments," rates available at balance sheet dates to the Company are used to estimate the fair value of existing debt.

F. Cash and Cash Equivalents - Cash and cash equivalents represent cash and short-term highly liquid investments with original maturities of three months or less. The Company places its cash and cash equivalents with high credit quality financial institutions which may exceed federally insured amounts at times.

G. Property, Plant and Equipment - Property, plant and equipment are carried at cost. Depreciation is provided over the estimated useful lives of the assets by the use of the straight-line and declining balance methods. These items consist of the following at December 31, 2004 and 2003:

2004	2003
-----	-----

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Land	\$	--	\$ 24,797
Building		--	548,967
Leasehold improvements		--	4,516
Machinery and equipment		43,708	43,708
		-----	-----
		43,708	621,988
Accumulated depreciation		41,809	132,016
		-----	-----
	\$	1,899	\$489,972
		=====	=====

Depreciation expense for the years ended December 31, 2004 and 2003 was \$4,658 and \$81,196, respectively.

At December 31, 2003, the Company owned rental property in Scranton, PA consisting of land, building and related leasehold improvements that was being held for sale. The Company assessed the fair value of this property based on the selling price less costs to sell resulting from an offer which was in negotiation at year-end. Based on this assessment, it was determined that the carrying costs of this property were impaired by \$1,466,109. This impairment was recognized in the General and Administrative expenses caption of the Consolidated Statements of Operations and reduced the value of the land, building and leasehold improvements to a net carrying cost of \$483,415 after accumulated depreciation of \$531,500 less costs to sell of 48,085. No gain or loss was recognized on the transaction as the property was previously written down to fair market value. The property was sold in January 2004.

F-9

Regency Affiliates, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

H. Aggregate Inventory - Inventory, which consists of 70+ million short tons of previously quarried and stockpiled aggregate rock located at the site of the Groveland Mine in Dickinson County, Michigan, is stated at lower of cost or market. The Company is also subject to a royalty agreement which requires the payment of certain royalties to a previous owner of the aggregate inventory upon sale of the aggregate.

In December, 2001 the aggregate inventory was sold to Iron Mountain Resources, Inc., a 75% owned subsidiary of the company in exchange for an \$18,200,000 note. After defaulting on the note, on February 9, 2005, Iron Mountain Resources reconveyed the aggregate inventory to NRDC in lieu of foreclosure and the note was deemed satisfied.

I. Debt Issuance Costs - Debt issuance costs are recorded at cost and were being amortized over 60-66 months, the life of the related loans using the effective interest method. The balance of these costs was written off due to the settlement of the related debts in the year ended December 31, 2003.

J. Income Taxes - The Company utilizes Statement of Financial Accounting Standards No. 109 ("SFAS 109"), "Accounting for Income Taxes," which requires an asset and liability approach to financial accounting and reporting for income taxes. The difference between the financial statement and tax basis of assets and liabilities is determined annually. Deferred income tax assets and liabilities are computed for those temporary

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

differences that have future tax consequences using the current enacted tax laws and rates that apply to the periods in which they are expected to affect taxable income. In some situations SFAS 109 permits the recognition of expected benefits of utilizing net operating loss and tax credit carryforwards. Valuation allowances are established based upon management's estimate, if necessary. Income tax expense is the current tax payable or refundable for the period plus or minus the net exchange in the deferred tax assets and liabilities.

K. Evaluation of Long Lived Assets - Long-lived assets are assessed for recoverability on an ongoing basis. In evaluating the fair value and future benefits of long-lived assets, their carrying value would be reduced by the excess, if any of the long-lived asset over management's estimate of the anticipated undiscounted future net cash flows of the related long-lived asset.

L. Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

F-10

Regency Affiliates, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements

Note 2. Marketable Securities

The cost and fair value of the Company's investments in marketable securities are as follows as of December 31, 2004:

Trading securities:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized
	-----	-----	-----
9,000,000 US Treasury bills	\$ 8,987,788	\$ 4,468	\$

Note 3. Investment in Partnerships

In November 1994, the Company purchased, for \$350,000, a limited partnership interest in Security Land and Development Company Limited Partnership ("Security"), which owns and operates an office complex. The Company has limited voting rights and is entitled to allocations of the profit and loss of Security and operating cash flow distributions, as amended (see below).

Security was organized to own and operate two buildings containing approximately 717,000 net rentable square feet consisting of a two-story office building and a connected six-story office tower. The buildings were purchased by Security in 1986 and are located on approximately 34.3 acres of land which is also owned by Security. The buildings have been occupied by the United States Social Security Administration's Office of Disability and International Operations for approximately 30 years under leases between the United States of America, acting by and through the General

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Services Administration ("GSA"). Effective November 1, 1994, Security and the GSA entered into a nine-year lease for 100% of the building. In March 2003, the General Services Administration agreed to extend the terms of the lease through October 31, 2018. Security has received an opinion of the Assistant General Counsel to the GSA that lease payments are not subject to annual appropriation by the United States Congress and the obligations to make such payments are unconditional general obligations of the United States Government.

In April 2003, the Company entered into an amendment to the Security partnership agreement. The amendment provides for the distribution of the net proceeds of a loan to Security to the Company and the non-Company partners on a 50/50 basis, provided that such allocation would result in a minimum distribution to the Company of \$39,000,000 (a "qualified financing"). This qualified financing was obtained in June 2003 (see below). The amendment also provides that, following the qualified financing, the Company will be entitled to (i) 95% of Security's distributions of cash flow until it has received \$2,000,000 of such distributions, and thereafter 50% of such distributions, and (ii) once it has received \$2,000,000 of cash flow distributions, it will receive \$180,000 annual management fee from Security. The foregoing percentages are inclusive of the Company's interest as a limited partner in 1500 Woodlawn, the general partner of Security.

F-11

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 3. Investment in Partnerships (Continued)

The refinancing of Security's property at 1500 Woodlawn Drive, Woodlawn, Maryland closed on June 24, 2003. US SSA LLC (a single purpose entity owned by Security) borrowed \$98,500,000 through a public debt issue underwritten by CTL Capital, LLC. Proceeds of the refinancing were used to repay the outstanding balance of Security's 1994 indebtedness, to establish reserves to make capital improvements to the property, to provide reserves required by the new debt, to pay costs and expenses related to issuing the debt, to pay fees related to the lease extension with the GSA and the financing, and to make a distribution to the partners of Security. The debt is for a term of 15.3 years maturing October 31, 2018 at which time the loan will have been paid down to a balance of \$10,000,000. Security also obtained residual value insurance for approximately \$10,000,000. The interest cost of the financing is 4.63%. The financing is non-recourse to the Company. The Company received \$41,018,943 from the Security distribution. In connection with the Security refinancing and distribution, the Company was required to repay its KBC Bank loan. The payoff amount was \$14,145,410, which included a release fee and make-whole premium.

For the years ended December 31, 2004 and 2003 the Company's income from its equity investment in Security was \$1,299,225 and \$3,283,381, respectively. These funds, however, are principally committed to the amortization of the outstanding principal balance on Security's real estate mortgage. Security does not currently provide liquidity to the Company. For the year ended December 31, 2003, the Company earned \$100,938 for management services provided to Security prior to the debt refinancing.

The Company accounts for the Investment in Partnerships using the equity

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

method, whereby the carrying value of these investments are increased or decreased by the Company's allocable share of book income or loss. The total amount of distributions made in excess of the Company's partnership basis as of December 31, 2004 was \$502,822, which is recorded as a deferred credit on the accompanying financial statements.

Summarized financial information for Security is as follows:

	2004 -----	2003 -----
Balance Sheet Data		
Cash and receivables	\$ 1,227,837	\$ 1,292,836
Restricted cash	2,744,101	3,591,631
Real estate, net	38,600,829	39,298,935
Deferred charges, net	9,472,752	10,174,438
Other assets	414,136	619,081
	-----	-----
Total Assets	52,459,655	54,976,921
	=====	=====
Accounts payable and accrued expenses	650,690	407,182
Project note payable	91,904,929	95,970,491
Other liabilities	177,453	240,271
	-----	-----
Total Liabilities	92,733,072	96,617,944
Partners' capital:		
Regency Affiliates, Inc.	(40,706,414)	(40,502,870)
Other partners	432,997	(1,138,153)
	-----	-----
Total Partners' Capital	(40,273,417)	(41,641,023)
	-----	-----
Total Liabilities and Partner's Capital	52,459,655	54,976,921
	=====	=====
	2004 -----	2003 -----
Statement of Operations Data		
Revenues	\$ 12,943,455	\$ 13,506,428
Expenses	8,294,164	7,246,630
	-----	-----
Net operating income	4,649,291	6,259,798
Other expenses	(3,281,685)	(2,803,607)
	-----	-----
Net income	\$ 1,367,606	\$ 3,456,191
	=====	=====

See Note 15 regarding Contingencies, Risks and Uncertainties related to the Company's investment in Security.

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### Note 3. Investment in Partnerships (Continued)

Effective November 30, 2000 the Company invested \$10,000 for a 5% limited partnership interest in 1500 Wood Lawn Limited Partnership, the general partner of Security. The Company recognized income of \$3,419 in 2004 and \$200,000 in 2003 from this investment.

### Note 4. Investment in LLC

On April 30, 2004, the Company, through a newly-formed, wholly-owned subsidiary called Regency Power Corporation, a Delaware corporation, acquired a 50% membership interest in MESC Capital, LLC, a Delaware limited liability company, from DTE Mobile, LLC, pursuant to an Assignment and Assumption Agreement dated as of April 30, 2004. The purchase price for the 50% membership interest was \$3,000,000 and was funded from Regency's working capital. The terms of the Assignment and Assumption Agreement were negotiated on an arms'-length basis between Regency and DTE Mobile. DTE Mobile, which is owned by an unregulated subsidiary of a large energy company that has significant experience in owning, managing and operating electric generation and on-site energy facilities, owns the other 50% membership interest in MESC Capital.

MESC Capital was formed to acquire all of the membership interests in Mobile Energy Services Company, LLC, an Alabama limited liability company. Mobile Energy owns an on-site energy facility that supplies steam and electricity to a Kimberly-Clark tissue mill in Mobile, Alabama. The acquisition of Mobile Energy was also consummated on April 30, 2004 pursuant to a Membership Interest Purchase Agreement, dated as of January 30, 2004, between MESC Capital and Mobile Energy Services Holdings, Inc. The purchase price under the Membership Interest Purchase Agreement, after certain pre-closing adjustments, was \$33,600,000, and is subject to certain post-closing adjustments. The purchase price and working capital reserves were funded by the issuance of \$28,500,000 of non-recourse debt, a total equity contribution by MESC Capital of \$8,600,290, \$4,300,145 of which was funded by Regency Power and \$4,300,145 of which was funded by

DTE Mobile, and a credit of \$1,000,000 on account of existing and continuing tax-exempt indebtedness of Mobile Energy. The terms of the Membership Interest Purchase Agreement were negotiated on an arms'-length basis between MESC Capital and Mobile Energy Services Holdings, Inc. The Company did not participate in negotiations with respect to the Membership Interest Purchase Agreement.

The \$28,500,000 acquisition indebtedness was obtained from Allied Irish Banks, P.L.C., which may assign or participate the loan in accordance with the terms of the loan agreement. The loan will be amortized over the fifteen year term. In connection with the acquisition of the 50% membership interest in MESC Capital, Regency Power and DTE Mobile entered into an Operating Agreement, dated April 30, 2004, which sets forth their respective rights and obligations as members of MESC Capital as well as the duties and authority of DTE Mobile as the managing member of MESC Capital. Under the Operating Agreement, Regency Power will receive 50% of all distributions. Neither Regency Power nor DTE Mobile is obligated to contribute additional capital, or loan or otherwise advance funds, to MESC Capital, and neither member can sell or transfer its interest in MESC Capital without the consent of the other and without first complying with a right of first offer in favor of the non-selling member.

Pursuant to APB No. 18, the Company is accounting for this investment under the equity method of accounting. The accompanying statements of operations include the equity income from operations of MESC for the

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

period from April 30, 2004 (date of acquisition) through December 31, 2004.

F-13

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 4. Investment in LLC (Continued)

The following summarized income statement information is presented for MESC Capital, LLC for the period from April 30, 2004 (date of acquisition) to December 31, 2004 and its predecessor:

	Eight Months Ended December 31, 2004
Sales	\$ 9,231,830
Net operating income	\$ 2,297,719
Net Income	\$ 1,708,649

#### Note 5. Loan Receivable

On November 4, 2002, the Company paid \$200,000 to PNC Bank in settlement of closing costs that were the obligation of RCI Wood Products, Inc. ("RCI") as the buyer in connection with the sale of the operating assets of Rustic Crafts. In addition, fees and reimbursable expenses were added to the amount advanced, bringing the total amount receivable to \$250,000 at December 31, 2002. The loan was paid in full during 2003.

#### Note 6. Notes Receivable

Pursuant to the sale of the net operating assets of the Company's subsidiary, Rustic Crafts, on September 30, 2002, Rustic Crafts obtained

F-14

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

notes receivable. At December 31, 2003, these notes consisted of the following:

	2003
Note receivable, 5% per annum, with monthly payments of principal and interest of \$13,342, due 9/30/07	\$ 707,000
Note receivable, 7.5% per annum, with monthly payments of principal and interest of \$5,032, with a balloon payment due 9/8/06	422,271
Total	\$1,129,271

Payments on the 5% note are contingent upon the quarterly positive net cash flows of the buyer, as defined by generally accepted accounting principles. No payments have been made on this note as of December 31,

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

2003.

In March, 2004, these notes were deemed to be uncollectible due to the lack of cash flows generated and the continual default on payment terms by the issuer. Management determined to record full impairment of the notes which totaled \$1,182,626. This impairment is included in the General and Administrative caption of the accompanying Consolidated Statement of Operations.

### Note 7. Notes Payable - Other

To finance the redemption under the Redemption Agreement of October 16, 2002 whereby all shares owned by Statesman Group, Inc. ("Statesman") were redeemed, the Company issued two notes to Royalty Holdings, LLC ("Royalty"), an affiliate of current management, consisting of the following:

5% Convertible Promissory Note, due 10/16/12, accruing interest compounded annually	\$3,500,000
9% Promissory Note, due 10/16/07, accruing interest compounded annually	1,250,000
	-----
Total	\$4,750,000
	=====

On July 3, 2003, the remaining principal and accrued interest of \$2,075,475 on the 5% Convertible Promissory Note was converted for 1,037,738 shares of common stock at \$2 per share. The 9% Promissory Note was repaid during 2003. At December 31, 2003, the balances of these notes payable are \$0.

At December 31, 2002, the Company had outstanding \$130,036 of demand notes bearing interest at 7%, with interest payable every 120 days and at date of full repayment of principal. On July 23, 2003 the Company repaid the full \$130,036 balance plus accrued interest of \$8,337 thereon.

F-15

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

### Note 8. Long-Term Debt

KBC Bank Loan - On June 24, 1998, the Company refinanced the long-term debt previously outstanding with Southern Indiana Properties, Inc. ("SIPI") and entered into a Loan Agreement (the "Loan") with KBC Bank N.V. ("KBC"). Under the terms of the Loan Agreement, KBC advanced \$9,383,320. The due date of the Loan was November 30, 2003 with interest at the rate of 7.5% compounded semi-annually on each June 1 and December 1, commencing December 1, 1998. The interest could be paid by the Company in cash on these semi-annual dates or the Company could elect to add the interest to the principal of the Loan then outstanding. In June 2003, the Company repaid its long-term debt with KBC. The payoff amount was \$14,145,410, which included a release fee and make-whole premium. As of December 31, 2003, the amount outstanding under the Loan was \$0.

To facilitate the loan from KBC, the Company purchased a residual value insurance policy through R.V.I. American Insurance Company ("RVI") which secured the repayment of the outstanding principal and interest when due

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

with a maximum liability of \$14 million. The costs related to the insurance (\$745,000) along with legal fees and other costs associated with obtaining the Loan (\$205,000) were capitalized as debt issuance costs and were amortized over the life of the Loan using the effective interest method.

KBC Bank Loan - On June 24, 1998, the Company refinanced the long-term debt previously outstanding with Southern Indiana Properties, Inc. ("SIPI") and entered into a Loan Agreement (the "Loan") with KBC Bank N.V. ("KBC"). Under the terms of the Loan Agreement, KBC advanced \$9,383,320. The due date of the Loan was November 30, 2003 with interest at the rate of 7.5% compounded semi-annually on each June 1 and December 1, commencing December 1, 1998. The interest could be paid by the Company in cash on these semi-annual dates or the Company could elect to add the interest to the principal of the Loan then outstanding. In June 2003, the Company repaid its long-term debt with KBC. The payoff amount was \$14,145,410, which included a release fee and make-whole premium.

To facilitate the loan from KBC, the Company purchased a residual value insurance policy through R.V.I. American Insurance Company ("RVI") which secured the repayment of the outstanding principal and interest when due with a maximum liability of \$14 million. The costs related to the insurance (\$745,000) along with legal fees and other costs associated with obtaining the Loan (\$205,000) were capitalized as debt issuance costs and were amortized over the life of the Loan using the effective interest method.

### Note 9. Modification of Authorized Shares and Repurchase of Stock

On October 22, 2003 the Company's Board of Directors approved an amendment to the Company's Restated Certificate of Incorporation, as amended, to decrease the number of shares of authorized stock from 30,000,000 to 10,000,000 shares (consisting of 8,000,000 shares of common stock and 2,000,000 shares of preferred stock) and submitted such proposed amendment to the Company's stockholders. On October 22, 2003, Royalty Holdings LLC, the majority shareholder of the issued and outstanding shares of the Company, executed a written consent in favor of the amendment and the reduction in the number of authorized shares was enacted.

F-16

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

In September 2003, the Company's Board of Directors authorized the repurchase of the Company's common stock in the aggregate amount not to exceed \$1,000,000. The shares will be repurchased from time to time in open market transactions or privately negotiated transactions at the Company's discretion, subject to market conditions and other factors. Under the program, no shares will knowingly be purchased from the Company's officers or directors or from any such person's affiliates. On September 15, 2005, the Company Purchased 47,000 shares from an independent, third party at a price per share of \$6.25 (the market price). The total cost, including commission and transfer fees was \$295,635.

### Note 10. Serial Preferred Stock

At December 31, 2004 and 2003, the Company had 2,000,000 of authorized shares of \$.10 par value serial preferred stock (see Note 10). Serial preferred stock at December 31, 2004 and 2003, all of which is convertible

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

(other than Series C) and cumulative, consists of:

Mandatory Redeemable Shares - Series E, \$100 stated value, 12.5% cumulative, 566,400 designated, none issued or outstanding at December 31, 2004 and 2003

Redeemable Shares at Company's Option

	Shares		Value		
	Designated	Outstanding	Carrying	2004 Liquidation	Liq
Series C, \$100 stated value, cumulative	210,000	208,850	\$ 229,136	\$20,885,000	\$20
Series B, \$10 stated value, 6% cumulative	370,747	370,747	566,912	3,707,470	3
Junior Series, D, \$10 Stated value, 7% cumulative	26,000	25,694	256,940	382,842	
	606,747	605,291	\$ 1,052,988	\$24,975,312	\$24
	606,747	605,291	\$ 1,052,988	\$24,975,312	\$24

(a) This represents the estimated maximum possible liquidation value of the Series C preferred shares, which is defined as the lesser of: 1) net proceeds of the assets of NRDC or 2) the redemption value (defined below). In the event of liquidation, the Series C shares are senior to all other shares of the Company's stock, with the exception of the Series E shares.

(b) The liquidation value of the Junior Series D shares includes accrued and unpaid dividends of \$0 at December 31, 2002 and 2001.

Series C - The Series C shares were issued on July 7, 1993 as part of the transaction to acquire an 80% interest in NRDC. The cumulative dividend right is equal to 20% (not to exceed \$500,000) of annual after tax earnings of NRDC. At the Company's option, the Series C may be redeemed at the lesser of (a) the stated value plus accrued and unpaid dividends or (b) the fair market value of the common stock interest acquired by the Company in NRDC. At the Company's option, the redemption price may be satisfied by the delivery of the shares in NRDC owned by the Company.

Also, on October 16, 2002, the Company entered into agreements with Statesman providing for the amendment to the Company's Series C Preferred Stock and certain restrictions relating to Statesman's future ownership of an interest in the Company and Statesman's ability to issue or transfer beneficial interests in Statesman, in exchange for a payment to Statesman of \$2,730,000. The payment is recorded as a reduction in paid-in capital in the accompanying financial statements.

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 10. Serial Preferred Stock (continued)

Series B - The Series B shares were issued in 1991 as part of a restructuring plan limited to senior lenders and was issued in exchange for all obligations and any claims or causes of action relating to the Company's obligations and guarantees. Such preferred stock includes, among other provisions and preferences, the following:

(a) A 6% cumulative dividend right commencing on the 24th month from the consummation of a defined "initial business combination transaction" (which occurred with the acquisition of Rustic Crafts in 1997 (see Note 6)) and if the Company has reached a defined ratio of earnings to fixed charges. In addition, dividends accrue for a period of 35 additional months without cash payment.

(b) At the Company's option, the shares may be redeemed, subject to certain limitations, by cash payment or by exchanging shares of its common stock at 77% of its stated value divided by the quoted market value of its common stock.

(c) A contingent conversion provision which conversion right, and the Company common shares to be issued in connection with the conversion, would be based on the stated value divided by the average bid and asked price for the 90 days preceding the conversion date of the Company's common shares. In addition, the number of the Company's common shares to be received upon conversion is subject to certain limitations.

Junior Series D - The junior preferred stock was issued in 1992 in exchange for the Company's Restructuring Serial Promissory Notes. This preferred stock is redeemable, at the Company's option, at the stated value plus accrued and unpaid dividends and is contingently convertible into common at the fair market value of the common as determined by the average of the bid and asked price for the thirty (30) day period preceding the conversion date.

Generally, no dividends can be paid on the Company's common stock until all cumulative dividends on the serial preferred stock have been paid. Additionally, no dividends on the Company's common shares can be paid if the Company is in default or in arrears with respect to any sinking or analogous fund or any call or tenders or other agreement for the purchase, redemption or other retirement of shares of preferred stock. No provision for dividends has been made for the Company's Series B and C "increasing rate preferred stock," as defined in Staff Accounting Bulletin Topic 5Q, due to the contingent nature of dividends on such shares.

Generally the preferred shares have limited voting rights. However, in the event dividends payable on the Series C and E shares, respectively, are accumulated and unpaid for seven quarterly dividends (whether or not declared and whether or not consecutive), the holders of record of the Series C shares, shall thereafter have the right to elect two directors (each) until all arrears in required cash dividends (whether or not declared) on such shares have been paid.

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 11. Stock Options/Stock Option Plans

Effective June 3, 1997, the Company issued options to purchase 6.1 million (pre-2002 10-1 reverse split) shares of common stock to Statesman Group, Inc. The options were issued to Statesman in order to secure the release of Mr. William R. Ponsoldt, Sr. to serve as President and Chief Executive Officer of the Company and to recognize in part, the amendment to the Series C preferred shares under which Statesman forfeited certain common stock conversion rights with respect thereto. Statesman also agreed to provide loan guarantees not to exceed the sum of \$300,000 upon the request of the Company and a showing of reasonable need. Statesman and/or its affiliated interests have provided loan guarantees and/or unsecured prime interest rate direct loans to the Company exceeding \$2,000,000 since June 1997.

On October 15, 2001 the Statesman Group, Inc. (Statesman) exercised in full its option, which had been granted in 1997, to acquire 610,000 post-reverse-split shares of the Company's common stock. The exercise was made pursuant to an agreement which provided for (1) a purchase price at \$0.40 per share (par value) rather than the formula price in the option, which would have yielded 25% less to the Company, (2) the execution of a note from Statesman to the Company in the principal amount of \$2,440,000 payable in five years with interest to accrue at the prevailing prime rate and (3) the obligation to be collateralized by the 610,000 post-reverse-split common shares of the Company purchased upon exercise of the option as well as the 20% remaining interest in the Company's 80% owned subsidiary, NRDC.

On October 16, 2002, the Company redeemed the 754,950 shares of common stock of the Company owned by Statesman for \$1,020,000. As a result of such transaction, Statesman is no longer a related party. The excess over par value of these shares was treated as a charge against additional paid-in capital in the accompanying financial statements. The number of shares above that were cancelled and returned to treasury stock were 0 and 45,208 in 2004 and 2003, respectively.

Also, the Company acquired from Statesman a three-year option to acquire Statesman's 20% interest in NRDC exercisable by delivery to Statesman of the aforementioned \$2,440,000 note. The Company acquired the option by paying Statesman \$250,000, amending the note (and underlying pledge agreement) to limit recourse and transferring to Statesman certain office furniture and equipment. The payment has been recorded as a deferred cost in the accompanying financial statements.

In 2003, the Company issued 190,000 non-qualified common stock options, as follows: 30,000 at a per share exercise price of \$2.40, one-third of which become exercisable on December 31, 2003, 2004 and 2005, respectively, through March 31, 2013; 50,000 at a per share exercise price of \$1.35, as amended, exercisable through April 3, 2013; 110,000 at a per share exercise price of \$1.53, exercisable through October 1, 2013. All issuances are pursuant to the Company's 2003 Stock Incentive Plan, as amended.

On August 13, 2004, the Company issued 100,000 non-qualified common stock options, 50,000 each to Messrs. Levy and Hasson, directors of the Company at a per share exercise price of \$2.01, immediately exercisable through June 10, 2014. These issuances are pursuant to the Company's 2003 Stock Incentive Plan, as amended.

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

In 2002, the Company issued 5,000 non-qualified common stock options at a per share exercise price of \$1.60 (2002 options), in accordance with a Director's Compensation Program approved by the shareholders in 1999. The 2002 options are fully vested, and are exercisable until August 5, 2007.

F-19

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 11. Stock Options/Stock Option Plans (continued)

The Company applies Accounting Principles Board Opinion No. 25 and related Interpretations in accounting for options. The Company has elected to treat these option awards to directors as employee based compensation and therefore has not recorded the estimated value of these options in the accompanying statement of operations. The fair value of the Company's stock-based compensation to directors was estimated using the Black-Scholes option pricing model. The Black-Scholes model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, the Black-Scholes model requires the input of highly subjective assumptions including the expected stock price volatility. The Company's stock-based compensation has characteristics significantly different from those traded options and changes in the subjective input can materially affect the fair value estimate. The fair value of the Company's stock awards was estimated assuming the following assumptions: no expected dividends, risk free interest rate of 3.5% expected average life of approximately 0.5 to 9.75 years and expected stock price volatility of 90% in 2004 and 90% in 2003. The weighted average fair value of options granted was \$5.57 during 2003 and \$1.14 during 2002.

Had compensation cost for the options been determined based on the fair value at the grant dates for the awards, net income and net income per common share basic and diluted would have been as follows for 2004:

	As Reported	ProForma
Net income	(1,323,570)	(1,894,570)
Net income attributable to common shares	(1,323,500)	(1,894,570)
Net income per common share:		
Basic and diluted	(.44)	(.61)

The following is a summary of the status of the Company's options for 2004:

	Options	Average Exercise Price
Outstanding at beginning of year	220,000	\$ 2.29
Issued	100,000	2.01
Cancelled	--	--
Outstanding at end of year	320,000	2.20

The following table summarizes information about options outstanding at December 31, 2004:

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Number of outstanding and exercisable	320,000 shares
Average remaining contractual life	7.66 years
Exercise price	2.20 per share

F-20

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 11. Stock Options/Stock Option Plans (continued)

Had compensation cost for the options been determined based on the fair value at the grant dates for the awards, net income and net income per common share basic and diluted would have been as follows for 2003:

	As Reported	ProForma
Net income	\$ (2,318,340)	\$ (3,459,240)
Net income attributable to common shares	(2,318,340)	(3,459,240)
Net income per common share:		
Basic and diluted	(0.93)	(1.38)

The following is a summary of the status of the Company's options for 2003:

	Options	Average Exercise Price
Outstanding at beginning of year	30,000	\$6.51
Issued	190,000	1.62
Cancelled	--	--
Outstanding at end of year	220,000	2.29

The following table summarizes information about options outstanding at December 31, 2003:

Number of outstanding and exercisable	200,000	shares
Average remaining contractual life	7.66	years
Exercise price	2.29	per share

#### Note 12. Income Taxes

As referred to in Note 1, the Company accounts for income taxes under SFAS 109, "Accounting for Income Taxes." The deferred taxes are the result of long-term temporary differences between financial reporting and tax reporting for depreciation, earnings from the Company's partnership investment in Security Land and Development Company Limited Partnership related to depreciation and amortization and the recognition of income tax carryforward items.

At December 31, 2004 and 2003, the Company's net deferred tax asset, utilizing a 34% effective tax rate, respectively, consists of:

2004	2003
-----	-----

Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Deferred tax assets:

Investment partnership earnings	\$	\$ 1,461,000
Net operating loss carry forward		942,500
Alternative minimum tax credits		493,000
Unrealized appreciation of marketable securities		(22,000)
Valuation allowance		(2,874,500)
	-----	-----
Subtotal	\$ --	\$ --
	=====	=====

F-21

Regency Affiliates, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements

Note 12. Income Taxes (continued)

The valuation allowance was established to reduce the net deferred tax asset to the amount that will more likely than not be realized. This reduction is necessary due to uncertainty of the Company's ability to utilize the net operating loss and tax credit carry forwards before they expire.

For regular federal income tax purposes, the Company has remaining net operating loss carryforwards of approximately (\$4,370,000). These losses can be carried forward to offset future taxable income and, if not utilized, will expire in varying amounts beginning in the year 2004. The Company's tax returns have not recently been examined by the Internal Revenue Service ("Service") and there is no assurance that the Service would not attempt to limit the Company's use of its net operating loss and tax credit carryforwards.

For the years ended December 31, 2004 and 2003, the tax effect of net operating loss carryforwards reduced the current provision for regular Federal income taxes by approximately \$1,388,616 and \$942,500, respectively. At December 31, 2004 and 2003, the Company has provided \$41,945 and \$70,724, respectively, for taxes, which relate to state income taxes.

The provision (benefit) for income taxes is as follows

	2004	2003
	-----	-----
Current	\$ 41,945	\$ 70,724
Deferred	--	--
	-----	-----
	\$ 41,945	\$ 70,724
	=====	=====

Note 13. Employment Agreements

On June 3, 1997, the Company entered into an Employment Agreement with William R. Ponsoldt, Sr., which provided for a base salary in annual installments, in advance, of \$250,000 each, which salary was adjusted on January 1 of every year by any increase since the previous January 1 in the Consumer Price Index ("CPI") for All Urban Consumers, U.S. city average, as published by the U. S. Department of Labor Bureau of Labor

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Statistics. As additional salary, Mr. Ponsoldt was entitled to receive an amount equal to 20% of the Company's increase in quarterly common stock net worth, which is defined to be the difference between (i) total shareholders' equity and (ii) any shareholders' equity accounts relating to preferred stock. During 2003, the Company settled the amount due Mr. Ponsoldt by payment through payroll of accrued wages of \$1,225,234, which included a reduction of \$250,000 from the amount offered under the Contingent Payment Agreement (see Note 15.). The Agreement provides that Mr. Ponsoldt will not compete with the Company for a two-year period following the termination of his employment and provides for indemnification under certain circumstances. On October 16, 2002, Mr. Ponsoldt resigned his position as director of the Company, and thereby terminated the Employment Agreement. Any disputes between the Company and Mr. Ponsoldt under the Agreement are to be resolved through arbitration.

In connection with the redemption of Statesman's interest, each of the Company's directors resigned effective October 28, 2002 with successors appointed by Royalty, the holder of certain notes payable (Note 8). Simultaneously, all officers of the Company resigned and were replaced by Laurence S. Levy (an affiliate of Royalty) as CEO and Neil Hasson (an affiliate of Royalty) as CFO and Secretary. On October 16, 2002, the Company entered into Employment Agreements with Mr. Levy and Mr. Hasson, with terms as follows:

F-22

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 13. Employment Agreements (continued)

Laurence S. Levy - base annual salary of no less than \$150,000 per annum, discretionary annual bonus, options to purchase 25,000 shares of common stock at an exercise price of \$1.35 per share, benefits, expense reimbursement and insurance (including, but not limited to, life, travel accident, health).

Neil Hasson - base annual salary of no less than \$50,000 per annum, discretionary annual bonus, options to purchase 25,000 shares of common stock at an exercise price of \$1.35 per share, benefits, expense reimbursement and insurance (including, but not limited to, life, travel accident, health).

On November 22, 2002, Mr. Hasson resigned as Secretary of the Corporation and the position was filled by Carol Zelinski.

#### Note 14. Related Party Transactions

On July 3, 2003, Royalty, the holder of a \$2,004,098 5% Convertible Promissory Note of the Company due October 16, 2012 (the "Note"), elected to convert the principal amount of the Note and the \$71,377 of accrued and unpaid interest thereon into 1,037,738 shares of the Company's Common Stock. Royalty is an affiliate of Laurence S. Levy and Neil N. Hasson, directors and executive officers of the Company. Also on July 3, 2003, the Company prepaid the full \$1,250,000 principal amount of, and all accrued and unpaid interest under, the 9% Promissory Note held by Royalty in accordance with the mandatory prepayment provisions of such note. The Company also repaid all amounts outstanding under the \$300,000 working capital loan facility from Royalty which was established in April 2003, and terminated the facility. This amount consisted of \$180,000 of

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

principal and \$2,910 of accrued and unpaid interest.

In September 2003, Royalty advanced \$90,000 to the Company under an existing credit facility. The Company repaid this advance and the accrued interest thereon of \$2,584. At December 31, 2004, there are no advances due to Royalty from the Company.

Pursuant to a License Agreement entered into in March 2003, Royalty Management, Inc., which is wholly-owned by Laurence Levy, the Company's President and a director, provides New York City office space, office supplies and services to the Company for \$100,000 per year.

Beginning with the fiscal quarter ended March 31, 2003, each non-employee director is granted 250 shares of Common Stock at the end of each full calendar quarter for which such individual has served as a director of the Company. Compensation expense of \$6,350 has been recognized for issuances for the year ended December 31, 2004.

F-23

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 14. Related Party Transactions (Continued)

On October 16, 2002, the Company redeemed all the shares of common stock of the Company owned by Statesman pursuant to the terms of a Redemption Agreement, dated October 16, 2002, between the Company and Statesman.

The Company funded the redemption from the proceeds of an aggregate of \$4,750,000 borrowed from Royalty Holdings, LLC (the "Lender"), an affiliate of Messrs. Levy and Hasson, in exchange for two notes - a \$3,500,000 5% Convertible Promissory Note due October 16, 2012 and a \$1,250,000 9% Promissory Note due October 16, 2007. Both notes allowed interest to accrue without current payment. The principal and interest under the Convertible Promissory Note were convertible into Common Stock at a conversion rate of \$2.00 per share. On November 7, 2002, the Lender converted \$1,495,902 of the principal amount of the Convertible Promissory Note plus accrued interest into 750,000 shares of Common Stock. During 2003, the remaining principal and accrued interest were converted (see first paragraph of this Note). At December 31, 2003, the balances of these notes payable are \$0.

In connection with the redemption, effective October 28, 2002, each of the former directors of the Company resigned and the four current directors were appointed to serve as the successor members of the Board of Directors. In addition, simultaneously with the redemption, all of the officers of the Company resigned and were replaced by designees of the Lender.

In connection with the redemption, the Company acquired from Statesman a three-year option to purchase the 20% stock interest in NRDC held by Statesman. To exercise the option, the Company must deliver to Statesman for cancellation the \$2.44 million note issued to the Company by Statesman in October 2001. As consideration for the option, the Company (i) paid Statesman \$250,000, (ii) amended the note and related pledge agreement to limit the Company's recourse under the note and (iii) transferred to Statesman certain office furniture and equipment owned by the Company.

In connection with the redemption, the Company entered into a Contingent

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

Payment Agreement with William R. Ponsoldt, Sr., the former President and Chief Executive Officer of the Company, whereby payment of \$1,508,000 of accrued compensation owed to Mr. Ponsoldt by the Company became subject to the satisfaction of certain conditions precedent. The Company also entered into an agreement with Statesman providing for (i) an amendment to the Certificate of Designations of the Series C Preferred Stock for the Company and (ii) certain limitations on the ability of Statesman to issue or transfer shares or other beneficial interests in Statesman or to sell, transfer, purchase or acquire any capital stock of the Company, in each case without first receiving written confirmation from the Company that such issuance or transfer would not adversely affect the Company's ability to utilize its net operating loss carryforwards. The Company paid Statesman an aggregate amount of \$2,730,000 in consideration of the foregoing agreements.

See Note 13 for a description of Employment Agreements entered into with certain current and past members of the Company's management and Note 11 for a description of certain option grants and related transactions.

F-24

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 15. Contingencies, Risks and Uncertainties

The Company is subject to numerous contingencies, risks and uncertainties including, but not limited to, the following that could have a severe impact on the Company:

(i) The Company currently lacks the necessary infrastructure at the site of the Groveland Mine in order to permit the Company to make more than casual sales of the aggregate (See Note 1.H).

(ii) A default in the Lease or sudden catastrophe to the Security West Building from uninsured acts of God or war could have a materially adverse impact upon the Company's investment in Security Land and Development Company Limited Partnership and, therefore, its financial position and results of operations (See Note 4).

(iii) On January 20, 2004, a purported derivative and class action lawsuit (the "Delaware State Action") was filed by two dissident Company shareholders, Edward E. Gatz and Donald D. Graham, in the New Castle County Court of Chancery, Delaware, captioned Gatz et al. v. Ponsoldt, Sr., et al, naming as defendants certain current and former directors of the Company, Royalty and certain of its affiliates, Statesman and, nominally, the Company. The complaint alleges, among other things, breaches of fiduciary duties by the former director defendants and Statesman in connection with (i) the exercise by Statesman in 2001 of an option to acquire shares of the Company's common stock, (ii) the 2001 sale of rock aggregate by the Company to Iron Mountain and (iii) the October 2002 Restructuring Transactions. The complaint also alleges breaches of fiduciary duties by the current director defendants in connection with the payment by the Company in 2003 of accrued compensation owed to William R. Ponsoldt, Sr. for periods prior to the October 2002 Restructuring Transactions. The complaint also alleges that Royalty and its affiliates knowingly participated in the breaches of fiduciary duties by the former director defendants relating to the October 2002 Restructuring Transactions. In addition to other

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

damages, plaintiffs seek unspecified compensatory and/or rescissory damages against all defendants, a declaration that all Company stock issued to Statesman, William R. Ponsoldt, Sr., Royalty and any person affiliated with the foregoing is void, an order rescinding any payments in any form made by the Company to William R. Ponsoldt, Sr. or any of his affiliates or family members, an order rescinding the October 2002 Restructuring Transactions, and an order rescinding Statesman's 2001 option exercise and rescinding the option itself. The Company, as a nominal defendant, has not taken any position with respect to the merits of the Delaware State Action. Each of the other defendants has moved to dismiss the Delaware State Action and these motions are pending.

The defendants in the Delaware State Action, other than Statesman, are entitled to be indemnified by the Company for damages, if any, and expenses, including legal fees, they may incur as a result of the lawsuit, subject to certain circumstances under which such indemnification is not available. In addition, other than with respect to the claims against the current director defendants in their capacities as such, the claims contained in the Delaware State Action are not covered by insurance, as the Company's carrier has declined coverage on the basis of the "insured vs. insured" exclusion since one of the named plaintiffs, Donald D. Graham, was previously a director of the Company. The Company has submitted a claim to its carrier with respect to the claims in the Delaware State Action against the current director defendants. No assurance can be given as to the position that the carrier will take with respect to such claims.

F-25

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 15. Contingencies, Risks and Uncertainties (Continued)

(iv) The Company has significant tax loss and credit carryforwards and no assurance can be provided that the Internal Revenue Service would not attempt to limit or disallow altogether the Company's use, retroactively and/or prospectively, of such carryforwards, due to ownership changes or any other reason. The disallowance of the utilization of the Company's net operating loss would severely impact the Company's financial position and results of operations due to the significant amounts of taxable income (generated by the Company's investment in Security) that has in the past been, and may in the future be, offset by the Company's net operating loss carryforwards (See Note 13).

(v) Royalty, an affiliate of the company's management, beneficially owns approximately 60% of the Company's common stock. As a result, Royalty has the ability to control the outcome of all matters requiring shareholder approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of the Company's assets.

(vi) The Company does not expect to pay dividends in the foreseeable future.

(vii) There are many public and private companies that are also searching for operating businesses and other business opportunities

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

as potential acquisition or merger candidates. The Company will be in direct competition with these other companies in its search for business opportunities. Many of these entities have significantly greater financial and personnel resources than the Company.

### Note 16. Lease Commitments

Regency leases office space and is committed to minimum lease payments through June 30, 2007 under an operating lease for premises, as follows:

2005	17,630
2006	18,511
2007	9,481
	-----
Total	45,622
	=====

Rent expense was \$16,790 and \$14,691 for the years ended December 31, 2004 and 2003, respectively.

F-26

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

### Note 17. Litigation

On January 20, 2004, a purported derivative and class action lawsuit was filed by two individual shareholders of the Company in the New Castle County Court of Chancery, Delaware (the "Court"), naming as defendants certain current and former directors of the Company, Royalty Holdings LLC and certain of its affiliates, Statesman Group, Inc. and, nominally, the Company. The complaint alleges, among other things, breaches of fiduciary duties by the former director defendants and Statesman Group, Inc. in connection with (i) the exercise by Statesman Group, Inc. in 2001 of an option to acquire shares of common stock of the Company, (ii) the 2001 sale of rock aggregate by the Company to Iron Mountain Resources, Inc. and (iii) the October 2002 recapitalization of the Company. The complaint also alleges breaches of fiduciary duties by the current director defendants in connection with the payment by the Company in 2003 of accrued compensation owed to William R. Ponsoldt, Sr. for periods prior to the October 2002 recapitalization of the Company. The complaint also alleges that Royalty Holdings LLC and its affiliates knowingly participated in the breaches of fiduciary duties by the former director defendants relating to the October 2002 recapitalization of the Company.

In addition to other damages, plaintiffs seek unspecified compensatory and/or rescissory damages against all defendants, a declaration that all Company stock issued to Statesman Group, Inc., William R. Ponsoldt, Sr., Royalty Holdings LLC and any person affiliated with the foregoing is void, an order rescinding any payments in any form made by the Company to William R. Ponsoldt, Sr. or any of his affiliates or family members, an order rescinding the October 2002 recapitalization of the Company, and an order rescinding Statesman Group, Inc.'s 2001 option exercise and rescinding the option itself.

F-27

## Edgar Filing: REGENCY AFFILIATES INC - Form 10KSB

### Regency Affiliates, Inc. and Subsidiaries Notes to Consolidated Financial Statements

#### Note 17. Litigation (Continued)

The defendants in the lawsuit other than Statesman Group, Inc. are entitled to be indemnified by the Company for damages, if any, and expenses, including legal fees, they may incur as a result of the lawsuit, subject to certain circumstances under which such indemnification is not available. In addition, other than with respect to the claims against the current director defendants in their capacities as such, none of the claims contained in the lawsuit are covered by insurance, as the Company's carrier has declined coverage on the basis of the "insured vs. insured" exclusion since one of the named plaintiffs, Donald D. Graham, was previously a director of the Company.

On May 10, 2004, Gary Nuttall, a former President of the Company, commenced an arbitration against the Company with respect to certain claims allegedly arising under his 1995 Employment Agreement with the Company. He is seeking severance and all other compensation and benefits due him under the 1995 Employment Agreement in an amount in excess of approximately \$1,650,000 (\$1,400,000 of which is a financing bonus), 466,667 unrestricted shares of the Company (pre-split), options to purchase additional stock of the Company, punitive damages, interest, fees and costs associated with the arbitration. The Company believes the claims are without merit and intends to defend them vigorously.

#### Note 18. Commitments and Contingencies

Pursuant to the Regency Power's acquisition of a 50% membership interest in MESC Capital, LLC (see Note 7), the Company contracted with an unaffiliated investment consulting firm to provide advisory services in connection with negotiation of the acquisition. Under the contract, the Company incurred success fees of \$350,000, of which \$150,000 was paid during the nine months ended September 30, 2004. The balance of these fees of \$200,000 are due and payable on March 31, 2005, provided, however, that such \$200,000 installment shall no longer be due and payable if, on or prior to March 31, 2005, the Energy Services Agreement between Mobile Energy Services Company, LLC and Kimberly-Clark shall have been terminated for any reason. In accordance with Statement of Financial Accounting Standards No. 5, the amount of the gain, if any, that may be ultimately realized from reversal of this provision has not been reflected in the accompanying financial statements.

F-28