

UNITED BANCORPORATION OF ALABAMA INC

Form 10-Q

May 15, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2006  
Commission file number 2-78572  
UNITED BANCORPORATION OF ALABAMA, INC.**

(Exact name of registrant as specified in its charter)

Delaware

63-0833573

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification Number)

200 East Nashville Avenue, Atmore, Alabama

36502

(Address of principal executive offices)

(Zip Code)

(251) 446-6000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of May 5, 2006.

Class A Common Stock.... 2,226,440 Shares

Class B Common Stock.... -0- Shares

**UNITED BANCORPORATION OF ALABAMA, INC.**

**FORM 10-Q**

For the Quarter Ended March 31, 2006

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**United Bancorporation of Alabama, Inc.  
and Subsidiary  
Consolidated Balance Sheets  
(Unaudited)**

|   | March 31,<br>2006<br>Unaudited | December 31,<br>2005<br>Audited |
|---|--------------------------------|---------------------------------|
| Assets:   |                                |                                 |
| Cash and due from banks   | \$ 18,885,368                  | \$ 20,876,806                   |
| Federal funds sold  | 7,114,204                      | 29,990,037                      |
| Cash and cash equivalents   | 25,999,572                     | 50,866,843                      |
| Securities available for sale (amortized cost of \$75,718,951 and \$71,770,277 respectively)                | 74,474,440                     | 70,932,624                      |
| Loans   | 238,610,283                    | 230,310,857                     |
| Allowance for loan losses   | 3,210,126                      | 3,028,847                       |
| Net loans   | 235,400,157                    | 227,282,010                     |
| Premises and equipment, net   | 10,905,201                     | 9,849,934                       |
| Interest Receivable   | 2,841,486                      | 3,073,531                       |
| Intangible Assets   | 917,263                        | 917,263                         |
| Other Assets  | 6,723,123                      | 6,907,554                       |
| Total assets  | 357,261,242                    | 369,829,759                     |
| Liabilities and Stockholders Equity:  |                                |                                 |
| Deposits:   |                                |                                 |
| Non-interest bearing  | 65,147,849                     | 66,774,418                      |
| Interest bearing  | 210,560,244                    | 224,246,053                     |
| Total deposits  | 275,708,093                    | 291,020,471                     |
| Securities sold under agreements to repurchase  | 39,977,355                     | 34,429,374                      |
| Advances from Federal Home Loan Bank of Atlanta   | 7,055,465                      | 9,112,915                       |
| Treasury, tax, and loan account   | 61,357                         | 1,001,000                       |
| Accrued expenses and other liabilities  | 1,810,269                      | 2,468,890                       |
| Note payable to Trust, net of debt issuance costs of \$118,725 and \$121,251 in 2006 and 2005, respectively | 4,005,275                      | 4,002,749                       |
| Total liabilities   | 328,617,814                    | 342,035,399                     |
| Stockholders equity:  |                                |                                 |

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|  |                |                |
|--|----------------|----------------|
| Class A common stock, \$0.01 par value. Authorized 5,000,000 shares; issued and outstanding, 2,366,871 and 2,366,871 shares in 2006 and 2005, respectively | 23,669         | 23,669         |
| Class B common stock, \$0.01 par value. Authorized 250,000 shares; no shares issued or outstanding   | 0              | 0              |
| Preferred stock of \$.01 par value. Authorized 250,000 shares; no shares issued or outstanding   | 0              | 0              |
| Additional paid in capital   | 5,461,663      | 5,445,822      |
| Accumulated other comprehensive income (loss), net of tax  | (756,416)      | (512,299)      |
| Retained earnings  | 24,682,328     | 23,642,879     |
|  | 29,411,244     | 28,600,071     |
| Less: 140,431 and 143,301 treasury shares, at cost, respectively   | 767,816        | 805,711        |
| Total stockholders' equity   | 28,643,428     | 27,794,360     |
| Total liabilities and stockholders' equity   | \$ 357,261,242 | \$ 369,829,759 |

See Notes to Consolidated Financial Statements

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**United Bancorporation of Alabama, Inc.  
And Subsidiary  
Consolidated Statements of Earnings  
and Comprehensive Income  
(Unaudited)**

|   | Three Months Ended<br>March |              |
|---|-----------------------------|--------------|
|   | 2006                        | 2005         |
| Interest income:                                      |                             |              |
| Interest and fees on loans                            | \$ 4,711,930                | \$ 3,293,351 |
| Interest on investment securities available for sale: |                             |              |
| Taxable   | 521,067                     | 382,672      |
| Nontaxable  | 295,339                     | 246,810      |
| Total investment income                               | 816,406                     | 629,482      |
| Other interest income                                 | 227,584                     | 158,655      |
| Total interest income                                 | 5,755,920                   | 4,081,488    |
| Interest expense:                                     |                             |              |
| Interest on deposits                                  | 1,386,131                   | 913,426      |
| Interest on other borrowed funds                      | 512,737                     | 140,912      |
| Total interest expense                                | 1,898,868                   | 1,054,338    |
| Net interest income                                   | 3,857,052                   | 3,027,150    |
| Provision for loan losses                             | 240,000                     | 195,000      |
| Net interest income after provision for loan losses   | 3,617,052                   | 2,832,150    |
| Noninterest income:                                   |                             |              |
| Service charge on deposits                            | 632,217                     | 507,968      |
| Commission on credit life                             | 10,835                      | 6,151        |
| Investment securities gains (losses), net             | (8,765)                     | 0            |
| Other   | 406,477                     | 187,198      |
| Total noninterest income                              | 1,040,764                   | 701,317      |
| Noninterest expense:                                  |                             |              |
| Salaries and benefits                                 | 1,795,761                   | 1,530,575    |
| Net occupancy expense                                 | 516,198                     | 493,376      |
| Other   | 926,986                     | 664,174      |

|   |              |              |
|---|--------------|--------------|
| Total noninterest expense   | 3,238,945    | 2,688,125    |
| Earnings before income tax expense                                    | 1,418,871    | 845,342      |
| Income tax expense  | 377,338      | 193,078      |
| Net earnings  | \$ 1,041,533 | \$ 652,264   |
| Basic earnings per share  | \$ 0.47      | \$ 0.29      |
| Diluted earnings per share  | \$ 0.47      | \$ 0.29      |
| Basic weighted average shares outstanding                             | 2,225,897    | 2,217,330    |
| Diluted weighted average shares outstanding                           | 2,232,933    | 2,219,679    |
| Cash dividend per share   | \$           | \$           |
| Statement of Comprehensive Income                                     |              |              |
| Net Earnings  | \$ 1,041,533 | \$ 652,264   |
| Other Comprehensive Income, net of tax:                               |              |              |
| Unrealized holding gain (loss) arising during the period              | (244,117)    | (903,642)    |
| Less: Reclassification adjustment for losses included in net earnings | (5,259)      |              |
| Comprehensive income (loss)   | \$ 802,675   | \$ (251,378) |

See Notes to Consolidated Financial Statements

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**UNITED BANCORPORATION OF ALABAMA, INC.  
AND SUBSIDIARY**

Consolidated Statements of Cash Flows  
for the Three Months Ended March 31, 2006 and 2005  
(Unaudited)

|   | <b>2006</b>     | <b>2005</b>     |
|---|-----------------|-----------------|
| Cash flows from operating activities  |                 |                 |
| Net earnings  | \$ 1,041,533    | \$ 652,264      |
| Adjustments to reconcile net earnings to net cash provided by operating activities                    |                 |                 |
| Provision for loan losses   | 240,000         | 195,000         |
| Depreciation of premises and equipment  | 243,981         | 231,722         |
| Net amortization of premium on investment securities  | 24,954          | 48,851          |
| Losses on sales of investment securities available for sale, net                                      | 8,765           |                 |
| Loss (gain) on sale of other real estate  | (12,501)        | (2,776)         |
| Gain on disposal of equipment   | (3,987)         |                 |
| Deferred income taxes (benefit)   | 162,743         |                 |
| Decrease in interest receivable   | 232,045         | 105,414         |
| Increase in other assets  | (14,656)        |                 |
| Increase in accrued expenses and other liabilities  | (250,375)       | 204,042         |
| Net cash provided by operating activities   | 1,672,502       | 1,434,517       |
| Cash flows from investing activities  |                 |                 |
| Proceeds from maturities, calls, and principal repayments of investment securities available for sale | 3,673,071       | 2,641,445       |
| Proceeds from sales of investment securities available for sale                                       | 1,743,150       |                 |
| Purchases of investment securities available for sale   | (9,398,615)     | (20,738,121)    |
| Net increase in loans   | (8,358,147)     | (4,008,891)     |
| Purchases of premises and equipment, net  | (1,313,822)     | (186,154)       |
| Proceeds from sale of premises and equipmet   | 24,832          |                 |
| Proceeds from sale of other real estate   | 177,501         | 11,776          |
| Net cash used in investing activities   | \$ (13,452,030) | \$ (22,279,945) |
| Cash fows from financing activities   |                 |                 |
| Net decrease in deposits  | \$ (15,312,378) | \$ (2,962,479)  |
| Net increase in securities sold under agreements to repurchase  | 5,547,981       | 6,028,083       |
| Cash dividends  | (377,904)       |                 |
| Purchase of treasury stock  |                 | (8,260)         |
| Proceeds from sale of treasury stock  | 51,652          |                 |
| Repayments of advances from FHLB Atlanta  | (2,057,450)     |                 |
| Increase (decrease) in other borrowed funds   | (939,643)       | 214,066         |
| Net cash provided by (used in) financing activites  | (13,087,742)    | 3,271,410       |



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|  |               |               |
|--|---------------|---------------|
| Net decrease in cash and cash equivalents                  | (24,867,271)  | (17,574,018)  |
| Cash and cash equivalents, beginning of year               | 50,866,843    | 43,941,000    |
| Cash and cash equivalents, end of year                     | \$ 25,999,572 | \$ 26,366,982 |
| Supplemental disclosures                                   |               |               |
| Cash paid during the year for:                             |               |               |
| Interest   | \$ 1,919,322  | \$ 1,025,007  |
| Income taxes   | 585,000       | 138,000       |
| Noncash transactions                                       |               |               |
| Transfer of loans to other real estate through foreclosure |               | 301,001       |

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UNITED BANCORPORATION OF ALABAMA, INC.  
AND SUBSIDIARY  
Notes to Condensed Consolidated Financial Statements

NOTE 1 General

This report includes interim consolidated financial statements of United Bancorporation of Alabama, Inc. (the Corporation or the Company ) and its wholly-owned subsidiary, United Bank (the Bank ). The interim consolidated financial statements in this report have not been audited. In the opinion of management, all adjustments necessary to present fairly the financial position and the results of operations for the interim periods have been made. All such adjustments are of a normal recurring nature. The results of operations are not necessarily indicative of the results of operations for the full year or any other interim periods. For further information, refer to the consolidated financial statements and footnotes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

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## NOTE 2 Net Earnings per Share

Basic net earnings per share were computed by dividing net earnings by the weighted average number of shares of common stock outstanding during the three month periods ended March 31, 2006 and 2005. Common stock outstanding consists of issued shares less treasury stock. Diluted net earnings per share for the three month periods ended March 31, 2006 and 2005 were computed by dividing net earnings by the weighted average number of shares of common stock and the dilutive effects of the shares subject to options awarded under the Company's Stock Option Plan, based on the treasury stock method using an average fair market value of the stock during the respective periods. Presented below is a summary of the components used to calculate diluted earnings per share for the three months ended March 31, 2006 and 2005:

|   | Three Months Ended<br>March 31 |           |
|---|--------------------------------|-----------|
|   | 2006                           | 2005      |
| Diluted earnings per share  | \$ 0.47                        | \$ 0.29   |
| Weighted average common shares outstanding  | 2,225,897                      | 2,217,330 |
| Effect of the assumed exercise of stock options based on the treasury stock method using average market price | 7,036                          | 2,349     |
| Total weighted average common shares and potential common stock outstanding                                   | 2,232,933                      | 2,219,679 |

## NOTE 3 Allowance for Loan Losses

The following table summarizes the activity in the allowance for loan losses for the three month periods ended March 31 (\$ in thousands):

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|                              | March 31 |       |
|------------------------------|----------|-------|
|                              | 2006     | 2005  |
| Balance at beginning of year | 3,029    | 2,562 |
| Provision charged to expense | 240      | 195   |
| Less Loans charged off       | 77       | 120   |
| Recoveries                   | 18       | 17    |
| Balance at end of period     | 3,210    | 2,654 |

At March 31, 2006 and 2005, the amounts of nonaccrual loans were \$2,219,662 and \$987,402, respectively.

**NOTE 4 Operating Segments**

Statement of Financial Accounting Standard 131 (SFAS 131), *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the disclosure made by public business enterprises to report information about operating segments in annual financial statements and requires those enterprises to report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. The Corporation operates in only one segment commercial banking.

**NOTE 5 Stock Based Compensation**

At March 31, 2006, the Company had one stock-based compensation plan, which is described more fully in Note 12 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2005. Effective January 1, 2006, the Company adopted SFAS No. 123 (revised), *Share-Based Payment* ( SFAS 123(R) ) utilizing the modified prospective approach. Prior to the adoption of SFAS 123(R) the Company accounted for stock-based compensation grants in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* (the intrinsic value method), and accordingly recognized no compensation expense for stock-based compensation grants.

Under the modified prospective approach, SFAS 123(R) applies to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. Under the modified prospective approach, compensation cost recognized in the first quarter of 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with

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the provisions of SFAS 123(R). Prior periods were not restated to reflect the impact of adopting the new standard. Grant-date fair value is measured on the date of grant using option-pricing models with market assumptions. The grant-date fair value is amortized into expense on a straight-line basis over the vesting period. Option pricing models require the use of highly subjective assumptions, including but not limited to, expected stock price volatility, forfeiture rates, and interest rates, which if changed can materially affect fair value estimates. Accordingly the model does not necessarily provide a reliable single measure of the fair value of our stock options.

As a result of adopting SFAS 123(R) on January 1, 2006, net income for the three months ended March 31, 2006, was approximately \$3,000 lower than if the Company had continued to account for stock-based compensation under APB opinion No. 25 for stock option grants. Basic and diluted earnings per share for the three months ended March 31, 2006 were not affected by the adoption of SFAS 123(R).

The following table provides pro forma net income and earnings per share information, as if the Company had applied the fair value recognitions provisions of SFAS No. 123, Accounting for Stock Based Compensation ( SFAS 123 ) to stock-based employee compensation option plans for the three months ended March 31, 2005:

|  |                           |
|--|---------------------------|
| Net earnings, as reported  | <b>2005</b><br>\$ 652,264 |
| Deduct:  |                           |
| Total stock-based employee compensation expense determined under fair value based method for all option awards | (4,119)                   |
| Pro forma net earnings   | \$ 648,145                |
| Basic Earnings Per Share   |                           |
| As reported  | \$ 0.29                   |
| Pro forma  | 0.29                      |
| Diluted Earnings Per Share   |                           |
| As reported  | \$ 0.29                   |
| Pro forma  | 0.29                      |

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The following is a summary of the Corporation's weighted average assumptions used to estimate the weighted-average per share fair value of options granted on the date of grant using the Black-Scholes option-pricing model. There were no stock options granted during the three months ended March 31, 2005.

|  | <b>For the three months<br/>ended<br/>March 31</b> |             |
|--|--|-------------|
|  | <b>2006</b>  | <b>2005</b> |
| Expected life (in years)                                       | 5.0  | N/A         |
| Expected volatility  | 20.00%   | N/A         |
| Risk-free interest rate  | 5.02%  | N/A         |
| Expected dividend yield  | 1.90%  | N/A         |
| Weighted-average fair value of options granted during the year | \$ 3.56  | N/A         |

At March 31, 2006, there was approximately \$19,000 of unrecognized compensation cost related to share-based payments which is expected to be recognized over a weighted-average period of 2 years.

The following table represents stock option activity for the three months ended March 31, 2006:

|  | <b>Number</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contract<br/>Life</b> |
|--|---------------|---|--|
| Options outstanding, beginning of year | 70,200        | \$ 14.50  |  |
| Granted                                | 2,000         | 16.00   |  |
| Exercised                              | 0             | 0   |  |
| Terminated                             | (10,000)      | 15.75   |  |
| Options outstanding, end of quarter    | 62,200        | 14.34   | 5.2 years  |
| Exercisable, end of quarter            | 55,368        | 14.16   | 5.0 years  |

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Shares available for future stock option grants to employees and directors under the 1998 Stock Option Plan of United Bancorporation of Alabama, Inc were 59,200 at March 31, 2006. At March 31, 2006 the aggregate intrinsic value of options outstanding was \$165,452, and the aggregate intrinsic value of options exercisable was \$157,245.

The following table summarizes nonvested stock option activity for the three months ended March 31, 2006:

|  | <b>Number</b> | <b>Weighted-Average Grant-Date Fair Value</b> |
|--|---------------|---|
| Options outstanding, beginning of year | 6,832         | \$ 3.00                                       |
| Granted                                | 2,000         | 3.56  |
| Exercised                              | 0             | 0   |
| Terminated                             | (2,000)       | 3.00  |
| Options outstanding, end of quarter    | 6,832         | 3.16  |

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Critical Accounting Estimates**

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions. Management believes that its determination of the allowance for loan losses is a critical accounting policy and involves a higher degree of judgment and complexity than the Bank's other significant accounting policies. Further, these estimates can be materially impacted by changes in market conditions or the actual or perceived financial condition of the Bank's borrowers, subjecting the Bank to significant volatility of earnings.

The allowance for loan losses is regularly evaluated by management and reviewed by the Board of Directors for accuracy by taking into consideration factors such as changes in the nature and volume of the loan portfolio; trends in actual and forecasted portfolio credit quality, including delinquency, charge-off and bankruptcy rates; and current economic conditions that may affect a borrower's ability to pay. The use of different estimates or assumptions could produce different provisions for loan losses. The allowance for credit losses is established through the provision for loan losses, which is a charge against earnings.

### **Results of Operations**

The following financial review is presented to provide an analysis of the results of operations of United Bancorporation of Alabama, Inc. (the Corporation) and its principal subsidiary for the three months ended March 31, 2006 and 2005, compared. This review should be used in conjunction with the condensed consolidated financial statements included in the Form 10-Q.

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**Three Months Ended March 31, 2006 and 2005, Compared**

**Summary**

Net income for the three months ended March 31, 2006 increased \$389,269, or 59.68%, as compared to the same period in 2005.

**Net Interest Income**

Total interest income increased \$1,674,432 or 41.03%, in the first quarter of 2006 as compared to 2005. Average interest-earning assets were \$324,443,978 for the first three months of 2006, as compared to \$287,016,612 for the same period in 2005, an increase of \$37,427,366, or 13.04%. This increase is largely attributable to the growth of the Bank's loan portfolio over the last year. The average rate earned during the first quarter of 2006 was 7.19% as compared to 5.68% in 2005, reflecting the continuing impact of the increases in rates by the Federal Reserve Board. Total interest expense increased by \$844,530 or 80.10% in the first quarter of 2006, when compared to the same period in 2005. Average interest bearing liabilities increased to \$264,808,824 in 2006 from \$222,363,849 in 2005, an increase of \$42,444,975, or 19.09%. The average rate paid increased to 2.91% in 2006 as compared to 1.90% in 2005. The net interest margin increased to 4.85% for the first quarter of 2006, as compared to 4.35% for the same period in 2005. This was due to the increases in interest rates by the Federal Reserve Board and the fact that the Bank's assets repriced faster than the Bank's liabilities.

**Provision for Loan Losses**

The provision for loan losses totaled \$240,000 for the first quarter of 2006 as compared to \$195,000 for the same period in 2005. The provision reflected the growth of the loan portfolio. For further discussion of the Provision for Loan Losses see Allowance for Loan Losses below.

**Noninterest Income**

Total noninterest income increased \$339,447 or 48.40% for the first quarter of 2006. Service charges on deposits increased \$124,249, or 24.46%, for the first quarter of 2006 as compared to 2005. This increase is primarily due to a increase in insufficient fund charges on checks. Other noninterest income increased during the first quarter of 2006 by \$219,279 or 117.14% as compared to 2005. Major factors were gain on the sale of single investment in a banking related entity of \$119,110, \$25,000 in mortgage origination fees, a \$20,428 increase in trust and brokerage revenue, and a \$45,000 increase in other income related to the Bank's automated teller machines and debit card processing.



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**Noninterest Expense**

Total noninterest expense increased \$550,820, or 20.49%, during the first quarter of 2006 compared to the same quarter of 2005. Salaries and benefits increased \$265,186, or 17.33%, in the first quarter of 2006 as compared to 2005. This increase is primarily due to the expansion of the Bank into new markets and increases in health care costs for Bank employees. Occupancy expense increased \$22,822, or 4.63%, in the first quarter of 2005. Other expenses increased \$262,812 or 39.57% during the first quarter of 2006 as compared to 2005, reflecting increases in general operating expenses including supplies, advertising, administration expenses related to the Bank's business support services, and an increase in accrued accounting expenses related to the costs of complying with the Sarbanes-Oxley Act of 2002.

**Income Taxes**

Earnings before taxes for the first quarter of 2006 were \$1,418,871 as compared to \$845,342 in the first quarter of 2005, an increase of \$573,529 or 67.85%. Income tax expense for the first quarter increased \$184,260 to \$377,338, or by 95.43%, when compared to \$193,078 for the same period in 2005. The effective tax rate increased to 26.59% in 2006 from 22.84% in 2005.

**Financial Condition and Liquidity**

Total assets on March 31, 2006 decreased \$12,568,517 or 3.40% from December 31, 2005. This decrease is largely attributable to the reduction in Federal Funds Sold and interest bearing balances in other banks due to the cyclical reduction in public funds during the period, see the discussion of Deposits below. Average total assets for the first three months of 2006 were \$352,820,883. The ratio of loans (net of allowance) to deposits plus repurchase agreements on March 31, 2006 was 74.57% as compared to 69.84% on December 31, 2005.

**Cash and Cash Equivalents**

Federal Funds Sold and interest bearing balances in other banks as of March 31, 2006 decreased by \$22,875,833, or by 76.28%, from December 31, 2005. This decrease is attributed to the increase in loans and the decrease in deposits of public funds in the first quarter of 2006, see the discussion of Deposits below.

**Loans**

Net loans increased by \$8,118,147 or 3.57% at March 31, 2006, from December 31, 2005. Agricultural lending and commercial real estate loans contributed the majority of this loan growth.

**Allowance for Loan Losses**

The allowance for loan losses is maintained at a level which, in management's opinion, is appropriate to provide for estimated losses in the portfolio at the balance sheet date. Factors

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considered in determining the adequacy of the allowance include historical loan loss experience, the amount of past due loans, loans classified from the most recent regulatory examinations and internal reviews, general economic conditions and the current portfolio mix. The amount charged to operating expenses is that amount necessary to maintain the allowance for loan losses at a level indicative of the associated risk, as determined by management, of the current portfolio.

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The allowance for loan losses consists of two portions: the classified portion and the nonclassified portion. The classified portion is based on identified problem loans and is calculated based on an assessment of credit risk related to those loans. Specific loss estimate amounts are included in the allowance based on assigned loan classifications as follows: monitor (5%), substandard (15%), doubtful (50%), loss (100%) and specific reserves based on identifiable losses. Any loan categorized loss is charged off in the period in which the loan is so categorized.

The nonclassified portion of the allowance is for inherent losses which probably exist as of the evaluation date even though they may not have been identified by the more specific processes for the classified portion of the allowance. This is due to the risk of error and inherent imprecision in the process. This portion of the allowance is particularly subjective and requires judgments based upon qualitative factors which do not lend themselves to exact mathematical calculations. Some of the factors considered are changes in credit concentrations, loan mix, historical loss experience, non-accrual and delinquent loans and the general economic environment in the Corporation's markets. However, unfavorable changes in the factors used by management to determine the adequacy of the allowance, including increased loan delinquencies and subsequent charge-offs, or the availability of new information, could require additional provisions, in excess of normal provisions, to the allowance for loan losses in future periods.

While the total allowance is described as consisting of a classified and a nonclassified portion, these terms are primarily used to describe a process. Both portions are available to support inherent losses in the loan portfolio. Management realizes that general economic trends greatly affect loan losses, and no assurances can be made that future charges to the allowance for loan losses will not be significant in relation to the amount provided during a particular period, or that future evaluations of the loan portfolio based on conditions then prevailing will not require sizable charges to income. Management does, however, consider the allowance for loan losses to be appropriate for the reported periods.

The allowance for possible loan losses represents 1.35% of gross loans at March 31, 2006, as compared to 1.31% at year-end 2005.

Loans on which the accrual of interest had been discontinued has increased to \$2,219,662 at March 31, 2006, as compared to \$1,406,422 at December 31, 2005. Net charged-off loans for the first three months of 2006 were \$59,000, as compared to \$103,000 for the same period in 2005.

Potential problem loans have increased over the last year due primarily to the Bank downgrading \$6,700,000 of agricultural loans (\$1,000,000 to monitor, \$4,900,000 to substandard, and \$800,000 to doubtful) following analysis of various factors in the third quarter of 2005. As of March 31, 2006, the total amount of the downgraded loans had decreased to \$4,465,644 (\$1,934,632 in monitor, \$1,643,708 in substandard, and \$887,304 in doubtful). This decrease is mainly attributable to the normal paydowns of agricultural loans in the first quarter, as expected due to the agricultural lending cycle. Losses that may pertain to these loans, if any, are not measurable at this time under impairment measures outlined by SFAS No. 114 or are not loss contingencies under SFAS No. 5.

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**Non-performing Assets:** The following table sets forth the Corporation's non-performing assets at March 31, 2006 and December 31, 2005. Under the Corporation's nonaccrual policy, a loan is placed on nonaccrual status when collectibility of principal and interest is in doubt or when principal and interest is 90 days or more past due except for credit cards, which continue to accrue interest after ninety days.

The amount of impaired loans determined under SFAS No. 114 and 118 has been considered in the summary of non-performing assets below. These credits were considered in determining the adequacy of the allowance for loan losses and are regularly monitored for changes within a particular industry or general economic trends, which could cause the borrowers financial difficulties. At March 31, 2006 the Bank had \$536,880 in impaired loans, compared to \$508,106 at December 31, 2005.

| Description   | March<br>31,<br>2006   | December<br>31,<br>2005 |
|---|------------------------|-------------------------|
|   | (Dollars in Thousands) |                         |
| A Loans accounted for on a nonaccrual basis   | \$ 2,220               | \$ 1,406                |
| B Loans which are contractually past due ninety days or more as to interest or principal payments (excluding balances included in (A) above)  | \$ 5                   | \$ 4                    |
| C Loans, the terms of which have been renegotiated to provide a reduction or deferral of interest or principal because of a deterioration in the financial position of the borrower | \$ 314                 | \$ 318                  |
| D Other non-performing assets   | \$ 966                 | \$ 1,131                |

**Investment Securities**

Total investments available for sale have increased \$3,541,816 at March 31, 2006 as compared to December 31, 2005 due to the Bank investing federal funds into higher yields in the investment portfolio.

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**Premises and Equipment**

Premises and equipment increased \$1,055,267 during the first quarter of 2006. This increase is primarily due to the renovation of the Bank's Atmore facilities including the Retail Branch, the building that houses the Information Systems Department, and the AgriFinance Office, as well as the on-going construction of a new branch in Magnolia Springs, Alabama.

**Intangible Assets**

On July 2, 2004, the Company acquired a State of Florida banking charter from a financial institution. Subsequent to the purchase, the charter was terminated but the Company retained the legal right to branch into Florida through its existing Alabama bank charter. The Company accounts for the charter cost as an indefinite lived intangible asset because the legal right acquired does not have an expiration date under Florida banking laws and there is no renewal process to keep the branching rights. The Company tests the intangible asset each September 30 for impairment. At March 31, 2006, the Company operates two branch offices in Florida.

For the three months ended March 31, 2006 and 2005, no impairment was recorded related to the intangible asset. As of March 31, 2006 and 2005, the Company had recorded \$917,263 in intangible assets related to the cost of the charter.

**Deposits**

Total deposits decreased \$15,312,378, or 5.26%, at March 31, 2006 from December 31, 2005, including a decrease of \$13,685,809 on interest bearing deposits. This decrease is largely due to the cyclical nature of deposits and withdrawals of public funds related to the collection and disbursement of property taxes in one of the Bank's local markets.

**Liquidity**

One of the Bank's goals is to provide adequate funds to meet changes in loan demand or any potential increase in the normal level of deposit withdrawals. This goal is accomplished primarily by generating cash from operating activities and maintaining sufficient short-term assets. These sources, coupled with a stable deposit base, allow the Bank to fund earning assets and maintain the availability of funds. Management believes that the Bank's traditional sources of maturing loans and investment securities, cash from operating activities and a strong base of core deposits are adequate to meet the Bank's liquidity needs for normal operations. To provide additional liquidity, the Bank utilizes short-term financing through the purchase of federal funds, and maintains a borrowing relationship with the Federal Home Loan Bank to provide liquidity. Should the Bank's traditional sources of liquidity be constrained, forcing the Bank to pursue avenues of funding not typically used, the Bank's net interest margin could be impacted negatively. The Corporation's bank subsidiary has an Asset Liability Management Committee, which has as its primary objective the maintenance of specific funding and investment strategies to achieve short-term and long-term financial goals. The Corporation's liquidity at March 31, 2006 is considered adequate by management. Also see Item 3 below.

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**Capital Adequacy**

The Corporation has generally relied primarily on internally generated capital growth to maintain capital adequacy. Total stockholders' equity on March 31, 2006, was \$28,643,428, an increase of \$849,068, or 3.05%, from December 31, 2005. This net increase is a combination of current period earnings, reduced by a increase in the unrealized losses on securities available for sale.

Primary capital to total assets at March 31, 2006, was 9.18%, as compared to 8.88% at year-end 2005. Total capital and allowances for loan losses to total assets at March 31, 2006, was 10.08%, as compared to 9.34% at December 31, 2005. The Corporation's risk based capital was \$36,014,401, or 13.37% of risk adjusted assets, at March 31, 2006, as compared to \$34,496,000, or 13.06%, at year-end 2005. The minimum requirement is 8.00%. Based on management's projections, existing internally generated capital and the capital previously raised by issuance of trust preferred securities should be sufficient to satisfy capital requirements in the foreseeable future for existing operations, and for some expansion efforts. Continued growth into new markets may require the Corporation to further access external funding sources. There can be no assurance that such funding sources will be available to the Corporation.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Market risk is the risk of loss from adverse changes in market prices and rates. The Bank's market risk arises principally from interest rate risk inherent in its lending, deposit and borrowing activities. Management actively monitors and manages its interest rate risk exposure. Although the Bank manages other risk, such as credit quality and liquidity risk, in the normal course of business, management considers interest rate risk to be its most significant market risk. Interest rate risk could potentially have the largest material effect on the Bank's financial condition and results of operations. Other types of market risks, such as foreign currency exchange rate risk, generally do not arise in the Bank's normal course of business activities to any significant extent.

The Bank's profitability is affected by fluctuations in interest rates. Management's goal is to maintain a reasonable balance between exposure to interest rate fluctuations and earnings. A sudden and substantial increase in interest rates may adversely impact the Bank's earnings to the extent that the interest rates on interest-earning assets and interest-bearing liabilities do not change at the same speed, to the same extent or on the same basis.

The Bank's Asset Liability Management Committee (ALCO) monitors and considers methods of managing the rate and sensitivity repricing characteristics of the balance sheet components consistent with maintaining acceptable levels of changes in the net portfolio value (NPV) and net interest income. NPV represents the market values of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items over a range of assumed changes in market interest rates. A primary purpose of the Bank's ALCO is to manage interest rate risk to effectively invest the Bank's capital and to preserve the value created by its core business operations. As such, certain management monitoring processes

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are designed to minimize the impact of sudden and sustained changes in interest rates on NPV and net interest income. The Bank's exposure to interest rate risk is reviewed on a quarterly basis by the Board of Directors and the ALCO. Interest rate risk exposure is measured using interest rate sensitivity analysis to determine the Bank's change in NPV in the event of hypothetical changes in interest rates. Further, interest rate sensitivity gap analysis is used to determine the repricing characteristics of the Bank's assets and liabilities. The ALCO is charged with the responsibility to maintain the level of sensitivity of the Bank's net interest margin within Board approved limits.

Interest rate sensitivity analysis is used to measure the Bank's interest rate risk by computing estimated changes in NPV of its cash flows from assets, liabilities, and off-balance sheet items in the event of a range of assumed changes in market interest rates. This analysis assesses the risk of loss in market risk sensitive instruments in the event of a sudden and sustained 100-300 basis points increase or decrease in the market interest rates. The Bank uses the HNC Asset Liability Model, which takes the current rate structure of the portfolio and shocks for each rate level and calculates the new market value equity at each level. The Bank's Board of Directors has adopted an interest rate risk policy, which establishes maximum allowable decreases in net interest margin in the event of a sudden and sustained increase or decrease in market interest rates. The following table presents the Bank's projected change in NPV for the various rate shock levels as of December 31, 2005, the most recent date for which the Corporation has a completed analysis. Management does not expect the analysis as of March 31, 2006 to change materially from the December 31, 2005 analysis. All market risk sensitive instruments presented in this table are held to maturity or available for sale. The Bank has no trading securities.

| Change in Interest Rates<br><br>(Basis Points) | Market Value | Change in<br>Market | Change in                   |
|--|--------------|---------------------|-----------------------------|
|  | Equity       | Value Equity        | Market<br>Value<br>Equity % |
| 300  | 70,721       | 14,888              | 27                          |
| 200  | 66,780       | 10,947              | 20                          |
| 100  | 61,843       | 6,010               | 11                          |
| 0  | 55,833       |                     |                             |
| -100   | 48,864       | (6,969)             | (12)                        |
| -200   | 40,018       | (15,815)            | (28)                        |
| -300   | 29,751       | (26,082)            | (47)                        |

The preceding table indicates that at December 31, 2005, in the event of a sudden and sustained increase in prevailing market interest rates, the Bank's NPV would be expected to increase and that in the event of a sudden decrease in prevailing market interest rates, the Bank's NPV would be expected to decrease. The recent growth in variable rate loans has caused the Corporation to become more asset sensitive over the period of a year, but the net interest margin remains fairly stable in all interest rate environments tested.

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**Derivative Financial Instruments**

To hedge the Company's exposure to changing interest rates, management entered into an agreement known as an interest rate floor on a portion of its variable rate loan portfolio during September 2005. Interest rate floors are typically used to mitigate a loan portfolio's exposure to falling interest rates. Pursuant to the agreement, the Company's counterparty agrees to pay the Company an amount equal to the difference between the prime rate and 5.75% multiplied by a \$35,000,000 notional amount should the prime rate fall below 5.75% during the two year term of the agreement. The Company paid its counterparty a one-time premium equal to \$52,500 which is being amortized during the 2 year term. The interest rate floor is being marked to market and accounted for as a cash flow hedge. As of March 31, 2006, the interest rate floor contract was carried at fair value which was equal to \$29,274. The Company considers the derivative (interest rate floor) as highly effective in offsetting changes in cash flows of the hedged items (variable rate loans).

Computation of prospective effects of hypothetical interest rate changes included in these forward-looking statements are subject to certain risks, uncertainties, and assumptions including relative levels of market interest rates, loan prepayments and deposit decay rates, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions the Bank could undertake in response to changes in interest rates.



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**Item 4. Controls and Procedures**

Based on evaluation of the Corporation's disclosure controls and procedures (as such term is defined in Rules 13a-4(c) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of the end of the period covered by this quarterly report, the principal executive officer and the principal financial officer of the Corporation have concluded that as of such date the Corporation's disclosure controls and procedures were effective to ensure that information the Corporation is required to disclose in its filings 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, and to ensure that information required to be disclosed by the Corporation in the reports that it files under the Exchange Act is accumulated and communicated to the Corporation's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

The Corporation has engaged consultants to assist the Corporation in its evaluation of internal controls in anticipation of the upcoming effectiveness of regulations under Section 404 of the Sarbanes-Oxley Act of 2002. There was no change in the Corporation's internal controls over financial reporting during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Forward Looking Statements**

When used or incorporated by reference herein, the words anticipate, estimate, expect, project, target, goal, and similar expressions, are intended to identify forward-looking statements within the meaning of Section 27A of the Securities Act of 1933. Such forward-looking statements are subject to certain risk, uncertainties, and assumptions including those set forth herein. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those expected or projected. These forward-looking statements speak only as of the date they are made. The Corporation expressly disclaims any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein to reflect any change in the Corporation's expectations with regard to any change in events, conditions or circumstances on which any such statement is based.

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**PART II OTHER INFORMATION**

**Item 1A. Risk Factors**

There have been no material changes to the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

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

- (a) The Annual Meeting of Stockholders of United Bancorporation of Alabama, Inc. was held on May 3, 2006.
- (b) The following nominees were elected as Directors of the Corporation, to serve until the 2009 Annual Meeting of Stockholders, by the votes indicated:

| Nominee            | For       | Against |
|--------------------|-----------|---------|
| L. Walter Crim     | 1,362,736 | 338     |
| William J. Justice | 1,355,075 | 7,999   |
| J. Wayne Trawick   | 1,362,736 | 338     |

The Directors of the Corporation whose terms of office continued after the 2005 Annual Meeting are as follows:

| Director             | To Serve Until the Annual Meeting of Stockholders in the year |
|----------------------|---|
| Michael R. Andreoli  | 2007  |
| David Swift          | 2007  |
| Robert R. Jones, III | 2008  |
| Dale M. Ash          | 2008  |

**Item 6. Exhibits**

- (a) Exhibits.
  - 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 31.2 Certification of interim principal accounting officer 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, adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
  - 32.2 Certification of interim principal accounting officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UNITED BANCORPORATION OF  
ALABAMA, INC.

Date: May 12, 2006

/s/ Robert R. Jones, III

Robert R. Jones, III  
President and CEO  
Interim Principal Accounting Officer

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INDEX TO EXHIBITS

| EXHIBIT<br>NUMBER | DESCRIPTION   |
|-------------------|---|
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