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 þ No o

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 o Accelerated filer o Non-accelerated filer þ

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

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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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2006 Unaudited	December 31, 2005 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 issueance 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:		

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 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)

	2006	2005
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

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 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:

	2005
Net earnings, as reported	$ 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.

	For the three months ended March 31	
	2006	**2005**
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:

	Number	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contract Life**
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 exerciseable was $157,245.
The following table summarizes nonvested stock option activity for the three months ended March 31, 2006:

	Number	Weighted-Average Grant-Date Fair Value
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 then 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