UNITED BANCORPORATION OF ALABAMA INC
Form 10-Q
August 15, 2005

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 June 30, 2005
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) 368-2525
(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 an accelerated filer (as defined 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 July 20, 2005.

Class A Common Stock.... 2,221,440 Shares
Class B Common Stock.... -0- Shares

UNITED BANCORPORATION OF ALABAMA, INC.
FORM 10-Q
For the Quarter Ended June 30, 2005
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Certification of Chief Executive Officer Pursuant to Section 302
Certification of Principal Accounting Officer Pursuant to Section 302
Certification of Chief Executive Officer Pursuant to Section 906
Certification of Principal Accounting Officer Pursuant to Section 906

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PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

United Bancorporation of Alabama, Inc.
and Subsidiary
Condensed Consolidated
Balance Sheets

	2005 Unaudited	2004 Audited
Assets:		
Cash and due from banks	$ 11,592,561	$ 16,446,574
Federal funds sold	7,897,849	27,494,426
Cash and cash equivalents	19,490,410	43,941,000
Securities available for sale (amortized cost of $73,289,134 and $54,502,411 respectively)	73,492,421	55,004,982
Loans	216,558,575	199,160,445
Allowance for loan losses	2,630,861	2,562,239
Net loans	213,927,714	196,598,206
Premises and equipment, net	7,068,216	7,192,202
Interest receivable and other assets	9,939,878	9,094,834
Total assets	$323,918,639	$311,831,224
Liabilities and Stockholders Equity:		
Deposits:		
Non-interest bearing	$ 59,325,961	$ 68,763,895
Interest bearing	191,127,619	184,174,772
Total deposits	250,453,580	252,938,667
Securities sold under agreements to repurchase	30,027,976	18,381,063
Other borrowed funds	9,963,544	8,292,612
Accrued expenses and other liabilities	2,311,974	1,881,143
Note payable to Trust	3,997,697	3,992,645
Total liabilities	296,754,771	285,486,130
Stockholders equity:		
Class A common stock, Authorized 5,000,000 shares of $.01 par value; 2,366,962 and 2,363,762 shares issued respectively	23,654	23,638
	0	0

Class B common stock of $.01 par value, Authorized 250,000 shares; -0- shares issued and outstanding		
Preferred stock of $.01 par value, Authorized 250,000 shares; -0- shares issued and outstanding	0	0
Additional Paid in Capital	5,435,679	5,444,563
Accumulated other comprehensive income, net of tax	121,972	301,542
Retained earnings	22,399,878	21,414,370
	27,981,183	27,184,113
Less: 145,522 and 148,966 treasury shares, at cost, respectively	817,315	839,019
Total stockholders equity	27,163,868	26,345,094
Total liabilities and stockholders equity	$323,918,639	$311,831,224

See Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended June		Six Months Ended June	
	2005	2004	2005	2004
Interest income:				
Interest and fees on loans	$3,802,191	$ 2,902,448	$7,095,542	$5,590,990
Interest on investment securities available for sale:				
Taxable	480,117	299,800	862,789	602,868
Nontaxable	261,383	256,223	508,193	507,450
Total investment income	741,500	556,023	1,370,982	1,110,318
Other interest income	61,133	23,647	219,788	50,773
Total interest income	4,604,824	3,482,118	8,686,312	6,752,081
Interest expense:				
Interest on deposits	1,056,175	726,897	1,969,601	1,380,538
Interest on other borrowed funds	158,051	138,277	298,963	283,038
Total interest expense	1,214,226	865,174	2,268,564	1,663,576
Net interest income	3,390,598	2,616,944	6,417,748	5,088,505
Provision for loan losses	195,000	180,000	390,000	360,000
Net interest income after provision for loan losses	3,195,598	2,436,944	6,027,748	4,728,505
Noninterest income:				
Service charge on deposits	592,719	586,878	1,100,687	1,175,120
Commission on credit life	22,795	22,003	28,946	35,700
Investment securities gains, net		20		3,288
Other	179,782	139,142	366,980	330,645
Total noninterest income	795,296	748,043	1,496,613	1,544,753
Noninterest expense:				
Salaries and benefits	1,636,155	1,419,620	3,166,730	2,781,416
Net occupancy expense	489,717	457,020	983,093	915,418
Other	939,554	741,902	1,603,728	1,371,677

Total non-interest expense	3,065,426	2,618,542	5,753,551	5,068,511
Earnings before income tax expense	925,468	566,445	1,770,810	1,204,746
Income tax expense	295,349	79,122	488,427	256,410
Net earnings	$ 630,119	$ 487,323	$1,282,383	$ 948,336
Basic earnings per share	$ 0.28	$ 0.22	$ 0.58	$ 0.43
Diluted earnings per share	$ 0.28	$ 0.22	$ 0.58	$ 0.43
Basic weighted average shares outstanding	2,219,858	2,214,779	2,219,849	2,214,719
Diluted weighted average shares outstanding	2,220,527	2,217,128	2,220,518	2,217,068
Cash dividend per share	$ 0.15	$ 0.15	$ 0.15	$ 0.15
Statement of Comprehensive Income				
Net Income	630,119	487,323	$1,282,383	$ 948,336
Other Comprehensive (Loss) Income, net of tax:				
Unrealized holding gain (loss) arising during the period	326,920	(1,129,997)	179,570	(700,988)
Less: Reclassification adjustment for gains included in net income		12		1,961
Comprehensive (loss) income	$ 957,039	$ (642,686)	$1,461,953	$ 245,387

See Notes to Condensed Consolidated Financial Statements

United Bancorporation of Alabama, Inc.
and Subsidiary
Condensed Consolidated Statements of Cash Flows
For The Six Months Ended June 2005 and 2004
(Unaudited)

	2005	2004
Operating Activities		
Net Income	$ 1,282,383	948,336
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities		
Provision for Loan Losses	390,000	360,000
Depreciation on Premises and Equipment	464,410	411,491
Amortizaton of Investment Securities Available for Sale	99,625	94,777
Gain on Investment Securities Available for Sale		(3,288)
Gain on Sale of Other Real Estate	(4,118)	
Gain on Disposal of Premises and Equipment		(4,850)
Writedown of Other Real Estate	103,201	
Increase in Interest Receivable and Other Assets	(944,603)	(4,880)
Increase (Decrease) in Accrued Expenses and Other Liabilities	430,831	(564,190)
Net Cash Provided by Operating Activities	1,821,729	1,237,396
Investing Activities		
Proceeds From Sales of Investment Securities Available for Sale		1,500,300
Proceeds From Maturities of Investment Securities Available for Sale	8,317,094	4,843,440
Purchases of Investment Securities Available for Sale	(27,203,399)	(11,788,315)
Net Increase in Loans	(17,769,508)	(24,329,385)
Purchases of Premises and Equipment	(340,424)	(319,521)
Proceeds From Sales of Premises and Equipment		21,104
Proceeds From Sales of Other Real Estate	170,147	
Net Cash Used in Investing Activities	(36,826,090)	(30,072,377)
Financing Activities		
Net (Decrease) Increase in Deposits	(2,485,087)	22,596,434
Net Increase in securities sold under agreement to repurchase	11,646,913	2,659,983
Cash Dividends	(288,579)	(332,215)
Net Tranactions on Treasury Stock		(2,387)
Proceeds from sale of common stock	4,540	39,581
(Increase) Decrease in Other Borrowed Funds	1,675,984	(666,848)
Net Cash Provided by Financing Activities	10,553,771	24,294,548
Decrease in Cash and Cash Equivalents	(24,450,590)	(4,540,433)
Cash and Cash Equivalents at Beginning of Period	43,941,000	24,447,625
Cash and Cash Equivalents at End of Period	$ 19,490,410	19,907,192

Supplemental disclosures

Cash paid during the year for:				
Interest	$	2,208,837	$	1,672,764
Income Taxes	$	503,000	$	230,000
Noncash transactions				
Transfer of loans to other real estate through foreclosure	$	50,000	$	230,001

See Notes to Condensed Consolidated Financial Statements

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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, 2004.

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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 and six month periods ended June 30, 2005 and 2004. Common stock outstanding consists of issued shares less treasury stock. Diluted net earnings per share for the three and six month periods ended June 30, 2005 and 2004 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 and six months ended June 30, 2005 and 2004:

	Three Months Ended June		Six Months Ended June	
	2005	2004	2005	2004
Diluted earnings per share	$ 0.28	$ 0.22	$ 0.58	$ 0.43
Weighted average common shares outstanding	2,219,858	2,214,779	2,219,849	2,214,719
Effect of the assumed exercise of stock options based on the treasury stock method using average market price	669	2,349	669	2,349
Total weighted average common shares and potential common stock outstanding*	2,220,527	2,217,128	2,220,518	2,217,068

* 33,584 and 23,888 shares subject to outstanding options for the three and six months ended June 30, 2005 and 2004, respectively, were not included in the calculation of diluted earnings per share, as the exercise price of these options was in excess of average market price.

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NOTE 3 Allowance for Loan Losses

The following table summarizes the activity in the allowance for loan losses for the six month periods ended June 30 ($ in thousands):

	June 30	
	2005	2004
Balance at beginning of year	2,562	2,117
Provision charged to expense	390	360
Less Loans charged off	352	188
Recoveries	31	49
Balance at end of period	2,631	2,338

At June 30, 2005 and 2004, the amount of nonaccrual loans was $963,741 and $1,331,976 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 New Accounting Standards

In December 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (revised December 2003) (FIN 46R), *Consolidation of Variable Interest Entities*, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. The Company will be required to apply FIN 46R to all entities subject to this interpretation no later than the end of the first reporting period that ends after December 15, 2004. This interpretation must be applied to those entities that are considered to be special purpose entities.

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For any variable interest entities (VIEs) that must be consolidated under FIN No. 46R that were created before January 1, 2004, the assets, liabilities, and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN No. 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE.

The Company has applied FIN No. 46R in accounting for United Bancorp Capital Trust I (Trust), established on June 27, 2002. Accordingly, the accompanying balance sheet includes, in other assets, the Company s investment in the Trust of $124,000 and also includes, in Note payable to Trust, the balance owed the Trust of $4,124,000. Except as related to the Trust, the application of this interpretation is not expected to have a material effect on the Company s consolidated financial statements.

In December 2004, the Financial Accounting Standards Board (FASB) published FASB Statement No. 123 (revised 2004), *Share-Based Payment* (FAS 123(R) or the Statement). FAS 123(R) requires that the compensation cost relating to share-based payment transactions, including grants of employee stock options, be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. FAS 123(R) covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. FAS 123(R) is a replacement of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related interpretive guidance.

The effect of the Statement will be to require entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. FAS 123(R) permits entities to use any option-pricing model that meets the fair value objective in the Statement.

The Company will be required to apply FAS 123(R) as of the beginning of its first interim period that begins after December 15, 2005, which will be the quarter ending March 31, 2006.

FAS 123(R) allows two methods for determining the effects of the transition: the modified prospective transition method and the modified retrospective method of transition. Under the modified prospective transition method, an entity would use the fair value based accounting method for all employee awards granted, modified, or settled after the effective date. As of the effective date, compensation cost related to the nonvested portion of awards outstanding as of that date would be based on the grant-date fair value of those awards as calculated under the original provisions of Statement No. 123; that is, an entity would not remeasure the grant-date fair value estimate of the unvested portion of awards granted prior to the effective date of FAS 123(R). Under the modified retrospective method of transition, an entity would revise its previously issued financial statements to recognize employee compensation cost for prior periods

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presented in accordance with the original provisions of Statement No. 123.

Although it has not yet completed its study of the transition methods, the Company believes it will elect the modified prospective transition method. The impact of this Statement on the Company in fiscal 2006 and beyond will depend upon various factors, among them being the Company s future compensation strategy. The pro forma compensation costs presented in the table below and in prior filings for the Company have been calculated using a Black-Scholes option pricing model and may not be indicative of amounts which should be expected in future years. No decisions have been made as to which option-pricing model is most appropriate for the Company for any future awards.

NOTE 6 Stock Based Compensation

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, in accounting for its fixed stock option plan. As such, compensation expense is recorded if the current market price on the date of grant of the underlying stock exceeds the exercise price.

Statement of Financial Accounting Standard (SFAS) No. 123 prescribes the recognition of compensation expense based on the fair value of options on the grant date and allows companies to apply APB No. 25 as long as certain pro forma disclosures are made assuming a hypothetical fair value method application.

Had compensation expense for the Company s stock options been recognized based on the fair value on the grant date under the methodology prescribed by SFAS No. 123, the Company s net earnings and earnings per share for the three and six months ended June 30, 2005 and 2004 would have been impacted as shown in the following table:

	For the three months ended June 30		For the six months ended June 30	
	2005	2004	2005	2004
Reported net earnings	$630,119	$487,323	$1,282,383	$948,336
Compensation expense, net of taxes	4,119	3,410	8,238	8,271
Pro forma net earnings	626,000	483,913	1,274,145	940,065
Reported basic earnings per share	$ 0.28	$ 0.22	$ 0.58	$ 0.43
Pro forma basic earnings per share	$ 0.28	$ 0.22	$ 0.57	$ 0.42
Reported diluted earnings per share	$ 0.28	$ 0.22	$ 0.58	$ 0.43
Pro forma diluted earnings per share	$ 0.28	$ 0.22	$ 0.57	$ 0.42

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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 and six months ended June 30, 2005 and 2004, compared. This review should be used in conjunction with the condensed consolidated financial statements included in the Form 10-Q.

Six Months ended June 30, 2005 and 2004, Compared

Summary

Net income for the six months ended June 30, 2005, increased by $334,046, or 35.22%, as compared to the same period in 2004.

Net Interest Income

Total interest income increased $1,934,231, or 28.65%, for the first six months of 2005 as compared to the same period in 2004. Average interest-earning assets were $290,537,708 for the first six months of 2005, as compared to $246,662,920 for the same period in 2004, an increase of $43,874,788, or 17.79%. A substantial portion of the increase is due to increases in the loan portfolio as the Company continues to implement management s growth initiatives. The average rate earned on interest earning assets in 2005 was 6.14% as compared to 5.24% in 2004, reflecting

the continuing impact of the increase in rates by the Federal Reserve Board during past and current years.
Total interest expense increased by $604,988, or 36.37%, in 2005, when compared to the same period in 2004. Average interest bearing liabilities increased to $226,183,827 in 2005 from $197,366,640 in 2004, an increase of $28,817,187, or 14.60%. The growth of the Company s interest bearing liabilities is due to a substantial increase in the funds held in Repurchase Agreements and an increase in interest bearing time deposits. The average rate paid rose to 2.02% in 2005 as compared to 1.69% in 2004.
The increase in interest expense can be attributed primarily to higher interest rates paid in 2005 on deposits, compared to lower rates paid on deposits during the same period in 2004.
Net interest margin increased to 4.45% for the first six months of 2005 as compared to 4.38% for the same period in 2004. This was due to the increase in interest rates by the Federal Reserve Board and interest rate sensitivity of the Bank s assets.

Provision for Loan Losses

The provision for loan losses totaled $390,000 for the first six months of 2005 as compared to $360,000 for the same period in 2004. This slight increase is due to the growth in the loan portfolio. See further discussion under Allowance for Loan Losses below.

Noninterest Income

Total noninterest income decreased $48,140 or 3.12% for the first six months of 2005. Service charges on deposits decreased $74,433, or 6.33%, for the first six months of 2005. This decrease is primarily due to a decrease in insufficient fund charges on checks due to a temporary increase in deposits as a result of insurance disbursements following Hurricane Ivan in September of 2004, which decreased $139,997 or 17.20%. The decrease in service charges was partially offset by an increase in ATM network fees.

Noninterest Expense

Total noninterest expense increased $685,040, or 13.52% during the first six months of 2005 as compared to 2004. Salaries and benefits increased $385,314 or 13.85% in the first six months of 2005 primarily due to the expansion of the Bank into new markets and the increased health care costs for the Bank. Occupancy expense increased $67,675 or 7.39%, also largely associated with branch expansion. Other expenses increased $232,051, or 16.92%, during the first six months of 2005. A substantial amount of this increase consists of $103,201 that was taken as a write down of several other real estate owned (OREO) properties. These properties are considered to be valued at their fair market value less any selling costs. The remaining increase in overhead expenses is attributable to the Company s expansion into new markets.