UNITED BANCORPORATION OF ALABAMA INC
Form 10-Q
November 10, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

Commission file number 000-25917

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o Non-accelerated filer o

Smaller Reporting Company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of November 10, 2011.

Class A Common Stock....	2,348,185 Shares
Class B Common Stock....	-0- Shares

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FORM 10-Q

For the Quarter Ended September 30, 2011

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PART I—FINANCIAL INFORMATION
United Bancorporation of Alabama, Inc.
and Subsidiary
Consolidated Balance Sheets
Item 1. Financial Statements

	September 30, 2011 (Unaudited)	December 31, 2010
Assets		
Cash and due from banks	$10,861,262	$18,179,566
Interest bearing deposits in banks	29,963,449	62,786,543
Cash and cash equivalents	40,824,711	80,966,109
Securities available for sale (amortized cost of $65,255,026 and $69,518,789 respectively)	65,799,046	68,808,624
Securities held to maturity (fair values of $22,143,182 and $17,302,864 respectively)	21,248,414	17,262,606
Loans held for sale	-	-
Loans held for investment	272,931,793	261,770,815
Less: Allowance for loan losses	5,677,419	5,139,998
Net loans held for investment	267,254,374	256,630,817
Premises and equipment, net	16,071,755	16,472,056
Interest receivable	2,248,180	2,192,768
Other assets	11,973,389	14,723,722
Other real estate owned	9,509,089	10,163,992
Total assets	434,928,958	467,220,694
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	116,728,171	142,681,749
Interest bearing	266,935,171	274,350,971
Total deposits	383,663,342	417,032,720
Advances from Federal Home Loan Bank of Atlanta	1,140,450	1,280,300
Treasury, tax, and loan account	903,130	944,078
Interest payable	301,943	402,953
Accrued expenses and other liabilities	1,636,524	1,731,437
Note payable to Trust	10,310,000	10,310,000
Total liabilities	397,955,389	431,701,488
Stockholders' equity		

Preferred stock of $.01 par value. Authorized 250,000 shares; 10,300 shares; issued and outstanding, net of discount	10,131,675	10,080,227
Class A common stock, $0.01 par value.Authorized 5,000,000 shares; issued and outstanding, 2,389,127 shares	23,891	23,891
Class B common stock, $0.01 par value.Authorized 250,000 shares; no shares issued or outstanding	-	-
Additional paid in capital	7,090,424	6,815,176
Accumulated other comprehensive income (loss) net of tax	326,406	(426,105)
Retained earnings	19,729,387	19,721,667
	37,301,783	36,214,856
Less: 40,942 and 86,757 treasury shares, at cost, respectively	328,214	695,650
Total stockholders' equity	36,973,569	35,519,206
Total liabilities and stockholders' equity	$434,928,958	$467,220,694

See Notes to Consolidated Financial Statements

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United Bancorporation of Alabama, Inc.
and Subsidiary
Consolidated Statement of Operations and Comprehensive Income (Loss)

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
Interest income:				
Interest and fees on loans	4,264,811	$4,182,618	$12,165,837	$12,554,464
Interest on investment securities available for sale:				
Taxable	386,396	423,790	1,254,775	1,248,468
Nontaxable	76,167	156,898	242,915	652,548
Total investment income	462,563	580,688	1,497,690	1,901,016
Other interest income	19,738	44,347	95,301	116,352
Total interest income	4,747,112	4,807,653	13,758,828	14,571,832
Interest expense:				
Interest on deposits	749,857	1,055,202	2,410,279	3,501,133
Interest on other borrowed funds	67,568	77,878	206,903	219,027
Total interest expense	817,425	1,133,080	2,617,182	3,720,160
Net interest income	3,929,687	3,674,573	11,141,646	10,851,672
Provision for loan losses	550,000	3,100,000	1,150,000	4,138,000
Net interest income after provision for loan losses	3,379,687	574,573	9,991,646	6,713,672
Noninterest income:				
Service charge on deposits	808,835	831,931	2,399,139	2,492,420
Investment securities gains, net	1,015,462	827,221	1,040,566	1,046,575
Mortgage loan and related fees	105,625	112,780	226,661	250,481
Other	236,905	(25,613)	679,853	397,193
Total noninterest income	2,166,827	1,746,319	4,346,219	4,186,669
Noninterest expense:				
Salaries and benefits	2,263,052	2,159,326	6,684,414	6,481,307
Net occupancy expense	499,747	568,779	1,468,249	1,665,045
Other	2,457,824	2,319,109	5,063,462	5,056,462
Total noninterest expense	5,220,623	5,047,214	13,216,125	13,202,814
Earnings (losses) before income tax expense (benefits)	325,891	(2,726,322)	1,121,740	(2,302,473)
Income tax expense (benefits)	73,608	(1,099,000)	277,631	(1,176,309)
Net earnings (losses)	252,283	(1,627,322)	844,109	(1,126,164)
Preferred stock dividends	51,500	154,500	154,500	412,000
Accretion on preferred stock discount	17,396	16,426	51,448	48,579
Net earnings (losses) available to common shareholders	$183,387	$(1,798,248)	$638,161	$(1,586,743)
Basic earnings (losses) per share	$0.08	$(0.78)	$0.27	$(0.69)
Diluted earnings (losses) per share	$0.08	$(0.78)	$0.27	$(0.69)

Basic weighted average shares outstanding	2,343,931	2,296,709	2,327,814	2,284,265
Diluted weighted average shares outstanding	2,343,931	2,297,385	2,327,814	2,284,941
Cash dividend per share	$-	$-	$-	$-
Statement of Comprehensive Income (Loss)				
Net earnings (losses)	$252,283	$(1,627,322)	$844,109	$(1,126,164)
Other comprehensive income (loss), net of tax:				
Unrealized holding gains arising during the period	817,785	328,083	1,376,851	844,510
Reclassification adjustment for gains included in net earnings (losses)	(609,277)	(496,333)	(624,340)	(627,945)
Comprehensive income (loss)	$460,791	$(1,795,572)	$1,596,620	$(909,599)

See Notes to Consolidated Financial Statements

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United Bancorporation of Alabama, Inc.
and Subsidiary
Consolidated Statements of Cash Flows
(Unudited)

	Nine Months Ended September 30 2011	Nine Months Ended September 30 2010
Cash flows from operating activities		
Net earnings (losses)	$844,109	$(1,126,164)
Adjustments to reconcile net earnings (losses) to net cash provided by operating activities		
Provision for loan losses	1,150,000	4,138,000
Depreciation of premises and equipment	712,009	876,948
Net amortization of premuim / discount on investment securities available for sale	311,233	216,555
Net amortization of premium / discount on investment securities held to maturity	123,779	41,552
Gain on sales of investment securities available for sale, net	(1,040,566)	(1,046,575)
(Gain) loss on sale of other real estate	(36,748)	1,277
Writedown on other real estate	1,352,964	200,722
Writeoff of intangible assets	-	934,763
Originations of loans held for sale	(2,890,976)	-
Proceeds from sales of loans held for sale	2,890,976	-
Stock-based compensation	18,669	21,501
(Increase) decrease in interest receivable	(55,412)	449,480
(Increase) decrease in other assets	2,248,661	(592,972)
Decrease in interest payable	(101,010)	(209,069)
Increase (decrease) in accrued expenses and other liabilities	(94,913)	289,868
Net cash provided by operating activities	5,432,775	4,195,886
Cash flows from investing activities		
Proceeds from maturities, calls, and principal repayments of investment securities available for sale	8,267,409	18,916,216
Proceeds from maturities, calls, and principal repayments of investment securities held to maturity	2,489,410	5,235,926
Proceeds from sales of investment securities available for sale	37,975,613	36,069,589
Purchases of investment securities available for sale	(41,249,927)	(54,964,039)
Purchases of investment securities held to maturity	(6,598,997)	(6,931,110)
Net increase in loans	(13,356,063)	(4,959,168)
Purchases of premises and equipment, net	(311,708)	(62,996)
Proceeds from sale of other real estate	921,193	1,450,347
Net cash used in investing activities	(11,863,070)	(5,245,235)
Cash flows from financing activities		
Net increase (decrease) in deposits	(33,369,378)	26,159,318
Cash dividends - preferred stock	(154,500)	(412,000)

Cash dividends - common stock	(6,427)	(5,969)
Repayments of advances from FHLB Atlanta	(139,850)	(139,850)
Increase (decrease) in other borrowed funds	(40,948)	285,083
Net cash provided by (used in) financing activities	(33,711,103)	25,886,582
Net increase (decrease) in cash and cash equivalents	(40,141,398)	24,837,233
Cash and cash equivalents, beginning of period	80,966,109	54,668,111
Cash and cash equivalents, end of period	$40,824,711	$79,505,344
Supplemental disclosures		
Cash paid during the period for:		
Interest	$2,718,192	$3,929,229
Income taxes	52,509	52,705
Noncash transactions		
Transfer of loans to other real estate through foreclosure	$1,582,506	$3,216,600

See Notes to 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") 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 Corporation's Annual Report on Form 10-K for the year ended December 31, 2010.

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NOTE 2 – Net Earnings (Losses) per Share

Basic net earnings (losses) per share were computed by dividing net losses by the weighted average number of shares of common stock outstanding during the three and nine month periods ended September 30, 2011 and 2010. Common stock outstanding consists of issued shares less treasury stock. Diluted net earnings (losses) per share for the three and nine month periods ended September 30, 2011 and 2010 were computed by dividing net earnings (losses) by the weighted average number of shares of common stock and the dilutive effects of the shares subject to options and restricted stock grants awarded under the Corporation's equity incentive plans, based on the treasury stock method using an average fair market value of the stock during the respective periods. There was no dilutive effect for the three and nine months ended September 30, 2011 because the exercise price of the stock awards, described in Note 7 below, was greater than the fair value of the stock as of September 30, 2011. Presented below is a summary of the components used to calculate diluted earnings (losses) per share for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Diluted earnings (losses) per share	$0.08	$(0.78)	$0.27	$(0.69)
Weighted average common shares outstanding	2,343,931	2,296,709	2,327,814	2,284,265
Effect of the assumed exercise of stock options based on the treasury stock method using average market price	-	676	-	676
Total weighted average common shares and potential common stock outstanding	2,343,931	2,297,385	2,327,814	2,284,941

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NOTE 3 – Investment Securities

The amortized cost and fair value of investment securities available for sale at September 30, 2011 and December 31, 2010 were as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2011				
U.S. Treasury securities	$7,007,583	$21,636	$-	$7,029,219
U.S. government sponsored agencies	49,299,044	468,215	(120,054)	49,647,205
State and political subdivisions	8,938,246	247,247	(69,361)	9,116,132
Mortgage-backed securities	-	-	-	-
Equity securities	10,153	-	(3,663)	6,490
	$65,255,026	$737,098	$(193,078)	$65,799,046
December 31, 2010				
U.S. Treasury securities	$19,207,231	$157,497	$(135,666)	19,229,062
U.S. government sponsored agencies	35,391,603	273,654	(497,372)	35,167,885
State and political subdivisions	9,744,841	69,416	(447,406)	9,366,851
Mortgage-backed securities	5,164,961	-	(126,710)	5,038,251
Equity securities	10,153	-	(3,578)	6,575
	$69,518,789	$500,567	$(1,210,732)	$68,808,624

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The amortized cost and fair value of investment securities held to maturity at September 30, 2011 and December 31, 2010 were as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2011				
U.S. government sponsored agencies	$14,816,613	$625,816	$-	$15,442,429
Mortgage-backed securities	6,431,801	268,952	-	6,700,753
	$21,248,414	$894,768	$-	$22,143,182
December 31, 2010				
U.S. government sponsored agencies	$17,262,606	$290,222	$(249,964)	$17,302,864
	$17,262,606	$290,222	$(249,964)	$17,302,864

Those investment securities classified as available for sale which have an unrealized loss position at September 30, 2011 and December 31, 2010 are detailed below:

September 30, 2011

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
U.S. Treasury securities	$-	$-	$-	$-	$-	$-
U.S. government sponsored agencies	20,567,905	(120,054)	-	-	20,567,905	(120,054)
State and political subdivisions	193,800	(4,586)	1,133,468	(64,775)	1,327,268	(69,361)
Mortgage-backed securities	-	-	-	-	-	-
Equity securities	-	-	6,490	(3,663)	6,490	(3,663)
Total temporarily impaired securities	$20,761,705	$(124,640)	$1,139,958	$(68,438)	$21,901,663	$(193,078)

December 31, 2010

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
U.S. Treasury securities	$3,954,531	$(135,666)	$-	$-	$3,954,531	$(135,666)
U.S. government sponsored agencies	17,681,269	(497,372)	-	-	17,681,269	(497,372)
State and political subdivdisions	4,537,904	(289,375)	636,830	(158,031)	5,174,734	(447,406)
Mortgage-backed securities	5,038,251	(126,710)	-	-	5,038,251	(126,710)
Equity securities	-	-	6,575	(3,578)	6,575	(3,578)
Total temporarily impaired securities	$31,211,955	$(1,049,123)	$643,405	$(161,609)	$31,855,360	$(1,210,732)

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No investment securities classified as held to maturity had an unrealized loss position at September 30, 2011. The investment securities classified as held to maturity which had an unrealized loss position as of December 31, 2010 are detailed below.

December 31, 2010

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
U.S. Government sponsored agencies	$7,640,567	$(249,964)	$-	$-	$7,640,567	$(249,964)
Total temporarily impaired securities	$7,640,567	$(249,964)	$-	$-	$7,640,567	$(249,964)

U.S. Treasury securities. There was no unrealized loss related to investments in U.S. Treasury obligations as of September 30, 2011.

U.S. Government sponsored agencies. The unrealized losses on eleven investments in direct obligations of U.S. government sponsored agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Corporation does not currently intend to sell the investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Corporation does not consider those investments to be other-than-temporarily impaired at September 30, 2011.

States and political subdivisions. The unrealized losses associated with five securities issued by state and political subdivisions are primarily driven by wider credit spreads and changes in interest rates. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Corporation does not currently intend to sell the investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Corporation does not consider those investments to be other-than-temporarily impaired at September 30, 2011.

Mortgage-backed securities. There was no unrealized loss related to investments in mortgage-backed securities as of September 30, 2011.

Equity securities. The Corporation's investment in equity securities consists of a single investment in the common stock of a government-sponsored enterprise. Because of the Corporation's ability and intent to hold the investment for a reasonable period of time sufficient for a forecasted recovery of fair value, the Corporation does not consider this investment to be other-than-temporarily impaired at September 30, 2011.

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The following table presents the amortized costs, fair value and weighted-average yield of securities available for sale by contractual maturity at September 30, 2011. In some cases, the issuers may have the right to call or prepay obligations without call or prepayment penalties prior to the contractual maturity date. Rates are calculated on a fully tax-equivalent basis using a 35% Federal Income Tax rate.

	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Amortized Cost					
U.S. Treasury securities	$7,007,583	$-	$-	$-	$7,007,583
U.S. governement sponsored agencies	1,024,849	42,177,846	6,096,349	-	49,299,044
State and political subdivisions	149,984	493,986	3,668,243	4,626,033	8,938,246
Equity securities	10,153	-	-	-	10,153
Total	$8,192,569	$42,671,832	$9,764,592	$4,626,033	$65,255,026
Fair Value					
U.S. Treasury securities	$7,029,219	$-	$-	$-	$7,029,219
U.S. governement sponsored agencies	1,032,228	42,438,336	6,176,641	-	49,647,205
State and political subdivisions	150,215	519,922	3,813,281	4,632,714	9,116,132
Equity securities	6,490	-	-	-	6,490
Total	$8,218,152	$42,958,258	$9,989,922	$4,632,714	$65,799,046
Total Average Yield	1.05 %	1.16 %	2.84 %	4.12 %	1.60 %

The following table presents the amortized costs, fair value and weighted-average yield of securities held to maturity by contractual maturity at September 30, 2011. In some cases, the issuers may have the right to call or prepay obligations without call or prepayment penalties prior to the contractual maturity date. Rates are calculated on a fully tax-equivalent basis using a 35% Federal income tax rate.

	Within 1 Year	1 to 5 Years	5 to 10 Years	Over 10 Years	Total
Amortized Cost					
U.S. government sponsored agencies	$999,955	$7,033,240	$6,783,418	$-	$14,816,613
Mortgage-backed securities	-	-	-	6,431,801	6,431,801
Total	$999,955	$7,033,240	$6,783,418	$6,431,801	$21,248,414
Fair Value					
U.S. government sponsored agencies	$1,005,004	$7,443,608	$6,993,817	$-	$15,442,429
Mortgage-backed securities	-	-	-	6,700,753	6,700,753
Total	$1,005,004	$7,443,608	$6,993,817	$6,700,753	$22,143,182
Total Average Yield	2.02 %	2.76 %	2.11 %	3.16 %	2.64 %

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The gross gains and gross losses realized by the Corporation from sales of investment securities available for sale for the three months and nine months ended September 30, 2011 and 2010 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Gross gains realized	$ 1,027,392	$ 889,500	$ 1,053,089	$ 1,133,280
Gross losses realized	(11,930)	(62,279)	(12,523)	(86,705)
Net gain (loss) realized	$ 1,015,462	$ 827,221	$ 1,040,566	$ 1,046,575

There were no sales of securities held to maturity for the three or nine months ended September 30, 2011 or 2010.

Investment securities available for sale with fair values of $23,580,793 and $28,143,732 at September 30, 2011 and December 31, 2010, respectively, were pledged to secure federal funds lines, Federal Home Loan Bank advances, and public and trust deposits as required by law and for other purposes.

Investment securities held to maturity with amortized costs of $13,817,563 and $15,424,330 at September 30, 2011 and December 31, 2010, respectively, were pledged to secure federal funds lines and public and trust deposits as required by law and for other purposes.

Restricted equity securities (included in Other assets in the Consolidated Balance Sheets) primarily consist of the following as of September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Federal Home Loan Bank stock	$ 896,900	$ 1,046,700
First National Bankers' Bank stock	825,000	825,000
	$ 1,721,900	$ 1,871,700

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NOTE 4 – Loans and Allowance for Loan Losses

At September 30, 2011 and December 31, 2010, the composition of the loan portfolio was as follows:

	September 30, 2011	December 31, 2010
Real estate:		
Construction and land loans	$ 38,122,009	$ 36,825,855
Farmland	30,380,181	30,269,876
1-4 family residential mortgage	53,783,077	58,342,993
Multifamily	4,111,348	3,082,066
Commercial	77,971,042	73,800,481
Agriculture	27,688,016	12,633,816
Commercial	22,934,438	29,413,147
Consumer	13,681,707	13,597,817
States and political subdivisions	4,168,942	3,735,144
Other loans	91,033	69,620
Gross loans held for investment	272,931,793	261,770,815
Allowance for loan losses	(5,677,419)	(5,139,998)
Net loans held for investment	267,254,374	256,630,817
Loans held for sale	-	-
Total loans	$ 267,254,374	$ 256,630,817

Historically, the Bank has acted in an agent or broker capacity when originating mortgage loans for customers. During the second quarter, the Bank began to originate mortgage loans in a principal capacity and hold them for resale. There were no loans held for sale as of September 30, 2011.

The following table summarizes the activity in the allowance for loan losses for the nine month periods ended (in thousands):

	September 30, 2011	September 30, 2010
Balance at beginning of year	5,140	7,436
Provision charged to expense	1,150	4,138
Loans charged off	(753)	(6,150)
Recoveries	140	91
Balance at end of period	5,677	5,515

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At September 30, 2011 and 2010, the totals of nonaccrual loans were $15,813,000 and $17,931,000, respectively.

The Corporation assigns a risk rating to each loan when approved. The rating categories are based on information about the ability of borrowers to service the debt. Such information includes, among other things, current financial information, payment history, credit documentation and current economic conditions. Loan Officers are expected and required to initiate recommendations for changes in assigned risk ratings according to changes in the overall levels of risk in each loan in their portfolio no less than monthly. The current risk rating will be reviewed from time to time by the Chief Credit Officer and the Special Assets Officer for concurrence. The Corporation uses the following guidelines in determining the appropriate risk rating:

Grade 1: Investment Grade – There is an absence of credit risk. Loans in this category are fully secured by United Bank certificates of deposit or savings accounts (demand deposit accounts are not eligible as collateral). The certificate should be sufficient in amount to cover principal and interest.

Grade 2: Minimal Credit Risk – The overall financial condition is very strong. Businesses should have high liquidity, a history of stable and predictable earnings, a strong management team and the primary source of repayment is clear and subject to little risk. Customers should have a substantial net worth in liquid assets with a well defined source of repayment.

Grade 3: Attractive Credit Risk - The overall financial condition is good. Financial statements are current and show satisfactory income, profits, cash flow, and debt service coverage, debt to worth ratio and credit history. Loans in this category are properly structured and documented and require only minimal supervision.

Grade 4: Average Risk – The overall financial condition is average. Credit history has been satisfactory. Refinancing could be obtained with normal effort. Financial statements are current and show some volatility in income, profits, cash flow, debt service coverage or credit history. The volatility is easily identifiable and has been addressed and does not constitute an unwarranted level of risk.

Grade 5: Acceptable Risk – The overall financial condition of the business or individual is acceptable. There is more than average credit risk and the credit should be more closely watched but there is little chance of loss. While acceptable, loans in this category may warrant close monitoring for any number of reasons including inconsistent earnings, leveraged balance sheet, economic conditions, collateral requiring close supervision, financial information that is stale or incomplete or irregular payment record.

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Grade 6: Monitor - This asset has potential weakness and deserves management attention. If left uncorrected the potential weakness may result in deterioration of the overall financial condition. There is no room for debt expansion and they are fully leveraged. If liquidation were to take place there could be a minimal loss and thus an analysis should be made to determine if a specific reserve is needed.

Grade 7: Substandard – This asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Loans in this category involve more than a normal risk. There is limited opportunity to refinance. If liquidation were to take place there could be some recognized loss exposure. If the loan is determined to be impaired, an analysis will be performed to determine the amount of reserve, if any, to be recognized.

Grade 8: Doubtful – A loss is highly likely and there probably will be a default. There is no ability to refinance. At this point collection effort should be in full process. Loans in this category will be reserved at a specific amount in line with the impairment analysis performed if the loan is determined to be impaired.

These risk ratings are summarized into categories as follows: Pass includes loans with Grades 1-5, Special Mention includes loans with a Grade of 6, and Substandard / Doubtful include loans with Grades 7 and 8.

The following tables summarize the credit risk profile of the loan portfolio by internally assigned grades as of September 30, 2011 (in thousands).

	Pass	Special Mention	Substandard / Doubtful	Total
Real estate:				
Construction and land loans	$ 23,304	$ 3,460	$ 11,358	$ 38,122
Farmland	20,354	4,970	5,056	30,380
1-4 family residential mortgage	48,976	3,931	876	53,783
Multifamily	4,111	-	-	4,111
Commercial	55,057	14,125	8,789	77,971
Agriculture	22,116	3,618	1,954	27,688
Commercial	21,178	763	994	22,935
Consumer	13,587	71	24	13,682
States and political subdivisions	4,169	-	-	4,169
Other loans	91	-	-	91
Total	$ 212,943	$ 30,938	$ 29,051	$ 272,932

Approximately $543,000 of the $29,051,000 identified as Substandard / Doubtful above were considered Doubtful as of September 30, 2011.

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The following table summarizes the credit risk profile of our loan portfolio by internally assigned grades as of December 31, 2010 (in thousands).

	Pass	Special Mention	Substandard / Doubtful	Total
Real estate:				
Construction and land loans	$ 19,306	$ 4,250	$ 13,270	$ 36,826
Farmland	18,438	6,352	5,480	30,270
1-4 family residential mortgage	52,544	3,538	2,261	58,343
Multifamily	3,082	-	-	3,082
Commercial	53,704	12,026	8,070	73,800
Agriculture	8,807	2,110	1,717	12,634
Commercial	21,853	3,223	4,337	29,413
Consumer	13,335	65	198	13,598
States and political subdivisions	3,735	-	-	3,735
Other loans	65	-	5	70
Total	$ 194,869	$ 31,564	$ 35,338	$ 261,771

Approximately $615,000 of the $35,338,000 identified as Substandard / Doubtful above were considered Doubtful as of December 31, 2010.

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The following table details the Bank's non-accrual loans as of September 30, 2011 and December 31, 2010 (in thousands).

	September 30, 2011	December 31, 2010
Non-accrual loans:		
Real estate:		
Construction, land development, and other land loans	$7,880	$8,966
Farmland	937	1,210
1-4 family residential mortgage	668	801
Multifamily	-	-
Commercial	3,910	2,803
Agriculture	1,485	1,603
Commercial	908	2,162
Consumer	25	-
States and political subdivisions	-	-
Other loans	-	-
Total nonaccrual loans	$15,813	$17,545

The following table details the Bank's allowance for loan loss as of September 30, 2011 and December 31, 2010 (in thousands).

	September 30, 2011	December 31, 2010
Allowance for loan losses:		
Real estate:		
Construction, land development, and other land loans	$2,571	$2,176
Farmland	147	119
1-4 family residential mortgage	505	576
Multifamily	9	7
Commercial	1,321	1,100
Agriculture	328	201
Commercial	627	772
Consumer	157	178
States and political subdivisions	9	9
Other loans	3	2
Total allowance for loan losses	$5,677	$5,140

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Changes in the allowance for loan losses for the periods ended September 30, 2011 and 2010 are as follows (in thousands):

	September 30, 2011	September 30, 2010
Average amount of loans outstanding, net	$ 264,178	$ 282,274
Reserve for loan losses:		
Beginning balance	$ 5,140	$ 7,436
Loans charged off:		
Real estate:		
Construction and land loans	(41)	(2,788)
Farmland	-	(11)
1-4 family residential mortgage	(225)	(609)
Multifamily	-	-
Commercial	(109)	(529)
Agriculture	(17)	(104)
Commercial	(301)	(1,949)
Consumer	(59)	(160)
States and political subdivisions	-	-
Other loans	(1)	(1)
Total charged off	(753)	(6,151)
Recoveries:		
Real estate:		
Construction and land loans	8	10
Farmland	-	2
1-4 family residential mortgage	6	41
Multifamily	-	-
Commercial	9	-
Agriculture	9	13
Commercial	85	3
Consumer	23	21
States and political subdivisions	-	-
Other loans	-	2
Total recoveries	140	92
Loans charged off, net	(613)	(6,059)
Additions to the allowance charged to operations	1,150	4,138
Ending balance	$ 5,677	$ 5,515
Net annualized charge offs to average loans	0.31 %	2.85 %

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A loan is considered impaired when, based on current information and events; it is probable that the Bank will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

The following tables detail the Bank's impaired loans, by portfolio class, as of September 30, 2011 (in thousands).

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no specific allowance reserved				
Real estate:				
Construction and land loans	$-	$-	$-	$-
Farmland	662	662	-	-
1-4 family residential mortgage	423	423	-	3
Multifamily	-	-	-	-
Commercial	314	314	-	13
Agriculture	1,350	1,350	-	156
Commercial	149	2,118	-	2
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	$2,898	$4,867	$-	$174

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With specific allowance reserved				
Real estate:				
Construction and land loans	$8,862	$10,465	$1,514	$52
Farmland	146	146	69	-
1-4 family residential mortgage	551	551	30	34
Multifamily	-	-	-	-
Commercial	3,803	3,803	934	29
Agriculture	116	116	65	-
Commercial	857	857	326	2
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	$14,335	$15,938	$2,938	$117

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	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
Total Impaired Loans				
Real estate:				
Construction and land loans	$8,862	$10,465	$1,514	$52
Farmland	808	808	69	-
1-4 family residential mortgage	974	974	30	37
Multifamily	-	-	-	-
Commercial	4,117	4,117	934	42
Agriculture	1,466	1,466	65	156
Commercial	1,006	2,975	326	4
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	$17,233	$20,805	$2,938	$291

The following tables detail the Bank’s impaired loans, by portfolio class, as of December 31, 2010 (in thousands).

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no specific allowance reserved				
Real estate:				
Construction and land loans	$2,748	$3,948	$-	$2
Farmland	3,485	3,485	-	55
1-4 family residential mortgage	1,320	1,320	-	42
Multifamily	-	-	-	-
Commercial	256	256	-	11
Agriculture	1,338	1,338	-	45
Commercial	1,157	3,168	-	12
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	$10,304	$13,515	$-	$167

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	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With specific allowance reserved				
Real estate:				
Construction and land loans	$6,813	$7,315	$1,029	$95
Farmland	150	150	33	5
1-4 family residential mortgage	223	223	129	9
Multifamily	-	-	-	-
Commercial	2,871	2,871	565	61
Agriculture	252	252	74	14
Commercial	987	987	445	8
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	$11,296	$11,798	$2,275	$192

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
Total Impaired Loans				
Real estate:				
Construction and land loans	$9,561	$11,263	$1,029	$97
Farmland	3,635	3,635	33	60
1-4 family residential mortgage	1,543	1,543	129	51
Multifamily	-	-	-	-
Commercial	3,127	3,127	565	72
Agriculture	1,590	1,590	74	59
Commercial	2,144	4,155	445	20
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	$21,600	$25,313	$2,275	$359

The average amount of impaired loans for the nine months ended September 30, 2011 was $18,785,000. If impaired loans had been current throughout their terms, interest income would have been increased by $445,349 as of the nine months ended September 30, 2011. There was $291,125 of interest income recognized from impaired loans for the nine months ended September 30, 2011.

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The following table summarizes the allowance related to impaired loans and the impaired loan balances by portfolio segment at September 30, 2011 (in thousands):

	ALL Ending Balance	Individually Evaluated	Collectively Evaluated
Real estate:			
Construction and land loans	$ 1,514	$ 8,862	$ -
Farmland	69	808	-
1-4 family residential mortgage	30	974	-
Multifamily	-	-	-
Commercial	934	4,117	-
Agriculture	65	1,466	-
Commercial	326	1,006	-
Consumer	-	-	-
States and political subdivisions	-	-	-
Other loans	-	-	-
Total	$ 2,938	$ 17,233	$ -

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The following table summarizes the allowance related to impaired loans and the impaired loan balances by portfolio segment at December 31, 2010 (in thousands):

	ALL Ending Balance	Individually Evaluated	Collectively Evaluated
Real estate:			
Construction and land loans	$ 1,029	$ 9,561	$ -
Farmland	33	3,635	-
1-4 family residential mortgage	129	1,543	-
Multifamily	-	-	-
Commercial	565	3,127	-
Agriculture	74	1,590	-
Commercial	445	2,144	-
Consumer	-	-	-
States and political subdivisions	-	-	-
Other loans	-	-	-
Total	$ 2,275	$ 21,600	$ -

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The table below provides an analysis of past due status as of September 30, 2011 (in thousands):

	Past Due Loans (Accruing Interest)						Total
	30-59 days	60-89 days	90+ days	Total	Nonaccrual	Current	Loans
Real estate:							
Construction and land loans	$625	$-	$-	$625	$7,880	$29,617	$38,122
Farmland	85	124	175	384	937	29,059	30,380
1-4 family residential mortgage	170	211	58	439	668	52,676	53,783
Multifamily	-	-	-	-	-	4,111	4,111
Commercial	1,401	956	512	2,869	3,910	71,192	77,971
Agriculture	-	-	-	-	1,485	26,203	27,688
Commercial	88	66	-	154	908	21,873	22,935
Consumer	71	13	4	88	25	13,569	13,682
States and political subdivisions	-	-	-	-	-	4,169	4,169
Other loans	-	-	-	-	-	91	91
Totals	$2,440	$1,370	$749	$4,559	$15,813	$252,560	$272,932

The table below provides an analysis of past due status as of December 31, 2010 (in thousands):

	Past Due Loans (Accruing Interest)						Total
	30-59 days	60-89 days	90+ days	Total	Nonaccrual	Current	Loans
Real estate:							
Construction and land loans	$860	$106	$-	$966	$8,966	$26,894	$36,826
Farmland	2,527	18	519	3,064	1,210	25,996	30,270
1-4 family residential mortgage	155	51	-	206	801	57,336	58,343
Multifamily	-	-	-	-	-	3,082	3,082
Commercial	880	610	-	1,490	2,803	69,507	73,800
Agriculture	-	-	-	-	1,603	11,031	12,634
Commercial	119	-	-	119	2,162	27,132	29,413
Consumer	100	15	19	134	-	13,464	13,598
States and political subdivisions	-	-	-	-	-	3,735	3,735
Other loans	1	-	-	1	-	69	70
Totals	$4,642	$800	$538	$5,980	$17,545	$238,246	$261,771

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Restructured loans are loans on which, because of a borrower's financial difficulties, the Corporation has granted a concession that would not otherwise be considered. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current market rate for new debt with similar risk, or a reduction of the face amount of debt, or either forgiveness of either principal or accrued interest.

The following table summarizes, as of September 30, 2011, loans that have been restructured during 2011 (in thousands):

	Troubled-Debt Restructurings		
	Number of Loans	Recorded Investment Prior to Modification	Recorded Investment After Modification
Real estate:			
Construction and land loans	4	$ 5,821	5,358
Farmland	2	245	234
1-4 family residential mortgage	3	533	486
Multifamily	-	-	-
Commercial	4	2,178	2,055
Agriculture	3	1,353	1,349
Commercial	5	692	642
Consumer	-	-	-
States and political subdivisions	-	-	-
Other loans	-	-	-
Total:	21	10,822	10,124

The Corporation has not forgiven any principal on the above loans. At September 30, 2011, $10,003,000 of the above loans restructured in 2011 are held as non-accrual.

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The following table summarizes, as of September 30, 2011, loans that were restructured within the last 12 months that have subsequently defaulted (in thousands):

	Troubled-Debt Restructurings That Have Subsequently Defaulted	
	Number of Loans	Recorded Investment
Real estate:		
Construction, land development, and other land loans	-	$-
Farmland	-	-
1-4 family residential mortgage	-	-
Multifamily	-	-
Commercial	1	32
Agriculture	-	-
Commercial	-	-
Consumer	-	-
States and political subdivisions	-	-
Other loans	-	-
Total:	1	$32

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NOTE 5 – Other Real Estate (ORE)

The table below presents a summary of the activity related to ORE (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Beginning balance	$10,852	$8,660	$10,164	$7,611
Additions	69	1,913	1,582	3,216
Sales (inclusive of gains and losses)	(109)	(1,196)	(884)	(1,450)
Direct write-downs	(1,303)	(201)	(1,353)	(201)
Ending balance	$9,509	$9,176	$9,509	$9,176

NOTE 6 – Operating Segments

The Corporation operates in only one segment – commercial banking.

NOTE 7 – Stock Based Compensation

At September 30, 2011, the Corporation had two stock-based compensation plans. The 1998 Stock Option Plan and the 2007 Equity Incentive Plan are described more fully in Note 13 to the Consolidated Financial Statements in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010. The Corporation recognizes compensation expense for all stock based payments based upon the grant date fair value.

Stock Options

1998 Stock Option Plan

The following table represents stock option activity for the nine months ended September 30, 2011:

	Shares under option	Weighted average exercise price per share	Weighted average remaining contractual life
Options outstanding, beginning of period	22,486	16.15	
Granted	—	—	
Surrendered	—	—	
Exercised	—	—	
Options outstanding, end of period	22,486	16.15	1.4
Exercisable, end of period	22,486	16.15	1.4

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There was no intrinsic value related to option shares outstanding and exercisable for the periods ended September 30, 2011 and 2010, respectively.

The 1998 Stock Option Plan terminated pursuant to its terms effective December 22, 1998 and no additional awards will be made under such plan.

2007 Equity Incentive Plan

The following table represents stock option activity for the nine months ended September 30, 2011:

	Shares under option	Weighted average exercise price per share	Weighted average remaining contractual life
Options outstanding, beginning of period	4,000	14.85	
Granted	—	—	
Surrendered	—	—	
Exercised	—	—	
Options outstanding, end of period	4,000	14.85	7.7
Exercisable, end of period	2,400	14.85	7.7

There was no intrinsic value related to option shares outstanding and exercisable for the periods ended September 30, 2011 and 2010, respectively.

Restricted Stock

The following table represents restricted stock activity under the 2007 Equity Incentive Plan for the nine months ended September 30, 2011:

	Restricted stock activity	Weighted average fair value
Shares under grant at beginning of period	5,515	16.65
Granted	-	—
Surrendered	-	—
Vested	(1,225)	15.98
Shares under grant at end of period	4,290	16.84

Shares available for future stock grants to employees and directors under the 2007 Equity Incentive Plan of United Bancorporation of Alabama, Inc. were 293,843 at September 30, 2011.

As of September 30, 2011, there was $47,271 of total unrecognized compensation costs related to the nonvested share based compensation arrangements granted under the 1998 and 2007 Plans. That cost is expected to be recognized over a period of approximately 4 years.

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NOTE 8 – Fair Value of Financial Instruments

The Corporation uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic (FASB ASC 820), the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Corporation groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

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A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Assets Measured at Fair Value on a Recurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Available for Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

	Fair Value Measurements at September 30, 2011 Using			
	Assets/Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs Level (2)	Significant Unobservable Inputs (Level 3)
AFS Securities	$65,799,046	$9,035,709	$56,763,337	$ -

	Fair Value Measurements at December 31, 2010 Using			
	Assets/Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs Level (2)	Significant Unobservable Inputs (Level 3)
AFS Securities	$68,808,624	$21,203,537	$47,605,087	$ -

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Assets Measured at Fair Value on a Nonrecurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans

Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan is confirmed. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the loan impairment as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the loan impairment as nonrecurring Level 3.

Other Real Estate (Foreclosed Assets)

Other real estate is adjusted to fair value upon transfer from the loan portfolio. Subsequently, other real estate assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management’s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the other real estate as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the other real estate as nonrecurring Level 3.

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The following tables present the assets carried on the balance sheet by asset type and by level within the FASB ASC 820 valuation hierarchy (as described above) as of September 30, 2011 and December 31, 2010, for which a nonrecurring change in fair value has been recorded.

	Carrying Value at September 30, 2011				Nine Months Ended September 30, 2011
	Total	Level 1	Level 2	Level3	Total losses
Impaired loans (1)	$14,916,650	$-	$-	$14,916,650	$ (1,415,597)
Foreclosed assets	9,509,089	-	-	9,509,089	(1,316,216)

(1) Losses related to loans were recognized as either charge-offs or specific allocations of the allowance for loan loss

	Carrying Value at December 31, 2010				Twelve Months Ended December 31, 2010
	Total	Level 1	Level 2	Level3	Total losses
Impaired loans (1)	$11,367,697	$-	$-	$11,367,697	$ (4,023,954)
Foreclosed assets	10,163,992	-	-	10,163,992	(199,999)

(1) Losses related to loans were recognized as either charge-offs or specific allocations of the allowance for loan loss

Fair Value of Financial Instruments

The assumptions used in estimating the fair value of the Corporation's financial instruments are explained below. Where quoted market prices are not available, fair values are based on estimates using discounted cash flow and other valuation techniques. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Corporation's financial instruments, but rather a good–faith estimate of the fair value of financial instruments held by the Corporation. FASB ASC 820 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

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The following methods and assumptions were used by the Corporation in estimating the fair value of its financial instruments:

(a) Cash and Short-term Investments

Fair value approximates the carrying value of such assets.

(b) Investment Securities and Other Securities

The fair value of investment securities is based on quoted market prices. The fair value of other securities, which includes Federal Home Loan Bank stock and other correspondent stocks, approximates their carrying value.

(c) Loans

The fair value of loans is calculated using discounted cash flows and excludes lease–financing arrangements. The discount rates used to determine the present value of the loan portfolio are estimated market discount rates that reflect the credit and interest rate risk inherent in the loan portfolio. The estimated maturities are based on the Corporation's historical experience with repayments adjusted to estimate the effect of current market conditions.

(d) Bank Owned Life Insurance

The fair value of bank owned life insurance approximates its carrying value.

(e) Deposits

The fair value of deposits with no stated maturity, such as non–interest bearing demand deposits, NOW accounts, savings and money market deposit accounts, approximates the carrying value. Certificates of deposit have been valued using discounted cash flows. The discount rates used are based on estimated market rates for deposits of similar remaining maturities.

The fair value estimates in the table below do not include the benefit that results from the low–cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

(f) FHLB, Other Borrowed Funds and Subordinated Debt

The fair value of the Corporation's other borrowed funds and subordinated debt approximates the carrying value of such liabilities. The fair value of FHLB advances have been valued using discounted cash flows. The discount rates used are based on estimated market rates for borrowings of similar remaining maturities.

(g) Accrued Interest

The fair value of accrued interest receivable and payable approximates their carrying value.

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(h) Commitments to Extend Credit and Standby Letters of Credit

There is no market for the commitment to extend credit and standby letters of credit and they were issued without explicit cost. Therefore, it is not practical to establish their fair value.

The carrying value and estimated fair value of the Corporation's financial instruments at September 30, 2011 and December 31, 2010 are as follows (in thousands):

	September 30, 2011		December 31, 2010	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets:		(Dollars in Thousands)		
Cash and short–term investments	$40,825	$40,825	$80,966	$80,966
Investment securities	87,047	87,942	86,071	86,111
Loans held for sale	—	—	—	—
Loans held for investment,net of the allowance for loan losses	267,254	270,957	256,631	264,155
Bank owned life insurance	2,928	2,928	2,845	2,845
Correspondent bank stock	1,722	1,722	1,872	1,872
Accrued interest receivable	2,248	2,248	2,193	2,193
Financial liabilities:				
Deposits	383,663	386,986	417,033	420,546
Other borrowed funds	903	903	944	944
FHLB advances	1,140	1,225	1,280	1,534
Subordinated Debt	10,310	10,310	10,310	10,310
Accrued interest payable	302	302	403	403

NOTE 9 – Recently Issued Accounting Pronouncements

FASB ASC 310 Receivables ("ASC 310") was amended to enhance disclosures about credit quality of financing receivables and the allowance for credit losses. The amendments require an entity to disclose credit quality information, such as internal risk gradings, more detailed nonaccrual and past due information, and modifications of its financing receivables. The disclosures under ASC 310, as amended, were effective for interim and annual reporting periods ending on or after December 15, 2010. The amendment did not have a significant impact on the Corporation's financial results, but it significantly expanded the disclosures that the Corporation is required to provide.

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On April 5, 2011, the FASB issued ASU 2011-02 "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring", which clarifies when creditors should classify loan modifications as troubled debt restructurings. The guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the year. The guidance on measuring the impairment of a receivable restructured in a troubled debt restructuring is effective on a prospective basis.

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

Forward Looking Statements

When used or incorporated by reference herein, the words “anticipate”, “estimate”, ”expect”, “project”, “target”, “goal” 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.

Critical Accounting Estimates

The Corporation’s accounting and reporting policies are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The Corporation’s significant accounting policies are described in the notes to the consolidated financial statements at December 31, 2010 as filed in the Corporation’s annual report on Form 10-K. Certain accounting policies require management to make significant estimates and assumptions, which have a material impact on the carrying value of certain assets and liabilities, and we consider these to be critical accounting policies. The estimates and assumptions used are based on historical experience and other factors that management believes to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and results of operations for the reporting periods.

Results of Operations

The following financial review is presented to provide an analysis of the results of operations of the Corporation and the Bank for the nine and three months ended September 30, 2011 and 2010, compared. This review should be used in conjunction with the condensed consolidated financial statements included in the Form 10-Q.

Nine Months Ended September 30, 2011 and 2010, Compared

Summary

The Corporation recorded net earnings of $844,109 for the nine month period ended September 30, 2011 as compared to the loss of $1,126,164 in the nine month period ended September 30, 2010. Net earnings available to common shareholders was $638,161 versus the loss of $1,586,743 in the year earlier period, both after recording the payment of the dividend on preferred shares and the associated amortization of warrants related to the Corporation’s participation in the Community Development Capital Initiative (“CDCI”) and Capital Purchase Program (“CPP”) offered by the United States Department of the Treasury. The CDCI dividends in 2011 were $154,500 compared with the $412,000 for the CPP dividends in 2010. This created improvement in the net earnings available to shareholders. The specifics of the changes are discussed in detail below.

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As has been discussed in the reports for the quarters ended in March 2011 and June 2011, total assets and non interest bearing deposits have decreased as a large depositor had accumulated funds in its account at the banking subsidiary at December 31, 2010 and subsequently withdrew these funds to repay debt to other lenders. The reduction from this particular account between December 31, 2010 and September 30, 2011 was $32,448,120. Additionally, because loan demand has been weak, the bank has not been aggressive in the time deposit market and has reduced balances in this category in response to the lower loan demand. Because of the decreased volatility of deposits from the account discussed above, total deposits and assets have declined to levels that the Corporation expects to be maintained.

Despite the lower level of earning assets, improvement was reported in net interest income, the difference between interest and fees earned on interest bearing assets and the interest paid on interest bearing liabilities. Net interest income increased by $289,974 or 2.7% to $11,141,646 and the net interest margin (net interest income divided by average assets) has increased to 3.77% in the first nine months of 2011 from 3.49% for the 2010 period.

The largest component contributing to the improvement in earnings was in the provision for losses on loans, which decreased by $2,988,000 or 72.2% to $1,150,000 as loan losses were lower in the 2011 period. Non-interest revenue was higher by 3.8% or $159,550 as losses from the sale of ORE were reduced in 2011. Non-interest expenses were virtually flat showing an increase of $13,311 or 0.1% between the two periods. There were two items present in the expense accounts (the write-down of ORE properties in 2011 and the write-off of intangible assets in 2010) that will be discussed in Noninterest expense below.

Net Interest Income

Net interest income was $11,141,646 during the first nine months of 2011, an increase of $289,974 or 2.7% from the level experienced during the same period in 2010.

Total interest income decreased $813,004 (5.6%) in the first nine months of 2011. The reduction in interest revenue is the result of lower levels of interest earning assets, particularly loans. Loan balances averaged approximately $18,100,000 less in the 2011 period than in the 2010 period. Loan yields averaged 5.92% compared to the 5.73% experienced in 2010. The Corporation has targeted increases in its loan portfolio in loan types with historically lower loss experience. Demand has not been strong resulting in the decline in interest income. The level of non-accrual loans noted in previous reports remains high and continues to have a negative impact on loan yields; however, the amount of these loans has declined since the beginning of 2011. In total, earning assets declined by $27,600,000 with the yield on these earning assets declining by .01% to 4.64% from 4.65% (The reduction is the effect of the reductions in deposits discussed above.)

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The decline in interest income was offset by a larger reduction in interest expense of $1,102,978, or 29.6%, compared to the same period in 2010. In the 2011 period, both the balances of interest bearing liabilities and the rate paid were lower than in 2010 as the Corporation managed the net interest margin. Loans averaged some $18,000,000 less than in the 2010 period and steps were taken to reduce the level of higher cost time deposits. As the result of this decision, interest bearing liabilities averaged $13,600,000 less in the first three quarters of 2011 than in the same period in 2010. The rate of interest paid on all interest bearing liabilities declined to 1.23% from 1.67% in 2010 or a reduction of 0.44%. Including the effect of non interest bearing demand deposits, the total cost of funds for the Corporation declined to 0.85% from 1.13% or by 0.28%.

The net interest margin expressed as a percentage of average total earning assets increased to 3.77% in the first nine months of 2011 from 3.49% in the same period in 2010.

Provision for Loan Losses

The provision for loan losses totaled $1,150,000 for the first nine months of 2011 as compared to $4,138,000 for the same period in 2010. For further discussion of this item see Allowance for Loan Losses below.

Noninterest Income

Total noninterest income increased by $159,550 in the 2011 period to $4,346,219 from the $4,186,669 reported in the 2010 period. A decrease in revenue from mortgage loan fees and service charges on deposits was offset by increased income from other sources.

Service charges on deposits decreased by $93,281 or 3.7% to $2,399,139 in 2011 from $2,492,420 in 2010. A reduction in fees for overdrafts (NSF fees) of $256,840 was partially offset by income from other service charges on deposit accounts, such as analysis fees, of $61,910 and income from increased ATM usage of $88,337. Income from the origination of mortgages was lower by 9.5% or $23,820. The reduction was to $226,661 for the 2011 period from $250,481 in the 2010 period.

Revenue from other income items was higher by $282,660. Several items combined to cause the increase with the largest being significantly lower losses on the disposal of ORE. This loss was reduced to $4,346 in 2011 from the loss of $149,899 experienced in 2010. Income from credit cards increased by $79,063 to $176,087 and several other income items combined to produce an increase of approximately $40,000.

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Noninterest Expense

Total noninterest expense for the nine months ended September 30, 2011 and 2010 was $13,216,125 and $13,202,814, respectively. This represents an increase of $13,311 or 0.1%. In
general, expense items that represent discretionary expenses were at or lower than the same period in 2010.

Salaries and benefits increased $203,107 (3.1%). Salaries to employees and officers increased by $73,745 or 1.4%. Benefits costs also increased. The cost of group insurance increased to $511,815 in 2011 from $454,671, an increase of 12.6%. This increase was the result of an increase in price as the number of employees was approximately the same in the two years. Matching contributions for the Corporations' 401(k) plan increased by $51,087 and payroll taxes were elevated from 2010 by $30,980.

Occupancy expenses were lower by $196,796 (11.8%) primarily due to lower depreciation expense ($160,116) as the Corporation has limited facilities' improvement and equipment purchases to situations where efficiency or customer experience may be compromised. Other categories of occupancy expenses were also generally lower.

The Other expense category totaled $5,063,462 which is an increase of $7,000 or 0.1% from the 2010 level of $5,056,462. Both the 2011 and 2010 periods contain large items. In 2011, the value of other real estate taken in foreclosure or satisfaction of loans (ORE) was written down by $1,352,964 as opposed to the $200,722 recorded in 2010, an increase of $1,284,584. In 2010, as a result of the Dodd Frank Act (which allowed interstate branching), the entire amount of intangible assets, approximately $935,000, was written off. These two transactions resulted in increased amounts of other expense in the nine months ended 2011 and 2010, respectively; however, the total expenses remained virtually unchanged as compared year-to-year.

FDIC insurance expense decreased by $256,493 in 2011 to $515,788 as the FDIC made a change to the method for calculating the insurance premium as defined by the Dodd Frank Act. Previously deposits were the base for calculation, but this was changed to be based on average total assets less average Tier I Equity and the assessment rates were lowered. The effect for smaller banks with fewer assets supported by borrowed funds is a reduction in FDIC insurance expense.

Income Taxes

Earnings before taxes of $1,121,740 were achieved in the first nine months of 2011. This is in contrast to the pre-tax loss of $2,302,473 recorded in the same period in 2010. For the 2011 period, the Corporation recorded an expense for taxes of $277,631 as compared to the tax benefit recognized in the same period in 2010 of $1,176,309. The increased expense was caused by the reduction in nontaxable interest income from investment in municipal securities and the general increase in profitability.

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Three Months Ended September 30, 2011 and 2010, Compared

Summary

Net earnings for the three months ended September 30, 2011 was $252,283 as compared to the net loss recorded in the same period in 2010 of $1,627,322. Net earnings available to common shareholders was $183,387 versus the loss in the 2010 period of $1,798,248. Both periods were after payments of the dividend on preferred shares of $51,500 in 2011 and $154,500 in 2010 and the associated amortization of warrants related to the Corporation's participation in the CDCI (2011) and the CPP (2010). The difference in the preferred dividends is the result of the reduction in the dividend rate to 2% from 5% as a result of the Treasury's exchange of CPP preferred shares (5% dividend rate) for preferred shares associated with the CDCI (2% dividend rate) in September, 2010. This exchange was discussed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2010.

Net Interest Income

Net interest income was $3,929,687 during the third quarter of 2011, an increase of $255,114 or 6.9% from the level experienced during the same period in 2010.

Total interest income decreased $60,541 (1.3%) in the third quarter of 2011. The decrease was the result of lower balances of earning assets in most categories partially offset by higher yields realized in the loan portfolio. Average earning asset balances declined by and average $54,500,000. Loans were lower by $14,300,000 on average and funds on deposit with the Federal Reserve were lower by $37,900,000. The reduction of funds held at the Federal Reserve is primarily the effect of the reductions in deposits discussed above and the loan decline was a function of lower loan demand. The yield realized on loans increased in the quarter by 0.41% from the 2010 period to 6.10%. The yield on total earning assets increased to 4.95% in the 2011 quarter from 4.43% in the 2010 quarter.

The decrease in interest income was more than offset by the decrease in interest cost. Total interest expense for the quarter ended September 30, 2011 was $817,425, which is a decrease of $315,655 from the $1,133,080 recorded in the same quarter in 2010. Interest bearing deposits and liabilities declined by $14,300,000 as the Corporation managed the interest margin as discussed previously. The rate paid on interest bearing deposits and liabilities showed a decline of 0.37% to 1.16% from 1.53%. When including non interest bearing deposits, the Corporation's total cost of funds declined to 0.82% for the quarter. This is a decrease of 0.18% from the cost of 1.00% in the 2010 quarter.

Net interest income increased for the third quarter of 2011 by $255,114 or 6.9% to $3,929,687. Expressed as a percentage of average assets, the Corporation had a net interest margin of 4.11% for the quarter ended September 30, 2011, an increase of 0.71% from the 3.41% reported in the same quarter of 2010.

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Provision for Loan Losses

The provision for loan losses totaled $550,000 for the third quarter of 2011 as compared to $3,100,000 for the same period in 2010. For further discussion of this account see Allowance for Loan Losses below.

Noninterest Income

Total noninterest income increased $420,508 or 24.1% for the third quarter of 2011. The total was $2,166,827. During the quarter, gains from the sale of investment securities were $1,015,462 or $188,241 more than the $827,221 recognized in the third quarter of 2010. Service charges on deposits were lower by $23,096 as lower NSF charges were partially offset by increased service charges on other depository accounts and increased ATM activity fees. Revenue from the sale of investment products and insurance increased by $23,000 as well. Losses from the sale of ORE properties were reduced by $182,000 from the level experienced in 2010.

Noninterest Expense

Total noninterest expense increased to $5,220,623 or by $173,409 in the third quarter of 2011 from the level experienced in the same quarter in 2010. Salaries and benefits increased by $103,726 with increased salary expense accounting for $33,000 and increased payroll taxes and benefits being the remainder. Included in the quarter was a one-time, lump sum salary adjustment paid to staff of $40,000. As there have been no general staff salary increases in the past three years, management and the board considered this a necessary expenditure. Occupancy expense declined by $69,032 to $499,747 as depreciation and utilities were lower.

Other expenses were $2,457,824 which represented an increase of $138,715 from the expenses recorded in the third quarter of 2010. The third quarter 2011 included a reduction in value of ORE of $1,352,964 reflecting the reduced estimate of market value. In comparing the third quarter of 2011 to the same period in 2010, it is noted that the 2010 period included the complete write off of intangible assets ($935,000) as the result of the Dodd Frank Act (which allowed interstate branching). These two transactions resulted in increased amounts of other expense in the nine months ended 2011 and 2010, respectively; however, the total expenses remained virtually unchanged as compared year-to-year.

FDIC expense was also lower as the result of the new deposit insurance assessment as included in the Dodd Frank Act as previously discussed in the nine months comparison.

Income Taxes

For the quarter ended September 30, 2011, pre-tax income was $325,891 vs. the pre-tax loss of $2,726,322 in the 2010 period. Tax expense for the 2011 period was $73,608 as opposed to the tax benefit of $1,099,000 recorded in the 2010 period. The increased expense was caused by the reduction in nontaxable interest income from investment in municipal securities and the general increase in profitability.

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Financial Condition and Liquidity

Total assets on September 30, 2011 were $434,928,958, which is a decrease of $32,291,736 or 6.9% from the December 31, 2010 level of $467,220,694. Total deposits decreased by $33,369,378 or 8.0% for the reasons discussed above. Total equity (common and preferred) increased by $1,454,363 or 4.1% from December 31, 2010.

Sufficient liquidity is a major priority for the Corporation. The Corporation is taking steps to reduce the highly conservative liquidity position that has been held since 2008. As mentioned in a previous report, the Corporation will be reducing the excess liquidity at a measured pace so as to redeploy these assets to higher return categories. The liquidity position will be maintained at a level that will provide sufficient availability of funds to meet anticipated needs. The ratio of total loans to deposits on September 30, 2011 was 71.1% as compared to 62.7% on December 31, 2010. The increase is the result of the reduction in the deposit base to the current level along with an increase in outstanding loans.

Cash and Cash Equivalents

Cash and cash equivalents were $40,824,711 as of September 30, 2011, a decrease of $40,141,398, or 49.6%, from December 31, 2010. The decrease is primarily the result of the reduction in deposits discussed above and the increase in loans discussed in Loans below.

Investment Securities – Available for Sale

Investment securities available for sale decreased $3,009,578, or 4.4%, compared to December 31, 2010 as a significant portion of matured or called securities available for sale were reinvested from this category to the held to maturity category.

Investment Securities – Held to Maturity

Investment securities held to maturity increased $3,985,808, or 23.1%. Securities designated as held to maturity are not liquid or subject to sale. The Corporation reviews the limits and target levels on this category regularly based on liquidity needs. A significant portion of the proceeds from matured or called securities were reinvested and designated as held-to-maturity. This will help lessen any negative impact on capital when interest rates rise.

Loans

Gross loans increased by $11,160,978, or 4.3%, to $272,931,793 at September 30, 2011, from $261,770,815 at December 31, 2010. The increase is primarily concentrated in agricultural production loans with limited reductions in revolving credit agreements for lines of credit secured by homes and commercial loans.

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Agricultural production loans are generally short term in nature with advances beginning with planting during the spring; peaking in the fall; and, paying down during the harvest in late fall and winter. As such, reductions would normally occur in the fourth quarter. The Corporation’s banking subsidiary continues to seek quality lending opportunities in its business areas.

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

The allowance for loan losses consists of two portions: the impaired portion and the un-impaired portion. The impaired portion is based on identified problem loans and is determined based on an assessment of credit risk related to those loans. Specific loss estimate amounts are included in the allowance based on an evaluation of the individual credits. Any loan categorized as loss is charged off or fully reserved in the period which the loan is so categorized.

The un-impaired portion of the allowance is for probable inherent losses which exist as of the evaluation date even though they may not have been identified by the more objective processes for the impaired 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, experience of loan management, effects of lending policies and general economic environment in the Corporation's markets.

The Corporation continues with the methodology introduced in the fourth quarter of 2010 in which the Corporation began to segment the loan portfolio by type of loan for analysis and to compute the needed reserve on non-impaired loans based on historical charge off performance for each segment. This was done to more accurately reflect performance of individual portfolio segments; as well was, to obtain more precise information regarding these segments. Also, this methodology allows the Corporation to better target loan growth by concentrating on those segments with lower loss histories and aid in identification of areas or segments requiring more attention. The effect on the calculated level of the reserve will be in direct proportion to the loss rate and volume of those sectors with loss rate histories either higher or lower than the average loss rate for the portfolio as a whole.

The ratio of reserves to loans at year end 2010 was 1.96%. At the end of the third quarter of 2011, a reserve level of $5,677,419 was considered to be appropriate. This is equivalent to 2.08% of gross loans and includes reserves specifically allocated to specific loans and reserves that are not allocated but based on the historical loss experience of specific loan categories. Net charged-off loans for the first nine months of 2011 were $612,579 or 0.31% on an annualized basis, as compared to $6,058,308 or 2.86% on an annualized basis for the same period in 2010.

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The Corporation has in place procedures to identify and deal with problem loans and potential problem loans. It is the goal of the Corporation to identify any problems, to develop and execute strategies to deal with those identified and establish reserves to deal with identified and historic shortfalls. Although reserves may be considered appropriate at a point in time, future events may change the ability of a borrower to pay or the underlying value of collateral. The Bank will continue to monitor closely the condition of the portfolio and continue with its program to maintain an appropriate allowance for losses on loans.

Premises and Equipment

Premises and equipment decreased $400,301, or 2.4%, during the first nine months of 2011. Capital expenditures continue at a low level, with depreciation reducing the level. Facilities improvements and equipment purchases have only been made when retaining the original equipment may adversely impact the customer experience or the effectiveness of operations.

Deposits

Total deposits decreased $33,369,378, or 8.0%, at September 30, 2011 from December 31, 2010, including decreases of $25,953,578 in non-interest bearing deposits and $7,415,800 in interest bearing deposits. The single depositor reduced non interest bearing deposits by approximately $32,450,000 between these dates as they had consolidated funds that were used to pay down debt at other lenders.

Liquidity

One of the Corporation'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 Corporation to fund earning assets and maintain the availability of funds. Management believes that the Corporation'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 Corporation's liquidity needs for normal operations. To provide additional liquidity, the Corporation has historically utilized market based sources such as short-term financing through the purchase of federal funds, and a borrowing relationship with the Federal Home Loan Bank. In the current economy, these sources are not as reliable as in more normal times. The Corporation has chosen to maintain on balance sheet sources of liquidity such as deposits at the Federal Reserve, federal funds sold and liquid, short term investments at a high level to assure an adequate source of liquid funding. This strategy has depressed the net interest margin as these short term; highly liquid assets have lower yields than loans or longer term, less liquid assets.

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Should the Corporation’s traditional sources of liquidity be constrained, forcing the Corporation to pursue avenues of funding not typically used, the Corporation’s net interest margin could be further 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 September 30, 2011 is considered appropriate by management.

Capital Adequacy

Total stockholders' equity on September 30, 2011, was $36,973,569, an increase of $1,454,363 from December 31, 2010. This increase is comprised of current period earnings of $844,109 and is supplemented by an increase in accumulated other comprehensive income net of tax of $752,511; and the recognition of $18,669 of capital related to previous years’ grants of stock options; offset by dividends of $154,500 related to the U.S. Treasury’s Community Development Capital Initiative as described more fully in Note 9 to the Consolidated Financial Statements in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2010; and $6,426 of cash paid on the fractional shares associated with the Corporation’s 1% stock dividends.

The table below sets forth various capital ratios for the Corporation and the Bank. Under current regulatory guidelines, debt associated with trust preferred securities qualifies for Tier 1 capital treatment. At September 30, 2011, trust preferred securities included in Tier 1 capital totaled $10 million.

Federal and State of Alabama Regulators have established quantitative measures to ensure capital adequacy requiring the Corporation and its Bank to maintain minimum capital levels. The primary target capital ratio is the maintenance of the Tier I Leverage Ratio by the Bank at or above 8.50% of average assets during any quarter. In its “Call Report” filed as of September 30, 2011, the Bank reported a Tier I Leverage Ratio of 9.61% of average assets for the third quarter. The payment of dividends has a direct impact on capital adequacy and is subject to approval by the Federal and State of Alabama Regulators.

As of September 30, 2011, the most recent notification from the Bank’s regulators categorized the Bank as “adequately capitalized.” There are no conditions or events since that notification that management believes have changed the Bank’s category.

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Information regarding risk-based capital and leverage ratios of the Corporation and the Bank are set forth in the table below:

	September 30, 2011		Well Capitalized Treatment	
United Bancorporation of Alabama, Inc.				
Total risk-based capital	14.90	%	N/A	
Tier 1 risk-based capital	13.65		N/A	
Leverage Ratio	9.53		N/A	
United Bank				
Total risk-based capital	14.97	%	10.00	%
Tier 1 risk-based capital	13.71		6.00	
Leverage ratio	9.61		5.00	

Based on management's projections, existing regulatory capital should be sufficient to satisfy capital requirements in the foreseeable future for existing operations. Although the Bank has suspended further immediate expansion plans, 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.

Off Balance Sheet items

The Bank is a party to financial obligations with off-balance sheet risk in the normal course of business. The financial obligations include commitments to extend credit and standby letters of credit issued to customers.

The following table sets forth the off-balance sheet risk of the Bank as of the end of the period.

		September 30, 2011
Commitments to extend credit	$	35,254,266
Standby letters of credit		1,404,922

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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-15 and 15d-15 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.

There were no changes in the Corporation’s internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Corporation’s internal control over financial reporting.

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PART II -- OTHER INFORMATION

Item 1A. Risk Factors

Loans Held for Sale

Loans held for sale are funded loan commitments of the Bank that are accompanied by third-party agreements to purchase at a date subsequent to the original commitment between the Bank and its borrower. Should the subsequent sale of the loan, or loans, from the Bank to the third party not occur due to either the failure of the third-party to complete the transaction or changes in macro-market conditions, the Bank could be required to lower the fair value of the loan in order to sell the loan to another entity or maintain the loan as held for investment. The difference between the values of the original loan contract and the later value would be recognized as a reduction of bank earnings.

Item 6.Exhibits

(a) Exhibits.

31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Principal 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 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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S I G N A T U R E S

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: November 10, 2011

/s/ Robert R. Jones, III
Robert R. Jones, III
President and Chief Executive Officer
(Principal Executive Officer)

Allen O. Jones, Jr.
Allen O. Jones, Jr.
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

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INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. Section 1350, adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification pursuant to 18 U.S.C. Section 1350, adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002