UNITED BANCORPORATION
OF ALABAMA, INC.
AND SUBSIDIARY

CONSOLIDATED FINANCIAL REPORT

DECEMBER 31, 2012

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AND SUBSIDIARY

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TABLE OF CONTENTS

	Page
INDEPENDENT AUDITOR'S REPORT	1
FINANCIAL STATEMENTS	
Consolidated balance sheets	2
Consolidated statements of earnings	3
Consolidated statements of comprehensive income	4
Consolidated statements of stockholders' equity	5
Consolidated statements of cash flows	6
Notes to consolidated financial statements	7-45

MAULDIN & JENKINS
CERTIFIED PUBLIC ACCOUNTANTS, LLC

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
United Bancorporation of Alabama, Inc.
Atmore, Alabama

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of **United Bancorporation of Alabama, Inc. and Subsidiary**, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of earnings, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of United Bancorporation of Alabama, Inc. and Subsidiary as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Mauldin & Jenkins, LLC

Birmingham, Alabama
April 4, 2013

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UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2012 AND 2011

Assets	2012	2011
Cash and due from banks	$ 18,911,407	$ 14,940,877
Interest-bearing deposits in banks	52,387,807	41,333,309
Cash and short-term investments	71,299,214	56,274,186
Securities available for sale, at fair value (amortized cost of $95,953,049 and $70,951,957 at December 31, 2012 and 2011, respectively)	97,251,331	71,493,832
Securities held to maturity (fair market value of $0 and $22,012,073 at December 31, 2012 and 2011, respectively)	-	21,048,977
Loans held for sale	206,625	169,400
Loans held for investment	264,620,015	263,093,320
Less allowance for loan losses	4,500,693	4,901,550
Loans, net	260,119,322	258,191,770
Premises and equipment, net	15,579,291	15,853,633
Interest receivable	2,060,649	2,155,497
Other real estate owned	8,198,175	9,946,107
Other assets	12,449,643	11,745,770
Total assets	$ 467,164,250	$ 446,879,172

Liabilities and Stockholders' Equity	2012	2011
Deposits		
Noninterest-bearing	$ 144,790,062	$ 126,469,004
Interest-bearing	270,609,984	268,984,934
Total deposits	415,400,046	395,453,938
Advances from Federal Home Loan Bank of Atlanta	956,566	1,115,500
Treasury, tax, and loan account	-	991,750
Interest payable	200,225	287,686
Accrued expenses and other liabilities	1,657,948	1,451,275
Note payable to Trust	10,310,000	10,310,000
Total liabilities	428,524,785	409,610,149
Commitments and contingencies (Note 18)		
Stockholders' equity		
Preferred stock, par value $.01. Authorized 250,000 shares; 10,300 shares issued in 2012 and 2011, respectively	10,222,501	10,149,323
Class A common stock, par value $0.01. Authorized 5,000,000 shares; issued and outstanding, 2,388,676 and 2,389,127 shares in 2012 and 2011, respectively	23,887	23,891
Class B common stock, par value $0.01. Authorized 250,000 shares; no shares issued or outstanding	-	-
Additional paid-in capital	7,170,327	7,114,042
Retained earnings	20,511,650	19,984,862
Accumulated other comprehensive income, net of tax	714,683	325,119
	38,643,048	37,597,237
Less 439 and 40,943 treasury shares, at cost, respectively	3,583	328,214
Total stockholders' equity	38,639,465	37,269,023
Total liabilities and stockholders' equity	$ 467,164,250	$ 446,879,172

See accompanying notes to consolidated financial statements

UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF EARNINGS
YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Interest income		
Interest and fees on loans	$ 16,016,853	$ 16,252,312
Interest on investment securities:		
Taxable securities	1,043,751	1,600,690
Nontaxable securities	224,901	313,049
Total investment income	1,268,652	1,913,739
Other interest income	126,085	120,162
Total interest income	17,411,590	18,286,213
Interest expense		
Interest on deposits	2,250,937	3,107,551
Interest on other borrowed funds	308,861	272,815
Total interest expense	2,559,798	3,380,366
Net interest income	14,851,792	14,905,847
Provision for loan losses	2,205,000	1,800,000
Net interest income after provision for loan losses	12,646,792	13,105,847
Noninterest income:		
Service charges on deposits	3,073,402	3,163,927
Investment securities gains, net	941,572	1,183,605
Mortgage loan and related fees	411,584	323,756
Other	1,332,150	1,137,617
Total noninterest income	5,758,708	5,808,905
Noninterest expense:		
Salaries and benefits	8,933,691	8,837,671
Net occurpancy expense	1,930,120	1,982,519
Other	6,019,002	6,502,817
Total noninterest expense	16,882,813	17,323,007
Net earnings before income tax expense	1,522,687	1,591,745
Income tax expense	347,466	405,619
Net earnings	1,175,221	1,186,126
Preferred stock dividends	206,000	206,000
Accretion on preferred stock discount	73,178	69,096
Net Earnings available to common shareholders	$ 896,043	$ 911,030
Basic earnings per share	$ 0.49	$ 0.51
Basic weighted-average shares outstanding	2,375,302	2,332,948
Diluted earnings per share	$ 0.49	$ 0.51
Diluted weighted-average shares outstanding	2,375,302	2,332,948

See accompanying notes to consolidated financial statements

UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Net earnings	$ 1,175,221	$ 1,186,126
Other comprehensive income		
Unrealized holding gains on securities available for sale arising during the period, net of tax of $679,193 and $974,257, respectively	1,018,786	1,461,387
Reclassification adjustment for gains on securities available for sale realized in net earnings from sales, net of taxes of $376,629 dn $473,442, respectively	(564,943)	(710,163)
Unrealized losses on cash flow hedges arising during period, net of tax benefit of $42,853	(64,279)	-
Total other comprehensive income	389,564	751,224
Comprehensive income	$ 1,564,785	$ 1,937,350

See accompanying notes to consolidated financial statements

UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2012 AND 2011

	Preferred Stock	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2010	$ 10,080,227	2,389,127	$ 23,891	$ 6,815,176	$ 19,721,667	$ (426,105)	$ (695,650)	$ 35,519,206
Net income	-	-	-	-	1,186,126	-	-	1,186,126
Other comprehensive income	-	-	-	-	-	751,224	-	751,224
Treasury shares issued as stock dividend	-	-	-	273,974	(641,410)	-	367,436	-
Cash portion of stock dividend (fractional shares)	-	-	-	-	(6,425)	-	-	(6,425)
Stock-based compensation	-	-	-	24,892	-	-	-	24,892
Accretion on preferred stock discount	69,096	-	-	-	(69,096)	-	-	-
Preferred stock dividends paid	-	-	-	-	(206,000)	-	-	(206,000)
Balance, December 31, 2011	10,149,323	2,389,127	23,891	7,114,042	19,984,862	325,119	(328,214)	37,269,023
Net income	-	-	-	-	1,175,221	-	-	1,175,221
Other comprehensive income	-	-	-	-	-	389,564	-	389,564
Treasury shares issued as stock dividend	-	-	-	39,899	(364,530)	-	324,631	-
Cash portion of stock dividend (fractional shares)	-	-	-		(4,725)	-	-	(4,725)
Cancellation of Restricted Stock Grants	-	(451)	(4)	(7,613)	-	-	-	(7,617)
Stock-based compensation	-	-	-	23,999	-	-	-	23,999
Accretion on preferred stock discount	73,178	-	-	-	(73,178)	-	-	-
Preferred stock dividends paid	-	-	-	-	(206,000)	-	-	(206,000)
Balance, December 31, 2012	$ 10,222,501	2,388,676	$ 23,887	$ 7,170,327	$ 20,511,650	$ 714,683	(3,583)	$ 38,639,465

See accompanying notes to consolidated financial statements

UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
OPERATING ACTIVITIES		
Net earnings	$ 1,175,221	$ 1,186,126
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	2,205,000	1,800,000
Depreciation of premises and equipment	883,111	963,577
Net amortization of premium on investment securities available for sale	745,098	453,479
Net amortization of premium on investment securities held to maturity	-	165,448
Gain on sales of investment securities available for sale, net	(941,572)	(1,183,605)
Gain on sales of other real estate owned	(56,260)	(83,146)
Gain on sales of loans held for sale	(310,984)	(124,436)
Originations of loans held for sale	(12,670,249)	(5,383,681)
Proceeds from sales of loans held for sale	12,944,008	5,338,717
Stock-based compensation	23,999	24,892
Decrease in deferred income taxes	269,544	403,940
Provision for other real estate losses	1,317,000	1,599,964
Decrease in interest receivable	94,848	37,271
(Increase) decrease in other assets	(1,827,879)	1,438,755
Decrease in Federal Deposit Insurance Corporation prepaid deposit assessment	382,090	635,942
Decrease in interest payable	(87,461)	(115,267)
Decrease in accrued expenses and other liabilities	294,134	(280,162)
Net cash provided by operating activities	4,439,648	6,877,814
INVESTING ACTIVITIES		
Proceeds from maturities, calls, and principal repayments of investment securities available for sale	19,986,348	9,899,459
Proceeds from maturities, calls, and principal repayments of investment securities held to maturity	1,244,668	2,647,178
Proceeds from sales of investment securities available for sale	16,647,543	46,974,574
Purchases of investment securities available for sale	(41,634,199)	(57,577,076)
Purchases of investment securities held to maturity	-	(6,598,997)
Net increase in loans	(5,599,329)	(5,821,143)
Purchases of premises and equipment, net	(608,769)	(345,154)
Proceeds from sale of other real estate owned	1,964,419	1,159,757
Net cash used in investing activities	(7,999,319)	(9,661,402)
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	19,946,108	(21,578,782)
Cash dividends - preferred stock	(206,000)	(206,000)
Cash dividends - common stock	(4,725)	(6,425)
Repayments of advances from FHLB Atlanta	(158,934)	(164,800)
Increase (decrease) in other borrowed funds	(991,750)	47,672
Net cash provided by (used in) financing activities	18,584,699	(21,908,335)
Net increase (decrease) in cash and short-term investments	15,025,028	(24,691,923)
Cash and short-term investments at beginning of year	56,274,186	80,966,109
Cash and short-term investments at end of year	$ 71,299,214	$ 56,274,186
SUPPLEMENTAL DISCLOSURE		
Cash paid during the year for:		
Interest	$ 2,647,259	$ 3,495,633
Taxes	$ 345,644	$ 56,977
OTHER NONCASH TRANSACTIONS		
Transfer of loans to other real estate through foreclosure	$ 1,715,772	$ 2,409,790
Transfer of securities from held to maturity to available for sale	$ 19,804,309	$ -

See accompanying notes to consolidated financial statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

United Bancorporation of Alabama, Inc. (the "Corporation") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, United Bank (the "Bank"). United Bank is a commercial bank with headquarters in Atmore, Alabama. The Bank provides a full range of banking services in its primary market areas of Baldwin, Escambia, and Monroe Counties, Alabama, and Santa Rosa County, Florida.

Principles of Consolidation

The accompanying consolidated financial statements include the financial statements of United Bancorporation of Alabama, Inc. and United Bank, collectively referred to as the Corporation. Significant inter-company balances and transactions have been eliminated in consolidation.

Market Concentrations

The Corporation operates primarily in one business segment, commercial banking, in Southwest Alabama and Northwest Florida.

Basis of Presentation and Accounting Estimates

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other real estate owned, deferred taxes, the valuation of other than temporary impairment for investment securities, and the fair value of financial instruments.

The Corporation has evaluated all transactions, events, and circumstances for consideration or disclosure through April 4, 2013, the date these financial statements were available to be issued and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate.

Reclassification

Certain amounts in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation.

Fair Value of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Short-Term Investments

The Corporation considers cash and due from banks, interest-bearing deposits in banks, and federal funds sold to be cash and short-term investments. Federal funds are generally sold for one–day periods.

Investment Securities

Investment securities are classified in one of three portfolios: (i) trading account securities, (ii) securities available for sale, or (iii) securities held to maturity. Trading account securities are stated at fair value. Investment securities available for sale are stated at fair value with any unrealized gains and losses reported in a separate component of stockholders' equity, net of tax effect, until realized. Once realized, gains and losses on investment securities available for sale are reflected in current period earnings. Investment securities held to maturity are stated at cost adjusted for amortization of premiums and accretion of discounts. As of December 31, 2012, the Corporation classified all securities available for sale and no securities were classified as securities held to maturity.

Net gains and losses on the sale of investment securities available for sale are recorded at trade date. The net gains and losses are computed using the specific identification method and are shown separately in noninterest income in the consolidated statements of earnings. Accretion of discounts and amortization of premiums are calculated on the effective interest method over the anticipated life of the security.

A decline in the fair value of any security below amortized cost that is deemed other than temporary is charged to income resulting in the establishment of a new cost basis for the security.

Restricted Equity Securities

The Corporation is required to maintain an investment in capital stock of various entities. Based on redemption provisions of these entities, the stock has no quoted market value and is carried at cost. At their discretion, these entities may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in these stocks.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances less the allowance for loan losses. Interest income is accrued on the outstanding principal balance. Loan origination fees, net of certain direct origination costs, are recognized at the time the loan is placed on the books.

The accrual of interest on loans is discontinued when there is a clear indication that the borrower may not be able to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining book balance of the asset is deemed to be collectible. If collectability is questionable, then cash payments are applied to principal. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

The allowance is an amount that management believes will be appropriate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the uncollectibility of loans in light of historical experience, the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions that may affect the borrower's ability to pay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses, and may require the Corporation to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans that are classified as impaired, an allowance is established when the collateral value, present value of expected future cash flows or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The qualitative factors considered by management include, among other factors, (1) changes in local and national economic conditions; (2) changes in asset quality; (3) changes in loan portfolio volume; (4) the composition and concentrations of credit; (5) the trends associated with the composition of the loan portfolio; (6) the trends related to classified assets and (7) effectiveness of the Corporation's loan policies, procedures and internal controls.

Management considers a loan to be impaired when it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. If the loan is collateral–dependent, the fair value of the collateral is used to determine the amount of impairment. Impairment losses are included in the allowance for loan losses through a charge to the provision for loan losses. Impaired loans are charged off against the allowance when such loans are deemed to be uncollectible. Subsequent recoveries are added to the allowance.

When a loan is considered impaired, cash receipts are applied under the contractual terms of the loan agreement, first to principal and then to interest income. Once the recorded principal balance has been reduced to zero, future cash receipts are recognized as interest income, to the extent that any interest has not been recognized. Any further cash receipts are recorded as recoveries of any amount previously charged off.

The ultimate ability to collect a substantial portion of the Corporation's loan portfolio is susceptible to changes in economic and market conditions in the geographic area served by the Corporation and various other factors.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled Debt Restructurings

The Corporation designates loan modifications as troubled debt restructurings ("TDRs") when for economic and legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. TDRs can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. In circumstances where the TDR involves charging off a portion of the loan balance, the Corporation typically classifies these restructurings as nonaccrual.

In connection with restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation includes consideration of the borrower's current capacity to pay, which among other things may include a review of the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations, a debt to income analysis, and an evaluation of secondary sources of payment from the borrower and any guarantors. This evaluation also includes an evaluation of the borrower's current willingness to pay, which may include a review of past payment history, an evaluation of the borrower's willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support. The credit evaluation also reflects consideration of the borrower's future capacity and willingness to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectability of receivables.

Restructured nonaccrual loans may be returned to accrual status based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation must include consideration of the borrower's sustained historical repayment for a reasonable period, generally a minimum of six months, prior to the date on which the loan is returned to accrual status.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight–line method over the estimated useful lives of the assets.

Other Real Estate Owned

Other real estate owned represents property acquired through foreclosure or deeded to the Corporation in lieu of foreclosure on real estate mortgage loans on which borrowers have defaulted. Other real estate owned is carried at the lower of cost or fair value, adjusted for estimated selling costs. Reductions in the balance of other real estate owned at the date of foreclosure are charged to the allowance for loan losses. Subsequent valuation decreases in the carrying value of other real estate owned as well as costs to carry other real estate owned are recognized as charges to noninterest expense.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Corporation accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, *Income Taxes)*. The Corporation applies the accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

The Corporation accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period of change.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets may be reduced by deferred tax liabilities and a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Stock Based Compensation

At December 31, 2012, the Corporation had stock options and other equity awards outstanding as defined by two stock-based employee compensation plans, which are described more fully in Note 12. The Corporation accounts for its stock based compensation plans under stock compensation accounting guidance (FASB ASC 718, *Compensation – Stock compensation)*. This guidance requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black-Scholes model is used to estimate the fair value of stock options, while the market price of the Corporation's common stock at the date of grant is used for restricted stock awards and stock grants.

Earnings per Share

FASB ASC 260, *Earnings Per Share*, provides for the computation of basic and diluted earnings per share. There was no dilutive effect for the years ended December 31, 2012 and 2011, because the exercise price of the stock awards, described in Note 12, was greater than the fair value of the stock on the respective dates. Therefore, the adjustment related to share-based awards would be anti-dilutive and are not computed.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative Financial Instruments

The Corporation maintains an overall interest-rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest-rate volatility. The Corporation's goal is to manage interest-rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of interest-rate fluctuations, hedged assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation will generally be offset by income or loss on the derivative instruments that are linked to the hedged assets and liabilities. The Corporation views this strategy as a prudent management of interest-rate sensitivity, such that earnings are not exposed to undue risk presented by changes in interest rates.

All derivatives are recognized on the balance sheet at their fair value. Derivative instruments that are used as part of the Corporation's interest-rate risk management strategy include interest rate caps. An interest rate cap will convert the variable interest rate on the Corporation's variable rate note payable to trust to fixed interest rates should interest rates rise above a specified level. On the date the interest rate cap contract is entered into, the Corporation designates the derivative as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability "cash flow" hedge. Changes in the fair value of a derivative that is highly effective as - and that is designated and qualifies as - a cash-flow hedge are recorded in other comprehensive income, until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings).

Recent Accounting Pronouncements

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of stockholders' equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in a two separate consecutive statement approach and changes the presentation of reclassification items out of other comprehensive income to net income. In December 2011, the FASB deferred certain provisions related to the reclassifications of items out of accumulated other comprehensive income and the presentation of the reclassification items. The adoption of this amendment changed the presentation of the components of comprehensive income for the Corporation as part of the consolidated statement of stockholders' equity effective January 1, 2012, with the components of comprehensive income presented in a separate statement.

In May 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this guidance are effective during interim and annual periods beginning after December 15, 2011. The adoption of this guidance did not have a material impact on the consolidated financial statements.

NOTE 2. CASH AND DUE FROM BANKS

The Bank is required by the Federal Reserve Bank to maintain daily cash balances. These required balances were $1,069,000 and $425,000 at December 31, 2012 and 2011, respectively.

NOTE 3. INVESTMENT SECURITIES

The amortized cost and fair value of investment securities available for sale at December 31, 2012 and 2011 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
December 31, 2012:				
U.S. Treasury securities	$ 1,041,313	$ 8,062	$ -	$ 1,049,375
U.S. government sponsored agencies	88,085,670	1,014,360	(33,603)	89,066,427
State and political subdivisions	6,815,913	318,429	(11,468)	7,122,874
Equity securities	10,153	2,502	-	12,655
	$ 95,953,049	$ 1,343,353	$ (45,071)	$ 97,251,331
Securities Available for Sale				
December 31, 2011:				
U.S. Treasury securities	$ 4,003,429	$ 10,009	$ -	$ 4,013,438
U.S. government sponsored agencies	59,403,763	413,643	(76,732)	59,740,674
State and political subdivisions	7,534,612	245,003	(45,940)	7,733,675
Equity securities	10,153	-	(4,108)	6,045
	$ 70,951,957	$ 668,655	$ (126,780)	$ 71,493,832

During 2012, investment securities with book values of approximately $19,804,000 were reclassified from held to maturity to available for sale. The securities had been classified as held-to-maturity from their purchase date; however, prevailing market conditions altered the intent to hold some of the securities to their maturities and thus the entire classification was transferred to available for sale. As a result of this reclassification, there were no securities classified as held to maturity as of December 31, 2012. The amortized cost and fair value of investment securities held to maturity at December 31, 2011 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Held to Maturity				
December 31, 2011:				
U.S. government sponsored agencies	$ 14,777,587	$ 679,208	$ -	$ 15,456,795
Mortgage-backed securities	6,271,390	283,888	-	6,555,278
	$ 21,048,977	$ 963,096	$ -	$ 22,012,073

NOTE 3. INVESTMENT SECURITIES (Continued)

Those investment securities classified as available for sale which have an unrealized loss position at December 31, 2012 and 2011 are detailed below:

	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2012:						
U.S. government sponsored agencies	$ (33,603)	$ 7,219,849	$ -	$ -	$ (33,603)	$ 7,219,849
State and political subdivisions	-	-	(11,468)	318,533	(11,468)	318,533
Total securities	$ (33,603)	$ 7,219,849	$ (11,468)	$ 318,533	$ (45,071)	7,538,382
December 31, 2011:						
U.S. government sponsored agencies	$ (76,732)	$ 31,544,265	$ -	$ -	$ (76,732)	$ 31,544,265
State and political subdivisions	-	-	(45,940)	1,150,186	(45,940)	1,150,186
Equity securities	-	-	(4,108)	6,045	(4,108)	6,045
Total securities	$ (76,732)	$ 31,544,265	$ (50,048)	$ 1,156,231	$ (126,780)	32,700,496

There were no investment securities classified as held to maturity which had an unrealized loss position at December 31, 2011.

The unrealized losses in investment securities available for sale at December 31, 2012 and 2011 were attributable to changes in market interest rates since the securities were purchased. The Corporation systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers, (3) structure of the security and (4) the Corporation's intent to sell the security or whether it is more likely than not that the Corporation would be required to sell the security before its anticipated recovery in market value. Because the Corporation does not currently intend to sell the investment securities and it is not more likely than not that the Corporation will be required to sell the investment securities before recovery of their amortized cost bases, which may be maturity, the Corporation does not consider these investment securities to be other-than-temporarily impaired at December 31, 2012.

The amortized cost and fair value of investment securities available for sale at December 31, 2012, categorized by contractual maturity are shown below.

	Securities Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 4,173,940	$ 4,212,792
Due after one year through five years	74,625,484	75,491,578
Due after five years through ten years	7,345,958	7,577,140
Due after ten years	9,807,667	9,969,821
	$ 95,953,049	$ 97,251,331

NOTE 3. INVESTMENT SECURITIES (Continued)

The gross gains and gross losses realized by the Corporation from sales of investment securities available for sale for the twelve months ended December 31, 2012 and 2011 were as follows:

	Years Ended December 31, 2012	Years Ended December 31, 2011
Gross gains	$ 941,572	$ 1,196,128
Gross losses	-	(12,523)
Net realized gains	$ 941,572	$ 1,183,605

Investment securities available for sale with fair values of $24,480,886 and $25,335,254 at December 31, 2012 and 2011, 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 $13,778,456 at December 31, 2011, were pledged to secure fed 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) consist of the following as of December 31, 2012 and 2011:

	December 31, 2012	December 31, 2011
Federal Home Loan Bank stock	$ 713,200	$ 842,500
First National Bankers' Bank stock	825,000	825,000
	$ 1,538,200	$ 1,667,500

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

At December 31, 2012 and 2011, the composition of the loan portfolio was as follows:

	December 31, 2012	December 31, 2011
Real estate:		
Construction and land loans	$ 30,289,382	$ 37,436,067
Farmland	34,871,688	30,360,189
1-4 family residential mortgages	57,024,018	53,905,156
Multifamily	4,220,311	4,083,577
Commercial	76,125,690	76,210,622
Agricultural	19,116,550	16,504,150
Commercial	24,468,370	26,861,247
Consumer	14,564,688	13,533,716
States and political subdivisions	3,926,536	4,108,510
Other loans	12,782	90,086
Total	$ 264,620,015	$ 263,093,320

As of December 31, 2012 and 2011, approximately 51% and 55%, respectively, of the Corporation's loans were commercial loans. The Corporation's commercial customers are primarily small to middle market enterprises. The Corporation also specializes in agricultural loans, including loans secured by farmland, which represented approximately 20% and 18% of the Corporation's total loans at December 31, 2012 and 2011, respectively.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management

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.

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.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management (Continued)

The following table summarizes the credit risk profile of our loan portfolio by internally assigned grades as of December 31, 2012 and 2011.

	Pass	Special Mention	Substandard/ Doubtful	Total
		(Dollars in Thousands)		
December 31, 2012:				
Real estate:				
Construction and land loans	$ 19,367	$ 2,995	$ 7,927	$ 30,289
Farmland	27,294	6,276	1,302	34,872
1-4 family residential mortgages	53,204	3,586	234	57,024
Multifamily	4,220	-	-	4,220
Commercial	60,741	8,849	6,536	76,126
Agricultural	15,554	2,928	635	19,117
Commercial	19,773	3,943	752	24,468
Consumer	14,473	67	25	14,565
States and political subdivisions	3,926	-	-	3,926
Other loans	13	-	-	13
Total	$ 218,565	$ 28,644	$ 17,411	$ 264,620

Approximately $518,000 of the $17,411,000 identified as Substandard/Doubtful above were considered Doubtful as of December 31, 2012.

	Pass	Special Mention	Substandard/ Doubtful	Total
		(Dollars in Thousands)		
December 31, 2011:				
Real estate:				
Construction and land loans	$ 23,581	$ 3,030	$ 10,825	$ 37,436
Farmland	21,763	6,631	1,966	30,360
1-4 family residential mortgages	50,459	2,822	624	53,905
Multifamily	4,084	-	-	4,084
Commercial	57,259	9,451	9,501	76,211
Agricultural	13,124	1,804	1,576	16,504
Commercial	25,241	782	838	26,861
Consumer	13,463	58	13	13,534
States and political subdivisions	4,108	-	-	4,108
Other loans	90	-	-	90
Total	$ 213,172	$ 24,578	$ 25,343	$ 263,093

Approximately $645,000 of the $25,343,000 identified as Substandard/Doubtful above were considered Doubtful as of December 31, 2011.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

	Beginning Balance	Charge-offs	Recoveries	Provision Allocation	Ending Balance
December 31, 2012:		*(Dollars in Thousands)*			
Real estate:					
Construction and land loans	$ 1,933	$ (1,366)	$ 6	$ 912	$ 1,485
Farmland	243	-	-	113	356
1-4 family residential mortgages	387	(322)	20	458	543
Multifamily	9	-	-	1	10
Commercial	1,412	(709)	25	417	1,145
Agriculture	159	-	4	(25)	138
Commercial	593	(171)	9	216	647
Consumer	155	(118)	18	111	166
States and political subdivisions	9	-	-	-	9
Other loans	2	(5)	3	2	2
Total:	$ 4,902	$ (2,691)	$ 85	$ 2,205	$ 4,501
December 31, 2011:					
Real estate:					
Construction and land loans	$ 2,176	$ (565)	$ 13	$ 309	$ 1,933
Farmland	119	-	-	124	243
1-4 family residential mortgages	576	(417)	7	221	387
Multifamily	7	-	-	2	9
Commercial	1,100	(658)	9	961	1,412
Agriculture	201	(37)	9	(14)	159
Commercial	772	(436)	88	169	593
Consumer	178	(80)	32	25	155
States and political subdivisions	9	-	-	-	9
Other loans	2	(6)	3	3	2
Total:	$ 5,140	$ (2,199)	$ 161	$ 1,800	$ 4,902

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Allowance for Loan Losses (Continued)

	Loan Balances			Allowance for Loan Loss		
	Total Loans	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Specific Reserves	General Reserves	Total Reserves
December 31, 2012:			*(Dollars in Thousands)*			
Real estate:						
Construction and land loans	$ 30,289	$ 7,739	$ 22,550	$ 514	$ 971	$ 1,485
Farmland	34,872	841	34,031	260	96	356
1-4 family residential mortgages	57,024	908	56,116	1	542	543
Multifamily	4,220	-	4,220	-	10	10
Commercial	76,126	6,866	69,260	483	662	1,145
Agriculture	19,117	1,288	17,829	-	138	138
Commercial	24,468	646	23,822	259	388	647
Consumer	14,565	-	14,565	-	166	166
States and political subdivisions	3,926	-	3,926	-	9	9
Other loans	13	-	13	-	2	2
Total:	$ 264,620	$ 18,288	$ 246,332	$ 1,517	$ 2,984	$ 4,501
December 31, 2011:						
Real estate:						
Construction and land loans	$ 37,436	$ 8,825	$ 28,611	$ 1,142	$ 791	$ 1,933
Farmland	30,360	656	29,704	125	118	243
1-4 family residential mortgages	53,905	1,102	52,803	28	359	387
Multifamily	4,084	-	4,084	-	9	9
Commercial	76,211	4,940	71,271	868	544	1412
Agriculture	16,504	1,420	15,084	-	159	159
Commercial	26,861	842	26,019	265	328	593
Consumer	13,534	-	13,534	-	155	155
States and political subdivisions	4,108	-	4,108	-	9	9
Other loans	90	-	90	-	2	2
Total:	$ 263,093	$ 17,785	$ 245,308	$ 2,428	$ 2,474	$ 4,902

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans

A loan is considered impaired when, based on current information and events; it is probable that the Corporation 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 Corporation's impaired loans, by portfolio class, as of December 31, 2012 and 2011.

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2012:			*(Dollars in Thousands)*		
With no related allowance recorded:					
Real estate:					
Construction and land loans	$ 5,907	$ 8,545	$ -	$ 3,167	$ 56
Farmland	-	-	-	-	-
1-4 family residential mortgages	779	779	-	743	31
Multifamily	-	-		-	-
Commercial	4,285	4,326	-	2,514	126
Agriculture	1,288	1,288	-	1,387	71
Commercial	129	2,098	-	170	2
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with no related allowance recorded	12,388	17,036	-	7,981	286
With an allowance recorded:					
Real estate mortgages:					
Construction and land loans	1,832	2,569	514	5,683	11
Farmland	841	841	260	566	15
1-4 family residential mortgages	129	129	1	214	3
Multifamily	-	-	-	-	-
Commercial	2,581	2,901	483	3,876	70
Agriculture	-	-	-	-	-
Commercial	517	517	259	662	-
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with an allowance recorded	5,900	6,957	1,517	11,001	99
Total impaired loans:	$ 18,288	$ 23,993	$ 1,517	$ 18,982	$ 385

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans (Continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2011:			*(Dollars in Thousands)*		
With no related allowance recorded:					
Real estate:					
Construction and land loans	$ 746	$ 990	$ -	$ 1,140	$ 9
Farmland	397	397	-	1,179	-
1-4 family residential mortgages	552	552	-	688	21
Multifamily	-	-	-	-	-
Commercial	845	845	-	429	45
Agriculture	1,420	1,420	-	1,362	163
Commercial	257	2,335	-	547	2
Consumer	-	-	-	41	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with no related allowance recorded	4,217	6,539	-	5,386	240
With an allowance recorded:					
Real estate mortgages:					
Construction and land loans	8,079	9,957	1,142	8,023	63
Farmland	259	259	125	170	-
1-4 family residential mortgages	550	550	28	554	34
Multifamily	-	-	-	-	-
Commercial	4,095	4,425	868	3,346	86
Agriculture	-	-		122	-
Commercial	585	585	265	984	2
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with an allowance recorded	13,568	15,776	2,428	13,199	185
Total impaired loans:	$ 17,785	$ 22,315	$ 2,428	$ 18,585	$ 425

If impaired loans had been current throughout their terms, interest income would have been increased by $420,501 and $619,143, for the years ended December 31, 2012 and 2011, respectively.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Past Due Loans

The table below provides an age analysis of past due loans as of December 31, 2012 and 2011:

		Past Due Status (Accruing Loans)					
	Current	30-59 Days	60-89 Days	90+ Days	Total Past Due	Non-accrual	Total
December 31, 2012:			*(Dollars in Thousands)*				
Real estate:							
Construction and land loans	$ 24,063	$ 271	$ 454	$ 129	$ 854	$ 5,372	$ 30,289
Farmland	33,865	325	-	-	325	682	34,872
1-4 family residential mortgages	55,696	901	215	130	1,246	82	57,024
Multifamily	4,220	-	-	-	-	-	4,220
Commercial	72,065	100	1,043	-	1,143	2,918	76,126
Agriculture	19,117	-	-	-	-	-	19,117
Commercial	23,291	171	311	23	505	672	24,468
Consumer	14,475	66	15	2	83	7	14,565
States and political subdivisions	3,926	-	-	-	-	-	3,926
Other loans	13	-	-	-	-	-	13
Total:	$ 250,731	$ 1,834	$ 2,038	$ 284	$ 4,156	$ 9,733	$ 264,620
December 31, 2011:							
Real estate:							
Construction and land loans	$ 29,076	$ 689	$ -	$ -	$ 689	$ 7,671	$ 37,436
Farmland	29,638	-	26	-	26	696	30,360
1-4 family residential mortgages	52,828	589	77	80	746	331	53,905
Multifamily	4,084	-	-	-	-	-	4,084
Commercial	71,476	1,406	633	-	2,039	2,696	76,211
Agriculture	15,063	21	-	-	21	1,420	16,504
Commercial	25,830	189	47	30	266	765	26,861
Consumer	13,412	83	27	1	111	11	13,534
States and political subdivisions	4,108	-	-	-	-	-	5,108
Other loans	90	-	-	-	-	-	90
Total:	$ 245,605	$ 2,977	$ 810	$ 111	$ 3,898	$ 13,590	$ 264,093

Related Party Transactions

Certain executive officers and directors of the Corporation, including their immediate families and companies with which they are associated, are loan customers of the Bank. Total loans outstanding and available lines of credit to these related parties at December 31, 2012 and 2011, totaled $5,104,071 and $4,239,272, respectively. Such loans are made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements, and do not represent more than a normal credit risk.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings

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 December 31, 2012 and 2011, loans that have been restructured:

	Troubled-Debt Restructurings			
	Number of Loans	Recorded Investment Prior to Modification	Recorded Investment After Modification	Effect on the Allowance for Loan Losses
		(Dollars in Thousands)		
December 31, 2012:				
Real estate:				
Construction and land loans	6	$ 6,966	$ 4,726	$ (426)
Farmland	2	665	637	1
1-4 family residential mortgages	3	533	471	-
Multifamily	-	-	-	-
Commercial	4	2,192	2,139	115
Agricultural	3	1,353	1,289	-
Commercial	5	878	657	6
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	23	$ 12,587	$ 9,919	$ (304)
December 31, 2011:				
Real estate:				
Construction and land loans	6	$ 6,030	$ 5,083	$ (186)
Farmland	1	154	144	35
1-4 family residential mortgages	3	533	482	-
Multifamily	-	-	-	-
Commercial	7	4,441	3,967	912
Agricultural	3	1,353	1,338	-
Commercial	5	759	700	160
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	25	$ 13,270	$ 11,714	$ 921

The Corporation has not forgiven any principal on the above loans. At December 31, 2012 and 2011, $5,321,860 and $10,369,000, respectively, of the above restructured loans were held as non-accrual.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings (Continued)

The following tables summarize, as of December 31, 2012 and 2011, loans that were restructured within the last 12 months of each year that have subsequently defaulted:

	Troubled-Debt Restructurings		
	Number of Loans	Recorded Investment	Effect on the Allowance for Loan Losses
		(Dollars in Thousands)	
December 31, 2012:			
Real estate:			
Construction and land loans	5	$ 3,745	$ (426)
Farmland	1	144	1
1-4 family residential mortgages	-	-	-
Multifamily	-	-	-
Commercial	1	23	150
Agricultural	-	-	-
Commercial	1	5	6
Consumer	-	-	-
States and political subdivisions	-	-	-
Other loans	-	-	-
Total	8	$ 3,917	$ (269)
December 31, 2011:			
Real estate:			
Construction and land loans	2	$ 4,045	$ (144)
Farmland	1	144	35
1-4 family residential mortgages	-	-	-
Multifamily	-	-	-
Commercial	2	1,463	470
Agricultural	-	-	-
Commercial	-	-	-
Consumer	-	-	-
States and political subdivisions	-	-	-
Other loans	-	-	-
Total	5	$ 5,652	$ 361

NOTE 5. OTHER REAL ESTATE OWNED

The table below presents a summary of the activity related to other real estate owned for the years ending December 31, 2012 and 2011, respectively.

	December 31, 2012	December 31, 2011
Balance, beginning of year	$ 9,946,107	$ 10,163,992
Additions	1,715,772	2,409,790
Sales proceeds	(1,964,419)	(1,150,857)
Internal financed sales	(238,545)	-
Gain on sales of other real estate owned	56,260	83,146
Provision for other real estate owned losses	(1,317,000)	(1,559,964)
Balance, end of year	$ 8,198,175	$ 9,946,107

Expenses applicable to other real estate owned for the year ended December 31, 2012 and 2011 are as follows:

	Years Ended December 31, 2012	Years Ended December 31, 2011
Net gain on sales of other real estate owned	$ (56,260)	$ (83,146)
Provision for other real estate owned losses	1,317,000	1,559,964
Operating expenses, net of lease income	100,853	230,627
	$ 1,361,593	$ 1,707,445

NOTE 6. PREMISES AND EQUIPMENT

At December 31, 2012 and 2011, premises and equipment were as follows:

	December 31, 2012	December 31, 2011
Land	$ 5,278,831	$ 5,278,831
Buildings and leasehold improvements (depreciated over 5 to 50 years)	16,013,894	15,810,791
Furniture, fixtures, and equipment (depreciated over 3 to 10 years)	8,707,217	8,354,352
Automobiles (depreciated over 3 years)	157,683	104,883
	30,157,625	29,548,857
Accumulated depreciation	(14,578,334)	(13,695,224)
	$ 15,579,291	$ 15,853,633

Depreciation expense for the years ended December 31, 2012 and 2011 was $883,111 and $963,577, respectively.

NOTE 7. DEPOSITS

At December 31, 2012 and 2011, deposits were as follows:

	December 31, 2012	December 31, 2011
Noninterest-bearing accounts	$ 144,790,062	$ 126,469,004
NOW accounts	72,833,622	67,242,878
Money market investment accounts	19,251,910	15,656,289
Savings accounts	28,756,584	25,007,218
Time deposits:		
Time deposits less than $100,000	86,964,990	94,805,600
Time deposits greater than $100,000	62,802,878	66,272,949
Total deposits	$ 415,400,046	$ 395,453,938

At December 31, 2012 and 2011 interest expense on deposits was as follows:

	December 31, 2012	December 31, 2011
NOW accounts	$ 283,963	$ 342,937
Money market investment accounts	47,720	53,026
Savings accounts	41,812	46,940
Time deposits:		
Time deposits less than $100,000	1,088,916	1,573,609
Time deposits greater than $100,000	788,526	1,091,039
Total deposits	$ 2,250,937	$ 3,107,551

At December 31, 2012, the contractual maturities of time deposits are as follows:

2013	$ 105,197,893
2014	22,091,896
2015	8,079,790
2016	7,701,357
2017	6,696,932
	$ 149,767,868

At December 31, 2012 and 2011, overdraft demand and savings deposits reclassified to loans totaled $244,396 and $160,400, respectively.

NOTE 8. PARTICIPATION IN U.S. TREASURY PROGRAMS

On December 23, 2008, the Corporation issued 10,300 shares of preferred stock to the U.S. Treasury for $10.3 million pursuant to its Capital Purchase Program (CPP). Additionally, the Corporation issued 104,040 common stock warrants to the U.S. Treasury as a condition of its participation in the CPP. The warrants have an exercise price of $14.85 each and are immediately exercisable and expire 10 years from the date of issuance. Proceeds from this sale of the preferred stock were expected to be used for general corporate purposes, including supporting the continued, anticipated growth of the Corporation. The CPP preferred stock was non-voting, other than having class voting rights on certain matters, and paid cumulative dividends quarterly at a rate of 5% per annum for the first five years and 9% thereafter. The preferred shares were redeemable at the option of the Corporation under certain circumstances during the first three years and thereafter without restriction.

On September 3, 2010, the Corporation completed the exchange of its $10,300,000 of preferred shares issued under the U.S. Capital Purchase Program (CPP) for a like amount of preferred shares issued under the Community Development Capital Initiative (CDCI). These shares carry essentially the same terms as the CPP shares but have the following differences. The initial dividend rate is set at 2% for the CDCI shares versus the 5% for the CPP shares resulting in preferred dividends owed by the Corporation of $206,000 annually. In both share programs, the initial dividend rate is replaced after a period by a 9% dividend rate. Under the CDCI program, the dividend will not increase until 2018.

The exchange of preferred shares did not impact the 104,040 common stock warrants the Corporation issued to the U.S. Treasury as a condition of its participation in the CPP. The warrants have an exercise price of $14.85 each and are immediately exercisable and expire 10 years from the date of issuance (December 23, 2018).

Based on a Black-Scholes-Merton options pricing model, the common stock warrants were assigned a fair value of $2.55 per warrant, or $265,303 in the aggregate, as of December 12, 2008. As a result of allocating the fair value of the preferred stock and the related common stock warrants, $346,619 has been recorded in additional paid in capital as the discount on the preferred stock obtained above and will be accreted as a reduction in net earnings available for common shareholders through December 2013.

As noted above $ 346,619 was assigned to the common stock warrants, and accordingly, $9,953,381 (total $10.3 million) has been assigned to the Series A preferred stock and will be accreted up to the redemption amount of $10.3 million over the five year period ending December 2013.

During the years ended December 31, 2012 and 2011, the number of shares represented by the warrants increased by a cumulative 1,911 due to the impact of stock dividends issued.

NOTE 9. BORROWED FUNDS

The Corporation owed the Federal Home Loan Bank of Atlanta the following advances:

	December 31, 2012	December 31, 2011
Maturity Date:		
May 2012 at 7.41%	$ -	$ 5,867
July 2017 at 6.93%	325,000	390,000
August 2017 at 6.84%	51,775	62,675
June 2020 at 4.62%	485,000	549,667
July 2020 at 7.54%	94,791	107,291
	$ 956,566	$ 1,115,500

The weighted average interest rate as of December 31, 2012 and 2011 was 5.81% and 5.85%, respectively.

At December 31, 2012 and 2011, Federal Home Loan Bank advances were collateralized by investment securities with carrying values of $2,066,889 and $2,071,186, respectively.

NOTE 10. NOTE PAYABLE TO TRUST

United Bancorp Capital Trust II

In 2007, the Corporation formed a wholly-owned grantor trust to issue cumulative trust preferred securities. The grantor trust has invested the proceeds of the trust preferred securities in junior subordinated debentures of the Corporation. The junior subordinated debentures can be redeemed prior to maturity at the option of the Corporation on or after September 30, 2011. The sole assets of the guarantor trust are the Junior Subordinated Deferrable Interest Debentures of the Corporation (the Debentures) held by the grantor trust. The debentures have the same interest rate (three month LIBOR plus 1.68%, floating) as the trust preferred securities. The interest rate in effect as of December 31, 2012 was 1.99%. The Corporation has the right to defer interest payments on the Debentures at any time or from time to time for a period not exceeding 20 consecutive quarters provided that no extension period may extend beyond the stated maturity of the related Debentures. During any such extension period, distributions on the trust preferred certificates would also be deferred.

Payment of periodic cash distributions and payment upon liquidation or redemption with respect to the trust preferred securities are guaranteed by the Corporation to the extent of funds held by the grantor trust (the Preferred Securities Guarantee). The Preferred Securities Guarantee, when taken together with the Corporation's other obligations under the Debentures, constitute a full and unconditional guarantee, on a subordinated basis, by the Corporation of payments due on the trust preferred securities.

The trust preferred securities and the related debentures were issued on September 27, 2007. Distributions on the trust preferred securities are paid quarterly on March 31, June 30, September 30 and December 31 of each year. Interest on the Debentures is paid on the corresponding dates. The aggregate principal amount of Debentures outstanding at December 31, 2012 and 2011 was $10,310,000.

NOTE 11. INCOME TAXES

The components of income tax expense are as follows:

	Years Ended December 31, 2012	Years Ended December 31, 2011
Current:		
Federal	$ 35,229	$ -
State	42,693	1,679
Total	77,922	1,679
Deferred:		
Federal	272,946	314,233
State	(3,402)	89,707
Total	269,544	403,940
Income tax expense	$ 347,466	$ 405,619

Total income tax expense differed from the amount computed by applying the statutory federal income tax rate of 34% to pretax income is as follows:

	Years Ended December 31, 2012	Years Ended December 31, 2011
Income tax expense at federal statutory rate	$ 517,714	$ 541,194
Increase (decrease) resulting from:		
Tax exempt interest	(157,756)	(175,319)
Interest disallowance	3,655	5,686
State income tax net of federal expense	25,931	60,675
Premium amortization on tax exempt investment securities	233	2,431
Cash surrender value of life insurance	(34,916)	(37,303)
Other, net	(7,395)	8,255
Total income tax expense	$ 347,466	$ 405,619

NOTE 11. INCOME TAXES (Continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2012 and 2011 are as follows:

	December 31, 2012	December 31, 2011
Deferred tax assets:		
Loans, principally due to the allowance for loan losses	$ 716,737	$ 1,087,893
Net operating loss carryforward	1,381,095	1,906,176
Other real estate, principally due to difference in carrying value	1,976,530	1,574,158
Intangible assets	150,288	172,466
Premises and equipment, principally due to difference in depreciation	52,029	-
Deferred compensation	382,975	374,539
Alternative minimum tax credit	88,402	53,147
Other	231,885	139,279
	4,979,941	5,307,658
Deferred income tax liabilities:		
Premises and equipment, principally due to differences in depreciation	-	56,651
Other comprehensive income items	476,466	216,755
Discount accretion	3,027	3,150
Other	(888)	511
	478,605	277,067
Net deferred income tax assets	$ 4,501,336	$ 5,030,591

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies. Based upon the level of historical taxable income and projection for future taxable income over the periods which the temporary differences resulting in the deferred tax assets are deductible, management believes it is more likely than not that the Corporation will realize the benefits of these deductible differences.

The federal and state income tax returns of the Corporation for 2009, 2010, and 2011 are subject to examination, generally for three years after they were filed.

At December 31, 2012, the Corporation had federal and state net operating loss carry forwards of approximately $4,090,000 and $1,186,000, respectively, which will begin to expire in 2028 and 2017, respectively.

NOTE 12. STOCK BASED COMPENSATION

Stock Options

1998 Stock Option Plan

The United Bancorporation of Alabama, Inc. 1998 Stock Option Plan (the 1998 Plan) provides for the grant of options to officers, directors, and employees of the Corporation to purchase up to an aggregate of 308,000 shares of Class A Stock. As of December 31, 2012, the 1998 Plan had terminated pursuant to its terms effective December 22, 1998.

The changes in outstanding options are as follows:

	Shares Under Option	Weighted-Average Exercise Price Per Share
Balance at December 31, 2010	22,486	$ 16.15
Granted	-	
Expired	(8,160)	16.25
Surrendered	-	
Exercised	-	
Balance at December 31, 2011	14,326	$ 16.09
Granted	-	
Expired	(10,326)	15.74
Surrendered	-	
Exercised	-	
Balance at December 31, 2012	4,000	$ 17.00

There was no intrinsic value related to option shares outstanding and exercisable for the periods ended December 31, 2012 and 2011, respectively.

At December 31, 2012, all shares were exercisable at prices between $16.00 and $18.00 per share. When options are exercised, par value of the shares issued is recorded as an addition to common stock, and the remainder of the proceeds (including any tax benefit, if applicable) is credited to capital surplus.

As of December 31, 2012 all stock options issued under the 1998 Plan were outstanding and exercisable. The details associated with these options were as follows:

Exercise Price Per Share	Shares Under Option	Weighted-Average Remaining Contractual Life in Years	Weighted-Average Exercise Price
16.00	2,000	3.0	$ 16.00
18.00	2,000	3.6	18.00
	4,000	3.3	$ 17.00

NOTE 12. STOCK BASED COMPENSATION (Continued)

Stock Options (Continued)

2007 Equity Incentive Plan

The United Bancorporation of Alabama, Inc. 2007 Equity Incentive Plan (the 2007 Plan) provides for the grant of stock options, stock appreciation rights, restricted stock awards (discussed below), performance units, or any combination thereof to officers, directors, and employees of the Corporation to purchase up to an aggregate of 308,000 shares of Class A Stock. As of December 31, 2012, 296,284 shares of stock could be granted in the future. The changes in outstanding options are as follows:

	Shares Under Option	Weighted-Average Exercise Price Per Share
Balance at December 31, 2010	4,000	$ 14.85
Granted	-	
Surrendered	-	
Exercised	-	
Balance at December 31, 2011	4,000	$ 14.85
Granted	-	
Surrendered	(2,000)	14.85
Exercised	-	
Balance at December 31, 2012	2,000	$ 14.85
Exercisable at December 31, 2012	1,600	$ 14.85

Grant-date fair value is measured on the date of grant using an option-pricing model with market assumptions. The grant-date fair values are amortized into expense on a straight-line basis over the vesting period. The company applies the Black-Scholes-Merton option-pricing model which requires the use of highly subjective assumptions, including but not limited to, expected stock price volatility, term, dividend rates, forfeiture rates, and risk-free interest rates, which if changed can materially affect fair value estimates.

As of December 31, 2012, there was $485 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 the next year.

Restricted Stock

No restricted stock grants were made by the Corporation during 2012. As of December 31, 2012 the Corporation has awarded restricted stock grants in two formats to two distinct classes of employees. Employees with more than 20 years of service have been awarded grants with a six month balloon vesting. The expense of these awards is recorded on a straight-line basis over the six month term. The second type of grant has been awarded to senior officers of the Corporation. These grants have five year terms (60 months) with 1/3 vesting on the grant anniversary date in years 3, 4, and 5. The expense of these awards is recorded on a straight-line basis over the 60 month term. As of December 31, 2012 there was $5,289 of unrecognized stock-based compensation related to these restricted stock grants which is expected to be recognized over a period of two years.

NOTE 12. STOCK BASED COMPENSATION (Continued)

Restricted Stock (Continued)

The following tables present restricted stock activity:

	Restricted Stock Activity	Weighted-Average Fair Value
Balance at December 31, 2010	5,515	$ 16.65
Granted	-	
Surrendered	-	
Vested	(2,059)	16.80
Balance at December 31, 2011	3,456	$ 16.56
Granted	-	
Surrendered	(451)	16.89
Vested	(1,881)	16.83
Balance at December 31, 2012	1,124	$ 15.96

The following table summarizes stock-based compensation expense for the years ended December 31, 2012 and 2011:

	Years Ended December 31, 2012	Years Ended December 31, 2011
Stock option expense	$ 2,425	$ 6,223
Restricted stock expense	21,574	21,013
Total stock based compensation expense	$ 23,999	$ 27,236

NOTE 13. DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

The Corporation sponsors a dividend reinvestment and share purchase plan. Under the plan, all holders of record of common stock are eligible to participate in the plan. Participants in the plan may direct the plan administrator to invest cash dividends declared with respect to all or any portion of their common stock. Participants may also make optional cash payments that will be invested through the plan. All cash dividends paid to the plan administrator are invested within 30 days of cash dividend payment date. Cash dividends and optional cash payments will be used to purchase common stock of the Corporation in the open market, from newly-issued shares, from shares held in treasury, in negotiated transactions, or in any combination of the foregoing. The purchase price of the shares of common stock is based on the average market price. All administrative costs are borne by the Corporation.

For the years ended December 31, 2012 and 2011 no shares were purchased under the Plan as there were no cash dividends declared. In place of cash dividends in 2012, the Corporation distributed 0.87% stock dividends to shareholders on January 23, 2012 and July 30, 2012. In place of cash dividends in 2011, the Corporation distributed 1% stock dividends to shareholders on February 14, 2011 and July 18, 2011.

NOTE 14. EMPLOYEE BENEFIT PLAN

401(k) Savings Plan

Under a new 401(k) savings plan that became effective October 1, 2006, employees are eligible after completing ninety days of service and attaining age 20.5. Eligible employees can contribute a minimum of 1% up to 15% of salary to the plan. The Corporation contributes one dollar for each dollar the employee contributes, up to 5.5% of the employee's salary.

Contributions to the Plan charged to expense during 2012 and 2011 were $294,727 and $289,948, respectively.

Profit-Sharing Plan

The Corporation also maintains a profit–sharing plan for eligible employees. Eligibility requirements for this plan are the same as the 401(k) Employee Incentive Savings Plan. Benefits paid under the Plan are subject to approval by the Board of Directors each year. Contributions to the Plan charged to expense during 2012 and 2011 were $64,703 and $56,218, respectively.

Salary Continuation Plan

The Corporation provides a salary continuation plan providing for death and retirement benefits for certain executive officers. The present value of the estimated amounts to be paid under the plan is being accrued over the remaining service period of the executives. The expense recognized for the salary continuation plan amounted to $36,128 and $103,561 for the years ended December 31, 2012 and 2011, respectively. The balance of the liability for the salary continuation plan included in other liabilities at December 31, 2012 and 2011 totaled $933,846 and $897,718, respectively.

The cost of the salary continuation plan described above is being offset by earnings from bank owned life insurance policies on the executives. The balance of the policy surrender values included in other assets totaled $3,057,126 and $2,954,433 at December 31, 2012 and 2011, respectively. Income recognized from the increase in cash surrender value on these policies totaled $102,693 and $109,716 for the years ended December 31, 2012 and 2011, respectively.

Employee Stock Purchase Plan

The Corporation sponsors an employee stock purchase plan which is available to all employees subject to certain minimum service requirements. The Plan is administered by a Board appointed committee which designates the offering period in which employees may purchase shares and the offering price. All administrative costs are borne by the Corporation. No shares were purchased under the Plan for the years ended December 31, 2012 and 2011, respectively.

NOTE 15. FAIR VALUATION 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 recent 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.

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.

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

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.

The following tables present financial assets measured at fair value on a recurring basis as of December 31, 2012 and 2011, respectively:

		Fair Value Measurements at December 31, 2012 Using		
	Assets (Liabilities) Measured at Fair Value December 31, 2012	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities	$ 97,251,331	$ 1,062,030	$ 96,189,301	$ -

		Fair Value Measurements at December 31, 2011 Using		
	Assets (Liabilities) Measured at Fair Value December 31, 2011	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities	$ 71,493,832	$ 4,019,483	$ 67,474,349	$ -

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

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 uncollectibility 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 Owned

Other real estate owned 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.

The following tables present the assets carried on the balance sheet by caption and by level within the (FASB ASC 820) valuation hierarchy (as described above) as of December 31, 2012 and 2011, for which a nonrecurring change in fair value has been recorded during the year ended December 31, 2012 and 2011, respectively.

		Carrying Value at December 31, 2012			
	Assets (Liabilities) Measured at Fair Value December 31, 2012	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Impaired loans	$ 10,292,257	$ -	$ -	$ 10,292,257	$ (700,715)
Other real estate	3,774,809	-	-	3,774,809	(1,382,457)

		Carrying Value at December 31, 2011			
	Assets (Liabilities) Measured at Fair Value December 31, 2011	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Impaired loans	$ 14,275,269	$ -	$ -	$ 14,028,269	$ (2,495,1123)
Other real estate	3,942,425	-	-	3,942,425	(1,591,129)

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

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.

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

Cash and Short-Term Investments*:* Fair value approximates the carrying value of such assets.

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.

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.

Bank Owned Life Insurance*:* The fair value of bank owned life insurance approximates its carrying value.

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.

FHLB, Other Borrowed Funds and Note payable to trust*:* The fair value of the Corporation's other borrowed funds and note payable to trust 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.

Accrued Interest*:* The fair value of accrued interest receivable and payable approximates their carrying value.

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.

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

The carrying value and estimated fair value of the Corporation's financial instruments at December 31, 2012 and 2011 are as follows:

	December 31,			
	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:	*(Dollars in Thousands)*			
Cash and short-term investments	$ 71,299	$ 71,299	$ 56,274	$ 56,274
Investment securities	97,251	97,251	82,543	93,506
Loans held for sale	207	207	169	169
Loans held for investment, net of the allowance for loan losses	260,119	268,761	258,192	257,403
Bank owned life insurance	3,057	3,057	2,954	2,954
Other securities	1,538	1,538	1,668	1,668
Accrued interest receivable	2,061	2,061	2,155	2,155
Financial liabilities:				
Deposits	415,400	419,052	395,454	398,598
Other borrowed funds	-	-	992	992
FHLB advances	957	1,088	1,116	1,274
Note payable to trust	10,310	10,310	10,310	10,310
Accrued interest payable	200	200	288	288

NOTE16. DIVIDENDS FROM BANK

Dividends paid by the Bank are the primary source of funds available to the Corporation for payment of dividends to its stockholders and for other needs. Applicable federal and state statutes and regulations impose restrictions on the amounts of dividends that may be declared by the subsidiary bank. In addition, the subsidiary bank is also required to maintain minimum amounts of capital to both total "risk–weighted" assets and total assets, as defined by banking regulators. Capital adequacy considerations could further limit the availability of dividends from the subsidiary bank. The payment of dividends from the Bank is regulated by the Alabama State Banking Department and is may be limited based on earnings and credit losses. Recent earnings and loan losses create a restriction on the ability of the Bank to pay dividends. Future payments of dividends by the Bank to the Corporation will be dependent on earnings, loan losses and approval from the Alabama State Banking Department and applicable federal regulators.

NOTE 17. LITIGATION

The Corporation is involved in various legal proceedings arising in connection with their business. In the opinion of management, based upon consultation with legal counsel, the ultimate resolution of these proceedings is not expected to have a material adverse effect upon the financial statements of the Corporation.

NOTE 18. COMMITMENTS

The Corporation leases certain property and equipment for use in its business. These leases have lease terms generally not in excess of five years. The Corporation is not committed to any operating leases, which have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2012.

Rental expense for all operating leases charged to earnings aggregated $40,413 and $30,468 for the years ended December 31, 2012 and 2011, respectively.

The Corporation is a party to financial instruments with off–balance–sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such instruments involve elements of credit risk in excess of the amounts recognized in the consolidated financial statements.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Corporation uses the same credit policies in making conditional obligations as it does for on–balance sheet instruments.

The financial instruments whose contractual amounts represent credit risk as of December 31, 2012 and 2011 are approximately as follows:

	December 31,	
	2012	2011
Commitments to extend credit	$ 36,593,000	$ 30,500,000
Standby letters of credit	716,000	1,405,000
	$ 37,309,000	$ 31,905,000

Standby letters of credit are commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation holds various assets as collateral supporting those commitments for which collateral is deemed necessary.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

NOTE 19. OTHER NONINTEREST EXPENSE

Components of other noninterest expense exceeding 1% of the total of net interest income and noninterest income for the years ended December 31, 2012 or 2011, respectively, include the following:

	December 31, 2012	December 31, 2011
Accounting and audit	$ 269,375	$ 177,275
Advertising	359,371	313,418
Armored care service	117,769	166,712
ATM network	442,937	456,834
Communications	367,315	403,908
Data processing	685,104	664,245
FDIC deposit insurance	410,136	663,206
Legal	165,370	253,111
Other real estate owned expenses	100,853	230,627
Provision for other real estate owned losses	1,317,000	1,559,964

NOTE 20. CONCENTRATIONS OF CREDIT RISK

On December 31, 2012, the Corporation had $53,988,238 of agriculture related loans as compared to $46,864,339 in 2011. Agriculture loans comprised approximately 20% of the loan portfolio. Additionally, real estate constructions accounted for approximately 11% of the total portfolio, while 1-4 family residential mortgage loans made up approximately 22% of the portfolio Real estate construction and 1-4 family residential mortgage loans were $30,289,382 and $57,024,018 respectively in 2012, $37,436,067 and $53,905,156, respectively, in 2011.

NOTE 21. REGULATORY MATTERS

The Corporation and its subsidiary bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Corporation. Under capital adequacy guidelines and the regulatory framework of prompt corrective action, the Corporation and its subsidiary bank must meet specific capital guidelines that involve quantitative measures of each bank's assets, liabilities, and certain off–balance–sheet items as calculated under regulatory accounting practices. The capital amounts and classification of the Corporation and its subsidiary bank are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and its subsidiary bank to maintain minimum core capital (Tier I Capital) of at least 4% of risk–weighted assets, minimum total capital (Total Qualifying Capital) of at least 8% of risk–weighted assets and a minimum leverage ratio of at least 4% of quarterly average assets. Management believes, as of December 31, 2012 and 2011, that the Corporation and its subsidiary bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2012, the most recent notification from the appropriate regulatory agencies categorized the subsidiary bank as "well-capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the subsidiary bank's category.

NOTE 21. REGULATORY MATTERS (Continued)

The following table presents the actual capital amounts and ratios of the Corporation and its subsidiary bank at December 31, 2012 and 2011:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in Thousands)			
December 31, 2012:						
Total Capital to Risk Weighted Assets						
United Bancorporation	$ 46,854	16.15%	$ 23,211	8.00%	N/A	N/A
United Bank	$ 46,262	15.96%	$ 23,186	8.00%	$ 28,982	10.00%
Tier I Capital to Risk Weighted Assets						
United Bancorporation	$ 43,220	14.90%	$ 11,605	4.00%	N/A	N/A
United Bank	$ 42,628	14.71%	$ 11,953	4.00%	$ 17,389	6.00%
Tier I Capital to Average Assets						
United Bancorporation	$ 43,220	9.44%	$ 18,311	4.00%	N/A	N/A
United Bank	$ 42,628	9.32%	$ 18,298	4.00%	$ 22,873	5.00%
December 31, 2011:						
Total Capital to Risk Weighted Assets						
United Bancorporation	$ 45,487	15.47%	$ 23,523	8.00%	N/A	N/A
United Bank	$ 45,326	15.44%	$ 23,488	8.00%	$ 29,360	10.00%
Tier I Capital to Risk Weighted Assets						
United Bancorporation	$ 41,805	14.22%	$ 11,759	4.00%	N/A	N/A
United Bank	$ 41,631	14.18%	$ 11,744	4.00%	$ 17,616	6.00%
Tier I Capital to Average Assets						
United Bancorporation	$ 41,805	9.53%	$ 17,547	4.00%	N/A	N/A
United Bank	$ 41,631	9.49%	$ 17,539	4.00%	$ 21,923	5.00%

Effective May 15, 2012, the Corporation, under Sections 12(g)(4) and 15(d) of the Securities Exchange Act of 1934, as amended by the Jumpstart Our Business Startups Act, terminated registration of its class of shares of common stock and suspended its reporting duties with respect to such common stock.

NOTE 22. DERIVATIVE FINANCIAL INSTRUMENTS

To hedge the Corporation's exposure to changing interest rates, management entered into an agreement known as an "interest rate cap" on its variable rate note payable to trust during April 2012. Interest rate caps are typically used to mitigate a borrowing's exposure to rising interest rates. Pursuant to the agreement, the Corporation's counterparty agrees to pay the Corporation an amount equal to the difference between the three-month LIBOR and 2.50% multiplied by a $10,000,000 notional amount should the three-month LIBOR rise above 2.50% during the five year term of the agreement. The Corporation paid its counterparty a one-time premium equal to $158,000 which will be amortized over the five year term. The interest rate cap is being marked to market and accounted for as a cash flow hedge. As of December 31, 2012, the interest rate cap contract was carried at fair value which was equal to $27,170. The Company considers the derivative (interest rate cap) as highly effective in offsetting changes in cash flows of the hedged items (variable rate note payable).

NOTE 23. PARENT CORPORATION FINANCIAL INFORMATION

The condensed financial information for United Bancorporation of Alabama, Inc. (Parent Corporation Only) follows:

CONDENSED BALANCE SHEETS

	2012	2011
Assets		
Cash	$ 27,729	$ 54,821
Investment in subsidiary	48,650,423	47,404,102
Other assets	280,928	154,729
Total assets	$ 48,959,080	$ 47,613,652
Liabilities and stockholders’ equity		
Other liabilities	$ 9,615	$ 34,629
Note payable to trust	10,310,000	10,310,000
Total liabilities	10,319,615	10,344,629
Stockholders’ equity		
Preferred stock of $.01 par value. Authorized 250,000 shares; 10,300 shares issued in 2012 and 2011, respectively	10,222,501	10,149,323
Class A common stock of $0.01 par value. Authorized 5,000,000 shares; issued 2,388,676 and 2,389,127 shares in 2012 and 2011, respectively	23,887	23,891
Class B common stock of $0.01 par value. Authorized 250,000 shares; no shares issued	-	-
Additional paid-in capital	7,175,616	7,123,510
Unearned stock based compensation	(5,289)	(26,863)
Retained earnings	20,511,650	20,002,257
Accumulated other comprehensive income, net of tax	714,683	325,119
Less: 439 and40,943 treasury shares at cost in 2012 and 2011, respectively	3,583	328,214
Total stockholders' equity	38,639,465	37,269,023
Total liabilities and stockholders’ equity	$ 48,959,080	$ 47,613,652

NOTE 23. PARENT CORPORATION FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF EARNINGS

	2012	2011
Income		
Dividend income from subsidiary	$ 570,000	$ 515,000
Other income	6,768	6,242
Total income	576,768	521,242
Expense		
Interest on subordinated debentures	225,089	207,588
Other operating expense	158,162	100,525
Total expense	383,251	308,113
Income before equity in undistributed earnings of subsidiary and income taxes	193,517	213,129
Income tax benefit	(138,905)	(111,376)
Income before equity in undistributed earnings of subsidiary	332,422	324,505
Equity in undistributed earnings of subsidiary	842,799	861,621
Net earnings	$ 1,175,221	$ 1,186,126

NOTE 23. PARENT CORPORATION FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	2012	2011
OPERATING ACTIVITIES		
Net earnings	$ 1,175,221	$ 1,186,126
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Equity in undistributed earnings of subsidiary	(842,799)	(861,621)
Stock based compensation	2,425	3,880
Increase (decrease) in other liabilities	(25,015)	7,548
Increase in other assets	(126,199)	(106,900)
Net cash provided by operating activities	183,633	229,033
FINANCING ACTIVITIES		
Cash dividends - preferred stock	(206,000)	(206,000)
Cash dividends - common stock	(4,725)	(6,425)
Net cash used in financing activities	(210,725)	(212,425)
Net increase (decrease) in cash	(27,092)	16,608
Cash at beginning of year	54,821	38,213
Cash at end of year	$ 27,729	$ 54,821