

UNITED COMMUNITY BANKS INC

Form 10-Q

November 07, 2006

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

For the Quarterly Period Ended September 30, 2006

OR

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

For the Transition Period from _____ to _____

Commission file number 0-21656

UNITED COMMUNITY BANKS, INC.

(Exact name of registrant as specified in its charter)

Georgia

58-1807304

(State of Incorporation)

(I.R.S. Employer Identification No.)

**63 Highway 515
Blairsville, Georgia**

30512

Address of Principal Executive Offices

(Zip Code)

(706) 781-2265

(Telephone Number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YES NO

**Common stock, par value \$1 per share: 40,268,604 shares
outstanding as of September 30, 2006**

Table of Contents

INDEX

PART I Financial Information

Item 1. Financial Statements.

Consolidated Statement of Income (unaudited) for the Three and Nine Months Ended September 30, 2006 and 2005 2

Consolidated Balance Sheet at September 30, 2006 (unaudited), December 31, 2005 (audited) and September 30, 2005 (unaudited) 3

Consolidated Statement of Changes in Shareholders' Equity (unaudited) for the Nine Months Ended September 30, 2006 and 2005 4

Consolidated Statement of Cash Flows (unaudited) for the Nine Months Ended September 30, 2006 and 2005 5

Notes to Consolidated Financial Statements 6

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. 9

Item 3. Quantitative and Qualitative Disclosures About Market Risk. 25

Item 4. Controls and Procedures. 25

PART II Other Information

Item 1. Legal Proceedings. 25

Item 1A. Risk Factors. 26

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds. 26

Item 3. Defaults Upon Senior Securities. 26

Item 4. Submission of Matters to a Vote of Security Holders. 26

Item 5. Other Information. 26

Item 6. Exhibits. 26

EX-31.1 SECTION 302. CERTIFICATION OF THE CEO

EX-31.2 SECTION 302. CERTIFICATION OF THE CFO

EX-32 SECTION 906. CERTIFICATION OF THE CEO AND CFO

Table of Contents**Part I Financial Information****Item 1 Financial Statements****UNITED COMMUNITY BANKS, INC.****Consolidated Statement of Income (unaudited)**

<i>(in thousands, except per share data)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Interest revenue:				
Loans, including fees	\$ 106,688	\$ 77,470	\$ 296,133	\$ 210,383
Investment securities:				
Taxable	11,822	10,340	34,661	29,544
Tax exempt	474	520	1,497	1,573
Federal funds sold and deposits in banks	365	253	685	662
Total interest revenue	119,349	88,583	332,976	242,162
Interest expense:				
Deposits:				
Demand	10,255	5,187	26,398	13,093
Savings	226	223	680	565
Time	34,694	17,653	89,679	45,680
Total deposit interest expense	45,175	23,063	116,757	59,338
Federal funds purchased, repurchase agreements, & other short-term borrowings	2,254	1,651	5,814	3,723
Federal Home Loan Bank advances	5,828	7,181	18,837	19,403
Long-term debt	2,174	2,138	6,495	6,386
Total interest expense	55,431	34,033	147,903	88,850
Net interest revenue	63,918	54,550	185,073	153,312
Provision for loan losses	3,700	3,400	10,900	8,600
Net interest revenue after provision for loan losses	60,218	51,150	174,173	144,712
Fee revenue:				
Service charges and fees	6,914	6,627	20,095	18,521
Mortgage loan and other related fees	1,928	2,367	5,149	5,592
Consulting fees	2,040	1,777	5,196	4,944
Brokerage fees	784	571	2,430	1,781
Securities losses, net	(382)	(153)	(385)	(155)
Other	862	1,207	3,395	4,092
Total fee revenue	12,146	12,396	35,880	34,775
Total revenue	72,364	63,546	210,053	179,487

Operating expenses:

Salaries and employee benefits	29,585	26,334	85,535	73,843
Communications and equipment	3,863	3,484	10,970	9,581
Occupancy	2,945	2,743	8,793	8,129
Advertising and public relations	1,882	1,683	5,718	4,745
Postage, printing and supplies	1,379	1,426	4,184	4,146
Professional fees	938	1,174	3,168	3,283
Amortization of intangibles	503	503	1,509	1,509
Other	3,844	3,947	10,767	9,645
Total operating expenses	44,939	41,294	130,644	114,881
Income before income taxes	27,425	22,252	79,409	64,606
Income taxes	10,012	7,954	29,028	23,094
Net income	\$ 17,413	\$ 14,298	\$ 50,381	\$ 41,512
Net income available to common shareholders	\$ 17,408	\$ 14,293	\$ 50,366	\$ 41,494
Earnings per common share:				
Basic	\$.43	\$.37	\$ 1.25	\$ 1.08
Diluted	.42	.36	1.22	1.05
Dividends per common share	.08	.07	.24	.21
Weighted average common shares outstanding:				
Basic	40,223	38,345	40,156	38,272
Diluted	41,460	39,670	41,327	39,499

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents**UNITED COMMUNITY BANKS, INC.
Consolidated Balance Sheet**

<i>(in thousands, except share and per share data)</i>	September 30, 2006 <i>(unaudited)</i>	December 31, 2005 <i>(audited)</i>	September 30, 2005 <i>(unaudited)</i>
ASSETS			
Cash and due from banks	\$ 130,038	\$ 121,963	\$ 139,147
Interest-bearing deposits in banks	16,032	20,607	28,935
Cash and cash equivalents	146,070	142,570	168,082
Securities available for sale	980,273	990,687	945,922
Mortgage loans held for sale	21,522	22,335	28,539
Loans, net of unearned income	4,965,365	4,398,286	4,254,051
Less allowance for loan losses	60,901	53,595	51,888
Loans, net	4,904,464	4,344,691	4,202,163
Premises and equipment, net	129,217	112,887	109,468
Accrued interest receivable	47,336	37,197	36,108
Goodwill and other intangible assets	120,430	118,651	119,154
Other assets	105,978	96,738	100,230
Total assets	\$ 6,455,290	\$ 5,865,756	\$ 5,709,666
LIABILITIES AND SHAREHOLDERS EQUITY			
Liabilities:			
Deposits:			
Demand	\$ 666,891	\$ 602,525	\$ 637,296
Interest-bearing demand	1,340,985	1,264,947	1,180,125
Savings	167,531	175,453	175,864
Time:			
Less than \$100,000	1,523,843	1,218,277	1,118,102
Greater than \$100,000	1,248,738	895,466	790,784
Brokered	361,231	320,932	294,198
Total deposits	5,309,219	4,477,600	4,196,369
Federal funds purchased, repurchase agreements, & other short-term borrowings	56,026	122,881	163,646
Federal Home Loan Bank advances	412,572	635,616	775,251
Long-term debt	111,869	111,869	111,869
Accrued expenses and other liabilities	38,870	45,104	38,531
Total liabilities	5,928,556	5,393,070	5,285,666

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Shareholders' equity:

Preferred stock, \$1 par value; \$10 stated value; 10,000,000 shares authorized; 32,200, 32,200 and 37,200 shares issued and outstanding	322	322	372
Common stock, \$1 par value; 100,000,000 shares authorized; 40,268,604, 40,019,853 and 38,407,874 shares issued	40,269	40,020	38,408
Common stock issuable; 22,741 and 9,948 shares as of September 30, 2006 and December 31, 2005, respectively	638	271	
Capital surplus	199,773	193,355	153,712
Retained earnings	291,281	250,563	238,144
Treasury stock; 24,449 shares as of September 30, 2005, at cost			(671)
Accumulated other comprehensive loss	(5,549)	(11,845)	(5,965)
Total shareholders' equity	526,734	472,686	424,000
Total liabilities and shareholders' equity	\$ 6,455,290	\$ 5,865,756	\$ 5,709,666

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents**UNITED COMMUNITY BANKS, INC.****Consolidated Statement of Changes in Shareholders' Equity (unaudited)****For the Nine Months Ended September 30,**

	Preferred	Common	Common	Capital	Retained	Treasury	Accumulated Other Comprehensive Income	Total
<i>(in thousands, except share and per share data)</i>	Stock	Stock	Issuable	Surplus	Earnings	Stock	(Loss)	
Balance, December 31, 2004	\$ 448	\$ 38,408	\$	\$ 155,076	\$ 204,709	\$ (4,413)	\$ 2,860	\$ 397,088
Comprehensive income:								
Net income					41,512			41,512
Other comprehensive loss:								
Unrealized holding losses on available for sale securities, net of deferred tax benefit and reclassification adjustment							(6,329)	(6,329)
Unrealized losses on derivative financial instruments qualifying as cash flow hedges, net of deferred tax benefit							(2,496)	(2,496)
Comprehensive income					41,512		(8,825)	32,687
Retirement of preferred stock (7,600 shares)	(76)							(76)
Cash dividends declared on common stock (\$.21 per share)					(8,059)			(8,059)
Exercise of stock options (195,103 shares)				(1,730)		3,254		1,524
Common stock issued (16,732 shares)				42		424		466
Amortization of restricted stock				388				388
Vesting of restricted stock (4,062 shares)				(64)		64		
Dividends declared on preferred stock (\$.45 per share)					(18)			(18)
Balance, September 30, 2005	\$ 372	\$ 38,408	\$	\$ 153,712	\$ 238,144	\$ (671)	\$ (5,965)	\$ 424,000
Balance, December 31, 2005	\$ 322	\$ 40,020	\$ 271	\$ 193,355	\$ 250,563	\$	\$ (11,845)	\$ 472,686
Comprehensive income:								
Net income					50,381			50,381
Other comprehensive income:								
Unrealized holding gains on available for sale securities, net of deferred tax expense and reclassification adjustment							749	749
Unrealized gains on derivative financial instruments qualifying as cash flow hedges, net of deferred tax expense and reclassification adjustment							5,547	5,547

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Comprehensive income				50,381		6,296	56,677
Cash dividends declared on common stock (\$.24 per share)				(9,648)			(9,648)
Exercise of stock options (98,025 shares)	99			641			740
Common stock issued to Dividend Reinvestment Plan and employee benefit plans (128,244 shares)	128			3,566			3,694
Amortization of stock options and restricted stock				2,233			2,233
Vesting of restricted stock (22,482 shares)	22			(22)			
Deferred compensation plan, net, including dividend equivalents			367				367
Dividends declared on preferred stock (\$.45 per share)				(15)			(15)
Balance, September 30, 2006		\$ 322	\$ 40,269	\$ 638	199,773	\$ 291,281	\$ (5,549) \$ 526,734

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4

Table of Contents**UNITED COMMUNITY BANKS, INC.**
Consolidated Statement of Cash Flows (unaudited)

<i>(in thousands)</i>	Nine Months Ended September 30,	
	2006	2005
Operating activities:		
Net income	\$ 50,381	\$ 41,512
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	12,774	11,530
Provision for loan losses	10,900	8,600
Stock based compensation	2,233	388
Loss on sale of securities available for sale	385	155
Gain on sale of other assets	(151)	(714)
Changes in assets and liabilities, net of effects of business combinations:		
Other assets and accrued interest receivable	(20,874)	(16,158)
Accrued expenses and other liabilities	(845)	7,053
Mortgage loans held for sale	813	8,555
Net cash provided by operating activities	55,616	60,921
Investing activities, net of effects of business combinations:		
Proceeds from sales of securities available for sale	72,402	10,878
Proceeds from maturities and calls of securities available for sale	97,479	188,526
Purchases of securities available for sale	(160,382)	(269,565)
Net increase in loans	(566,008)	(525,630)
Proceeds from sales of premises and equipment	1,700	2,963
Purchases of premises and equipment	(25,097)	(14,740)
Net cash received from branch acquisitions	26,413	
Proceeds from sale of other real estate	2,487	1,979
Net cash used by investing activities	(551,006)	(605,589)
Financing activities, net of effects of business combinations:		
Net change in deposits	793,577	515,853
Net change in federal funds purchased, repurchase agreements, and other short-term borrowings	(66,855)	30,715
Proceeds from FHLB advances	525,000	1,423,600
Repayments of FHLB advances	(748,000)	(1,386,100)
Proceeds from exercise of stock options	740	1,524
Proceeds from issuance of common stock for dividend reinvestment and employee benefit plans	3,694	466
Retirement of preferred stock		(76)
Cash dividends on common stock	(9,251)	(8,054)
Cash dividends on preferred stock	(15)	(18)
Net cash provided by financing activities	498,890	577,910

Net change in cash and cash equivalents	3,500	33,242
Cash and cash equivalents at beginning of period	142,570	134,840
Cash and cash equivalents at end of period	\$ 146,070	\$ 168,082

Supplemental disclosures of cash flow information:

Cash paid during the period for:

Interest	\$ 143,378	\$ 88,339
Income taxes	43,161	22,464

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents**United Community Banks, Inc.**

Notes to Consolidated Financial Statements

Note 1 Accounting Policies

The accounting and financial reporting policies of United Community Banks, Inc. (United) and its subsidiaries conform to accounting principles generally accepted in the United States of America and general banking industry practices. The accompanying interim consolidated financial statements have not been audited. All material intercompany balances and transactions have been eliminated. A more detailed description of United s accounting policies is included in the 2005 annual report filed on Form 10-K.

In management s opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments are normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim periods.

Note 2 Stock-Based Compensation

United has applied the modified prospective method with the adoption of Statement of Financial Accounting Standards (SFAS) 123(R), effective January 1, 2006. Consequently, the financial statements for prior interim periods and fiscal years do not reflect any adjustments. The following table shows pro forma net income available to common shareholders and basic and diluted earnings per share as if United had adopted the fair value method of recognizing option expense for all periods presented (dollars in thousands, except per share data).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income available to common shareholders:				
As reported	\$ 17,408	\$ 14,293	\$ 50,366	\$ 41,494
Pro forma	17,408	13,870	50,366	40,325
Basic earnings per common share:				
As reported	.43	.37	1.25	1.08
Pro forma	.43	.36	1.25	1.05
Diluted earnings per common share:				
As reported	.42	.36	1.22	1.05
Pro forma	.42	.35	1.22	1.02

United has an equity compensation plan that allows for grants of incentive stock options, nonqualified stock options, restricted stock (also referred to as nonvested stock), restricted stock units, stock awards, performance share awards or stock appreciation rights. Options granted under the plan have an exercise price equal to the fair market value of the underlying stock at the date of grant. The number of awards available for grant is adjusted with the change in the number of shares outstanding in accordance with the terms of the plan. The general terms of the plan include a vesting period (usually four years) with an exercisable period not to exceed ten years. Certain option and restricted stock grants provide for accelerated vesting if there is a change in control (as defined in the plan). As of September 30, 2006, approximately 672,000 awards could be granted under the plan. Through September 30, 2006, only incentive stock options, nonqualified stock options and restricted stock had been granted under the plan. The following table shows option activity for the first nine months of 2006.

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
---------	--------	---------------------------------------	--	--

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Outstanding at December 31, 2005	2,220,340	\$	16.36		
Granted	479,400		28.90		
Exercised	(113,249)		10.70		
Forfeited	(10,950)		22.41		
Expired	(500)		28.66		
Outstanding at September 30, 2006	2,575,041	\$	18.91	6.7	\$ 28,697
Exercisable at September 30, 2006	1,507,321	\$	14.54	5.2	\$ 23,384

Table of Contents

The weighted average fair value of options granted in the first nine months of 2006 and 2005 was \$8.51 and \$5.72, respectively. The fair value of each option granted was estimated on the date of grant using the Black-Scholes model. The key assumptions used to determine the fair value of options are presented in the table below.

	Nine Months Ended September 30,	
	2006	2005
Expected volatility	22%	20%
Expected dividend yield	1.0% to 1.2%	1.0% to 1.3%
Expected life (in years)	6.25	6.25
Risk-free rate	4.3% to 5.2%	3.8% to 4.4%

United's stock trading history began in March of 2002 when United listed on the Nasdaq Global Select Market. For the first nine months of 2006 and 2005, expected volatility was determined using United's historical monthly volatility over the period beginning in March of 2002 through the end of the last completed year. Compensation expense relating to options of \$1.4 million, net of deferred tax benefit of \$240,000, was included in earnings for the first nine months of 2006. In 2005, compensation expense relating to options of \$1.2 million, net of deferred tax benefit of \$111,000, was not included in earnings but has been included in the pro forma results in this note for comparative purposes. The amount of compensation expense for both periods was determined based on the fair value of the options at the time of grant, multiplied by the number of options granted that were expected to vest, which was then amortized, net of any applicable tax benefit, over the vesting period. The forfeiture rate for options is estimated to be approximately 3% per year. The total intrinsic value of options exercised during the nine months ended September 30, 2006 was \$2.2 million.

The table below presents the activity in restricted stock for the first nine months of 2006.

Restricted Stock	Shares	Weighted- Average Grant- Date Fair Value
Outstanding at December 31, 2005	70,512	\$ 23.22
Granted	35,125	29.11
Vested	(22,482)	23.00
Outstanding at September 30, 2006	83,155	\$ 25.77

For the nine months ended September 30, 2006 and 2005, compensation expense of \$612,000 and \$388,000, respectively, was recognized related to restricted stock. The total intrinsic value of the restricted stock was \$2.5 million at September 30, 2006.

As of September 30, 2006, there was \$7.3 million of unrecognized compensation cost related to nonvested stock options and restricted stock granted under the plan. That cost is expected to be recognized over a weighted-average period of 1.6 years. The aggregate grant date fair value of shares vested during the nine months ended September 30, 2006, was \$2.3 million.

Note 3 Common Stock Issued / Common Stock Issuable

In August 2005 United established a Dividend Reinvestment and Share Purchase Plan (DRIP). Under the plan, shareholders of record can voluntarily reinvest all or a portion of their cash dividends into shares of United's common stock, as well as purchase additional stock through the plan for cash. United's 401(k) retirement plan regularly purchases shares of United's common stock directly from United. In addition, United started an Employee Stock

Purchase Program (ESPP) on January 1, 2006. Under this plan, eligible employees have the opportunity to purchase shares of common stock at a 5% discount, with no commission charges. For the first nine months of 2006, United issued 128,244 shares of common stock and increased capital by \$3.7 million through these plans.

In the fourth quarter of 2005, United began offering its common stock as an investment option in its deferred compensation plan. The common stock component is accounted for as an equity instrument and is reflected in the consolidated financial statements as common stock issuable. At September 30, 2006, 22,741 shares were issuable under the deferred compensation plan.

Table of Contents**Note 4 Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30.

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Basic earnings per share:				
Weighted average shares outstanding	40,223	38,345	40,156	38,272
Net income available to common shareholders	\$ 17,408	\$ 14,293	\$ 50,366	\$ 41,494
Basic earnings per share	\$.43	\$.37	\$ 1.25	\$ 1.08
Diluted earnings per share:				
Weighted average shares outstanding	40,223	38,345	40,156	38,272
Net effect of the assumed exercise of stock options based on the treasury stock method using average market price for the period	843	953	781	855
Common stock issuable under deferred compensation plan	22		18	
Effect of conversion of subordinated debt	372	372	372	372
Total weighted average shares and common stock equivalents outstanding	41,460	39,670	41,327	39,499
Net income available to common shareholders	\$ 17,408	\$ 14,293	\$ 50,366	\$ 41,494
Income effect of conversion of subordinated debt, net of tax	43	34	122	94
Net income, adjusted for effect of conversion of subordinated debt, net of tax	\$ 17,451	\$ 14,327	\$ 50,488	\$ 41,588
Diluted earnings per share	\$.42	\$.36	\$ 1.22	\$ 1.05

Note 5 Mergers and Acquisitions

At September 30, 2006, accrued merger costs of \$1.1 million remained unpaid relating to acquisitions closed in 2004 and 2003. Severance and related costs include change in control payments for which payment had been deferred. Contract termination costs include amounts claimed by service providers as a result of early termination of service contracts related to the acquisitions. The unpaid balance at September 30, 2006 relates to one contract termination charge that is in dispute. A summary of the activities related to accrued merger costs is shown below (in thousands):

Activity with accrued merger cost**For the nine months ended September 30, 2006**

	Beginning Balance	Amounts Paid	Ending Balance
Severance and related costs	\$ 336	\$ (25)	\$ 311
Professional fees	81	(66)	15
Contract termination costs	816		816

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

Other merger-related expenses	85	(85)	
Totals	\$ 1,318	\$ (176)	\$ 1,142

On September 22, 2006, United completed the acquisition of two branch facilities in Bryson City, North Carolina and Sylva, North Carolina from another financial institution. In the transaction, United paid a premium of \$3.1 million and received loans of \$8 million and deposits of \$38 million.

Note 6 Reclassification

Certain amounts for the comparative periods of 2005 have been reclassified to conform to the 2006 presentation.

Table of Contents

Note 7 Recent Accounting Pronouncements

Accounting for Uncertainty in Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48 (FIN 48) Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements and prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation will be effective for United beginning in January of 2007. United is in the process of assessing the impact of this interpretation on its financial position and results of operations.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Form 10-Q contains forward-looking statements regarding United Community Banks, Inc. (United), including, without limitation, statements relating to United s expectations with respect to revenue, credit losses, levels of nonperforming assets, expenses, earnings and other measures of financial performance. Words such as may , could , would , should , believes , expects , anticipates , estimates , intends , plans , targets or similar expressions identify forward-looking statements. These forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties that are subject to change based on various factors (many of which are beyond United s control). The following factors, among others, could cause United s financial performance to differ materially from the expectations expressed in such forward-looking statements:

our recent operating results may not be indicative of future operating results;

our corporate culture has contributed to our success and, if we cannot maintain this culture as we grow, we could lose the productivity fostered by our culture, which could harm our business;

we may face risks with respect to future expansion and acquisitions or mergers;

changes in prevailing interest rates may negatively affect our net income and the value of our assets;

our construction and land development loans are subject to unique risks that could adversely affect our earnings;

if our allowance for loan losses is not sufficient to cover actual loan losses, our earnings would decrease;

competition from financial institutions and other financial service providers may adversely affect our profitability;

business increases, productivity gains and other investments are lower than expected or do not occur as quickly as anticipated;

competitive pressures among financial services companies increase significantly;

the strength of the United States economy in general and/or the strength of the local economies of the states in which United conducts operations changes;

trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, change;

inflation or market conditions fluctuate;

conditions in the stock market, the public debt market and other capital markets deteriorate;

financial services laws and regulations change;

technology changes and United fails to adapt to those changes;

consumer spending and saving habits change;

unanticipated regulatory or judicial proceedings occur; and

United is unsuccessful at managing the risks involved in the foregoing.

Additional information with respect to factors that may cause actual results to differ materially from those contemplated by such forward-looking statements may also be included in other reports that United files with the Securities and Exchange Commission. United cautions that the foregoing list of factors is not exclusive and not to place undue reliance on forward-looking statements. United does not intend to update any forward-looking statement, whether written or oral, relating to the matters discussed in this Form 10-Q.

Table of Contents

Overview

United is a bank holding company registered with the Federal Reserve under the Bank Holding Company Act of 1956 that was incorporated under the laws of the state of Georgia in 1987 and commenced operations in 1988. At September 30, 2006, United had total consolidated assets of \$6.5 billion, total loans of \$5.0 billion, total deposits of \$5.3 billion and stockholders' equity of \$527 million.

United's activities are primarily conducted by its two wholly-owned Georgia and North Carolina banking subsidiaries (which are collectively referred to as the Banks in this discussion) and Brintech, Inc., a consulting firm providing professional services to the financial services industry.

Critical Accounting Policies

The accounting and reporting policies of United Community Banks and its subsidiaries are in accordance with accounting principles generally accepted in the United States and conform to general practices within the banking industry. The more critical accounting and reporting policies include United's accounting for the allowance for loan losses. In particular, United's accounting policies relating to the allowance for loan losses involve the use of estimates and require significant judgment to be made by management. Different assumptions in the application of these policies could result in material changes in United's consolidated financial position or consolidated results of operations. See Asset Quality and Risk Elements herein for additional discussion of United's accounting methodologies related to the allowance.

Results of Operations

Net income was \$17.4 million for the third quarter of 2006, an increase of \$3.1 million, or 22%, from the same period in 2005. Diluted earnings per share was \$.42 for the third quarter of 2006, compared with \$.36 for the third quarter of 2005, an increase of 17%. Return on tangible equity for the third quarter was 17.29% for 2006, compared with 18.90% for 2005. Return on assets for the third quarter was 1.09% for 2006, compared with 1.01% for 2005.

Year-to-date through September 30, 2006, net income was \$50.4 million compared to \$41.5 million for the first nine months of 2005, an increase of 21%. Diluted earnings per share was \$1.22 for the nine months ended September 30, 2006, compared with \$1.05 for the same period in 2005, an increase of 16%. Return on tangible equity for the first nine months of 2006 was 17.54% compared to 19.30% for the first nine months of 2005. The decrease in return on tangible equity reflects the \$40.5 million in equity added by United's fourth quarter 2005 stock offering. Return on assets for the nine months ended September 30, 2006 was 1.09% compared to 1.03% for the nine months ended September 30, 2005.

Table of Contents**Table 1 Financial Highlights
Selected Financial Information**

Amounts, except per share (table equivalent)	2006		2005		Third	For the Nine		
	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Quarter 2006-2005 Change	2006	Months Ended 2005	
REVENUE SUMMARY								
Revenue	\$ 119,802	\$ 111,728	\$ 102,797	\$ 95,465	\$ 89,003		\$ 334,327	\$ 243,353
Expense	55,431	49,407	43,065	38,576	34,033		147,903	88,850
Net revenue	64,371	62,321	59,732	56,889	54,970	17%	186,424	154,503
Provision for loan losses	3,700	3,700	3,500	3,500	3,400		10,900	8,600
Revenue	12,146	11,976	11,758	11,373	12,396	(2)	35,880	34,775
Revenue	72,817	70,597	67,990	64,762	63,966	14	211,404	180,678
Operating expenses	44,939	43,483	42,222	40,520	41,294	9	130,644	114,881
Income before taxes	27,878	27,114	25,768	24,242	22,672	23	80,760	65,797
Taxes	10,465	10,185	9,729	9,012	8,374		30,379	24,285
Income	\$ 17,413	\$ 16,929	\$ 16,039	\$ 15,230	\$ 14,298	22	\$ 50,381	\$ 41,512
PERFORMANCE MEASURES								
Per share:								
Earnings	\$.43	\$.42	\$.40	\$.39	\$.37	16	\$ 1.25	\$ 1.08
Earnings	.42	.41	.39	.38	.36	17	1.22	1.05
Dividends declared	.08	.08	.08	.07	.07	14	.24	.21
Book value	13.07	12.34	12.09	11.80	11.04	18	13.07	11.04
Book value ⁽²⁾	10.16	9.50	9.25	8.94	8.05	26	10.16	8.05
Performance ratios:								
Return on tangible equity ⁽¹⁾⁽²⁾⁽³⁾	17.29%	17.68%	17.66%	18.20%	18.90%		17.54%	19.30%
Return on equity ⁽¹⁾⁽³⁾	13.22	13.41	13.25	13.30	13.42		13.29	13.51
Assets ⁽³⁾	1.09	1.10	1.09	1.05	1.01		1.09	1.03
Cost margin ⁽³⁾	4.30	4.34	4.33	4.20	4.17		4.32	4.12
Efficiency ratio	58.44	58.53	59.06	58.80	61.16		58.67	60.64
Payout ratio	18.60	19.05	20.00	17.95	18.92		19.20	19.44
Assets	8.04	7.95	8.04	7.69	7.46		8.01	7.60
Equity to assets ⁽²⁾	6.35	6.22	6.24	5.82	5.53		6.27	5.57
QUALITY								
Provision for loan losses	\$ 60,901	\$ 58,508	\$ 55,850	\$ 53,595	\$ 51,888		\$ 60,901	\$ 51,888
Nonperforming assets	9,347	8,805	8,367	12,995	13,565		9,347	13,565
Charge-offs	1,307	1,042	1,245	1,793	1,385		3,594	3,908
Provision for loan losses to loans	1.23%	1.22%	1.22%	1.22%	1.22%		1.23%	1.22%
Nonperforming assets to total	.14	.14	.14	.22	.24		.14	.24

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

...e-offs to average loans ⁽³⁾ .11 .09 .11 .16 .13 .10 .13

GE BALANCES

	\$ 4,865,886	\$ 4,690,196	\$ 4,505,494	\$ 4,328,613	\$ 4,169,170	17	\$ 4,688,512	\$ 3,970,937
nt securities	1,029,981	1,039,707	1,038,683	1,004,966	1,008,687	2	1,036,092	983,889
ssets	5,942,710	5,758,697	5,574,712	5,383,096	5,239,195	13	5,760,055	5,016,702
ets	6,350,205	6,159,152	5,960,801	5,769,632	5,608,158	13	6,158,147	5,371,966
	5,085,168	4,842,389	4,613,810	4,354,275	4,078,437	25	4,848,849	3,884,733
ers equity	510,791	489,821	478,960	443,746	418,459	22	493,307	408,399
shares outstanding:								
	40,223	40,156	40,088	39,084	38,345		40,156	38,272
	41,460	41,328	41,190	40,379	39,670		41,327	39,499

OD END

	\$ 4,965,365	\$ 4,810,277	\$ 4,584,155	\$ 4,398,286	\$ 4,254,051	17	\$ 4,965,365	\$ 4,254,051
nt securities	980,273	974,524	983,846	990,687	945,922	4	980,273	945,922
ssets	6,012,987	5,862,614	5,633,381	5,470,718	5,302,532	13	6,012,987	5,302,532
ets	6,455,290	6,331,136	6,070,596	5,865,756	5,709,666	13	6,455,290	5,709,666
	5,309,219	4,976,650	4,748,438	4,477,600	4,196,369	27	5,309,219	4,196,369
ers equity	526,734	496,297	485,414	472,686	424,000	24	526,734	424,000
shares outstanding	40,269	40,179	40,119	40,020	38,383		40,269	38,383

(1) Net income available to common shareholders, which excludes preferred stock dividends, divided by average realized common equity, which excludes accumulated other comprehensive income (loss).

(2) Excludes effect of acquisition related intangibles and associated amortization.

(3) Annualized.

Table of Contents***Net Interest Revenue (Taxable Equivalent)***

Net interest revenue (the difference between the interest earned on assets and the interest paid on deposits and borrowed funds) is the single largest component of total revenue. United actively manages this revenue source to provide an optimal level of revenue while balancing interest rate, credit and liquidity risks. Net interest revenue for the third quarter 2006 was \$64.4 million, up 17% over last year. Year-to-date net interest revenue of \$186.4 million increased 21% as compared to the first nine months of 2005. The increase for the third quarter of 2006 was driven by strong loan growth funded by customer deposit growth and a 13 basis point widening of the net interest margin to 4.30%. Average loans for the third quarter increased \$697 million, or 17%, from the third quarter of 2005, and year to date average loans increased \$718 million, or 18% from the first nine months of 2005. This loan growth was due to the continued high loan demand across all markets and the generation of loans at de novo offices. Period end loan balances for the third quarter of 2006 increased \$711 million as compared with September 30, 2005. Of this increase, \$396 million was in the North Georgia market (which includes \$144 million in Gainesville / Hall County related to the de novo expansion in May 2005), \$88 million in western North Carolina (which includes \$8 million in loans received with branches purchased in September 2006), \$161 million in the metro Atlanta market, \$17 million in east Tennessee, and \$49 million in the coastal Georgia market.

Average interest-earning assets for the third quarter and first nine months of 2006 increased \$703.5 million, or 13%, and \$743.4 million, or 15%, respectively, over the same periods in 2005. These increases reflect strong organic loan growth, as well as a modest increase in the average investment securities portfolio. The majority of the increase in interest-earning assets was funded by interest-bearing deposits resulting in increases in average interest-bearing liabilities for the third quarter and year-to-date of approximately \$607 million and \$620 million, respectively, as compared with the same periods in 2005.

The banking industry uses two ratios to measure relative profitability of net interest revenue. The net interest rate spread measures the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities. The interest rate spread eliminates the impact of non-interest-bearing sources of funds and gives a direct perspective on the effect of market interest rate movements. The net interest margin is defined as net interest revenue as a percent of average total interest-earning assets and takes into account the positive impact of investing non interest-bearing deposits and capital.

For the three months ended September 30, 2006, the net interest spread was 3.73%, down slightly from 3.77% for the three months ended September 30, 2005, while the net interest margin increased to 4.30% from 4.17% over the same period. The increase in the net interest margin while the net interest spread fell slightly reflects the rising benefit of funding a portion of the balance sheet with non-interest bearing sources in a rising interest rate environment. For the first nine months of 2006 and 2005, the net interest spread was 3.79% and 3.75%, respectively, while the net interest margin was 4.32% and 4.12%, respectively. Since June of 2004, the Federal Reserve has increased the federal funds rate 17 times for a total of 425 basis points. This had a positive impact on net interest revenue and net interest margin due to United's slightly asset sensitive balance sheet. The widening of the spread was primarily attributed to United's ability to reprice deposits slower and less substantially than loans in response to the rise in short-term interest rates. This trend reversed slightly in the third quarter of 2006 causing the net interest spread to decrease slightly. Over the last few quarters, United was able to remain competitive in deposit pricing and gather deposits at rates comparable to or below wholesale borrowings.

The increases in the prime and federal funds rates, which effect variable rate assets and liabilities, along with the loan growth mentioned above were the two primary reasons for the increases in the net interest margin and net interest revenue. Most of the loan growth added over the last three years has been prime-based, adjusted daily. At September 30, 2006, United had approximately \$2.8 billion in loans indexed to the daily Prime Rate published in the Wall Street Journal compared with \$2.4 billion a year ago. At September 30, 2006 and 2005, United had receive-fixed swap contracts with a total notional value of \$405 million and \$583 million, respectively, that were used to reduce United's exposure to changes in interest rates that were accounted for as cash flow hedges of prime-based loans. In addition, at September 30, 2006, United had prime based interest rate floor contracts with a total notional value of \$500 million that were also accounted for as cash flow hedges of prime-based loans. United had \$10 million in notional of receive fixed, pay LIBOR swap contracts that were accounted for as fair value hedges of brokered

deposits. The use of derivative contracts is more fully explained in the Interest Rate Sensitivity Management section of this report beginning on page 21.

The average yield on interest-earning assets for the third quarter was 8.01%, compared with 6.75% in the third quarter of 2005. Year-to-date average yield on interest-earning assets was 7.76%, compared with 6.48% for the first nine months of 2005. Loan yields for the third quarter and the first nine months of 2006 were up 135 and 138 basis points, respectively, as compared to the same periods of 2005, due to the increases in the prime lending rate.

The average cost of interest-bearing liabilities for the third quarter was 4.28%, an increase of 130 basis points from the third quarter of 2005. Year-to-date average cost of interest-bearing liabilities was 3.97%, an increase of 124 basis points from the first nine months of 2005. The increase reflects the impact of rising rates on United's floating rate sources of funding, increased deposit pricing in selected products and markets, and a changing deposit mix with a higher proportion of certificates of deposit.

Table of Contents

The following table shows the relationship between interest revenue and expense and the average balances of interest-earning assets and interest-bearing liabilities for the three months ended September 30, 2006 and 2005.

Table 2 Average Consolidated Balance Sheets and Net Interest Analysis

For the Three Months Ended September 30,

<i>(dollars in thousands, taxable equivalent)</i>	2006			2005		
	Average Balance	Interest	Avg. Rate	Average Balance	Interest	Avg. Rate
Assets:						
Interest-earning assets:						
Loans, net of unearned income ⁽¹⁾⁽²⁾	\$ 4,865,886	\$ 106,559	8.69%	\$ 4,169,170	\$ 77,112	7.34%
Taxable securities ⁽³⁾	984,189	11,822	4.80	960,513	10,340	4.31
Tax-exempt securities ⁽¹⁾⁽³⁾	45,792	780	6.81	48,174	856	7.10
Federal funds sold and other interest-earning assets	46,843	641	5.47	61,338	695	4.53
Total interest-earning assets	5,942,710	119,802	8.01	5,239,195	89,003	6.75
Non-interest-earning assets:						
Allowance for loan losses	(60,606)			(51,278)		
Cash and due from banks	116,004			108,784		
Premises and equipment	125,423			106,347		
Other assets ⁽³⁾	226,674			205,110		
Total assets	\$ 6,350,205			\$ 5,608,158		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Interest-bearing deposits:						
Transaction accounts	\$ 1,311,042	10,255	3.10	\$ 1,164,563	5,187	1.77
Savings deposits	170,079	226	.53	175,833	223	.50
Time deposits less than \$100,000	1,446,388	16,503	4.53	1,074,926	8,439	3.11
Time deposits greater than \$100,000	1,162,207	14,382	4.91	736,217	6,779	3.65
Brokered deposits	340,301	3,809	4.44	307,531	2,435	3.14
Total interest-bearing deposits	4,430,017	45,175	4.05	3,459,070	23,063	2.65
Federal funds purchased & other borrowings						
	162,372	2,254	5.51	185,233	1,651	3.54
Federal Home Loan Bank advances	438,875	5,828	5.27	779,912	7,181	3.65
Long-term debt	111,869	2,174	7.71	111,869	2,138	7.58
Total borrowed funds	713,116	10,256	5.71	1,077,014	10,970	4.04
Total interest-bearing liabilities	5,143,133	55,431	4.28	4,536,084	34,033	2.98

Non-interest-bearing liabilities:			
Non-interest-bearing deposits	655,151	619,367	
Other liabilities	41,130	34,248	
Total liabilities	5,839,414	5,189,699	
Shareholders' equity	510,791	418,459	
Total liabilities and shareholders' equity	\$ 6,350,205	\$ 5,608,158	
Net interest revenue	\$ 64,371	\$ 54,970	
Net interest-rate spread	3.73%	3.77%	
Net interest margin ⁽⁴⁾	4.30%	4.17%	

(1) Interest revenue on tax-exempt securities and loans has been increased to reflect comparable interest on taxable securities and loans. The rate used was 39%, reflecting the statutory federal tax rate and the federal tax adjusted state tax rate.

(2) Included in the average balance of loans outstanding are loans where the accrual of interest has been discontinued.

(3) Securities available for sale are shown at amortized cost. Pretax

unrealized losses of \$21.6 million and \$2.2 million in 2006 and 2005, respectively, are included in other assets for purposes of this presentation.

- (4) Net interest margin is taxable equivalent net-interest revenue divided by average interest-earning assets.

Table of Contents

The following table shows the relationship between interest revenue and expense and the average balances of interest-earning assets and interest-bearing liabilities for the nine months ended September 30, 2006 and 2005.

Table 3 Average Consolidated Balance Sheets and Net Interest Analysis

For the Nine Months Ended September 30,

<i>(dollars in thousands, taxable equivalent)</i>	2006			2005		
	Average Balance	Interest	Avg. Rate	Average Balance	Interest	Avg. Rate
Assets:						
Interest-earning assets:						
Loans, net of unearned income ⁽¹⁾⁽²⁾	\$ 4,688,512	\$ 295,778	8.43%	\$ 3,970,937	\$ 209,378	7.05%
Taxable securities ⁽³⁾	988,504	34,661	4.68	934,691	29,544	4.21
Tax-exempt securities ⁽¹⁾⁽³⁾	47,588	2,463	6.90	49,198	2,589	7.02
Federal funds sold and other interest-earning assets	35,451	1,425	5.36	61,876	1,842	3.97
Total interest-earning assets	5,760,055	334,327	7.76	5,016,702	243,353	6.48
Non-interest-earning assets:						
Allowance for loan losses	(57,716)			(49,681)		
Cash and due from banks	122,603			98,615		
Premises and equipment	120,664			104,079		
Other assets ⁽³⁾	212,541			202,251		
Total assets	\$ 6,158,147			\$ 5,371,966		
Liabilities and Shareholders Equity:						
Interest-bearing liabilities:						
Interest-bearing deposits:						
Transaction accounts	\$ 1,280,101	\$ 26,398	2.76	\$ 1,116,573	\$ 13,093	1.57
Savings deposits	173,448	680	.52	175,302	565	.43
Time deposits less than \$100,000	1,354,421	42,604	4.21	1,032,142	22,208	2.88
Time deposits greater than \$100,000	1,068,376	36,938	4.62	663,751	16,663	3.36
Brokered deposits	327,877	10,137	4.13	322,028	6,809	2.83
Total interest-bearing deposits	4,204,223	116,757	3.71	3,309,796	59,338	2.40
Federal funds purchased & other borrowings						
	152,303	5,814	5.10	158,249	3,723	3.15
Federal Home Loan Bank advances	510,168	18,837	4.94	778,750	19,403	3.33
Long-term debt	111,868	6,495	7.76	111,868	6,386	7.63
Total borrowed funds	774,339	31,146	5.38	1,048,867	29,512	3.76
Total interest-bearing liabilities	4,978,562	147,903	3.97	4,358,663	88,850	2.73

Non-interest-bearing liabilities:			
Non-interest-bearing deposits	644,626	574,937	
Other liabilities	41,652	29,967	
Total liabilities	5,664,840	4,963,567	
Shareholders' equity	493,307	408,399	
Total liabilities and shareholders' equity	\$ 6,158,147	\$ 5,371,966	
Net interest revenue	\$ 186,424	\$ 154,503	
Net interest-rate spread	3.79%	3.75%	
Net interest margin ⁽⁴⁾	4.32%	4.12%	

(1) Interest revenue on tax-exempt securities and loans has been increased to reflect comparable interest on taxable securities and loans. The rate used was 39%, reflecting the statutory federal tax rate and the federal tax adjusted state tax rate.

(2) Included in the average balance of loans outstanding are loans where the accrual of interest has been discontinued.

(3) Securities available for sale are shown at amortized cost. Pretax

unrealized losses of \$19.1 million in 2006 and pretax unrealized gains of \$7,000 in 2005 are included in other assets for purposes of this presentation.

- (4) Net interest margin is taxable equivalent net-interest revenue divided by average interest-earning assets.

Table of Contents

The following table shows the relative impact on net interest revenue for changes in the average outstanding balances (volume) of interest-earning assets and interest-bearing liabilities and the rates earned and paid on such assets and liabilities (rate). Variances resulting from a combination of changes in rate and volume are allocated in proportion to the absolute dollar amounts of the change in each category.

Table 4 Change in Interest Revenue and Expense on a Taxable Equivalent Basis*(in thousands)*

	Three Months Ended September 30, 2006 Compared to 2005 Increase (decrease) Due to Changes in			Nine Months Ended September 30, 2006 Compared to 2005 Increase (decrease) Due to Changes in		
	Volume	Rate	Total	Volume	Rate	Total
Interest-earning assets:						
Loans	\$ 14,015	\$ 15,433	\$ 29,448	\$ 41,397	\$ 45,003	\$ 86,400
Taxable securities	260	1,222	1,482	1,765	3,352	5,117
Tax-exempt securities	(42)	(34)	(76)	(84)	(42)	(126)
Federal funds sold and other interest-earning assets	(182)	128	(54)	(1,174)	757	(417)
Total interest-earning assets	14,051	16,749	30,800	41,904	49,070	90,974
Interest-bearing liabilities:						
Transaction accounts	723	4,345	5,068	2,153	11,152	13,305
Savings deposits	(7)	10	3	(6)	121	115
Time deposits less than \$100,000	3,488	4,576	8,064	8,226	12,170	20,396
Time deposits greater than \$100,000	4,769	2,834	7,603	12,525	7,750	20,275
Brokered deposits	281	1,093	1,374	126	3,202	3,328
Total interest-bearing deposits	9,254	12,858	22,112	23,024	34,395	57,419
Federal funds purchased & other borrowings	(224)	827	603	(145)	2,236	2,091
Federal Home Loan Bank advances	(3,831)	2,478	(1,353)	(8,037)	7,471	(566)
Long-term debt		36	36		109	109
Total borrowed funds	(4,055)	3,341	(714)	(8,182)	9,816	1,634
Total interest-bearing liabilities	5,199	16,199	21,398	14,842	44,211	59,053

**Increase in net interest
revenue**

\$ 8,852	\$ 550	\$ 9,402	\$ 27,062	\$ 4,859	\$ 31,921
----------	--------	----------	-----------	----------	-----------

Provision for Loan Losses

The provision for loan losses was \$3.7 million for the third quarter of 2006, compared with \$3.4 million for the same period in 2005. Year-to-date provision for loan losses of \$10.9 million was \$2.3 million, or 27% higher than the first nine months of 2005. Net loan charge-offs as an annualized percentage of average outstanding loans for the three months ended September 30, 2006 were .11%, as compared with .13% for the third quarter of 2005. Year-to-date, annualized net charge-offs as a percentage of average outstanding loans were .10%, compared to .13% for the first nine months of 2005. Net loan charge-offs remained in line with management's expectation and within our historical loss range as a percentage of average outstanding loans.

The provision for loan losses is based on management's evaluation of losses inherent in the loan portfolio and the corresponding analysis of the allowance for loan losses at quarter-end. Although United's credit quality indicators such as the relative level of nonperforming assets and net charge-offs showed improvement when compared to the prior year, other factors considered in management's evaluation of the adequacy of the allowance for loan losses support the higher provision for loan losses. The primary factors affecting the increase in the provision for loan losses include an increasing level of construction and land development loans, some moderate slowing in the residential real estate market, the increasing size of individual credit exposures and the effect of rising interest rates on United's substantially floating rate loan portfolio. Management believes that the third quarter credit quality indicators are volatile while at the lower end of historic levels and nonperforming assets and net charge-offs will return to a range in line with United's experience over the last few years. Additional discussion on loan quality and the allowance for loan losses is included in the Asset Quality section of this report.

Table of Contents**Fee Revenue**

Fee revenue for the third quarter of 2006 totaled \$12.1 million, a decrease of \$250,000, or 2%, from the third quarter of 2005, due primarily to lower mortgage fees, losses from the sale of securities and \$290,000 in charges for the prepayment of Federal Home Loan Bank advances in the third quarter of 2006 recorded as a charge to other fee revenue. Year-to-date fee revenue was \$35.9 million, an increase of \$1.1 million, or 3%, from the first nine months of 2005. Fee revenue accounted for approximately 17% of total revenue for the third quarter of 2006, compared with 19% for the third quarter of 2005. Year-to-date fee revenue also accounted for approximately 17% of total revenue, compared with 19% for the first nine months of 2005. The decrease in fee revenue as a percentage of total revenue reflects the strong growth in net interest revenue from a year ago and declines in mortgage originations. United continues to focus on increasing fee revenue through new products and services. The following table presents the components of fee revenue for the third quarter and first nine months of 2006 and 2005.

Table 5 Fee Revenue

For the Three and Nine Months Ended September 30,

(dollars in thousands)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2006	2005	Change	2006	2005	Change
Service charges and fees	\$ 6,914	\$ 6,627	4%	\$ 20,095	\$ 18,521	8%
Mortgage loan and related fees	1,928	2,367	(19)	5,149	5,592	(8)
Consulting fees	2,040	1,777	15	5,196	4,944	5
Brokerage fees	784	571	37	2,430	1,781	36
Securities losses, net	(382)	(153)		(385)	(155)	
Other	862	1,207	(29)	3,395	4,092	(17)
Total	\$ 12,146	\$ 12,396	(2)	\$ 35,880	\$ 34,775	3

Service charges and fees for the third quarter of 2006 increased \$287,000, or 4%, from 2005. Year-to-date service charges increased \$1.6 million, or 8%, over the same period in 2005. This increase was primarily due to growth in transactions and new accounts resulting from core deposit programs, growth in overdraft products, and the cross-selling of other products and services. Included in service charges and fees is electronic banking revenue which was \$1.5 million for the third quarter of 2006, an increase of 28% from 2005. This increase is the result of higher debit card usage fees, a larger customer base, and a tendency for customers to migrate towards the convenience of electronic forms of banking.

Mortgage loans and related fees of \$1.9 million for the third quarter were down \$439,000, or 19%, from the third quarter of 2005. Year-to-date mortgage loans and related fees of \$5.1 million were down \$443,000, or 8%, from the first nine months of 2005. Mortgage loan originations of \$94 million for the third quarter of 2006 were down \$28 million, or 23%, from an exceptionally strong third quarter of 2005. Year-to-date mortgage loan originations of \$263 million were down \$37 million, or 12%, from the first nine months of 2005. These reductions were reflective of a less favorable rate environment in the third quarter and first nine months of 2006. The decreases in the amount of originations were partially offset by improved pricing. Substantially all originated residential mortgages were sold into the secondary market, including the right to service these loans.

Consulting fees of \$2.0 million for the third quarter were up \$263,000, or 15%, from the third quarter of 2005. Year-to-date consulting fees of \$5.2 million were up \$252,000, or 5%, from the first nine months of 2005. These increases are a reflection of overall business growth, especially in the areas of advisory services and strategic planning.

Brokerage fees of \$784,000 for the third quarter were up \$213,000, or 37%, from the third quarter of 2005. Year-to-date brokerage fees were up \$649,000, or 36%, from the first nine months of 2005 due to strong market

activity and continued business growth.

Other fee revenue of \$862,000 for the third quarter was down \$345,000, or 29%, from the third quarter of 2005. Year-to-date other fee revenue of \$3.4 million was down \$697,000, or 17%, from the first nine months of 2005. This decrease was primarily the result of \$290,000 and \$280,000, respectively, in charges for the prepayment of Federal Home Loan Bank advances in the third and second quarters of 2006. Also contributing to the lower level of other fee revenue in the third quarter of 2006 was a gain of \$160,000 from the sale of a former banking location in the third quarter of 2005.

Table of Contents**Operating Expenses**

Operating expenses for the third quarter of 2006 totaled \$44.9 million, an increase of \$3.6 million, or 9%, from the third quarter of 2005. Year-to-date operating expenses of \$130.6 million increased \$15.8 million, or 14%, from the first nine months of 2005. The following table presents the components of operating expenses for the three and nine months ended September 30, 2006 and 2005.

Table 6 Operating Expenses

For the Three and Nine Months Ended September 30,
(dollars in thousands)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2006	2005	Change	2006	2005	Change
Salaries and employee benefits	\$ 29,585	\$ 26,334	12%	\$ 85,535	\$ 73,843	16%
Communications and equipment	3,863	3,484	11	10,970	9,581	14
Occupancy	2,945	2,743	7	8,793	8,129	8
Advertising and public relations	1,882	1,683	12	5,718	4,745	21
Postage, printing and supplies	1,379	1,426	(3)	4,184	4,146	1
Professional fees	938	1,174	(20)	3,168	3,283	(4)
Amortization of intangibles	503	503		1,509	1,509	
Other	3,844	3,947	(3)	10,767	9,645	12
Total	\$ 44,939	\$ 41,294	9	\$ 130,644	\$ 114,881	14

Salaries and employee benefits for the third quarter of 2006 totaled \$29.6 million, an increase of \$3.3 million, or 12%, over the third quarter of 2005. Year-to-date salaries and employee benefits of \$85.5 million were up \$11.7 million, or 16%, from the first nine months of 2005. At September 30, 2006, total staff was 1,843, an increase of 148 employees from the third quarter of 2005. De novo expansion and branch acquisitions accounted for 45% of this increase as United added 7 new offices in the past twelve months through de novo expansion and acquisitions. The remainder of the increase in salaries and employee benefit costs was due to the additional staff required to support United's business growth, expensing of stock options, and higher insurance and other health-care related expenses.

Communication and equipment expense for the third quarter of 2006 was up \$379,000, or 11%, from the third quarter of 2005, and up \$1.4 million, or 14%, for the first nine months of 2006 as compared to the same period of 2005. This increase was the result of additional banking offices and further investments and upgrades in technology equipment to support business growth.

Occupancy expense for the third quarter of 2006 was up \$202,000, or 7%, from the third quarter of 2005. Year-to-date occupancy expense increased \$664,000, or 8%, from the first nine months of 2005. The majority of this increase was the result of higher facilities costs and maintenance expenses resulting from additional banking offices added through de novo expansion.

Advertising and public relations expense for the third quarter of 2006 was up \$199,000, or 12%, from the third quarter of 2005. Year-to-date advertising and public relations expense increased \$973,000, or 21%, from the first nine months of 2005. These increases reflect the program costs associated with several initiatives to raise core deposits and marketing campaigns to generate brand awareness in selected markets.

Professional fees for the third quarter was down \$236,000, or 20%, from the third quarter of 2005, and down \$115,000, or 4%, for the first nine months of 2006 as compared to the same period of 2005. The changes are primarily due to the timing of services provided for Sarbanes-Oxley compliance.

Other expense for the third quarter of 2006 decreased by \$103,000, or 3%, from 2005 partially due to a reduction of fraud losses in 2006 and higher lending costs in the third quarter of 2005 related to our significant de novo expansion in Gainesville, Georgia. Year-to-date other expense increased \$1.1 million, or 12%, from the first nine months of 2005. This increase was primarily due to higher costs to support electronic and internet banking, as well as continued de novo expansion and business growth.

The efficiency ratio measures total operating expenses as a percentage of total revenue, excluding the provision for loan losses and net securities gains or losses. United's efficiency ratio for the third quarter was 58.44% compared with 61.16% for the third quarter of 2005. Year-to-date, the efficiency ratio was 58.67% compared with 60.64% for the first nine months of 2005. The decrease is primarily the result of the increase in net interest revenue, offset by the cost of additional de novo locations. United's efficiency ratio remained within management's long-term efficiency goal of 58% - 60%.

Table of Contents**Income Taxes**

Income tax expense was \$10.0 million for the third quarter of 2006, as compared with \$8.0 million for the third quarter of 2005, representing a 36.51% and 35.75% effective tax rate, respectively. The effective tax rates were lower than the statutory tax rates primarily due to interest revenue on certain investment securities and loans that are exempt from income taxes and tax credits received on affordable housing investments. The effective tax rate has increased as tax-exempt interest revenue on securities and loans has declined as a percentage of pre-tax earnings, and due to the expensing of stock options, which includes incentive stock options that are not deductible for tax purposes. Additional information regarding income taxes can be found in Note 14 to the consolidated financial statements filed with United's 2005 Form 10-K.

Balance Sheet Review

Total assets at September 30, 2006 were \$6.5 billion, 10% higher than the \$5.9 billion at December 31, 2005 and 13% higher than the \$5.7 billion at September 30, 2005. Average total assets for the third quarter of 2006 were \$6.4 billion, up \$742 million, or 13%, from average assets in the third quarter of 2005.

Loans

The following table presents a summary of the loan portfolio.

Table 7 Loans Outstanding

(dollars in thousands)

	September 30, 2006	December 31, 2005	September 30, 2005
Commercial (commercial and industrial)	\$ 271,803	\$ 236,882	\$ 232,870
Commercial (secured by real estate)	1,157,561	1,055,191	1,029,159
Total commercial	1,429,364	1,292,073	1,262,029
Construction and land development	2,064,756	1,738,990	1,616,809
Residential mortgage	1,299,511	1,205,685	1,214,734
Installment	171,734	161,538	160,479
Total loans	\$ 4,965,365	\$ 4,398,286	\$ 4,254,051
As a percentage of total loans:			
Commercial (commercial and industrial)	5%	5%	5%
Commercial (secured by real estate)	24	24	24
Total commercial	29	29	29
Construction and land development	42	40	38
Residential mortgage	26	27	29
Installment	3	4	4
Total	100%	100%	100%

At September 30, 2006, total loans were \$5.0 billion, an increase of \$711 million, or 17%, from September 30, 2005 and an increase of \$567 million, or 13%, from December 31, 2005. United continues to experience strong loan growth in all markets, with particular strength in construction and land development loans. Substantially all loans are to customers located in the immediate market areas of the banks in Georgia, North Carolina, and Tennessee and these markets continue to experience strong population growth.

Table of Contents**Asset Quality and Risk Elements**

United manages asset quality and controls credit risk through close review and oversight of the loan portfolio as well as adherence to policies designed to promote sound underwriting and loan monitoring practices. United's credit administration function is responsible for monitoring asset quality, establishing credit policies and procedures and the consistent application of these policies and procedures at the Banks. Additional information on the credit administration function is included in Item 1 under the heading *Loan Review and Non-performing Assets* in United's Annual Report on Form 10-K.

The provision for loan losses charged to earnings was based upon management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb probable losses at quarter-end. The amount each period is dependent upon many factors including growth and changes in the composition of the loan portfolio, net charge-offs, delinquencies, management's assessment of loan portfolio quality, the value of collateral, and other economic factors and trends. The evaluation of these factors is performed quarterly by management through an analysis of the adequacy of the allowance for loan losses.

Reviews of non-performing loans, past due loans and larger credits, designed to identify potential charges to the allowance for loan losses, as well as determine the adequacy of the allowance, are conducted on a regular basis. These reviews are performed by the responsible lending officers, as well as a separate loan review department, and consider such factors as the financial strength of borrowers, the value of the applicable collateral, past loan loss experience, anticipated loan losses, growth in the loan portfolio, prevailing economic conditions and other factors. United also uses external loan review to supplement the activities of the loan review department and to ensure the independence of the loan review process.

The following table presents a summary of the changes in the allowance for loan losses for the three and nine-month periods ended September 30, 2006 and 2005.

Table 8 Summary of Loan Loss Experience*(dollars in thousands)*

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Balance beginning of period	\$ 58,508	\$ 49,873	\$ 53,595	\$ 47,196
Loans charged-off	(1,578)	(2,009)	(4,991)	(5,117)
Recoveries	271	624	1,397	1,209
Net charge-offs	(1,307)	(1,385)	(3,594)	(3,908)
Provision for loan losses	3,700	3,400	10,900	8,600
Balance end of period	\$ 60,901	\$ 51,888	\$ 60,901	\$ 51,888
Total loans:				
At period end	\$ 4,965,365	\$ 4,254,051	\$ 4,965,365	\$ 4,254,051
Average	4,865,886	4,169,170	4,688,512	3,970,937
As a percentage of average loans (annualized):				
Net charge-offs	.11%	.13%	.10%	.13%
Provision for loan losses	.30	.33	.31	.29
Allowance as a percentage of period end loans	1.23	1.22	1.23	1.22
Allowance as a percentage of period end non-performing loans	732	406	732	406

Management believes that the allowance for loan losses at September 30, 2006 is adequate to absorb losses inherent in the loan portfolio. This assessment involves uncertainty and judgment; therefore, the adequacy of the allowance for loan losses cannot be determined with precision and may be subject to change in future periods. In addition, bank regulatory authorities, as part of their periodic examination of the Banks, may require adjustments to the provision for loan losses in future periods if, in their opinion, the results of their review warrant such additions.

Table of Contents**Non-performing Assets**

The table below summarizes non-performing assets.

Table 9 Non-Performing Assets

(dollars in thousands)

	September 30, 2006	December 31, 2005	September 30, 2005
Non-accrual loans	\$ 8,324	\$ 11,997	\$ 12,784
Loans past due 90 days or more and still accruing			
Total non-performing loans	8,324	11,997	12,784
Other real estate owned	1,023	998	781
Total non-performing assets	\$ 9,347	\$ 12,995	\$ 13,565
Non-performing loans as a percentage of total loans	.17%	.27%	.30%
Non-performing assets as a percentage of total assets	.14	.22	.24

Non-performing loans, which include non-accrual loans and accruing loans past due over 90 days, totaled \$8.3 million at September 30, 2006, compared with \$12.0 million at December 31, 2005 and \$12.8 million at September 30, 2005. The ratio of non-performing loans to total loans decreased 13 basis points from September 30, 2005 and 10 basis points from December 31, 2005. Non-performing assets, which include non-performing loans and foreclosed real estate, totaled \$9.3 million at September 30, 2006, compared with \$13.0 million at December 31, 2005 and \$13.6 million at September 30, 2005.

United's policy is to place loans on non-accrual status when, in the opinion of management, the principal and interest on a loan is not likely to be repaid in accordance with the loan terms or when the loan becomes 90 days past due and is not well secured and in the process of collection. When a loan is placed on non-accrual status, interest previously accrued, but not collected, is reversed against current interest revenue. Depending on management's evaluation of the borrower and loan collateral, interest revenue on a non-accrual loan may be recognized on a cash basis as payments are received. There were no commitments to lend additional funds to customers whose loans were on non-accrual status at September 30, 2006.

At September 30, 2006 and 2005, there were \$2.1 million and \$7.2 million, respectively, of loans classified as impaired under the definition outlined in SFAS No. 114. Specific reserves allocated to these impaired loans totaled \$526,000 at September 30, 2006, and \$1.8 million at September 30, 2005. The average recorded investment in impaired loans for the quarters ended September 30, 2006 and 2005, was \$2.2 million and \$7.6 million, respectively. Interest revenue recognized on loans while they were impaired for the third quarter and first nine months of 2006 approximated \$33,000 and \$55,000, respectively, compared with \$13,000 for the first nine months of 2005.

Investment Securities

The composition of the investment securities portfolio reflects United's strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of revenue. The investment securities portfolio also provides a balance to interest rate risk and credit risk in other categories of the balance sheet while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as required collateral for certain deposits.

Total investment securities available for sale at quarter-end increased \$34 million from third quarter of 2005. The investment portfolio is used as a supplemental tool to stabilize interest rate sensitivity and increase net interest revenue. At September 30, 2006, the securities portfolio accounts for approximately 15% of total assets, compared with 17% at both December 31, 2005 and September 30, 2005.

The investment securities portfolio primarily consists of U.S. Government agency securities, U.S. Government sponsored agency mortgage-backed securities, non-agency mortgage-backed securities, and municipal securities. Mortgage-backed securities rely on the underlying pools of mortgage loans to provide a cash flow of principal and interest. The actual maturities of these securities will differ from the contractual maturities because loans underlying the securities may prepay. Decreases in interest rates will generally cause an acceleration of prepayment levels. In a declining interest rate environment, United may not be able to reinvest the proceeds from these prepayments in assets that have comparable yields. In a rising rate environment, the opposite occurs. Prepayments tend to slow and the weighted average life extends. This is referred to as extension risk which can lead to lower levels of liquidity due to the delay of timing of cash receipts and can result in the holding of a below market yielding asset for a longer time period.

Table of Contents***Deposits***

Total deposits at September 30, 2006 were \$5.3 billion, an increase of \$1.1 billion, or 27%, from September 30, 2005. Total non-interest-bearing demand deposit accounts of \$667 million increased \$30 million, or 5%, from September 30, 2005, and interest-bearing demand and savings accounts of \$1.5 billion increased \$153 million, or 11%, reflecting the success of United's initiatives to raise core deposits.

Total time deposits as of September 30, 2006 were \$3.1 billion, an increase of \$931 million, or 42%, from the third quarter of 2005. Time deposits less than \$100,000 totaled \$1.5 billion, compared with \$1.1 billion a year ago, an increase of 36%. Time deposits of \$100,000 and greater totaled \$1.2 billion, compared with \$791 million at September 30, 2005, an increase of 58%. United utilizes brokered time deposits, issued in certificates of less than \$100,000, as an alternative source of cost-effective funding. Brokered time deposits outstanding at September 30, 2006 were \$361 million compared with \$294 million at September 30, 2005, an increase of 23%.

Wholesale Funding

At September 30, 2006, both of the Banks were shareholders in the Federal Home Loan Bank (FHLB). Through this affiliation, FHLB secured advances totaled \$413 million and \$775 million at September 30, 2006 and 2005, respectively, and were priced at rates competitive with time deposits of like maturities. United anticipates continued utilization of this short and long-term source of funds. FHLB advances outstanding at September 30, 2006 had both fixed and floating interest rates ranging from 2.85% to 6.59%. Additional information regarding FHLB advances, including scheduled maturities, is provided in Note 10 to the consolidated financial statements included in United's 2005 Form 10-K.

Interest Rate Sensitivity Management

The absolute level and volatility of interest rates can have a significant impact on United's profitability. The objective of interest rate risk management is to identify and manage the sensitivity of net interest revenue to changing interest rates, in order to achieve United's overall financial goals. Based on economic conditions, asset quality and various other considerations, management establishes tolerance ranges for interest rate sensitivity and manages within these ranges.

Net interest revenue is influenced by changes in the level of interest rates. United manages its exposure to fluctuations in interest rates through policies established by the Asset/Liability Management Committee (ALCO). ALCO meets regularly and has responsibility for approving asset/liability management policies, formulating and implementing strategies to improve balance sheet positioning and/or earnings, and reviewing United's interest rate sensitivity.

One of the tools management utilizes to estimate the sensitivity of net interest revenue to changes in interest rates is an interest rate simulation model. Such estimates are based upon a number of assumptions for various scenarios, including the level of balance sheet growth, deposit repricing characteristics and the rate of prepayments. The simulation model measures the potential change in net interest revenue over a twelve-month period under various interest rate scenarios. United's baseline scenario assumes rates remain flat (flat rate scenario) over the next twelve months and is the scenario that all others are compared to in order to measure the change in net interest revenue. United runs ramp scenarios that assume gradual increases and decreases of 200 basis points each over the next twelve months. United's policy for net interest revenue simulation is limited to a change from the flat rate scenario of less than 10% for the up or down 200 basis point ramp scenarios over twelve months. At September 30, 2006, United's simulation model indicated that a 200 basis point increase in rates over the next twelve months would cause an approximate 2.3% increase in net interest revenue and a 200 basis point decrease in rates over the next twelve months would cause an approximate 1.0% decrease in net interest revenue. At September 30, 2005, United's simulation model indicated that a 200 basis point increase in rates over the next twelve months would cause an approximate 3.3% increase in net interest revenue and a 200 basis point decrease in rates over the next twelve months would cause an approximate 6.3% decrease in net interest revenue. The decrease in interest rate sensitivity from a year ago is primarily due to hedging activities in the third quarter of 2006 described later in this section.

In order to manage its interest rate sensitivity, United uses off-balance sheet contracts that are considered derivative financial instruments. Derivative financial instruments can be a cost and capital effective means of modifying the repricing characteristics of on-balance sheet assets and liabilities. The offset of these instruments is included in

United's simulation modeling. At September 30, 2006, United was a party to both interest rate floor and interest rate swap contracts under which it pays a variable rate and receives a fixed rate.

Derivative financial instruments used for hedging purposes are classified as either cash flow or fair value hedges. The change in fair value of cash flow hedges is recognized in other comprehensive income. Fair value hedges recognize currently in earnings both the impact of change in the fair value of the derivative financial instrument and the offsetting impact of the change in fair value of the hedged asset or liability.

Table of Contents

During the third quarter of 2006, United's management took steps to reduce its exposure to falling interest rates by terminating its existing receive fixed / pay prime interest rate swap contracts and entering into new interest rate swap and floor contracts. The loss of approximately \$3.5 million resulting from the termination of the existing interest rate swap contracts is being amortized straight line over the remaining contractual life of each terminated swap contract. United entered into new receive-fixed / pay-prime interest rate swap contracts having an aggregate notional amount of \$405 million that are being accounted for as cash flow hedges of daily repricing, prime-based loans. The effect of terminating the old swaps and entering into the new swaps was to increase the notional amount of swaps and to lengthen the weighted average remaining term of these contracts from 11 months to 21 months. United also entered into one receive-fixed / pay 1-month LIBOR interest rate swap with a notional amount of \$10 million that is being accounted for as a fair value hedge of brokered time deposits.

In addition to the new swap contracts, United purchased interest rate floors having a total notional amount of \$500 million at a cost of \$13 million that are being accounted for as cash flow hedges of daily repricing, prime-based loans. The purchase price of the floors will be amortized into interest revenue over the life of each individual instrument.

The following table presents the interest rate derivative contracts outstanding at September 30, 2006.

Table 10 Derivative Financial Instruments

As of September 30, 2006

(dollars in thousands)

Type/Maturity	Notional Amount	Rate Received / Floor Rate	Rate Paid	Fair Value ⁽⁴⁾
Fair Value Hedges:				
LIBOR Swaps (Brokered CDs)⁽¹⁾				
September 29, 2008	\$ 10,000	5.25%	5.32%	\$ 28
Total Fair Value Hedges:	10,000	5.25	5.32	28
Cash Flow Hedges:				
Prime Swaps (Prime Loans)⁽²⁾				
August 4, 2008	50,000	8.32	8.25	211
February 1, 2009	25,000	8.31	8.25	143
May 1, 2008	50,000	8.33	8.25	168
February 1, 2008	50,000	8.40	8.25	135
May 1, 2008	50,000	8.34	8.25	175
May 4, 2009	30,000	8.29	8.25	205
November 4, 2008	100,000	8.32	8.25	530
November 5, 2007	50,000	8.41	8.25	95
Total Prime Swaps:	405,000	8.34	8.25	1,662
Prime Floors (Prime Loans)⁽³⁾				
February 4, 2010	100,000	8.75		3,248
May 4, 2010	100,000	8.75		3,507
August 4, 2010	50,000	8.75		1,888

Edgar Filing: UNITED COMMUNITY BANKS INC - Form 10-Q

August 1, 2009	75,000	8.75	2,018
November 1, 2009	75,000	8.75	2,229
August 1, 2010	50,000	8.75	1,884
February 1, 2009	25,000	8.75	534
May 1, 2009	25,000	8.75	601
Total Prime Floors:	500,000		15,909
Total Cash Flow Hedges:	905,000		17,571
Total Derivative Contracts	\$ 915,000		\$ 17,599

(1) Rate Paid equals
1-Month
LIBOR minus
.0075 as of
September 30,
2006

(2) Rate Paid equals
Prime rate as of
September 30,
2006

(3) Floor contracts
receive cash
payment equal
to the floor rate
less the prime
rate.

(4) Excludes
accrued interest

Table of Contents

No ineffectiveness was recorded on any of the cash flow hedging relationships. Ineffectiveness of \$21,000 was recorded in other expense for the fair value hedging relationship during the third quarter of 2006.

United's policy requires all derivative financial instruments be used only for asset/liability management through the hedging of specific transactions or positions, and not for trading or speculative purposes. Management believes that the risk associated with using derivative financial instruments to mitigate interest rate risk is minimal and should not have any material unintended impact on the financial condition or results of operations. In order to mitigate potential credit risk, from time to time United may require the counterparties to derivative contracts to pledge securities as collateral to cover the net exposure.

Liquidity Management

The objective of liquidity management is to ensure that sufficient funding is available, at reasonable cost, to meet the ongoing operational cash needs and to take advantage of revenue producing opportunities as they arise. While the desired level of liquidity will vary depending upon a variety of factors, it is the primary goal of United to maintain a sufficient level of liquidity in all expected economic environments. Liquidity is defined as the ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining United's ability to meet the daily cash flow requirements of the Banks' customers, both depositors and borrowers.

The primary objectives of asset/liability management are to provide for adequate liquidity in order to meet the needs of customers and to maintain an optimal balance between interest-sensitive assets and interest-sensitive liabilities, so that United can also meet the investment requirements of its shareholders as market interest rates change. Daily monitoring of the sources and uses of funds is necessary to maintain a position that meets both requirements.

The asset portion of the balance sheet provides liquidity primarily through loan principal repayments and the maturities and sales of securities. Mortgage loans held for sale totaled \$21.5 million at September 30, 2006, and typically turn over every 45 days as the closed loans are sold to investors in the secondary market.

The liability section of the balance sheet provides liquidity through interest-bearing and noninterest-bearing deposit accounts. Federal funds purchased, Brokered CDs, FHLB advances and securities sold under agreements to repurchase are additional sources of liquidity and represent United's incremental borrowing capacity. These sources of liquidity are generally short-term in nature and are used as necessary to fund asset growth and meet other short-term liquidity needs.

United has available two lines of credit at its holding company with other financial institutions totaling \$75 million. At September 30, 2006, United had no outstanding balance on these lines of credit. United had sufficient qualifying collateral to increase FHLB advances by \$558 million at September 30, 2006. United's internal policy limits brokered deposits to 25% of total non-brokered deposits. At September 30, 2006, United had the capacity to increase brokered deposits by \$876 million and still remain within this limit.

As disclosed in United's consolidated statement of cash flows, net cash provided by operating activities was \$55.6 million for the nine months ended September 30, 2006. The major contributors in this category were net income of \$50.4 million, plus non-cash expense items such as depreciation, amortization and accretion of \$12.8 million, provision for loan losses of \$10.9 million, and stock based compensation of \$2.2 million. These sources were offset by a decrease in mortgage loans held for sale of \$813,000, a decrease in accrued expenses and other liabilities of \$845,000, and an increase in other assets and accrued interest receivable of \$21 million. Net cash used by investing activities of \$551.0 million consisted primarily of a net increase in loans totaling \$566.0 million, purchases of premises and equipment of \$25.1 million, and \$160.4 million used to purchase investment securities, partially offset by proceeds from sales of securities of \$72.4 million, maturities and calls of investment securities of \$97.5 million, and net cash received from branch acquisitions of \$26.4 million. Net cash provided by financing activities consisted primarily of a net increase in deposits of \$793.6 million, a net decrease in federal funds purchased, repurchase agreements, and other short-term borrowings of \$66.9 million, and proceeds from exercise of stock options and common stock issued for employee benefit plans of \$4.4 million, partially offset by a net decrease in FHLB advances of \$223.0 million, and cash dividends paid of \$9.3 million. In the opinion of management, the liquidity position at September 30, 2006 is sufficient to meet its expected cash flow requirements.

Capital Resources and Dividends

Shareholders' equity at September 30, 2006 was \$526.7 million, an increase of \$102.7 million, or 24% from September 30, 2005. Accumulated other comprehensive income (loss) is not included in the calculation of regulatory capital adequacy ratios. Excluding the change in the accumulated other comprehensive income (loss), shareholders' equity increased \$102.3 million, or 24%, from September 30, 2005. Dividends of \$9.6 million, or \$.24 per share, were declared on common stock during the first nine months of 2006, an increase of 20% from the amount declared in the same period in 2005 due to a 14% increase in the dividend rate and an increase in the number of outstanding shares. The dividend payout ratio for the third quarter was 19% for 2006 and 2005. United has historically retained the majority of its earnings in order to provide a cost effective source of capital for continued growth and expansion. However, in recognition that cash dividends are an important component of shareholder value, United has instituted a dividend program that provides for increased cash dividends when earnings and capital levels permit.

United's Board of Directors has authorized the repurchase of United's outstanding common stock for the general corporate purposes. At September 30, 2006, 1,000,000 shares may be repurchased under the current authorization through December 31, 2007.

Table of Contents

United's common stock trades on the Nasdaq Global Select Market under the symbol UCBI. Below is a quarterly schedule of high, low and closing stock prices and average daily volume for 2006 and 2005.

Table 11 Stock Price Information

	2006				2005			
	High	Low	Close	Avg Volume	High	Low	Close	Avg Volume
First quarter	\$29.64	\$26.02	\$28.15	59,252	\$27.92	\$23.02	\$23.73	42,662
Second quarter	31.26	27.02	30.44	92,937	26.44	21.70	26.02	63,805
Third quarter	33.10	27.51	30.05	86,495	29.36	25.75	28.50	59,305
Fourth quarter					30.50	25.32	26.66	74,710

The following table presents the quarterly cash dividends declared in 2006 and 2005 and the respective payout ratios as a percentage of basic earnings per share.

Table 12 Dividend Payout Information

	2006		2005	
	Dividend	Payout %	Dividend	Payout %
First quarter	\$.08	20	\$.07	20
Second quarter	.08	19	.07	19
Third quarter	.08	19	.07	19
Fourth quarter			.07	18

The Board of Governors of the Federal Reserve System has issued guidelines for the implementation of risk-based capital requirements by U.S. banks and bank holding companies. These risk-based capital guidelines take into consideration risk factors, as defined by regulators, associated with various categories of assets, both on and off-balance sheet. Under the guidelines, capital strength is measured in two tiers that are used in conjunction with risk-adjusted assets to determine the risk based capital ratios. The guidelines require an 8% total risk-based capital ratio, of which 4% must be Tier I capital. To be considered well capitalized under the guidelines, a 10% total risk-based capital ratio and a 6% Tier I risk-based capital ratio are required.

The following table shows United's capital ratios, as calculated under regulatory guidelines, at September 30, 2006 and 2005.

Table 13 Capital Ratios

(dollars in thousands)

	2006		2005	
	Actual Amount	Regulatory Minimum	Actual Amount	Regulatory Minimum
Tier I Leverage:				
Amount	\$457,079	\$187,020	\$355,571	\$164,815
Ratio	7.33%	3.00%	6.47%	3.00%
Tier I Risk-Based:				
Amount	\$457,079	\$206,290	\$355,571	\$175,703
Ratio	8.86%	4.00%	8.09%	4.00%
Total Risk-Based:				
Amount	\$587,580	\$412,581	\$477,059	\$351,407
Ratio	11.39%	8.00%	10.86%	8.00%

United's Tier I capital excludes other comprehensive income, and consists of stockholders' equity and qualifying capital securities less goodwill and deposit-based intangibles. Tier II capital components include supplemental capital

items such as a qualifying allowance for loan losses and qualifying subordinated debt. Tier I capital plus Tier II capital components is referred to as Total Risk-Based capital.

Table of Contents

A minimum leverage ratio is required in addition to the risk-based capital standards and is defined as Tier I capital divided by quarterly average assets adjusted for goodwill and deposit-based intangibles. Although a minimum leverage ratio of 3% is required for the highest-rated bank holding companies which are not undertaking significant expansion programs, the Federal Reserve Board requires a bank holding company to maintain a leverage ratio greater than 3% if it is experiencing or anticipating significant growth or is operating with less than well-diversified risks in the opinion of the Federal Reserve Board. The Federal Reserve Board uses the leverage and risk-based capital ratios to assess capital adequacy of banks and bank holding companies.

The capital ratios of United and the Banks currently exceed the minimum ratios as defined by federal regulators. United monitors these ratios to ensure that United and the Banks remain above regulatory minimum guidelines.

Impact of Inflation and Changing Prices

A bank's asset and liability structure is substantially different from that of an industrial firm in that primarily all assets and liabilities of a bank are monetary in nature with relatively little investment in fixed assets or inventories. Inflation has an important impact on the growth of total assets and the resulting need to increase equity capital at higher than normal rates in order to maintain an appropriate equity to assets ratio.

United's management believes the impact of inflation on financial results depends on United's ability to react to changes in interest rates and, by such reaction, reduce the inflationary impact on performance. United has an asset/liability management program to manage interest rate sensitivity. In addition, periodic reviews of banking services and products are conducted to adjust pricing in view of current and expected costs.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

There have been no material changes in United's quantitative and qualitative disclosures about market risk as of September 30, 2006 from that presented in the Annual Report on Form 10-K for the year ended December 31, 2005. The interest rate sensitivity position at September 30, 2006 is included in management's discussion and analysis on page 21 of this report.

Item 4. Controls and Procedures

United's management, including the Chief Executive Officer and Chief Financial Officer, supervised and participated in an evaluation of the company's disclosure controls and procedures as of September 30, 2006. Based on, and as of the date of, that evaluation, United's Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective in accumulating and communicating information to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures of that information under the Securities and Exchange Commission's rules and forms and that the disclosure controls and procedures are designed to ensure that the information required to be disclosed in reports that are filed or submitted by United under the Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in United's internal controls over financial reporting that occurred during United's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, United's internal controls over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

In the ordinary course of operations, United and the Banks are defendants in various legal proceedings. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision could result in a material adverse change in the consolidated financial condition or results of operations of United.

Table of Contents

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in United's Form 10-K for the year ended December 31, 2005, but United did revise and clarify the following risk factor:

The risk factor under the heading **United's concentration of construction loans is subject to unique risks that could adversely affect earnings.** is replaced with the following:

United's concentration of construction and land development loans is subject to unique risks that could adversely affect earnings.

United's construction and land development loan portfolio was \$2.1 billion at September 30, 2006, comprising 42% of total loans. Construction and land development loans are often riskier than home equity loans or residential mortgage loans to individuals. In the event of a general economic slowdown, they would represent higher risk due to slower sales and reduced cash flow that could impact the borrowers' ability to repay on a timely basis.

In addition, although regulations and regulatory policies affecting banks and financial services companies undergo continuous change and we cannot predict when changes will occur or the ultimate effect of any changes, there has been recent regulatory focus on construction, development and other commercial real estate lending. A change in the state and federal banking laws, regulations or policies applicable to construction, development or other commercial real estate loans could subject us to substantial limitations with respect to making such loans, increase the costs of making such loans, or require us to have a greater amount of capital to support this kind of lending, all of which could have a material adverse effect on our profitability or financial condition.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds None

Item 3. Defaults upon Senior Securities None

Item 4. Submission of Matters to a Vote of Securities Holders None

Item 5. Other Information None

Item 6. Exhibits

- 3.1 Restated Articles of Incorporation of United Community Banks, Inc., (incorporated herein by reference to Exhibit 3.1 to United Community Banks, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, File No. 0-21656, filed with the Commission on August 14, 2001).
- 3.2 Amendment to the Restated Articles of Incorporation of United Community Banks, Inc. (incorporated herein by reference to Exhibit 3.3 to United Community Banks, Inc.'s Registration Statement on Form S-4, File No. 333-118893, filed with the Commission on September 9, 2004).
- 3.3 Amended and Restated Bylaws of United Community Banks, Inc., dated September 12, 1997 (incorporated herein by reference to Exhibit 3.1 to United Community Banks, Inc.'s Annual Report on Form 10-K, for the year ended December 31, 1997, File No. 0-21656, filed with the Commission on March 27, 1998).
- 4.1 See Exhibits 3.1, 3.2 and 3.3 for provisions of the Restated Articles of Incorporation, as amended, and Amended and Restated Bylaws, which define the rights of the Shareholders.
- 31.1 Certification by Jimmy C. Tallent, President and Chief Executive Officer of United Community Banks, Inc., as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification by Rex S. Schuette, Executive Vice President and Chief Financial Officer of United Community Banks, Inc., as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

Signatures

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

UNITED COMMUNITY BANKS, INC.

/s/ Jimmy C. Tallent

Jimmy C. Tallent
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Rex S. Schuette

Rex S. Schuette
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

/s/ Alan H. Kumler

Alan H. Kumler
Senior Vice President and Controller
(Principal Accounting Officer)

Date: November 7, 2006

27