

Edgar Filing: UNIONBANCORP INC - Form 10-Q

UNIONBANCORP INC
Form 10-Q
August 11, 2006

=====

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

QUARTERLY REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2006
Commission File Number: 0-28846

UnionBancorp, Inc.

(Exact name of Registrant as specified in its charter)

Delaware

36-3145350

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification
Number)

122 West Madison Street Ottawa, Illinois 61350

(Address of principal executive offices including zip code)

(815) 431-2720

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such 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.
Large accelerated filer Accelerated filer Non-accelerated filer .

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Shares outstanding at August 11, 2006 |
|--------------------------------|---------------------------------------|
| ----- | ----- |
| Common Stock, Par Value \$1.00 | 3,742,751 |

UnionBancorp, Inc.
Form 10-Q Index

Edgar Filing: UNIONBANCORP INC - Form 10-Q

June 30, 2006

| | Page ---- |
|---|--------------|
| PART I. FINANCIAL INFORMATION | |
| Item 1. Financial Statements | |
| o Unaudited Consolidated Balance Sheets..... | 1 |
| o Unaudited Consolidated Statements of Income and Comprehensive Income | 2 |
| o Unaudited Consolidated Statements of Cash Flows..... | 3 |
| o Notes to Unaudited Consolidated Financial Statements..... | 4 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations..... | 13 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk..... | 29 |
| Item 4. Controls and Procedures | 29 |
| PART II. OTHER INFORMATION | |
| Item 1. Legal Proceedings..... | 31 |
| Item 1A. Risk Factors..... | 31 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds..... | 31 |
| Item 3. Defaults Upon Senior Securities..... | 31 |
| Item 4. Submission of Matters to a Vote of Security Holders..... | 32 |
| Item 5. Other Information..... | 32 |
| Item 6. Exhibits..... | 32 |
| SIGNATURES..... | 33 |

UNIONBANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED BALANCE SHEETS
 June 30, 2006 and December 31, 2005 (In Thousands, Except Share Data)

| | June 30, 2006 | De |
|-------------------------------|------------------|-------|
| ASSETS | | |
| Cash and cash equivalents | \$ 30,265 | \$ |
| Securities available-for-sale | 182,914 | |
| Loans | 403,455 | |
| Allowance for loan losses | (6,848) | |
| | ----- | ----- |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | |
|--|------------|-------|
| Net loans | 396,607 | |
| Cash surrender value of life insurance | 15,775 | |
| Mortgage servicing rights | 2,373 | |
| Premises and equipment, net | 13,789 | |
| Goodwill | 6,963 | |
| Intangible assets, net | 446 | |
| Other real estate | 1,390 | |
| Other assets | 6,309 | |
| | ----- | ----- |
| Total assets | \$ 656,831 | \$ |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits | | |
| Non-interest-bearing | \$ 56,119 | \$ |
| Interest-bearing | 466,576 | |
| | ----- | ----- |
| Total deposits | 522,695 | |
| Federal funds purchased and securities sold under agreements to repurchase | 7,297 | |
| Advances from the Federal Home Loan Bank | 46,700 | |
| Notes payable | 8,824 | |
| Series B mandatory redeemable preferred stock | 831 | |
| Other liabilities | 5,180 | |
| | ----- | ----- |
| Total liabilities | 591,527 | |
| | ----- | ----- |
| Stockholders' equity | | |
| Preferred stock; 200,000 shares authorized; none issued | -- | |
| Series A convertible preferred stock; 2,765 shares authorized, 2,762.24 shares outstanding (aggregate liquidation preference of \$2,762) | 500 | |
| Series C preferred stock; 4,500 shares authorized; none issued | -- | |
| Common stock, \$1 par value; 10,000,000 shares authorized; 4,697,893 shares issued at June 30, 2006 and 4,684,393 shares issued at December 31, 2005 | 4,698 | |
| Additional paid-in capital | 23,381 | |
| Retained earnings | 50,775 | |
| Accumulated other comprehensive income | (1,204) | |
| | ----- | ----- |
| | 78,150 | |
| Treasury stock, at cost; 955,142 shares at June 30, 2006 and 877,517 at December 31, 2005 | (12,846) | |
| | ----- | ----- |
| Total stockholders' equity | 65,304 | |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$ 656,831 | \$ |
| | ===== | ===== |

See Accompanying Notes to Unaudited Financial Statements

1.

UNIONBANCORP, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

Edgar Filing: UNIONBANCORP INC - Form 10-Q

Three and Six Months Ended June 30, 2006 and 2005 (In Thousands, Except Per Share Data)

| | Three Months Ended June 30 | | Six Mon Ju |
|---|-------------------------------|----------|---------------|
| | 2006 | 2005 | 2006 |
| Interest income | | | |
| Loans | \$ 7,194 | \$ 6,751 | \$ 14,349 |
| Securities | | | |
| Taxable | 2,027 | 1,481 | 4,018 |
| Exempt from federal income taxes | 210 | 263 | 426 |
| Federal funds sold and other | 45 | 50 | 66 |
| | 9,476 | 8,545 | 18,859 |
| Interest expense | | | |
| Deposits | 3,845 | 2,571 | 7,324 |
| Federal funds purchased and securities sold under agreements to repurchase | 51 | 37 | 123 |
| Advances from the Federal Home Loan Bank | 455 | 550 | 938 |
| Series B mandatory redeemable preferred stock | 13 | 13 | 25 |
| Notes payable | 161 | 94 | 315 |
| | 4,525 | 3,265 | 8,725 |
| Net interest income | 4,951 | 5,280 | 10,134 |
| Provision for loan losses | (300) | -- | (1,100) |
| Net interest income after provision for loan losses | 5,251 | 5,280 | 11,234 |
| Noninterest income | | | |
| Service charges | 495 | 525 | 935 |
| Trust income | 199 | 187 | 418 |
| Mortgage banking income | 281 | 364 | 527 |
| Insurance commissions and fees | 414 | 472 | 793 |
| Banked owned life insurance | 137 | 135 | 277 |
| Securities gains, net | (88) | -- | (88) |
| Gain on sale of assets, net | (9) | 1 | (9) |
| Other income | 268 | 347 | 604 |
| | 1,697 | 2,031 | 3,457 |
| Noninterest expenses | | | |
| Salaries and employee benefits | 2,910 | 3,366 | 5,955 |
| Occupancy expense, net | 346 | 385 | 789 |
| Furniture and equipment expense | 521 | 461 | 1,033 |
| Marketing | 98 | 128 | 209 |
| Supplies and printing | 65 | 86 | 162 |
| Telephone | 118 | 106 | 235 |
| Other real estate owned expense | 2 | 29 | 8 |
| Amortization of intangible assets | 43 | 43 | 87 |
| Other expenses | 1,026 | 1,023 | 1,985 |
| | 5,129 | 5,627 | 10,463 |
| Income before income taxes | 1,819 | 1,684 | 4,228 |
| Income taxes | 525 | 302 | 1,288 |
| Net income | 1,294 | 1,382 | 2,940 |
| Preferred stock dividends | 52 | 52 | 104 |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | | |
|------------------------------------|----------|----------|----------|
| Net income for common stockholders | \$ 1,242 | \$ 1,330 | \$ 2,836 |
| | ===== | ===== | ===== |
| Basic earnings per common share | \$ 0.33 | \$ 0.33 | \$ 0.75 |
| | ===== | ===== | ===== |
| Diluted earnings per common share | \$ 0.33 | \$ 0.33 | \$ 0.74 |
| | ===== | ===== | ===== |
| Total comprehensive income | \$ 351 | \$ 1,521 | \$ 1,641 |
| | ===== | ===== | ===== |

See Accompanying Notes to Unaudited Financial Statements

2.

UNIONBANCORP, INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
 Six Months Ended June 30, 2006 and 2005 (In Thousands)

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2006 | 2005 |
| | ----- | ----- |
| Cash flows from operating activities | | |
| Net income | \$ 2,940 | \$ 2,346 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 931 | 855 |
| Amortization of intangible assets | 87 | 87 |
| Amortization of mortgage servicing rights | 160 | 91 |
| Amortization of bond premiums, net | 244 | 584 |
| Stock Option Expense | 68 | -- |
| Federal Home Loan Bank stock dividend | (47) | (109) |
| Provision for loan losses | (1,100) | 100 |
| Provision for deferred income taxes | (310) | 466 |
| Net change in BOLI | (277) | (269) |
| Net change in OREO | (2) | -- |
| (Gain) loss on sale of assets | 9 | (3) |
| Loss on sale of securities | 88 | -- |
| Gain on sale of loans | (353) | (540) |
| Gain on sale of real estate acquired in settlement of loans | -- | (7) |
| Proceeds from sales of loans held for sale | 27,395 | 22,927 |
| Origination of loans held for sale | (25,796) | (20,710) |
| Change in assets and liabilities | | |
| (Increase) in other assets | 577 | (178) |
| Increase in other liabilities | 569 | 124 |
| | ----- | ----- |
| Net cash provided by operating activities | 5,183 | 5,764 |
| Cash flows from investing activities | | |
| Securities available-for-sale | | |
| Proceeds from maturities and paydowns | 19,554 | 27,795 |
| Proceeds from sales | 16,594 | -- |
| Purchases | (25,012) | (29,757) |
| Purchase of loans | (19,513) | (3,275) |
| Net decrease in loans | 30,618 | 15,429 |
| Purchase of premises and equipment | (758) | (1,327) |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | |
|--|-----------|-----------|
| Sale of branch | (6,054) | -- |
| Proceeds from sale of real estate acquired in settlement of loans | 173 | 67 |
| | ----- | ----- |
| Net cash provided by (used in) investing activities | 15,602 | 8,932 |
| Cash flows from financing activities | | |
| Net increase (decrease) in deposits | (15,138) | 8,723 |
| Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase | 6,685 | (8,044) |
| Payments on notes payable | (2,045) | (542) |
| Proceeds from notes payable | 1,400 | 3,085 |
| Net increase in other borrowed funds | -- | 11 |
| Net decrease in advances from the Federal Home Loan Bank | (3,300) | (5,800) |
| Dividends on common stock | (898) | (878) |
| Dividends on preferred stock | (104) | (104) |
| Proceeds from exercise of stock options | 160 | 420 |
| Purchase of treasury stock | (1,638) | (2,997) |
| | ----- | ----- |
| Net cash provided by financing activities | (14,878) | (6,126) |
| | ----- | ----- |
| Net increase in cash and cash equivalents | 5,907 | 8,570 |
| Cash and cash equivalents | | |
| Beginning of period | 24,358 | 22,802 |
| | ----- | ----- |
| End of period | \$ 30,265 | \$ 31,372 |
| | ===== | ===== |
| Supplemental disclosures of cash flow information | | |
| Cash payments for | | |
| Interest | \$ 4,575 | \$ 6,129 |
| Income taxes | 861 | 643 |
| Transfers from loans to other real estate owned | 1,307 | 310 |

See Accompanying Notes to Unaudited Financial Statements

3.

UNIONBANCORP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands, Except Per Share Data)

Note 1. Summary of Significant Accounting Policies

The accompanying unaudited interim consolidated financial statements of UnionBancorp, Inc. (the "Company") have been prepared in accordance with U.S. generally accepted accounting principles and with the rules and regulations of the Securities and Exchange Commission for interim financial reporting. Accordingly, they do not include all of the information and footnotes required for complete financial statements. In the opinion of management, all normal and recurring adjustments which are necessary to fairly present the results for the interim periods presented have been included. The preparation of financial statements requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. For further information with respect to significant accounting policies followed by the Company in the preparation of its consolidated financial statements, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005. The annualized results of operations during the three and six months ended June 30, 2006 are not necessarily indicative of the results expected for the year ending December 31, 2006. All financial information is in thousands (000's), except per share data.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

Note 2. Earnings Per Share

Basic earnings per share for the three and six months ended June 30, 2006 and 2005 were computed by dividing net income by the weighted average number of shares outstanding. Diluted earnings per share for the three and six months ended June 30, 2006 and 2005 were computed by dividing net income by the weighted average number of shares outstanding, adjusted for the dilutive effect of the stock options. Computations for basic and diluted earnings per share are provided below:

Basic Earnings Per Common Share

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| Net income | | | | |
| available to common shareholders | \$ 1,242 | \$ 1,330 | \$ 2,836 | \$ 2,242 |
| Weighted average common shares outstanding | 3,743 | 3,993 | 3,765 | 4,021 |
| | | | | |
| Basic Earnings Per Common Share | \$ 0.33 | \$ 0.33 | \$ 0.75 | \$ 0.56 |
| | | | | |
| Diluted Earnings Per Common Share | | | | |
| Weighted average common shares outstanding | 3,743 | 3,993 | 3,765 | 4,021 |
| Add: dilutive effect of assumed exercised stock options | 44 | 62 | 45 | 62 |
| | | | | |
| Weighted average common and dilutive Potential shares outstanding | 3,787 | 4,055 | 3,810 | 4,083 |
| | | | | |
| Diluted Earnings Per Common Share | \$ 0.33 | \$ 0.33 | \$ 0.74 | \$ 0.55 |
| | | | | |

There were approximately 60,000 and 40,000 options outstanding at June 30, 2006 and 2005, respectively, that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common stock and were, therefore, antidilutive.

4.

UNIONBANCORP, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (In Thousands, Except Per Share Data)

Note 3. Securities

The Company's consolidated securities portfolio, which represented 32.1% of the Company's 2006 second quarter average earning asset base, is managed to minimize interest rate risk, maintain sufficient liquidity, and maximize return. The portfolio includes several callable agency debentures, adjustable rate mortgage pass-throughs, and collateralized mortgage obligations.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

Corporate bonds consist of investment grade obligations of public corporations. Equity securities consist of Federal Reserve stock, Federal Home Loan Bank stock, and trust preferred stock. Securities classified as available-for-sale, carried at fair value, were \$182,914 at June 30, 2006 compared to \$196,440 at December 31, 2005. The Company does not have any securities classified as trading or held-to-maturity.

The following table describes the fair value, gross unrealized gains and losses of securities available-for-sale at June 30, 2006 and December 31, 2005, respectively:

| | June 30, 2006 | | |
|--|---------------|------------------------------|-------------------------------|
| | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses |
| U.S. government agencies | \$ 40,418 | \$ -- | \$ (795) |
| States and political subdivisions | 19,177 | 258 | (110) |
| U.S. government mortgage-backed securities | 75,374 | 203 | (1,082) |
| Collateralized mortgage obligations | 23,777 | -- | (479) |
| Equity securities | 17,363 | 95 | (33) |
| Corporate | 6,805 | 14 | (37) |
| | \$ 182,914 | \$ 570 | \$ (2,536) |

| | December 31, 2005 | | |
|--|-------------------|------------------------------|-------------------------------|
| | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses |
| U.S. government agencies | \$ 30,857 | \$ 8 | \$ (364) |
| States and political subdivisions | 18,400 | 424 | (16) |
| U.S. government mortgage-backed securities | 101,022 | 854 | (675) |
| Collateralized mortgage obligations | 20,938 | 21 | (157) |
| Equity securities | 18,316 | 54 | (49) |
| Corporate | 6,907 | 62 | (7) |
| | \$ 196,440 | \$ 1,423 | \$ (1,268) |

5.

UNIONBANCORP, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (In Thousands, Except Per Share Data)

 Note 4. Loans and Allowance for Loan Losses

The Company offers a broad range of products, including agribusiness,

Edgar Filing: UNIONBANCORP INC - Form 10-Q

commercial, residential, and installment loans, designed to meet the credit needs of its borrowers. The Company concentrates its lending activity in the geographic market areas that it serves, generally lending to consumers and small to mid-sized businesses from which deposits are garnered in the same market areas. As a result, the Company strives to maintain a loan portfolio that is diverse in terms of loan type, industry, borrower and geographic concentrations. The following table describes the composition of loans by major categories outstanding as of June 30, 2006 and December 31, 2005, respectively:

| | June 30, 2006 | | December 31, 2005 | |
|---------------------------|-------------------|----------------|-------------------|----------------|
| | \$ | % | \$ | % |
| Commercial | \$ 84,711 | 21.00% | \$ 91,537 | 21.92% |
| Agricultural | 21,178 | 5.25 | 26,694 | 6.39 |
| Real estate: | | | | |
| Commercial mortgages | 130,942 | 32.46 | 126,503 | 30.31 |
| Construction | 75,424 | 18.69 | 68,508 | 16.41 |
| Agricultural | 27,590 | 6.84 | 33,033 | 7.91 |
| 1-4 family mortgages | 52,876 | 13.11 | 57,920 | 13.87 |
| Installment | 9,531 | 2.36 | 12,747 | 3.05 |
| Other | 1,203 | 0.30 | 583 | 0.14 |
| Total loans | 403,455 | 100.00% | 417,525 | 100.00% |
| | | ===== | | ===== |
| Allowance for loan losses | (6,848) | | (8,362) | |
| | | | | |
| Loans, net | \$ 396,607 | | \$ 409,163 | |
| | | ===== | | ===== |

The following table presents data on impaired loans:

| | June 30, 2006 | December 31, 2005 |
|---|------------------|----------------------|
| Impaired loans for which an allowance has been provided | \$ 6,455 | \$ 12,585 |
| Impaired loans for which no allowance has been provided | 3,955 | 563 |
| | | |
| Total loans determined to be impaired | \$ 10,410 | \$ 13,148 |
| | | |
| Allowance for loan loss for impaired loans included in the allowance for loan losses | \$ 2,571 | \$ 3,913 |
| | | |

In originating loans, the Company recognizes that credit losses will be experienced and the risk of loss will vary with, among other things, current economic conditions; the type of loan being made; the creditworthiness of the borrower over the term of the loan; and in the case of a collateralized loan, the quality of the collateral for such loan. The allowance for loan losses represents the Company's estimate of the allowance necessary to provide for probable incurred losses in the loan portfolio. In making this determination, the Company analyzes the ultimate collectibility of the loans in its portfolio,

Edgar Filing: UNIONBANCORP INC - Form 10-Q

incorporating feedback provided by internal loan staff, the independent loan review function and information provided by examinations performed by regulatory agencies. The Company makes an ongoing evaluation as to the adequacy of the allowance for loan losses. Transactions in the allowance for loan losses for the three and six months ended June 30, 2006 and 2005 are summarized below:

6.

UNIONBANCORP, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (In Thousands, Except Per Share Data)

Note 4. Loans and Allowance For Loan Losses (Continued)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|------------|------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Beginning balance | \$ 7,506 | \$ 9,948 | \$ 8,362 | \$ 9,948 |
| Charge-offs: | | | | |
| Commercial | 203 | 464 | 223 | 464 |
| Real estate mortgages | 414 | 419 | 482 | 419 |
| Installment and other loans | 34 | 82 | 73 | 82 |
| Total charge-offs | 651 | 965 | 778 | 965 |
| Recoveries: | | | | |
| Commercial | 120 | 10 | 135 | 10 |
| Real estate mortgages | 168 | 122 | 209 | 122 |
| Installment and other loans | 5 | 44 | 20 | 44 |
| Total recoveries | 293 | 176 | 364 | 176 |
| Net charge-offs | 358 | 789 | 414 | 789 |
| Provision for loan losses | (300) | 0 | (1,100) | 0 |
| Ending balance | \$ 6,848 | \$ 9,159 | \$ 6,848 | \$ 9,159 |
| Period end total loans, net of unearned interest | \$ 403,455 | \$ 404,462 | \$ 403,455 | \$ 404,462 |
| Average loans | \$ 407,360 | \$ 414,289 | \$ 410,780 | \$ 415,200 |
| Ratio of net charge-offs to average loans | 0.09% | 0.19% | 0.10% | 0.19% |
| Ratio of provision for loan losses to average loans | 0.07% | 0.00% | 0.02% | 0.00% |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | | | |
|---|---------|---------|---------|-----|
| to average loans | (0.07)% | 0.00% | (0.27)% | 0 |
| Ratio of allowance for loan losses to ending total loans | 1.70% | 2.26% | 1.70% | 2 |
| Ratio of allowance for loan losses to total nonperforming loans | 244.05% | 238.83% | 244.05% | 238 |
| Ratio of allowance at end of period to average loans | 1.68% | 2.21% | 1.67% | 2 |

Note 5. Stock Option Plans

In April 1993, the Company adopted the UnionBancorp 1993 Stock Option Plan ("the 1993 Option Plan"). A total of 490,206 shares were issued pursuant to stock options issued to employees and outside directors under this plan. The 1993 Stock Option Plan was terminated on April 12, 2003.

In 1999, the Company adopted the UnionBancorp, Inc. Non-qualified Stock Option Plan ("the 1999 Option Plan"). Under the 1999 Option Plan, nonqualified options may be granted to employees and eligible directors of the Company and its subsidiaries to purchase the Company's common stock at 100% of the fair market value on the date the option is granted. The Company has authorized 50,000 shares for

7.

UNIONBANCORP, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (In Thousands, Except Per Share Data)

Note 5. Stock Option Plans (Continued)

issuance under the 1999 Option Plan. During 1999, 40,750 of these shares were granted and are 100% fully vested. The options have an exercise period of ten years from the date of grant. There are 9,250 shares available to grant under this plan.

In April 2003, the Company adopted the UnionBancorp 2003 Stock Option Plan ("the 2003 Option Plan"). Under the 2003 Option Plan, nonqualified options, incentive stock options, and/or stock appreciation rights may be granted to employees and outside directors of the Company and its subsidiaries to purchase the Company's common stock at an exercise price to be determined by the 2003 Option Plan's administrative committee. Pursuant to the 2003 Option Plan, 200,000 shares of the Company's unissued common stock have been reserved and are available for issuance upon the exercise of options and rights granted under the 2003 Option Plan. The options have an exercise period of ten years from the date of grant. There are 110,000 shares available to grant under this plan.

A summary of the status of the option plans as of June 30, 2006, and changes during the quarter ended on those dates is presented below:

| | June 30, 2006 | |
|-------------------------------------|---------------|---------------------------------|
| | Shares | Weighted-Average Exercise Price |
| Outstanding at beginning of quarter | 301,675 | \$ 15.74 |
| Granted | -- | -- |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | |
|---|----------|----------|
| Exercised | (13,500) | 8.09 |
| Forfeited | (21,811) | 15.96 |
| | ----- | ----- |
| Outstanding at end of quarter | 266,364 | \$ 16.11 |
| | ===== | ===== |
| Options exercisable at quarter end | 175,233 | \$ 14.08 |
| | ===== | ===== |
| Weighted-average fair value of options granted during the quarter | | \$ -- |
| | | ===== |

8.

UNIONBANCORP, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (In Thousands, Except Per Share Data)

 Note 5. Stock Option Plans (Continued)

Options outstanding at June 30, 2006 and December 31, 2005 were as follows:

| June 30, 2006 | | | | |
|--------------------------|---------|---|-------------|---------------------------------|
| Outstanding | | | Exercisable | |
| Range of Exercise Prices | Number | Weighted Average Remaining Contractual Life | Number | Weighted Average Exercise Price |
| ----- | ----- | ----- | ----- | ----- |
| \$ 7.25 - \$ 9.75 | 9,000 | 0.7 years | 9,000 | \$ 9.75 |
| 11.25 - 13.00 | 59,681 | 3.9 years | 59,681 | 11.64 |
| 13.88 - 18.50 | 112,683 | 4.5 years | 94,552 | 14.94 |
| 20.30 - 23.29 | 85,000 | 8.6 years | 12,000 | 22.78 |
| | ----- | ----- | ----- | ----- |
| | 266,364 | 5.6 years | 175,233 | \$ 14.08 |
| | ===== | ===== | ===== | ===== |

| December 31, 2005 | | | | |
|--------------------------|---------|---|-------------|---------------------------------|
| Outstanding | | | Exercisable | |
| Range of Exercise Prices | Number | Weighted Average Remaining Contractual Life | Number | Weighted Average Exercise Price |
| ----- | ----- | ----- | ----- | ----- |
| \$ 7.25 - \$ 9.75 | 22,300 | 0.7 years | 22,300 | \$ 8.69 |
| 11.25 - 13.00 | 62,681 | 4.5 years | 54,855 | 11.63 |
| 13.88 - 18.50 | 126,694 | 5.0 years | 98,356 | 15.04 |
| 20.30 - 23.29 | 90,000 | 9.2 years | 12,000 | 22.78 |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | | |
|---------|-----------|---------|----------|
| ----- | ----- | ----- | ----- |
| 301,675 | 5.8 years | 187,511 | \$ 13.78 |
| ===== | ===== | ===== | ===== |

The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of our common stock as of the reporting date. The intrinsic value of options exercised during the second quarter of 2006 and 2005 was \$174 and \$308. The company recorded \$68 in stock compensation expense during the six months ended June 30, 2006 to salaries and employee benefits.

The fair value of each stock option granted is estimated using the Black-Scholes based stock option valuation model. This model requires the input of subjective assumptions that will usually have a significant impact on the fair value estimate. Expected volatilities are based on historical volatility of the Company's stock, and other factors. Expected dividends are based on dividend trends and the market price of the Company's stock price at grant. The Company uses historical data to estimate option exercises and employee terminations within the valuation model. The risk-free rate for periods within the contractual life of the options is based on the U. S. Treasury yield curves in effect at the time of grant. There were no grants during the six months ended June 30, 2006 and 2005.

The Company elected to adopt the modified prospective application method as provided by SFAS 123R, and, accordingly the Company recorded compensation costs as the requisite service rendered for the unvested portion of previously issued awards that remain outstanding at the initial date of adoption and any awards issued, modified, repurchased, or cancelled after the effective date of SFAS 123R.

9.

UNIONBANCORP, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (In Thousands, Except Per Share Data)

 Note 5. Stock Option Plans (Continued)

Prior to January 1, 2006, the Company accounted for share-based compensation to employees in accordance with Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company also followed the disclosure requirements of SFAS 123, "Accounting for Stock-Based Compensation". No stock-based compensation was recognized on employee stock options in the consolidated statement of income before January 1, 2006. Accordingly, financial statement amounts for the prior periods presented in this Form 10-Q have not been restated to reflect the fair value method of expensing share-based compensation.

SFAS 123R requires the recognition of stock based compensation for the number of awards that are ultimately expected to vest. As a result, recognized stock option compensation expense was reduced for estimated forfeitures prior to vesting primarily based on historical annual forfeiture rates of approximately three percent. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances. Prior to January 1, 2006, actual forfeitures were accounted for as they occurred for purposes of required pro forma stock compensation disclosures.

Unrecognized stock option compensation expense related to unvested awards (net of estimated forfeitures) for the remainder of 2006 and beyond is estimated as follows:

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| Year | Expense |
|-----------------------------|---------|
| ----- | ----- |
| July, 2006 - December, 2006 | \$ 68 |
| 2007 | 67 |
| 2008 | 47 |
| 2009 | 28 |
| | ----- |
| Total | \$ 210 |
| | ===== |

The following table illustrates the effect on net income and earnings per share if expense was measured using the fair value recognition provisions of SFAS 123R as of June 30, 2005:

| | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2005 |
|--|--|--------------------------------------|
| | ----- | ----- |
| Net income as reported for common stockholders | \$ 1,330 | \$ 2,242 |
| Deduct: stock-based compensation expense determined under fair value based method | 27 | 57 |
| | ----- | ----- |
| Pro forma net income | \$ 1,303 | \$ 2,185 |
| | ===== | ===== |
| Basic earnings per common share as reported | \$ 0.33 | \$ 0.56 |
| Pro forma basic earnings per common share | \$ 0.33 | \$ 0.54 |
| Diluted earnings per common share as reported | \$ 0.33 | \$ 0.55 |
| Pro forma diluted earnings per common share | \$ 0.32 | \$ 0.53 |

10.

UNIONBANCORP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands, Except Per Share Data)

Note 6. Contingent Liabilities And Other Matters

Neither the Company nor any of its subsidiaries are involved in any pending legal proceedings other than routine legal proceedings occurring in the normal course of business, which, in the opinion of management, in the aggregate, are not material to the Company's consolidated financial condition.

Note 7. Segment Information

The reportable segments are determined by the products and services offered, primarily distinguished between retail, commercial, treasury, financial services, and operations & other. Loans, and deposits generate the revenues in the commercial segments; deposits, loans, secondary mortgage sales and servicing

Edgar Filing: UNIONBANCORP INC - Form 10-Q

generates the revenue in the retail segment; investment income generates the revenue in the treasury segment; insurance, brokerage, and trust services generate the revenue in the financial services segment; and holding company services generate the revenue in the operations & other segment.

The accounting policies used with respect to segment reporting are the same as those described in the summary of significant accounting policies set forth in Note 1 on page 4. Segment performance is evaluated using net income. Information reported internally for performance assessment follows.

| | Three Months Ended June 30, 2006 | | | |
|----------------------------|-------------------------------------|-----------------------|---------------------|-----------------------|
| | Retail Segment | Commercial Segment | Treasury Segment | Financial Services |
| Net interest income (loss) | \$ 1,926 | \$ 3,126 | \$ 86 | \$ 50 |
| Other revenue | 908 | 110 | (89) | 565 |
| Other expense | 1,497 | 523 | 63 | 710 |
| Noncash items | | | | |
| Depreciation | 200 | 3 | -- | 35 |
| Provision for loan losses | (100) | (200) | -- | -- |
| Other intangibles | -- | -- | -- | 15 |
| Net allocations | 624 | 1,256 | 158 | 233 |
| Income tax expense | 207 | 540 | (146) | (128) |
| Segment profit (loss) | 406 | 1,114 | (78) | (250) |
| Goodwill | 2,512 | 2,631 | -- | 1,820 |
| Segment assets | 91,575 | 326,048 | 209,259 | 3,575 |

| | Three Months Ended June 30, 2005 | | | |
|----------------------------|-------------------------------------|-----------------------|---------------------|-----------------------|
| | Retail Segment | Commercial Segment | Treasury Segment | Financial Services |
| Net interest income (loss) | \$ 1,886 | \$ 3,284 | \$ 43 | \$ 11 |
| Other revenue | 1,026 | 112 | -- | 657 |
| Other expense | 1,647 | 1,053 | 59 | 671 |
| Noncash items | | | | |
| Depreciation | 229 | 3 | -- | 39 |
| Provision for loan losses | 190 | (190) | -- | -- |
| Other intangibles | -- | -- | -- | 15 |
| Net allocations | 757 | 864 | 120 | 197 |
| Income tax expense | 28 | 358 | (98) | (63) |
| Segment profit (loss) | 61 | 1,308 | (38) | (191) |
| Goodwill | 2,512 | 2,631 | -- | 1,820 |
| Segment assets | 104,239 | 311,763 | 218,152 | 3,975 |

11.

UNIONBANCORP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands, Except Per Share Data)

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | Six Months Ended June 30, 2006 | | | |
|----------------------------|-----------------------------------|-----------------------|---------------------|-----------------------|
| | Retail Segment | Commercial Segment | Treasury Segment | Financial Services |
| Net interest income (loss) | \$ 3,908 | \$ 6,389 | \$ 216 | \$ 106 |
| Other revenue | 1,758 | 221 | (88) | 1,198 |
| Other expense | 2,936 | 1,167 | 131 | 1,374 |
| Noncash items | | | | |
| Depreciation | 443 | 6 | -- | 73 |
| Provision for loan losses | 25 | (1,125) | -- | -- |
| Other intangibles | -- | -- | -- | 30 |
| Net allocations | 1,471 | 2,469 | 318 | 466 |
| Income tax expense | 264 | 1,389 | (252) | (215) |
| Segment profit (loss) | 527 | 2,704 | (69) | (424) |
| Goodwill | 2,512 | 2,613 | -- | 1,820 |
| Segment assets | 91,575 | 326,048 | 209,259 | 3,575 |

| | Six Months Ended June 30, 2005 | | | |
|----------------------------|-----------------------------------|-----------------------|---------------------|-----------------------|
| | Retail Segment | Commercial Segment | Treasury Segment | Financial Services |
| Net interest income (loss) | \$ 3,620 | \$ 6,418 | \$ 177 | \$ 18 |
| Other revenue | 1,976 | 226 | -- | 1,290 |
| Other expense | 3,188 | 1,700 | 117 | 1,404 |
| Noncash items | | | | |
| Depreciation | 454 | 6 | -- | 83 |
| Provision for loan losses | 290 | (190) | -- | -- |
| Other intangibles | -- | -- | -- | 30 |
| Net allocations | 1,541 | 2,210 | 231 | 354 |
| Income tax expense | 35 | 760 | (195) | (162) |
| Segment profit (loss) | 88 | 2,158 | 24 | (401) |
| Goodwill | 2,512 | 2,613 | -- | 1,820 |
| Segment assets | 104,239 | 311,763 | 218,152 | 3,975 |

12.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS

(In Thousands, Except Per Share Data)

The following discussion provides an analysis of the Company's results of operations and financial condition for the three and six months ended June 30, 2006 as compared to the same period in 2005. Management's discussion and analysis (MD&A) should be read in conjunction with the consolidated financial statements and accompanying notes presented elsewhere in this report as well as the Company's 2005 Annual Report on Form 10-K. Annualized results of operations during the three and six months ended June 30, 2006 are not necessarily indicative of results to be expected for the full year of 2006. Unless otherwise

Edgar Filing: UNIONBANCORP INC - Form 10-Q

stated, all earnings per share data included in this section and throughout the remainder of this discussion are presented on a diluted basis. All financial information is in thousands (000's), except per share data.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Act of 1934 as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Company, are generally identified by the use of words such as "believe," "expect," "intend," "anticipate," "estimate," "project," "planned" or "potential" or similar expressions. The Company's ability to predict results, or the actual effect of future plans or strategies, is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects of the Company and the subsidiaries include, but are not limited to, changes in: interest rates; general economic conditions; legislative/regulatory changes; monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Federal Reserve Board; the quality and composition of the loan or securities portfolios; demand for loan products; deposit flows; competition; demand for financial services in the Company's market areas; the Company's implementation of new technologies; the Company's ability to develop and maintain secure and reliable electronic systems; and accounting principles, policies, and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. By their nature, changes in these assumptions and estimates could significantly affect the Company's financial position or results of operations. Actual results could differ from those estimates. Discussed below are those critical accounting policies that are of particular significance to the Company.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required based on past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, current economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes that the uncollectibility of a loan balance is confirmed.

13.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS
(In Thousands, Except Per Share Data)

General

UnionBancorp, Inc. is a bank holding company organized under the laws of the state of Delaware. The Company derives most of its revenues and income from the operations of its bank subsidiary, UnionBank (the "Bank"). The Company provides a full range of services to individual and corporate customers located in the north central and central Illinois areas. These services include demand, time, and savings deposits; lending; mortgage banking; insurance products; brokerage services; asset management; and trust services. The Company is subject to competition from other financial institutions, including banks, thrifts and credits unions, as well as nonfinancial institutions providing financial services. Additionally, the Company and the Bank are subject to regulations of certain regulatory agencies and undergo periodic examinations by those regulatory agencies.

Second Quarter Highlights

- o On June 30, 2006, UnionBancorp, Inc. and Centru Financial Corporation (NASDAQ: TRUE) announced that they have signed a definitive agreement to join forces in a merger of equals transaction. Under the terms of the agreement, as the purchaser, UnionBancorp will issue to Centru shareholders shares of UnionBancorp common stock using a fixed exchange ratio of 1.2 shares of UnionBancorp common stock for each share of Centru common stock outstanding. The combined company will adopt the Centru name and change its stock market ticker symbol to TRUE. The merger is subject to approval by UnionBancorp's and Centru's stockholders and banking regulators and other customary conditions. The transaction is expected to be completed during the fourth quarter of 2006.
- o Earnings per share were unchanged compared to the second quarter of 2005.
- o The Company's earnings were positively impacted by a \$300 negative provision for loan losses largely based on continued improvements in the quality of the loan portfolio, which was partially offset by a loss on sale of securities of \$88 in order to better position the securities portfolio. Excluding these items, net income for the quarter would have equaled \$1,163 or \$0.29 per diluted share.
- o The second quarter of 2005 results were positively impacted by a \$251 reduction in state income taxes and \$90 of interest received due to the receipt of a tax refund related to amended tax returns outstanding from prior years. Excluding these items, net income for the second quarter of 2005 would have equaled \$1,076 or \$0.25 per diluted share.
- o Due to the flat yield curve, the net interest margin decreased to 3.37% during the second quarter of 2006 as compared with 3.59% for the same period in 2005 and 3.50% in the first quarter of 2006.
- o The loan portfolio decreased to \$403.5 million as compared to \$417.5 million at December 31, 2005. Of this decrease in balances, approximately \$7.7 million or 55% was related to the pay-off of action list credits refinanced with a competitor.
- o The level of nonperforming loans to end of period loans totaled 0.70% as of June 30, 2006 compared to 0.95% at June 30, 2005 and 0.96% on December 31, 2005.
- o Net charge-offs for the second quarter of 2006 were 0.09% of average loans as compared to 0.19% for the same period 2005.

14.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS

(In Thousands, Except Per Share Data)

Second Quarter Highlights (Continued)

- o The Company's Board of Directors approved the payment of a \$0.12 quarterly cash dividend on the Company's common stock, marking the 85th consecutive quarter of dividends paid to stockholders.

Results of Operations

Net Income

Net income equaled \$1,294 or \$0.33 per diluted share for the three months ended June 30, 2006, versus \$1,382 or \$0.33 per diluted share for the same period in 2005. For the six months ended June 30, 2006 net income equaled \$2,940 or \$0.74 per diluted share compared to \$2,346 or \$0.55 per diluted share earned in the same period during 2005.

The Company's quarterly results were positively impacted by a negative provision of \$300 to the allowance for loan losses. This action was largely based on continued improvements in the quality of the loan portfolio, favorable loan loss experience and management's beliefs regarding the probability and estimations of future losses inherent in the loan portfolio. Additionally, quarterly earnings were assisted by continued management of noninterest expense levels led to decreased expense levels, and fewer FTE's drove salary and benefit costs lower and lower accounting and professional fees. These items were partially offset by increased interest expense due to higher rates and an adverse shift in the deposit base from lower paying core deposit accounts to higher paying time deposit accounts. Also contributing to the change in earnings were decreases in revenue generated from the mortgage banking division and insurance and brokerage product lines due to lower production volumes.

Return on average assets was 0.79% for the second quarter of 2006 compared to 0.83% for the same period in 2005. Return on average assets was 0.89% for the six month period ended June 30, 2006 compared to 0.71% for the same period in 2005.

Return on average stockholders' equity was 7.93% for the second quarter of 2006 compared to 7.94% for the same period in 2005. Return on average stockholder's equity was 9.03% for the six month period ended June 30, 2006 compared to 6.73% for the same period in 2005.

Net Interest Income/ Margin

Net interest income is the difference between income earned on interest-earning assets and the interest expense incurred for the funding sources used to finance these assets. Changes in net interest income generally occur due to fluctuations in the volume of earning assets and paying liabilities and the rates earned and paid, respectively, on those assets and liabilities. The net yield on total interest-earning assets, also referred to as net interest margin, represents net interest income divided by average interest-earning assets. Net interest margin measures how efficiently the Company uses its earning assets and underlying capital. The Company's long-term objective is to manage those assets and liabilities to provide the largest possible amount of income while balancing interest rate, credit, liquidity and capital risks. For

Edgar Filing: UNIONBANCORP INC - Form 10-Q

purposes of this discussion, both net interest income and margin have been adjusted to a fully tax equivalent basis for certain tax-exempt securities and loans.

Net interest income, on a tax equivalent basis, was \$5,078 for the three months ended June 30, 2006, compared with \$5,438 earned during the same three-month period in 2005. This represented a decrease of \$360 or 6.6% from the prior year period. The change in net interest income is attributable to the

15.

UNIONBANCORP, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In Thousands, Except Per Share Data)

increase in interest expense paid on interest bearing liabilities totaling \$1,260 partially offset by an increase in interest income earned on interest earning assets totaling \$900.

The \$900 increase in interest income resulted from an increase of \$976 due to rate partially offset by a decrease of \$76 due to volume. The majority of the change in interest income was related to the increases in rates experienced from the loan and investment portfolios. Additionally, the volume within the security portfolio was \$7,049 higher for the second quarter of 2006 as compared to the same period in 2005. These increases were slightly offset by lower volume in the loan portfolio.

The \$1,260 increase in interest expense resulted from increases of \$1,182 associated with rate and \$78 associated with volume. The majority of the change was attributable to a 107 basis point increase in rates paid on time deposits, a 114 basis point increase in rates paid on money market accounts and a 68 basis point increase in rates paid on NOW accounts.

The net interest margin decreased 22 basis points to 3.37% in the second quarter 2006 as compared with 3.57% for the same period in 2005. The expectation of a flat yield curve is likely to maintain pressure on margins for the remainder of 2006.

Net interest income, on a tax equivalent basis, for the six months ended June 30, 2006 totaled \$10,392, representing a decrease of \$289 or 2.7% compared to the \$10,681 earned during the same period in 2005. Net interest income decreased largely due to the increase in interest expense paid on interest bearing liabilities totaling \$2,403 exceeding the increase in the interest income earned on interest-earning assets totaling \$2,114. The net interest margin for the first six months of 2006 decreased 12 basis points to 3.44% compared to 3.56% for the same period in 2005.

The Company's net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume change." It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds referred to as "rate change." The following table details each category of average amounts outstanding for interest-earning assets and interest-bearing liabilities, average rate earned on all interest-earning assets, average rate paid on all interest-bearing liabilities, and the net yield on average interest-earning assets. In addition, the table reflects the changes in net interest income stemming from changes in interest rates and from asset and liability volume, including mix. The change in interest attributable to both rate and volume has been allocated to the changes in the rate and the volume on a pro rata basis.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

16.

UNIONBANCORP, INC. AND SUBSIDIARIES
 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
 OPERATIONS
 (In Thousands, Except Per Share Data)

AVERAGE BALANCE SHEET
 AND ANALYSIS OF NET INTEREST INCOME

For the Three Months Ended June 30,

| | 2006 | | | 2005 | | |
|--------------------------------------|--------------------|--------------------------------|-----------------|--------------------|--------------------------------|-----------------|
| | Average Balance | Interest Income/ Expense | Average Rate | Average Balance | Interest Income/ Expense | Average Rate |
| ASSETS | | | | | | |
| Interest-earning assets | | | | | | |
| Interest-earning deposits | \$ 211 | \$ 3 | 5.70% | \$ 158 | \$ 3 | 7.62% |
| Securities (1) | | | | | | |
| Taxable | 175,260 | 2,030 | 4.64 | 164,510 | 1,484 | 3.61 |
| Non-taxable (2) | 18,317 | 318 | 6.99 | 22,018 | 399 | 7.27 |
| Total securities (tax equivalent) | 193,577 | 2,345 | 4.86 | 186,528 | 1,880 | 4.04 |
| Federal funds sold | 2,960 | 39 | 5.69 | 6,424 | 44 | 2.93 |
| Loans (3) (4) | | | | | | |
| Commercial | 111,997 | 1,981 | 7.09 | 119,364 | 2,018 | 6.79 |
| Real estate | 284,843 | 4,986 | 7.02 | 276,962 | 4,338 | 6.29 |
| Installment and other | 10,364 | 246 | 9.52 | 17,963 | 417 | 9.31 |
| Gross loans (tax equivalent) | 407,204 | 7,213 | 7.10 | 414,289 | 6,773 | 6.56 |
| Total interest- earning assets | 603,952 | 9,603 | 6.38 | 607,399 | 8,703 | 5.75 |
| Noninterest-earning assets | | | | | | |
| Cash and cash equivalents | 17,735 | | | 19,889 | | |
| Premises and equipment, net | 13,740 | | | 13,818 | | |
| Other assets | 23,285 | | | 23,975 | | |
| Total nonearning assets | 54,760 | | | 57,682 | | |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | | | | | |
|--|------------|----------|-------|------------|----------|-------|
| Total assets | \$ 658,712 | | | \$ 665,081 | | |
| | ===== | | | ===== | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Interest-bearing | | | | | | |
| liabilities | | | | | | |
| NOW accounts | \$ 69,410 | \$ 314 | 1.82% | \$ 71,981 | \$ 204 | 1.14% |
| Money market accounts | 52,834 | 360 | 2.73 | 58,944 | 234 | 1.59 |
| Savings deposits | 37,050 | 68 | 0.74 | 44,028 | 51 | 0.46 |
| Time deposits | 308,770 | 3,103 | 4.03 | 282,356 | 2,082 | 2.96 |
| Federal funds | | | | | | |
| purchased and | | | | | | |
| repurchase agreements | 3,955 | 51 | 5.17 | 4,921 | 37 | 3.02 |
| Advances from FHLB | 47,074 | 455 | 3.88 | 57,430 | 550 | 3.87 |
| Notes payable and other | 9,668 | 174 | 7.18 | 8,660 | 107 | 4.96 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total interest-bearing liabilities | 528,761 | 4,525 | 3.43 | 528,320 | 3,265 | 2.48 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Noninterest-bearing | | | | | | |
| liabilities | | | | | | |
| Noninterest-bearing deposits | 59,659 | | | 63,049 | | |
| Other liabilities | 4,843 | | | 3,860 | | |
| | ----- | | | ----- | | |
| Total noninterest-bearing liabilities | 64,502 | | | 66,909 | | |
| | ----- | | | ----- | | |
| Stockholders' equity | 65,449 | | | 69,852 | | |
| | ----- | | | ----- | | |
| Total liabilities and stockholders' equity | \$ 658,712 | | | \$ 665,081 | | |
| | ===== | | | ===== | | |
| Net interest income (tax equivalent) | | \$ 5,078 | | | \$ 5,438 | |
| | | ===== | | | ===== | |
| Net interest income (tax equivalent) to total earning assets | | | 3.37% | | | 3.59% |
| | | | ===== | | | ===== |
| Interest-bearing liabilities to earning assets | | 87.55% | | | 86.98% | |
| | | ===== | | | ===== | |

-
- (1) Average balance and average rate on securities classified as available-for-sale is based on historical amortized cost balances.
 - (2) Interest income and average rate on non-taxable securities are reflected on a tax equivalent basis based upon a statutory federal income tax rate of 34%.
 - (3) Nonaccrual loans are included in the average balances.
 - (4) Overdraft loans are excluded in the average balances.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In Thousands, Except Per Share Data)

AVERAGE BALANCE SHEET AND ANALYSIS OF NET INTEREST INCOME

For the Six Months Ended June 30,

| | 2006 | | | 2005 | | |
|-----------------------------------|--------------------|--------------------------------|-----------------|--------------------|--------------------------------|-----------------|
| | Average Balance | Interest Income/ Expense | Average Rate | Average Balance | Interest Income/ Expense | Average Rate |
| ASSETS | | | | | | |
| Interest-earning assets | | | | | | |
| Interest-earning deposits | \$ 231 | \$ 7 | 6.11% | \$ 143 | \$ 3 | 4.23% |
| Securities (1) | | | | | | |
| Taxable | 178,249 | 4,025 | 4.54 | 163,438 | 2,909 | 3.59 |
| Non-taxable (2) | 18,173 | 645 | 7.17 | 22,186 | 790 | 7.18 |
| Total securities (tax equivalent) | 196,422 | 4,663 | 4.79 | 185,624 | 3,696 | 4.02 |
| Federal funds sold | 2,263 | 52 | 5.26 | 4,051 | 53 | 2.79 |
| Loans (3) (4) | | | | | | |
| Commercial | 115,016 | 4,042 | 7.09 | 119,533 | 3,866 | 6.53 |
| Real estate | 284,405 | 9,820 | 6.96 | 277,207 | 8,517 | 6.20 |
| Installment and other | 11,173 | 526 | 9.49 | 19,169 | 865 | 9.10 |
| Gross loans (tax equivalent) | 410,594 | 14,388 | 7.07 | 415,909 | 13,248 | 6.43 |
| Total interest-earning assets | 609,510 | 19,117 | 6.32 | 605,727 | 17,003 | 5.66 |
| Noninterest-earning assets | | | | | | |
| Cash and cash equivalents | 18,126 | | | 18,729 | | |
| Premises and equipment, net | 13,791 | | | 13,630 | | |
| Other assets | 23,624 | | | 23,919 | | |
| Total nonearning assets | 55,541 | | | 56,278 | | |
| Total assets | \$ 665,051 | | | \$ 662,005 | | |

LIABILITIES AND STOCKHOLDERS' EQUITY

Interest-bearing

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | | | | | | |
|--|------------|-----------|-------|------------|-----------|-------|-------|
| liabilities | | | | | | | |
| NOW accounts | \$ 69,702 | \$ 596 | 1.73% | \$ 71,272 | \$ 369 | 1.04% | |
| Money market accounts | 54,305 | 709 | 2.63 | 58,554 | 448 | 1.54 | |
| Savings deposits | 37,790 | 122 | 0.65 | 43,661 | 113 | 0.52 | |
| Time deposits | 308,490 | 5,897 | 3.85 | 279,146 | 3,960 | 2.86 | |
| Federal funds purchased and repurchase agreements | 4,977 | 123 | 4.98 | 7,993 | 111 | 2.80 | |
| Advances from FHLB | 48,205 | 938 | 3.92 | 58,812 | 1,133 | 3.90 | |
| Notes payable and other | 10,356 | 340 | 6.62 | 8,102 | 188 | 4.68 | |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Total interest- bearing liabilities | 533,825 | 8,725 | 3.30 | 527,540 | 6,322 | 2.42 | |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Noninterest-bearing liabilities | | | | | | | |
| Noninterest-bearing deposits | 60,689 | | | 60,211 | | | |
| Other liabilities | 4,903 | | | 3,946 | | | |
| | ----- | | | ----- | | | |
| Total noninterest- bearing liabilities | 65,592 | | | 64,157 | | | |
| | ----- | | | ----- | | | |
| Stockholders' equity | 65,634 | | | 70,308 | | | |
| | ----- | | | ----- | | | |
| Total liabilities and stockholders' equity | \$ 665,051 | | | \$ 662,005 | | | |
| | ===== | | | ===== | | | |
| Net interest income (tax equivalent) | | \$ 10,392 | | | \$ 10,681 | | |
| | | ===== | | | ===== | | |
| Net interest income (tax equivalent) to total earning assets | | | 3.44% | | | 3.56% | |
| | | | ===== | | | ===== | |
| Interest-bearing liabilities to earning assets | 87.58% | | | 87.09% | | | |
| | ===== | | | ===== | | | |

-
- (1) Average balance and average rate on securities classified as available-for-sale is based on historical amortized cost balances.
 - (2) Interest income and average rate on non-taxable securities are reflected on a tax equivalent basis based upon a statutory federal income tax rate of 34%.
 - (3) Nonaccrual loans are included in the average balances.
 - (4) Overdraft loans are excluded in the average balances.

18.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS

(In Thousands, Except Per Share Data)

Provision for Loan Losses

The Company recorded a negative provision of \$300 to the allowance for loan losses for the second quarter of 2006 which is a decrease of \$300 from the

Edgar Filing: UNIONBANCORP INC - Form 10-Q

\$0 recorded during the same period a year ago. A negative \$1,100 provision for the loan losses was charged to operation expense for the six months ended June 30, 2006 which was a decrease of \$1,200 from \$100 recorded during the same period a year ago. The decrease in the provision was largely based on continued improvements in the quality of the loan portfolio, favorable loan loss experience and management's beliefs regarding the probability and estimations of future losses inherent in the loan portfolio. Nonperforming loans decreased \$1,029 from \$3,835 as of June 30, 2005 to \$2,806 as of June 30, 2006. In comparison to December 31, 2005, nonperforming loans decreased \$1,198 from \$4,004.

Net charge-offs for the second quarter of 2006 were \$358 compared with \$789 for the comparable period in 2005. Annualized net charge-offs were 0.09% of average loans for the second quarter of 2006 compared with 0.19% of average loans for same period in 2005. Net charge-off for the six months ended June 30, 2006 were \$414 compared with \$673 for the comparable period in 2005. Annualized net charge-offs also decreased to 0.10% of average loans for the six months ended June 30, 2006 compared to 0.16% in the same period in 2005. See "Nonperforming Assets" and "Other Potential Problem Loans" for further information.

The amount of the provision for loan losses is based on management's evaluations of the loan portfolio, with particular attention directed toward nonperforming, impaired and other potential problem loans. During these evaluations, consideration is also given to such factors as management's evaluation of specific loans, the level and composition of impaired loans, other nonperforming loans, other identified potential problem loans, historical loss experience, results of examinations by regulatory agencies, results of the independent asset quality review process, the market value of collateral, the estimate of discounted cash flows, the strength and availability of guarantees, concentrations of credits, and various other factors, including concentration of credit risk in various industries and current economic conditions.

Management remains watchful of credit quality issues. Should the economic climate deteriorate from current levels, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision.

Noninterest Income

Noninterest income consists of a wide variety of fee-based revenues from bank-related service charges on deposits and mortgage revenues. Also included in this category are revenues generated by the Company's insurance, brokerage, trust and asset management product lines as well as increases in cash surrender value on bank-owned life insurance. The following table summarizes the Company's noninterest income:

19.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In Thousands, Except Per Share Data)

| Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------------------|-------|------------------------------|-------|
| 2006 | 2005 | 2006 | 2005 |
| ----- | ----- | ----- | ----- |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | | | |
|--------------------------------|----------|----------|----------|----------|
| Service charges | \$ 495 | \$ 525 | \$ 935 | \$ 1,008 |
| Trust income | 199 | 187 | 418 | 402 |
| Mortgage banking income | 281 | 364 | 527 | 704 |
| Insurance commissions and fees | 414 | 472 | 793 | 893 |
| Bank owned life insurance | 137 | 135 | 277 | 269 |
| Securities gains (losses), net | (88) | -- | (88) | -- |
| Gain on the sale of assets | (9) | 1 | (9) | 3 |
| Other income | 268 | 347 | 604 | 602 |
| | ----- | ----- | ----- | ----- |
| | \$ 1,697 | \$ 2,031 | \$ 3,457 | \$ 3,881 |
| | ===== | ===== | ===== | ===== |

Noninterest income totaled \$1,697 for the three months ended June 30, 2006, compared to \$2,031 for the same period in 2005. Exclusive of the net gains on sale of assets and net securities gains for both periods, noninterest income equaled \$1,794 for the three months ended June 30, 2006, compared to \$2,030 for the same period in 2005. This represented a decrease of \$236 or 11.6%. The quarter-over-quarter decrease was primarily attributable to a production level decrease in revenue generated from the mortgage banking division, lower brokerage and insurance revenue and losses related to investment activity.

Noninterest income totaled \$3,457 for the six months ended June 30, 2006, compared to \$3,881 for the same time frame in 2005. Excluding all net gains on sale of assets and net securities gains for both periods, noninterest income decreased \$324 or 8.4%. The change was largely reflective of the same items discussed regarding the second quarter.

Noninterest Expense

Noninterest expense is comprised primarily of compensation and employee benefits, occupancy and other operating expense. The following table summarizes the Company's noninterest expense:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------------|--------------------------------|----------|------------------------------|-----------|
| | 2006 | 2005 | 2006 | 2005 |
| | ----- | ----- | ----- | ----- |
| Salaries and employee benefits | \$ 2,910 | \$ 3,366 | \$ 5,955 | \$ 6,842 |
| Occupancy expense, net | 346 | 385 | 789 | 779 |
| Furniture and equipment expense | 521 | 461 | 1,033 | 885 |
| Marketing | 98 | 128 | 209 | 224 |
| Supplies and printing | 65 | 86 | 162 | 163 |
| Telephone | 118 | 106 | 235 | 213 |
| Other real estate owned expense | 2 | 29 | 8 | 34 |
| Amortization of intangible assets | 43 | 43 | 87 | 87 |
| Other expenses | 1,026 | 1,023 | 1,985 | 1,946 |
| | ----- | ----- | ----- | ----- |
| | \$ 5,129 | \$ 5,627 | \$ 10,463 | \$ 11,173 |
| | ===== | ===== | ===== | ===== |

Noninterest expense totaled \$5,129 for the three months ended June 30, 2006, as compared to \$5,627 for the same period in 2005. This represented a decrease of \$498 or 8.9%. This improvement in noninterest expense was primarily due to the reduction of salary and benefit costs, and lower accounting and professional fees. These savings were offset by a modest increase in furniture

Edgar Filing: UNIONBANCORP INC - Form 10-Q

and fixture expense.

20.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS

(In Thousands, Except Per Share Data)

Noninterest expense totaled \$10,463 for the six months ended June 30, 2006, decreasing by \$710 or 6.4% from the same period in 2005. The change was largely reflective of the same items discussed regarding the second quarter.

Applicable Income Taxes

Income tax expense for the periods included benefits for tax-exempt income, tax-advantaged investments and general business tax credits offset by the effect of nondeductible expenses. The following table shows the Company's income before income taxes, as well as applicable income taxes and the effective tax rate for the three and six months ended June 30, 2006 and 2005.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------|--------------------------------|----------|------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| Income before income taxes | \$ 1,819 | \$ 1,684 | \$ 4,228 | \$ 2,973 |
| Applicable income taxes | 525 | 302 | 1,288 | 627 |
| Effective tax rates | 28.9% | 17.9% | 30.5% | 21.1% |

The Company recorded an income tax expense of \$525 and of \$302 for the three months ended June 30, 2006 and 2005, respectively. Effective tax rates equaled 28.9% and 17.9% respectively, for such periods. During the second quarter of 2005, the Company recorded a \$251 reduction in state income taxes due to the receipt of a tax refund related to amended returns outstanding from prior years. Excluding this refund, the effective tax rate would have been 32.8% for that period.

Income tax expense for the periods included benefits for tax-exempt income, tax-advantaged investments and general business tax credits offset by the effect of nondeductible expenses. The Company's effective tax rate was lower than statutory rates due to the Company deriving interest income from municipal securities and loans, which are exempt from federal tax and certain U. S. government agency securities, which are exempt from Illinois State tax. Additionally, the Company has reduced tax expense through various tax planning initiatives.

The Company recorded income tax expense of \$1,288 and \$627 for the six months ended June 30, 2006 and 2005, respectively. Effective tax rates equaled 30.5% and 21.1% respectively, for such periods.

Preferred Stock Dividends

The Company paid \$52 in preferred stock dividends for the three months ended June 30, 2006 and 2005, respectively. The Company paid \$104 in preferred stock dividends for the six months ended June 30, 2006 and 2005, respectively.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

Interest Rate Sensitivity Management

The business of the Company and the composition of its balance sheet consist of investments in interest-earning assets (primarily loans and securities) which are primarily funded by interest-bearing liabilities (deposits and borrowings). All of the financial instruments of the Company are for other than trading purposes. Such financial instruments have varying levels of sensitivity to changes in market rates of interest. The operating income and net income of the Bank depends, to a substantial extent, on "rate differentials," i.e., the differences between the income the Bank receives from loans,

21.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In Thousands, Except Per Share Data)

securities, and other earning assets and the interest expense they pay to obtain deposits and other liabilities. These rates are highly sensitive to many factors that are beyond the control of the Bank, including general economic conditions and the policies of various governmental and regulatory authorities.

The Company measures its overall interest rate sensitivity through a net interest income analysis. The net interest income analysis measures the change in net interest income in the event of hypothetical changes in interest rates. This analysis assesses the risk of changes in net interest income in the event of a sudden and sustained 100 to 200 basis point increase in market interest rates or a 100 basis point decrease in market rates. The interest rates scenarios are used for analytical purposes and do not necessarily represent management's view of future market movements. The tables below present the Company's projected changes in net interest income for the various rate shock levels at June 30, 2006 and December 31, 2005, respectively:

| June 30, 2006 | | | | | |
|------------------------|--------|--------|--------|---------|--------|
| Net Interest Income | | | | | |
| Amount | Change | | Change | | |
| (Dollars in Thousands) | | | | | |
| +200 bp | \$ | 23,116 | \$ | 347 | 1.52% |
| +100 bp | | 23,013 | | 244 | 1.07 |
| Base | | 22,769 | | -- | -- |
| -100 bp | | 22,412 | | (357) | (1.57) |
| -200 bp | | 21,339 | | (1,430) | (6.28) |

Based upon the Company's model at June 30, 2006, the effect of an immediate 200 basis point increase in interest rates would increase the Company's net interest income by \$347 or 1.52%. The effect of an immediate 200 basis point decrease in rates would decrease the Company's net interest income by \$1,430 or 6.28%.

December 31, 2005

Net Interest Income

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | Amount ----- | Change ----- | Change ----- |
|------------------------|-----------------|-----------------|-----------------|
| (Dollars in Thousands) | | | |
| +200 bp | \$ 23,043 | \$ 959 | 4.34% |
| +100 bp | 22,629 | 545 | 2.47 |
| Base | 22,084 | -- | -- |
| -100 bp | 21,314 | (770) | (3.49) |
| -200 bp | 19,744 | (2,340) | (10.59) |

Based upon the Company's model at December 31, 2005, the effect of an immediate 200 basis point increase in interest rates would increase the Company's net interest income by \$959 or 4.34%. The effect of an immediate 200 basis point decrease in rates would decrease the Company's net interest income by \$2,340 or 10.59%.

22.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In Thousands, Except Per Share Data)

Financial Condition

General

As of June 30, 2006, the Company had total assets of \$656,831, total gross loans of \$403,455, total deposits of \$522,695 and total stockholders' equity of \$65,304. Total assets decreased by \$19,391 or 2.9% from year-end 2005. Total gross loans decreased by \$14,070 or 3.4% from year-end 2005. Total deposits declined by \$21,146 or 3.9% from year-end 2005.

Nonperforming Assets

The Company's financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on its loan portfolio, unless a loan is placed on nonaccrual status. Loans are placed on nonaccrual status when there are serious doubts regarding the collectibility of all principal and interest due under the terms of the loans. Amounts received on nonaccrual loans generally are applied first to principal and then to interest after all principal has been collected. It is the policy of the Company not to renegotiate the terms of a loan because of a delinquent status. Rather, a loan is generally transferred to nonaccrual status if it is not in the process of collection and is delinquent in payment of either principal or interest beyond 90 days. Loans that are 90 days delinquent but are well secured and in the process of collection are not included in nonperforming assets. Other nonperforming assets consist of real estate acquired through loan foreclosures or other workout situations and other assets acquired through repossessions.

The classification of a loan as nonaccrual does not necessarily indicate that the principal is uncollectible, in whole or in part. The Bank makes a determination as to collectibility on a case-by-case basis. The Bank considers both the adequacy of the collateral and the other resources of the borrower in determining the steps to be taken to collect nonaccrual loans. The final determination as to the steps taken is made based upon the specific facts of each situation. Alternatives that are typically considered to collect nonaccrual loans are foreclosure, collection under guarantees, loan restructuring, or judicial collection actions.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

Each of the Company's loans is assigned a rating based upon an internally developed grading system. A separate credit administration department also reviews grade assignments on an ongoing basis. Management continuously monitors nonperforming, impaired, and past due loans to prevent further deterioration of these loans. The Company has an independent loan review function which is separate from the lending function and is responsible for the review of new and existing loans.

23.

UNIONBANCORP, INC. AND SUBSIDIARIES
 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
 (In Thousands, Except Per Share Data)

The following table summarizes nonperforming assets and loans past due 90 days or more and still accruing for the previous five quarters.

| | 2006 | | | 2005 |
|--|-----------------|-----------------|-----------------|-----------------|
| | Jun 30, | Mar 31, | Dec 31, | Sept |
| Non-accrual loans | \$ 2,289 | \$ 2,785 | \$ 3,082 | \$ 2,835 |
| Loans 90 days past due and still accruing interest | 517 | 567 | 922 | 1,004 |
| Total nonperforming loans | 2,806 | 3,352 | 4,004 | 3,839 |
| Other real estate owned | 1,390 | 536 | 203 | 1,004 |
| Total nonperforming assets | \$ 4,196 | \$ 3,888 | \$ 4,207 | \$ 4,843 |
| Nonperforming loans to total end of period loans | 0.70% | 0.82% | 0.96% | 0.95% |
| Nonperforming assets to total end of period loans | 1.04 | 0.96 | 1.01 | 1.00 |
| Nonperforming assets to total end of period assets | 0.64 | 0.59 | 0.62 | 0.62 |

The level of nonperforming loans at June 30, 2006 decreased to \$2,806 versus the \$4,004 that existed as of December 31, 2005 and from \$3,835 at June 30, 2005. The level of nonperforming loans to total end of period loans was 0.70% at June 30, 2006, as compared to 0.96% at December 31, 2005 and 0.95% at June 30, 2005. The reserve coverage ratio (allowance to nonperforming loans) was reported at 244.05% as of June 30, 2006 as compared to 208.84% as of December 31, 2005 and 238.83% as of June 30, 2005.

Other Potential Problem Loans

The Company has other potential problem loans that are currently performing, but where some concerns exist as to the ability of the borrower to comply with present loan repayment terms. Excluding nonperforming loans and loans that management has classified as impaired, these other potential problem loans totaled \$1,218 at June 30, 2006, as compared to \$6,857 at June 30, 2005 and \$2,879 at December 31, 2005. The classification of these loans, however, does not imply that management expects losses on each of these loans, but believes that a higher level of scrutiny and close monitoring is prudent under the circumstances. Such classifications relate to specific concerns for each individual borrower and do not relate to any concentration risk common to all loans in this group.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

Allowance for Loan Losses

At June 30, 2006, the allowance for loan losses was \$6,848 or 1.70% of total loans as compared to \$8,362 or 2.00% at December 31, 2005, and \$9,159 or 2.26% at June 30, 2005. The decrease in the allowance was largely based on continued improvements in the quality of the loan portfolio, favorable loan loss experience and management's beliefs regarding the probability and estimations of future losses inherent in the loan portfolio. In originating loans, the Company recognizes that credit losses will be experienced and the risk of loss will vary with, among other things, general economic conditions; the type of loan being made; the creditworthiness of the borrower over the term of the loan; and, in the case of a collateralized loan, the quality of the collateral for such a loan. The allowance for loan losses represents the Company's estimate of the allowance necessary to provide for probable incurred losses in the loan portfolio. In making this determination, the Company analyzes the ultimate collectibility of the loans in its portfolio, incorporating feedback provided by internal loan staff, the independent loan review function, and information provided by examinations performed by regulatory agencies. The Company makes an ongoing evaluation as to the adequacy of the allowance for loan losses.

24.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS
(In Thousands, Except Per Share Data)

On a quarterly basis, management reviews the adequacy of the allowance for loan losses. Commercial credits are graded by the loan officers and the Loan Review function validates the officers' grades. In the event that the loan review function downgrades the loan, it is included in the allowance analysis at the lower grade. The grading system is in compliance with the regulatory classifications and the allowance is allocated to the loans based on the regulatory grading, except in instances where there are known differences (i.e., collateral value is nominal, etc.). To establish the appropriate level of the allowance, a sample of loans (including impaired and nonperforming loans) are reviewed and classified as to potential loss exposure.

Based on an estimation computed pursuant to the requirements of Financial Accounting Standards Board ("FASB") Statement No. 5, "Accounting for Contingencies," and FASB Statements Nos. 114 and 118, "Accounting by Creditors for Impairment of a Loan," the analysis of the allowance for loan losses consists of three components: (i) specific credit allocation established for expected losses resulting from analysis developed through specific credit allocations on individual loans for which the recorded investment in the loan exceeds its fair value; (ii) general portfolio allocation based on historical loan loss experience for each loan category; and (iii) subjective reserves based on general economic conditions as well as specific economic factors in the markets in which the Company operates.

The specific credit allocation component of the allowance for loan losses is based on a regular analysis of loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. The fair value of the loan is determined based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the market price of the loan, or, if the loan is collateral dependent, the fair value of the underlying collateral less cost of sale.

The general portfolio allocation component of the allowance for loan losses is determined statistically using a loss migration analysis that examines

Edgar Filing: UNIONBANCORP INC - Form 10-Q

historical loan loss experience. The loss migration analysis is performed quarterly and loss factors are updated regularly based on actual experience. The general portfolio allocation element of the allowance for loan losses also includes consideration of the amounts necessary for concentrations and changes in portfolio mix and volume.

The allowance for loan losses is based on estimates, and ultimate losses will vary from current estimates. These estimates are reviewed monthly, and as adjustments, either positive or negative, become necessary, a corresponding increase or decrease is made in the provision for loan losses. The composition of the loan portfolio has not significantly changed since year-end 2004. The methodology used to determine the adequacy of the allowance for loan losses is consistent with prior years, and there were no reallocations.

Management remains watchful of credit quality issues. Should the economic climate deteriorate from current levels, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision.

Liquidity

The Company manages its liquidity position with the objective of maintaining sufficient funds to respond to the needs of depositors and borrowers and to take advantage of earnings enhancement opportunities. In addition to the normal inflow of funds from core-deposit growth together with repayments and maturities of loans and investments, the Company utilizes other short-term funding sources such as brokered time deposits, securities sold under agreements to repurchase, overnight federal funds purchased from correspondent banks and the acceptance of short-term deposits from public entities, and Federal Home Loan Bank advances.

25.

UNIONBANCORP, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In Thousands, Except Per Share Data)

The Company monitors and manages its liquidity position on several bases, which vary depending upon the time period. As the time period is expanded, other data is factored in, including estimated loan funding requirements, estimated loan payoffs, investment portfolio maturities or calls, and anticipated depository buildups or runoffs.

The Company classifies all of its securities as available-for-sale, thereby maintaining significant liquidity. The Company's liquidity position is further enhanced by structuring its loan portfolio interest payments as monthly and by the significant representation of retail credit and residential mortgage loans in the Company's loan portfolio, resulting in a steady stream of loan repayments. In managing its investment portfolio, the Company provides for staggered maturities so that cash flows are provided as such investments mature.

The Company's cash flows are comprised of three classifications: cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities. Cash flows provided by operating activities and investing activities offset by those used in financing activities, resulted in a net increase in cash and cash equivalents of \$5,907 from December 31, 2005 to June 30, 2006.

During the first six months of 2006, the Company experienced net cash in flows of \$3,931 in operating activities due to negative provision and net

Edgar Filing: UNIONBANCORP INC - Form 10-Q

income and \$16,854 in investing activities largely due to the decrease in net loans and securities. In contrast, net cash outflow of \$14,878 in financing activities primarily due to a decrease in deposits and borrowed funds.

Contractual Obligations, Commitments, Contingencies, and Off-Balance Sheet Financial Instruments

The Company has entered into contractual obligations and commitments and off-balance sheet financial instruments. The following tables summarize the Company's contractual cash obligations and other commitments and off balance sheet instruments as of June 30, 2006.

| Contractual Obligations | Payments Due by Period | | | |
|---|------------------------|------------------|------------------|------------------|
| | Within 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
| Short-term debt | \$ 8,824 | \$ -- | \$ -- | \$ -- |
| Long-term debt | -- | 224 | -- | -- |
| Certificates of Deposit | 233,681 | 70,547 | 618 | 2,000 |
| Series B Mandatory redeemable Preferred stock | -- | 831 | -- | -- |
| FHLB Advances | 10,100 | 20,400 | 16,200 | -- |
| Total contractual cash obligations | \$ 252,605 | \$ 92,002 | \$ 16,818 | \$ 2,000 |

| Off-Balance Sheet Financial Instruments | Amount of Commitment Expiration per Period | | | |
|---|--|-----------------|-----------------|------------------|
| | Within 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
| Lines of credit | \$ 89,058 | \$ 4,130 | \$ 1,287 | \$ 16,000 |
| Standby letters of credit | 7,764 | 792 | -- | -- |
| Total commercial commitments | \$ 96,822 | \$ 4,922 | \$ 1,287 | \$ 16,000 |

26.

UNIONBANCORP, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (In Thousands, Except Per Share Data)

If the announced merger between UnionBancorp, Inc. and Centru Financial Corporation (NASDAQ: TRUE) is terminated, UnionBancorp, Inc is required to fulfill the certain specified obligations to make certain payments to Centru Financial Corporation as described below:

- o If the merger agreement is terminated by Centru because UnionBancorp has not satisfied its conditions or the closing has not occurred by March 1, 2007 and UnionBancorp knowingly breached its covenants, agreements, representations or warranties under the merger agreement

Edgar Filing: UNIONBANCORP INC - Form 10-Q

(unless such breach is a result of the failure by Centrue to perform and comply with any of its obligations) then, provided Centrue is in compliance with its obligations under the merger agreement, UnionBancorp must pay \$2,700,000 to Centrue.

- o If the merger agreement is terminated by UnionBancorp or Centrue because UnionBancorp's stockholders fail to approve the merger (a "UnionBancorp Stockholder Termination"); then, provided Centrue is in compliance with its obligations under the merger agreement, UnionBancorp must pay \$500,000 to Centrue.
- o In addition to the \$500,000 payment described above (if any), if there is a UnionBancorp Stockholder Termination and, within twelve months after such UnionBancorp Stockholder Termination, UnionBancorp enters into an agreement with any party other than Centrue providing for the acquisition of UnionBancorp, then, provided Centrue was in compliance with its obligations under the merger agreement, UnionBancorp must pay \$2,200,000 to Centrue.
- o If UnionBancorp terminates the merger agreement as a result of a Superior UnionBancorp Proposal, then UnionBancorp must pay \$2,700,000 to Centrue.

Capital Resources

Stockholders' Equity

The Company is committed to managing capital for maximum shareholder benefit and maintaining strong protection for depositors and creditors. Stockholders' equity at June 30, 2006 was \$65,304, a decrease of \$771 or 1.2%, from December 31, 2005. The decrease in stockholders' equity was the result of the dividends paid to shareholders and a decrease in accumulated other comprehensive income partially offset by net income for the period. Average quarterly equity as a percentage of average quarterly assets was 9.94% at June 30, 2006, compared to 10.39% at December 31, 2005. Book value per common share equaled \$17.31 at June 30, 2006 compared to \$17.23 at December 31, 2005.

Stock Repurchase

On May 2, 2003, the Board of Directors approved a stock repurchase plan whereby the Company may repurchase from time to time up to 5% of its outstanding shares of common stock in the open market or in private transactions over an 18 month period. On September 23, 2004, the Board of Directors extended the Company's stock repurchase program through May 2, 2006. On June 16, 2005, the Board of Directors amended the repurchase plan to enable the Company to acquire an additional 5% of its outstanding shares of common stock in the open market or in private transactions. On March 16, 2006, the Board of Directors approved an additional 5% stock repurchase program that begins when the existing plan is completed. Under the revised plan, the Company can repurchase approximately 188,000 shares of its outstanding shares of common stock. Under the terms of the plan, the Company is able to repurchase, from time to time, up to 5% of its

27.

UNIONBANCORP, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS

(In Thousands, Except Per Share Data)

outstanding shares of common stock in the open market or in private

Edgar Filing: UNIONBANCORP INC - Form 10-Q

transactions. Purchases are dependent upon market conditions and the availability of shares. The extension of the repurchase program enables the Company to optimize its use of capital relative to other investment alternatives and benefits both the Company and the shareholders by enhancing earnings per share and return on equity. During the quarter ending June 30, 2006, no shares were repurchased and to date, the Company has repurchased 364,879 shares at a weighted average cost of \$21.16.

Capital Measurements

The Company is expected to meet a minimum risk-based capital to risk-weighted assets ratio of 8%, of which at least one-half (or 4%) must be in the form of Tier 1 (core) capital. The remaining one-half (or 4%) may be in the form of Tier 1 (core) or Tier 2 (supplementary) capital. The amount of loan loss allowance that may be included in capital is limited to 1.25% of risk-weighted assets. The ratio of Tier 1 (core) and the combined amount of Tier 1 (core) and Tier 2 (supplementary) capital to risk-weighted assets for the Company was 12.4% and 13.7%, respectively, at June 30, 2006. The Company is currently, and expects to continue to be, in compliance with these guidelines.

The following table sets forth an analysis of the Company's capital ratios:

| | June 30, 2006 | December 31, ----- 2005 2004 ----- | | Minimum Capital Ratios ----- | Well Capitali Ratios ----- |
|---------------------------|------------------|--|-----------|---------------------------------------|-------------------------------------|
| Tier 1 risk-based capital | \$ 61,130 | \$ 60,546 | \$ 63,347 | | |
| Tier 2 risk-based capital | 6,144 | 6,266 | 6,067 | | |
| Total capital | 67,274 | 66,812 | 69,414 | | |
| Risk-weighted assets | 491,503 | 501,342 | 485,325 | | |
| Capital ratios | | | | | |
| Tier 1 risk-based capital | 12.4% | 12.1% | 13.0% | 4.00% | 6. |
| Tier 2 risk-based capital | 13.7 | 13.3 | 14.3 | 8.00 | 10. |
| Leverage ratio | 9.4 | 9.0 | 9.5 | 4.00 | 5. |

Impact of Inflation, Changing Prices, and Monetary Policies

The financial statements and related financial data concerning the Company have been prepared in accordance with U.S. generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, changes in interest rates have a more significant effect on the performance of a financial institution than do the effects of changes in the general rate of inflation and changes in prices. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Interest rates are highly sensitive to many factors which are beyond the control of the Company, including the influence of domestic and foreign economic conditions and the monetary and fiscal policies of the United States government and federal agencies, particularly the Federal Reserve Board.

Edgar Filing: UNIONBANCORP INC - Form 10-Q

UNIONBANCORP, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(In Thousands, Except Per Share Data)

Recent Regulatory and Accounting Developments

In February, 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - An Amendment of FASB Statement No. 133 and 140" ("SFAS155"). SFAS 155 simplifies the accounting for certain hybrid financial instruments that contain an embedded derivative that otherwise would have required bifurcation. SFAS 155 also eliminates the interim guidance in FASB Statement No. 133, which provides that beneficial interest in securitized financial assets are not subject to the provisions of FASB Statement No. 133. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006, which for the Company will be as of the beginning of fiscal 2007. The Company does not believe that the adoption of SFAS 155 will have a significant effect on its financial statements as the Company does not have any hybrid financial instruments at this time.

In March, 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets - An Amendment of FASB Statement No. 140" ("SFAS 156"). SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. SFAS 156 is effective as of the beginning of the entity's first fiscal year that begins after September 15, 2006. The Company is currently evaluating any potential impact of the adoption of this SFAS.

In June, 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An interpretation of FASB No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of the adoption of FIN 48, with respect to its results of operations, financial position and liquidity.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The information required by this Item 3 is incorporated by reference from the discussion on page 21 of this Form 10-Q under the caption "Interest Rate Sensitivity Management" and the discussion on page 28 under the caption "Impact of Inflation, Changing Prices, and Monetary Policies."

Item 4. Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended). Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic filings with the Securities and Exchange Commission. It should be noted that in designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well

Edgar Filing: UNIONBANCORP INC - Form 10-Q

designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. The Company has designed its disclosure controls and procedures to reach a level of reasonable assurance of achieving the desired control objectives and, based on the evaluation described above, the Company's Chief

29.

UNIONBANCORP, INC. AND SUBSIDIARIES
 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
 (In Thousands, Except Per Share Data)

 Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at reaching that level of reasonable assurance.

There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

30.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In the normal course of business the Company may be involved in various legal proceedings from time to time. The Company does not believe it is currently involved in any claim or action the ultimate disposition of which would have a material adverse effect on the Company's financial statements.

Item 1A. Risk Factors

The Company did not experience any material changes in the Risk Factors during the Company's most recently completed fiscal quarter. For specific information about the risks facing the Company refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

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

The following table provides information about purchases of the Company's common stock by the Company during the quarter ended June 30, 2006.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs |
|---------------------|----------------------------------|------------------------------|--|
| 04/01/06 - 04/30/06 | -- | -- | -- |

Edgar Filing: UNIONBANCORP INC - Form 10-Q

| | | | |
|------------|----|----|----|
| 05/01/06 - | -- | -- | -- |
| 05/31/06 | | | |
| 06/01/06 - | -- | -- | -- |
| 06/30/06 | | | |
| Total (1) | -- | -- | -- |

- (1) The Company did not repurchase any stock during the quarter ended June 30, 2006. The current repurchase program approved on March 23, 2006 provides for the repurchase by us of an additional 5% of the outstanding shares of our common stock. The expiration date of this program is September 23, 2007. Unless terminated earlier by resolution of our board of directors, the program will expire on the earlier of such expiration date or when we have repurchased all shares authorized for repurchase under the program.

Item 3. Defaults Upon Senior Securities

None.

31.

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

At the April 25, 2006 annual meeting of stockholders, Robert J. Doty, I. J. Reinhardt, Jr. and Scott A. Yeoman were elected to serve as Class II directors until 2009. Continuing as Class III directors until 2007 are Dennis J. McDonnell, John A. Shinkle and Scott C. Sullivan. Continuing as Class I directors until 2008 are Richard J. Berry, Walter E. Breipohl, and John A. Trainor.

There were 3,762,876 issued and outstanding shares of common stock entitled to vote at the annual meeting. The voting on each item presented at the annual meeting was as follows:

| | For | Withheld |
|-----------------------|-----------|----------|
| | ----- | ----- |
| Election of Directors | | |
| Robert J. Doty | 3,455,405 | 8,317 |
| I. J. Reinhardt, Jr. | 3,456,405 | 7,317 |
| Scott A. Yeoman | 3,446,839 | 16,883 |

Item 5. Other Information

None.

Item 6. Exhibits

Exhibits:

- 2.1 Agreement and Plan of Merger between UnionBancorp, Inc and Centru Financial Corporation (incorporated by reference from current report on form 8-K filed on July 7, 2006).
- 4.1 Amendment No. 1 to rights agreement (incorporated by reference

Edgar Filing: UNIONBANCORP INC - Form 10-Q

from current report on form 8-K filed on July 7, 2006).

- 10.1 UnionBancorp voting agreement (incorporated by reference from current report of form 8-K filed on July 7, 2006).
- 10.2 Centrue voting agreement (incorporated by reference from current report of form 8-K filed on July 7, 2006).
- 31.1 Certification of Scott A. Yeoman, President and Principal Executive Officer, required by Rule 13a - 14(a).
- 31.2 Certification of Kurt R. Stevenson, Senior Executive Vice President and Principal Financial and Accounting Officer required by Rule 13a - 14(a).
- 32.1(1) Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, from the Company's President and Principal Executive Officer.
- 32.2(1) Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, from the Company's Senior Executive Vice President and Principal Financial and Accounting Officer.

(1) This certification is not "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

32.

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.

UNIONBANCORP, INC.

Date: August 11, 2006

By: /s/ SCOTT A. YEOMAN

Scott A. Yeoman
President and Principal Executive
Officer

Date: August 11, 2006

By: /s/ KURT R. STEVENSON

Kurt R. Stevenson
Senior Executive Vice President and
Principal Financial and
Accounting Officer

33.