

HOME BANCSHARES INC

Form 10-K

March 06, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549  
FORM 10-K**

(Mark One)

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Fiscal Year Ended December 31, 2008**

**or**

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 000-51904**

**HOME BANCSHARES, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Arkansas

71-0682831

(State or other jurisdiction of  
incorporation or organization)

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

719 Harkrider, Suite 100, Conway, Arkansas

72032

(Address of principal executive offices)

(Zip Code)

(501) 328-4770

(Registrant's telephone number, including area code)  
Securities registered pursuant to Section 12(b) of the Act:

None

N/A

Title of each class	Name of each exchange on which registered
Securities registered pursuant to Section 12(g) of the Act:	
Common Stock, par value \$0.01 per share	
(Title of Class)	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting

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company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's common stock, par value \$0.01 per share, held by non-affiliates on June 30, 2008, was \$266.4 million based upon the last trade price as reported on the NASDAQ Global Select Market of \$20.81 (8% stock dividend adjusted).

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

Common Stock Issued and Outstanding: 19,864,647 shares as of February 25, 2009.

Documents incorporated by reference: Part III is incorporated by reference from the registrant's Proxy Statement relating to its 2009 Annual Meeting to be held on April 23, 2009.

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**HOME BANCSHARES, INC.**  
**FORM 10-K**  
**December 31, 2008**  
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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Some of our statements contained in this document, including matters discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operation are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements relate to future events or our future financial performance and include statements about the competitiveness of the banking industry, potential regulatory obligations, our entrance and expansion into other markets, our other business strategies and other statements that are not historical facts. Forward-looking statements are not guarantees of performance or results. When we use words like may, plan, contemplate, anticipate, believe, intend, continue, expect, project, predict, estimate, could, should, or other expressions, you should consider them as identifying forward-looking statements, although we may use other phrasing. These forward-looking statements involve risks and uncertainties and are based on our beliefs and assumptions, and on the information available to us at the time that these disclosures were prepared. These forward-looking statements involve risks and uncertainties and may not be realized due to a variety of factors, including, but not limited to, the following:

the effects of future economic conditions, including inflation or a continued decrease in residential housing values;

governmental monetary and fiscal policies, as well as legislative and regulatory changes;

the risks of changes in interest rates or the level and composition of deposits, loan demand and the values of loan collateral, securities and interest sensitive assets and liabilities;

the effects of terrorism and efforts to combat it;

credit risks;

the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally and internationally, together with competitors offering banking products and services by mail, telephone and the Internet;

the effect of any mergers, acquisitions or other transactions to which we or our subsidiaries may from time to time be a party, including our ability to successfully integrate any businesses that we acquire; and

the failure of assumptions underlying the establishment of our allowance for loan losses.

All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this Cautionary Note. Our actual results may differ significantly from those we discuss in these forward-looking statements. For other factors, risks and uncertainties that could cause our actual results to differ materially from estimates and projections contained in these forward-looking statements, see Risk Factors.

**PART I**

**Item 1. BUSINESS**

**Home BancShares**

We are a Conway, Arkansas headquartered bank holding company registered under the federal Bank Holding Company Act of 1956. In 1998, an investor group led by John W. Allison, our Chairman and CEO, and Robert H.

Bunny Adcock, Jr., our Vice Chairman formed Home BancShares, Inc. After obtaining a bank charter, we established First State Bank in Conway, Arkansas, in 1999. We acquired and integrated Community Bank, Bank of Mountain View and Centennial Bank in 2003, 2005 and 2008, respectively. Home BancShares and its founders were also involved in the formation of Twin City Bank and Marine Bank, both of which we acquired and integrated in 2005.



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Our bank subsidiaries provide a broad range of commercial and retail banking and related financial services to businesses, real estate developers and investors, individuals and municipalities. They have locations in central Arkansas, north central Arkansas, southern Arkansas, the Florida Keys and southwestern Florida.

During 2008, we announced plans to combine the charters of our banks into a single charter and adopt Centennial Bank as the common name. This combination is in process and is expected to be completed by the middle of 2009.

We acquire, organize and invest in community banks that serve attractive markets. Our community banking team is built around experienced bankers with strong local relationships.

The Company's common stock is traded through the NASDAQ Global Select Market under the symbol HOMB.

### **Our Bank Subsidiaries and Investments**

We believe that many individuals and businesses prefer banking with a locally managed community bank capable of providing flexibility and quick decisions. The execution of our community banking strategy has allowed us to rapidly build our network of bank subsidiaries.

*Centennial Bank (Formerly First State Bank)* - In October 1998, we acquired Holly Grove Bancshares, Inc. for the purpose of obtaining a bank charter. Following the purchase, we changed the name of the bank subsidiary to First State Bank and relocated the charter to Conway, Arkansas, to serve the central Arkansas market. In December 2008, we began the process of combining the charters of our banks and adopting Centennial Bank as the common name. During the first step in this process we changed the name of First State Bank to Centennial Bank and combined the charter of Marine Bank into this renamed First State Bank. As of December 31, 2008, we have two separately chartered banks with the same Centennial Bank name. We anticipate that our remaining bank charters will be merged into this Centennial Bank (Formerly First State Bank) charter by the middle of 2009. At December 31, 2008, Centennial Bank (Formerly First State Bank) had total assets of \$1.02 billion, total loans of \$810.8 million and total deposits of \$756.2 million.

*Twin City Bank* - In May 2000, we were the largest investor in a group that formed a holding company (subsequently renamed TCBancorp, Inc.), acquired an existing bank charter, and relocated the charter to North Little Rock, Arkansas. The holding company named its subsidiary Twin City Bank, which had been used by North Little Rock's largest bank until its sale in 1994, and hired Robert F. Birch, Jr., who had been president of the former Twin City Bank. Twin City Bank grew quickly in North Little Rock and, in 2003, expanded into the adjacent Little Rock market. In January 2005, we acquired through merger the 68% of TCBancorp's common stock we did not already own. We anticipate that Twin City Bank's charter will be merged into the Centennial Bank (Formerly First State Bank) charter during the middle of 2009. At December 31, 2008, Twin City Bank had total assets of \$723.3 million, total loans of \$530.3 million and total deposits of \$523.1 million.

*Community Bank* - In December 2003, we acquired Community Financial Group, Inc., the holding company for Community Bank of Cabot. We anticipate that Community Bank's charter will be merged into the Centennial Bank (Formerly First State Bank) charter late in the first quarter of 2009. At December 31, 2008, Community Bank had total assets of \$424.2 million, total loans of \$298.8 million and total deposits of \$294.4 million.

*Marine Bank* - In June 2005, we acquired Marine Bancorp, Inc., and its subsidiary, Marine Bank, in Marathon, Florida. Marine Bank was established in 1995. Our Chairman and Chief Executive Officer, John W. Allison, was a founding board member and the largest shareholder of Marine Bancorp, owning approximately 13.9% of its stock at the time of our acquisition. Marine Bank's charter was merged into the Centennial Bank (Formerly First State Bank) charter in December 2008.

*Bank of Mountain View* - In September 2005, we acquired Mountain View Bancshares, Inc., and its subsidiary, Bank of Mountain View. We anticipate that Bank of Mountain View's charter will be merged into the Centennial Bank (Formerly First State Bank) charter late in the first quarter of 2009. At December 31, 2008, Bank of Mountain View had total assets of \$186.6 million, total loans of \$97.6 million and total deposits of \$137.0 million.



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*Centennial Bank* - On January 1, 2008, we acquired Centennial Bancshares, Inc. and its subsidiary, Centennial Bank. We anticipate that Centennial Bank's charter will be merged into the Centennial Bank (Formerly First State Bank) charter during the middle of 2009. At December 31, 2008, Centennial Bank had total assets of \$266.5 million, total loans of \$218.7 million and total deposits of \$170.5 million.

*Investment in White River Bancshares* - In January 2005, we purchased 20% of the common stock during the formation of White River Bancshares, Inc. of Fayetteville, Arkansas for \$9.1 million. White River Bancshares owns all of the stock of Signature Bank of Arkansas, with branch locations in northwest Arkansas. In January 2006, White River Bancshares issued an additional \$15.0 million of common stock. To maintain our 20% ownership, we made an additional investment of \$3.0 million in January 2006. During April 2007, White River Bancshares acquired 100% of the stock of Brinkley Bancshares, Inc. in Brinkley, Arkansas. As a result, we made a \$2.6 million additional investment in White River Bancshares on June 29, 2007 to maintain our 20% ownership. On March 3, 2008, White River Bancshares repurchased our 20% investment in their company which resulted in a one-time gain of \$6.1 million.

**Our Management Team**

The following table sets forth, as of December 31, 2008, information concerning the individuals who are our executive officers.

<b>Name</b>	<b>Age</b>	<b>Position Held</b>	<b>Positions Held with Bank Subsidiaries</b>
John W. Allison	62	Chairman of the Board and Chief Executive Officer	Chairman of the Board, Centennial Bank (Formerly First State Bank); Director, Community Bank, Twin City Bank, Bank of Mountain View, and Centennial Bank
Ron W. Strother	60	President, Chief Operating Officer, and Director	Director, Centennial Bank (Formerly First State Bank), Community Bank, Twin City Bank, Bank of Mountain View and Centennial Bank
Randy E. Mayor	43	Chief Financial Officer and Treasurer	Director, Centennial Bank (Formerly First State Bank)
Brian S. Davis	43	Director of Financial Reporting and Investor Relations Officer	
C. Randall Sims	54	Director and Secretary	President, Chief Executive Officer, and Director, Centennial Bank (Formerly First State Bank); Director, Community Bank
Robert Hunter Padgett	50		Regional President, Centennial Bank (Formerly First State Bank)
Robert F. Birch, Jr.	58		President, Chief Executive Officer, and Director, Twin City Bank
Tracy M. French	47		President, Chief Executive Officer, and Director, Community Bank
Michael L. Waddington	65		Chief Executive Officer, and Director, Bank of Mountain View
Chris S. Roberts	40		President, Chief Executive Officer, and Director, Centennial Bank

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### **Our Growth Strategy**

Our goals are to achieve growth in earnings per share and to create and build shareholder value. Our growth strategy entails the following:

*Organic growth* - We believe that our current branch network provides us with the capacity to grow within our existing market areas. Thirty-six of our 63 branches (including branches of banks we have acquired) have been opened since the beginning of 2001.

*De novo branching* - We intend to continue to open *de novo* branches in our current markets and in other attractive market areas if opportunities arise. During 2008, we opened two *de novo* branch locations. These branch locations are located in the Arkansas communities of Morrilton and Cabot. Presently, we are evaluating additional opportunities and have one firm commitment for a *de novo* branch in Heber Springs, Arkansas during the first part of 2009.

*Strategic acquisitions* - In our continuing evaluation of our growth plans for the Company, we believe properly priced bank acquisitions can complement our organic growth and *de novo* branching growth strategies. The Company's acquisition focus will be to expand in its primary market areas of Arkansas and Florida. We are continually evaluating potential bank acquisitions to determine what is in the best interest of our Company. Our goal in making these decisions is to maximize the return to our investors.

### **Community Banking Philosophy**

Our community banking philosophy consists of four basic principles:

manage our community banking franchise with experienced bankers and local boards who are empowered to make customer-related decisions quickly;

provide exceptional service and develop strong customer relationships;

pursue the business relationships of our local boards of directors, executive officers, shareholders, and customers to actively promote our community banks

Maintain our commitment to the communities we serve by supporting civic and nonprofit organizations.

### **Operating Strategy**

Our operating strategies focus on improving credit quality, increasing profitability, finding experienced bankers, and leveraging our infrastructure:

*Emphasis on credit quality* - Credit quality is our first priority in the management of our bank subsidiaries. We employ a set of credit standards across our bank subsidiaries that are designed to ensure the proper management of credit risk. Our management team plays an active role in monitoring compliance with these credit standards at each of our bank subsidiaries. We have a centralized loan review process and regularly monitor each of our bank subsidiaries' loan portfolios, which we believe enables us to take prompt action on potential problem loans.

*Continue to improve profitability* - We intend to improve our profitability as we leverage the available capacity of our newer branches and employees. We believe our investments in our branch network and centralized technology infrastructure is sufficient to support a larger organization, and therefore believe future increases in our expenses should be lower than the corresponding increases in our revenues.

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*Attract and motivate experienced bankers* - We believe a major factor in our success has been our ability to attract and retain bankers who have experience in and knowledge of their local communities. For example, in January 2006, we hired eight experienced bankers in the Searcy, Arkansas market (located approximately 50 miles northeast of Little Rock), where we subsequently opened three new branches. In January 2009, we announced a commitment for our first de novo branch in Heber Springs, Arkansas. For this new location, we were able to attract a four person banking team. Hiring and retaining experienced relationship bankers has been integral to our ability to grow quickly when entering new markets.

*Leveraging our infrastructure* - The support services we provide to our bank subsidiaries are generally centralized in Conway, Arkansas. These services include finance and accounting, internal audit, compliance, loan review, human resources, training, and data processing. In 2008, management of Home BancShares, Inc. approved the combining of all six of the Company's individually chartered banks into one charter. The six banks will adopt Centennial Bank as their common name. We will complete the process in the summer of 2009. All of the banks will, at that time, have the same name, logo and charter allowing for a more customer-friendly banking experience and seamless transactions across our entire banking network.

**Our Market Areas**

As of December 31, 2008, we conducted business principally through 45 Arkansas branches located in central Arkansas, 2 branches in north central Arkansas, four branches in southern Arkansas, nine branches in the Florida Keys and three branches in southwestern Florida. Our branch footprint includes markets in which we are the deposit market share leader as well as markets where we believe we have significant opportunities for deposit market share growth.

**Lending Activities**

We originate loans primarily secured by single and multi-family real estate, residential construction and commercial buildings. In addition, we make loans to small and medium-sized commercial businesses as well as to consumers for a variety of purposes.

Our loan portfolio as of December 31, 2008, was comprised as follows:

	Amount (Dollars in thousands)	Percentage of portfolio
Real estate:		
Commercial real estate loans:		
Non-farm/non-residential	\$ 816,603	41.7%
Construction/land development	320,398	16.4
Agricultural	23,603	1.2
Residential real estate loans:		
Residential 1-4 family	391,255	20.0
Multifamily residential	56,440	2.9
Total real estate	1,608,299	82.2
Consumer	46,615	2.4
Commercial and industrial	255,153	13.0
Agricultural	23,625	1.2
Other	22,540	1.2
Total loans receivable	\$ 1,956,232	100.0%

*Real Estate Non-farm/Non-residential.* Non-farm/non-residential loans consist primarily of loans secured by real estate mortgages on income-producing properties. We make commercial mortgage loans to finance the purchase of

real property as well as loans to smaller business ventures, credit lines for working capital and inventory financing, including letters of credit, that are also secured by real estate. Commercial mortgage lending typically involves higher loan principal amounts, and the repayment of loans is dependent, in large part, on sufficient income from the properties collateralizing the loans to cover operating expenses and debt service.

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*Real Estate Construction/Land Development.* We also make construction and development loans to residential and commercial contractors and developers located primarily within our market areas. Construction loans generally are secured by first liens on real estate.

*Real Estate Residential Mortgage.* Our residential mortgage loan program primarily originates loans to individuals for the purchase of residential property. We generally do not retain long-term, fixed-rate residential real estate loans in our portfolio due to interest rate and collateral risks and low levels of profitability. Residential loans to individuals retained in our loan portfolio primarily consist of shorter-term first liens on 1-4 family residential mortgages, home equity loans and lines of credit.

*Consumer.* While our focus is on service to small and medium-sized businesses, we also make a variety of loans to individuals for personal, family and household purposes, including secured and unsecured installment and term loans.

*Commercial and Industrial.* Our commercial loan portfolio includes loans to smaller business ventures, credit lines for working capital and short-term inventory financing, as well as letters of credit that are generally secured by collateral other than real estate. Commercial borrowers typically secure their loans with assets of the business, personal guaranties of their principals and often mortgages on the principals' personal residences.

*Credit Risks.* The principal economic risk associated with each category of the loans that we make is the creditworthiness of the borrower and the ability of the borrower to repay the loan. General economic conditions and the strength of the services and retail market segments affect borrower creditworthiness. General factors affecting a commercial borrower's ability to repay include interest rates, inflation and the demand for the commercial borrower's products and services as well as other factors affecting a borrower's customers, suppliers and employees.

Risks associated with real estate loans also include fluctuations in the value of real estate, new job creation trends, tenant vacancy rates, and in the case of commercial borrowers, the quality of the borrower's management. Consumer loan repayments depend upon the borrower's financial stability and are more likely to be adversely affected by divorce, job loss, illness and other personal hardships.

*Lending Policies.* We have established common documentation and policies, based on the type of loan, for all of our bank subsidiaries. The board of directors of each bank subsidiary supplements our standard policies to meet local needs and establishes loan approval procedures for that bank. Each bank's board periodically reviews its lending policies and procedures. There are legal restrictions on the dollar amount of loans available for each lending relationship. The Arkansas Banking Code provides that no loan relationship may exceed 20% of a bank's capital.

*Loan Approval Procedures.* Our bank subsidiaries have supplemented our common loan policies to establish their own loan approval procedures as follows:

*Individual Authorities.* The board of directors of each bank establishes the authorization levels for individual loan officers on a case-by-case basis. Generally, the more experienced a loan officer, the higher the authorization level. The approval authority for individual loan officers range from \$15,000 to \$600,000 for secured loans and from \$1,000 to \$250,000 for unsecured loans.

*Officer Loan Committees.* Most of our bank subsidiaries also give their Officer Loan Committees loan approval authority. In those banks, credits in excess of individual loan limits are submitted to the appropriate bank's Officer Loan Committee. The Officer Loan Committees consist of members of the senior management team of that bank and are chaired by that bank's chief lending officer. The Officer Loan Committees have approval authority up to \$750,000 at Centennial Bank (Formerly First State Bank), \$500,000 at Community Bank, and \$1.0 million at Twin City Bank. Since Bank of Mountain View and Centennial Bank have no Officer Loan Committee, loans exceeding an officer's individual authority are approved by the Directors Loan Committee.

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*Directors Loan Committee.* Each of our bank subsidiaries has a Directors Loan Committee consisting of outside directors and senior lenders of the bank. Generally, each bank requires a majority of outside directors be present to establish a quorum. Generally, this committee is chaired either by the chief lending officer or the chief executive officer of the bank. Each bank's board of directors establishes the approval authority for this committee, which may be up to that bank's legal lending limit.

Currently, our board of directors has established an in-house consolidated lending limit of \$20.0 million to any one borrowing relationship without obtaining the approval of any two of our Chairman, our President and our director Richard H. Ashley.

### **Deposits and Other Sources of Funds**

Our principal source of funds for loans and investing in securities is core deposits. We offer a wide range of deposit services, including checking, savings, money market accounts and certificates of deposit. We obtain most of our deposits from individuals and small businesses, and municipalities in our market areas. We believe that the rates we offer for core deposits are competitive with those offered by other financial institutions in our market areas. Additionally, our policy also permits the acceptance of brokered deposits. Secondary sources of funding include advances from the Federal Home Loan Banks of Dallas and Atlanta and other borrowings. These secondary sources enable us to borrow funds at rates and terms, which, at times, are more beneficial to us.

### **Other Banking Services**

Given customer demand for increased convenience and account access, we offer a range of products and services, including 24-hour Internet banking and voice response information, cash management, overdraft protection, direct deposit, safe deposit boxes, United States savings bonds and automatic account transfers. We earn fees for most of these services. We also receive ATM transaction fees from transactions performed by our customers participating in a shared network of automated teller machines and a debit card system that our customers can use throughout the United States, as well as in other countries.

### **Insurance**

Community Insurance Agency, Inc. is an independent insurance agency, originally founded in 1959 and purchased July 1, 2000, by Community Bank. Community Insurance Agency writes policies for commercial and personal lines of business, with approximately 60% and 40% of the business coming from commercial and personal lines, respectively. It is subject to regulation by the Arkansas Insurance Department. The offices of Community Insurance Agency are located in Jacksonville, Cabot, and Conway, Arkansas.

### **Trust Services**

FirsTrust Financial Services, Inc. provides trust services, focusing primarily on personal trusts, corporate trusts and employee benefit trusts. In the fourth quarter of 2006, we made a strategic decision to enter into agent agreement for the management of our trust services to a non-affiliated third party. This change was caused by our aspiration to improve the overall profitability of our trust efforts. FirsTrust Financial Services still has ownership rights to the trust assets under management.

### **Competition**

As of December 31, 2008, we conducted business through 63 branches in our primary market areas of Pulaski, Faulkner, Lonoke, Stone, Saline, White, Dallas, Cleveland, and Conway Counties in Arkansas and Monroe, Charlotte and Collier Counties in Florida. Many other commercial banks, savings institutions and credit unions have offices in our primary market areas. These institutions include many of the largest banks operating in Arkansas and Florida, including some of the largest banks in the country. Many of our competitors serve the same counties we do. Our competitors often have greater resources, have broader geographic markets, have higher lending limits, offer various services that we may not currently offer and may better afford and make broader use of media advertising, support services and electronic technology than we do. To offset these competitive disadvantages, we depend on our reputation as having greater personal service, consistency, and flexibility and the ability to make credit and other business decisions quickly.

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### **Employees**

On December 31, 2008, we had 594 full-time equivalent employees. We expect that our staff will increase as a result of our increased branching activities anticipated in 2009. We consider our employee relations to be good, and we have no collective bargaining agreements with any employees.

### **Troubled Asset Relief Program.**

On January 16, 2009, we issued and sold, and the United States Department of the Treasury purchased, (1) 50,000 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock Series A, liquidation preference of \$1,000 per share, and (2) a ten-year warrant to purchase up to 288,129 shares of the Company's common stock, par value \$0.01 per share, at an exercise price of \$26.03 per share, for an aggregate purchase price of \$50.0 million in cash. Cumulative dividends on the Preferred Shares will accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter.

These preferred shares will qualify as Tier 1 capital. The preferred shares will be callable at par after three years. Prior to the end of three years, the preferred shares may be redeemed with the proceeds from a qualifying equity offering of any Tier 1 perpetual preferred or common stock. The Treasury must approve any quarterly cash dividend on our common stock above \$0.06 per share or share repurchases until three years from the date of the investment unless the shares are paid off in whole or transferred to a third party.

## **SUPERVISION AND REGULATION**

### **General**

We and our subsidiary banks are subject to extensive state and federal banking regulations that impose restrictions on and provide for general regulatory oversight of our company and its operations. These laws generally are intended to protect depositors, the deposit insurance fund of the Federal Deposit Insurance Corporation ( FDIC ) and the banking system as a whole, and not shareholders. The following discussion describes the material elements of the regulatory framework that applies to us.

### **Recent Regulatory Developments**

In response to global credit and liquidity issues involving a number of financial institutions, the United States government, particularly the United States Department of the Treasury (the U.S. Treasury ) and the FDIC, have taken a variety of extraordinary measures designed to restore confidence in the financial markets and to strengthen financial institutions, including capital injections, guarantees of bank liabilities and the acquisition of illiquid assets from banks.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the EESA ) was signed into law. Pursuant to the EESA, the U.S. Treasury was granted the authority to take a range of actions for the purpose of stabilizing and providing liquidity to the U.S. financial markets and has proposed several programs, including the purchase by the U.S. Treasury of certain troubled assets from financial institutions (the Troubled Asset Relief Program ) and the direct purchase by the U.S. Treasury of equity of healthy financial institutions (the Capital Purchase Program ). The EESA also temporarily raised the limit on federal deposit insurance coverage provided by the FDIC from \$100,000 to \$250,000 per depositor.

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Among other programs and actions taken by the U.S. regulatory agencies, the FDIC implemented the Temporary Liquidity Guarantee Program ( TLGP ) to strengthen confidence and encourage liquidity in the banking system. The TLGP is comprised of the Debt Guarantee Program ( DGP ) and the Transaction Account Guarantee Program ( TAGP ). The DGP guarantees all newly issued senior unsecured debt (e.g., promissory notes, unsubordinated unsecured notes and commercial paper) up to prescribed limits issued by participating entities beginning on October 14, 2008 and continuing through June 30, 2009. For eligible debt issued by that date, the FDIC will provide the guarantee coverage until the earlier of the maturity date of the debt or June 30, 2012. The TAGP offers full guarantee for noninterest-bearing transaction accounts held at FDIC-insured depository institutions. The unlimited deposit coverage was voluntary for eligible institutions and was in addition to the \$250,000 FDIC deposit insurance per account that was included as part of the EESA. The limits are presently scheduled to return to \$100,000 on January 1, 2010. The TAGP coverage became effective on October 14, 2008 and will continue for participating institutions until December 31, 2009.

**Capital Purchase Program**

Pursuant to the Capital Purchase Program, on January 16, 2009, the Company issued and sold, and the United States Department of the Treasury (the Treasury ) purchased, (1) 50,000 shares (the Preferred Shares ) of the Company s Fixed Rate Cumulative Perpetual Preferred Stock Series A, liquidation preference of \$1,000 per share, and (2) a ten-year warrant (the Warrant ) to purchase up to 288,129 shares of the Company s common stock, par value \$0.01 per share ( Common Stock ), at an exercise price of \$26.03 per share, for an aggregate purchase price of \$50.0 million in cash. Cumulative dividends on the Preferred Shares will accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter. The securities have not been registered under the Securities Act of 1933 and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements.

The securities purchase agreement, dated January 16, 2009 (the SPA ), between the Company and the Treasury, pursuant to which the Preferred Shares and the Warrant were sold, limits the payment of dividends on the Common Stock to a quarterly cash dividend of not more than \$0.06 per share, limits the Company s ability to repurchase its Common Stock, grants the holders of the Preferred Shares, the Warrant and the Common Stock to be issued under the Warrant certain registration rights and subjects the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 ( EESA ).

As a condition to the closing of the transaction, each of the Company s Senior Executive Officers (as defined in the SPA) (the Senior Executive Officers ), (i) executed a waiver voluntarily waiving any claim against the Treasury or the Company for any changes to such Senior Executive Officer s compensation or benefits that are required to comply with the regulation issued by the Treasury under the TARP Capital Purchase Program as published in the Federal Register on October 20, 2008, and acknowledging that the regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements and policies and agreements (including so-called golden parachute agreements) as they relate to the period the Treasury holds any equity or debt securities of the Company acquired through the TARP Capital Purchase Program; and (ii) entered into a letter agreement with the Company amending the Benefit Plans with respect to such Senior Executive Officer as may be necessary, during the period that the Treasury owns any debt or equity securities of the Company acquired pursuant to the SPA or the Warrant, as necessary to comply with Section 111(b) of the EESA.

**Temporary Liquidity Guarantee Program**

Initially, the TLGP programs, the DGP and TAGP, were provided at no cost for the first 30 days. On November 3, 2008, the FDIC extended the opt-out period to December 5, 2008 to provide eligible institutions additional time to consider the terms before making a final decision regarding participation in the program. We did not opt out. As a result, we will continue participating in the DGP and the TAGP to the extent applicable. Participants in the DGP are charged an annualized fee ranging from 50 basis points (bps) to 100 bps (depending on the maturity of the debt issued) multiplied by the amount of debt issued, and calculated for the maturity period of that debt, or through June 30, 2012, whichever is earlier. In addition to the existing risk-based deposit insurance premium paid on such deposits, TAGP participants will be assessed, on a quarterly basis, an annualized 10 bps fee on balances in noninterest-bearing transaction accounts that exceed the existing deposit insurance limit of \$250,000.





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On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (the *ARRA*) was signed into law. Section 7001 of the ARRA amended Section 111 of the EESA in its entirety. While the U.S. Treasury must promulgate regulations to implement the restrictions and standards set forth in Section 7001, the ARRA, among other things, significantly expands the executive compensation restrictions previously imposed by the EESA. Such restrictions apply to any entity that has received or will receive financial assistance under the Troubled Asset Recovery Program, and shall generally continue to apply for as long as any obligation arising from financial assistance provided under TARP, including preferred stock issued under the Capital Purchase Program, remains outstanding. These ARRA restrictions shall not apply to any Troubled Asset Recovery Program recipient during such time when the federal government (i) only holds any warrants to purchase common stock of such recipient or (ii) holds no preferred stock or warrants to purchase common stock of such recipient. As a result of our participation in the Capital Purchase Program, the restrictions and standards set forth in Section 7001 of the ARRA shall be applicable to Home BancShares, subject to regulations promulgated by the U.S. Treasury. Pursuant to Section 7001(g) of the ARRA, we shall be permitted to repay the \$50 million we received under the Capital Purchase Program, subject to consultation with the Federal Reserve, without regard to certain repayment restrictions in the Purchase Agreement.

### **Home BancShares**

We are a bank holding company registered under the federal Bank Holding Company Act of 1956 (the *Bank Holding Company Act*) and are subject to supervision, regulation and examination by the Federal Reserve Board. We have elected under the Gramm-Leach-Bliley Act to become a bank holding company. The Bank Holding Company Act and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

*Acquisitions of Banks.* The Bank Holding Company Act requires every bank holding company to obtain the Federal Reserve Board's prior approval before:

acquiring direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the bank's voting shares;

acquiring all or substantially all of the assets of any bank; or

merging or consolidating with any other bank holding company.

Under the Bank Holding Company Act, if adequately capitalized and adequately managed, we, as well as other banks located within Arkansas or Florida, may purchase a bank located outside of Arkansas or Florida. Conversely, an adequately capitalized and adequately managed bank holding company located outside of Arkansas or Florida may purchase a bank located inside Arkansas or Florida. In each case, however, restrictions may be placed on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits. For example, Florida law prohibits a bank holding company from acquiring control of a Florida financial institution until the target institution has been incorporated for three years.

*Permitted Activities.* A bank holding company is generally permitted under the Bank Holding Company Act to engage in or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in the following activities:

banking or managing or controlling banks; and

any activity that the Federal Reserve Board determines to be so closely related to banking as to be a proper incident to the business of banking.

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Activities that the Federal Reserve Board has found to be so closely related to banking as to be a proper incident to the business of banking include: factoring accounts receivable; making, acquiring, brokering or servicing loans and usual related activities; leasing personal or real property; operating a non-bank depository institution, such as a savings association; trust company functions; financial and investment advisory activities; conducting discount securities brokerage activities; underwriting and dealing in government obligations and money market instruments; providing specified management consulting and counseling activities; performing selected data processing services and support services; acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and performing selected insurance underwriting activities.

*Gramm-Leach-Bliley Act; Financial Holding Companies.* The Gramm-Leach-Bliley Financial Modernization Act of 1999 revised and expanded the provisions of the Bank Holding Company Act by including a new section that permits a bank holding company to elect to become a financial holding company to engage in a full range of activities that are financial in nature. The qualification requirements and the process for a bank holding company that elects to be treated as a financial holding company require that all of the subsidiary banks controlled by the bank holding company at the time of election to become a financial holding company must be and remain at all times well-capitalized and well managed. We elected to become a financial holding company initially, but withdrew that election in 2008.

*Support of Subsidiary Institutions.* Under Federal Reserve Board policy, we are expected to act as a source of financial strength for our subsidiary banks and are required to commit resources to support them. Moreover, an obligation to support our bank subsidiaries may be required at times when, without this Federal Reserve Board policy, we might not be inclined to provide it.

*Safe and Sound Banking Practices.* Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board's Regulation Y, for example, generally requires a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve Board could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their non-banking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as \$1 million for each day the activity continues.

*Annual Reporting; Examinations.* We are required to file annual reports with the Federal Reserve Board, and such additional information as the Federal Reserve Board may require pursuant to the Bank Holding Company Act. The Federal Reserve Board may examine a bank holding company or any of its subsidiaries, and charge the company for the cost of such examination.

*Capital Adequacy Requirements.* The Federal Reserve Board has adopted a system using risk-based capital guidelines to evaluate the capital adequacy of bank holding companies having \$500 million or more in assets on a consolidated basis. We currently have consolidated assets in excess of \$500 million, and are therefore subject to the Federal Reserve Board's capital adequacy guidelines.

Under the guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a risk-weighted asset base. The guidelines require a minimum total risk-based capital ratio of 8.0% (of which at least 4.0% is required to consist of Tier 1 capital elements). Total capital is the sum of Tier 1 and Tier 2 capital. As of December 31, 2008, our Tier 1 risk-based capital ratio was 12.70% and our total risk-based capital ratio was 13.95%. Thus, we are considered adequately capitalized for regulatory purposes.

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In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company's Tier 1 capital divided by its average total consolidated assets. Certain highly-rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies are required to maintain a leverage ratio of at least 4.0%. As of December 31, 2008, our leverage ratio was 10.87%.

The federal banking agencies' risk-based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions, substantially above the minimum supervisory levels, without significant reliance on intangible assets.

### **Subsidiary Banks**

*General.* Centennial Bank (Formerly First State Bank), Community Bank, Bank of Mountain View, Twin City Bank, and Centennial Bank are chartered as Arkansas state banks and are members of the Federal Reserve System, making them primarily subject to regulation and supervision by both the Federal Reserve Board and the Arkansas State Bank Department. In addition, our subsidiary banks are subject to various requirements and restrictions under federal and state law, including requirements to maintain reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that they may charge, and limitations on the types of investments they may make and on the types of services they may offer. Various consumer laws and regulations also affect the operations of our subsidiary banks.

*Prompt Corrective Action.* The Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) in which all institutions are placed. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. The federal banking agencies have specified by regulation the relevant capital level for each category.

An institution that is categorized as undercapitalized, significantly undercapitalized or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution to a lower capital category based on supervisory factors other than capital.

*FDIC Insurance Assessments.* Deposit accounts are insured by the FDIC, generally up to a maximum of \$100,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts. However, the EESA included a provision for a temporary increase from \$100,000 to \$250,000 in deposit insurance per depositor effective October 3, 2008 through December 31, 2009.

The FDIC imposes an assessment against institutions for deposit insurance. This assessment is based on the risk category of the institution. In December, 2008, the FDIC adopted a rule that raises the current deposit insurance assessment rates uniformly for all institutions.

On February 27, 2009, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) voted to amend the restoration plan for the Deposit Insurance Fund. The Board took action by imposing a special assessment on insured institutions of 20 basis points, implementing changes to the risk-based assessment system, and increased regular premium rates for 2009, which banks must pay on top of the special assessment. The 20 basis point special assessment on the industry will be as of June 30, 2009 payable on September 30, 2009. As a result of the special assessment and increased regular assessments, the Company projects it will experience an increase in FDIC assessment expense by approximately \$6.8 million from 2008 to 2009. The 20 basis point special assessment represents \$4.0 million of this increase.

On March 5, 2009, the FDIC Chairman announced that the FDIC intends to lower the special assessment from 20 basis points to 10 basis points. The approval of the cutback is contingent on whether Congress clears legislation that would expand the FDIC's line of credit with the Treasury to \$100 billion. Legislation to increase the FDIC's borrowing authority on a permanent basis is also expected to advance to Congress, which should aid in reducing the burden on the industry.

The assessment rates, including the special assessment, are subject to change at the discretion of the Board of Directors of the FDIC.

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The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

*Community Reinvestment Act.* The Community Reinvestment Act requires, in connection with examinations of financial institutions, that federal banking regulators evaluate the record of each financial institution in meeting the credit needs of its local community, including low and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on our subsidiary banks. Additionally, we must publicly disclose the terms of various Community Reinvestment Act-related agreements. Each of our subsidiary banks received satisfactory CRA ratings from their applicable federal banking regulatory at their last examinations.

*Other Regulations.* Interest and other charges collected or contracted for by our subsidiary banks are subject to state usury laws and federal laws concerning interest rates.

*Loans to Insiders.* Sections 22(g) and (h) of the Federal Reserve Act and its implementing regulation, Regulation O, place restrictions on loans by a bank to executive officers, directors, and principal shareholders. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% shareholder of a bank and certain of their related interests, or insiders, and insiders of affiliates, may not exceed, together with all other outstanding loans to such person and related interests, the bank's loans-to-one-borrower limit (generally equal to 15% of the institution's unimpaired capital and surplus). Section 22(h) also requires that loans to insiders and to insiders of affiliates be made on terms substantially the same as offered in comparable transactions to other persons, unless the loans are made pursuant to a benefit or compensation program that (i) is widely available to employees of the bank and (ii) does not give preference to insiders over other employees of the bank. Section 22(h) also requires prior Board of Directors approval for certain loans, and the aggregate amount of extensions of credit by a bank to all insiders cannot exceed the institution's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers.

*Capital Requirements.* Our subsidiary banks are also subject to certain restrictions on the payment of dividends as a result of the requirement that it maintain adequate levels of capital in accordance with guidelines promulgated from time to time by applicable regulators.

The Federal Reserve Bank, with respect to our bank subsidiaries that are members of the Federal Reserve System, monitors the capital adequacy of our subsidiary banks by using a combination of risk-based guidelines and leverage ratios. The agencies consider each of the bank's capital levels when taking action on various types of applications and when conducting supervisory activities related to the safety and soundness of individual banks and the banking system.

*The FDIC Improvement Act.* The Federal Deposit Insurance Corporation Improvement Act of 1991, or FDICIA, made a number of reforms addressing the safety and soundness of the deposit insurance system, supervision of domestic and foreign depository institutions, and improvement of accounting standards. This statute also limited deposit insurance coverage, implemented changes in consumer protection laws and provided for least-cost resolution and prompt regulatory action with regard to troubled institutions.

FDICIA requires every bank with total assets in excess of \$500 million to have an annual independent audit made of the bank's financial statements by a certified public accountant to verify that the financial statements of the bank are presented in accordance with generally accepted accounting principles and comply with such other disclosure requirements as prescribed by the FDIC. FDICIA also places certain restrictions on activities of banks depending on their level of capital.

The capital classification of a bank affects the frequency of examinations of the bank and impacts the ability of the bank to engage in certain activities and affects the deposit insurance premiums paid by such bank. Under FDICIA, the federal banking regulators are required to conduct a full-scope, on-site examination of every bank at least once every 12 months. An exception to this requirement, however, provides that a bank that (i) has assets of less than \$500 million, (ii) is categorized as well-capitalized, (iii) during its most recent examination, was found to be well managed and its composite rating was outstanding or, in the case of a bank with total assets of not more than \$100 million, outstanding or good, (iv) is not currently subject to a formal enforcement proceeding or order by the



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FDIC or the appropriate federal banking agency and (v) has not been subject to a change in control during the last 12 months, need only be examined once every 18 months.

*Brokered Deposits.* Under FDICIA, banks may be restricted in their ability to accept brokered deposits, depending on their capital classification. Well-capitalized banks are permitted to accept brokered deposits, but all banks that are not well-capitalized are not permitted to accept such deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank.

*Interstate Branching.* Effective June 1, 1997, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amended the FDIA and certain other statutes to permit state and national banks with different home states to merge across state lines, with approval of the appropriate federal banking agency, unless the home state of a participating bank had passed legislation prior to May 31, 1997 expressly prohibiting interstate mergers. Under the Riegle-Neal Act amendments, once a state or national bank has established branches in a state, that bank may establish and acquire additional branches at any location in the state at which any bank involved in the interstate merger transaction could have established or acquired branches under applicable federal or state law. If a state opts out of interstate branching within the specified time period, no bank in any other state may establish a branch in the state which has opted out, whether through an acquisition or de novo.

*Federal Home Loan Bank System.* The Federal Home Loan Bank system, of which each of our subsidiary banks is a member, consists of regional FHLBs governed and regulated by the Federal Housing Finance Board, or FHFBB. The FHLBs serve as reserve or credit facilities for member institutions within their assigned regions. They are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB system. They make loans (i.e., advances) to members in accordance with policies and procedures established by the FHLB and the Boards of directors of each regional FHLB.

As a system member, our subsidiary banks are entitled to borrow from the FHLB of their respective region and is required to own a certain amount of capital stock in the FHLB. Each of our subsidiary banks is in compliance with the stock ownership rules described above with respect to such advances, commitments and letters of credit and home mortgage loans and similar obligations. All loans, advances and other extensions of credit made by the FHLB to our subsidiary banks are secured by a portion of their respective loan portfolio, certain other investments and the capital stock of the FHLB held by such bank.

*Mortgage Banking Operations.* Each of our subsidiary banks is subject to the rules and regulations of FHA, VA, FNMA, FHLMC and GNMA with respect to originating, processing, selling and servicing mortgage loans and the issuance and sale of mortgage-backed securities. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines which include provisions for inspections and appraisals, require credit reports on prospective borrowers and fix maximum loan amounts, and, with respect to VA loans, fix maximum interest rates. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act and the Real Estate Settlement Procedures Act and the regulations promulgated thereunder which, among other things, prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. Our subsidiary banks are also subject to regulation by the Arkansas State Bank Department, as applicable, with respect to, among other things, the establishment of maximum origination fees on certain types of mortgage loan products.

### **Payment of Dividends**

We are a legal entity separate and distinct from our subsidiary banks and other affiliated entities. The principal sources of our cash flow, including cash flow to pay dividends to our shareholders, are dividends that our subsidiary banks pay to us as their sole shareholder. Statutory and regulatory limitations apply to the dividends that our subsidiary banks can pay to us, as well as to the dividends we can pay to our shareholders.

The policy of the Federal Reserve Board that a bank holding company should serve as a source of strength to its subsidiary banks also results in the position of the Federal Reserve Board that a bank holding company should not maintain a level of cash dividends to its shareholders that places undue pressure on the capital of its bank subsidiaries or that can be funded only through additional borrowings or other arrangements that may undermine the bank holding company's ability to serve as such a source of strength. Our ability to pay dividends is also subject to the provisions of



Arkansas law.

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There are certain state-law limitations on the payment of dividends by our bank subsidiaries. Centennial Bank (Formerly First State Bank), Community Bank, Twin City Bank and Bank of Mountain View, which are subject to Arkansas banking laws, may not declare or pay a dividend of 75% or more of the net profits of such bank after all taxes for the current year plus 75% of the retained net profits for the immediately preceding year without the prior approval of the Arkansas State Bank Commissioner. Members of the Federal Reserve System must also comply with the dividend restrictions with which a national bank would be required to comply. Among other things, these restrictions require that if losses have at any time been sustained by a bank equal to or exceeding its undivided profits then on hand, no dividend may be paid. Although we have regularly paid dividends on our common stock beginning with the second quarter of 2003, there can be no assurances that we will be able to pay dividends in the future under the applicable regulatory limitations.

The payment of dividends by us, or by our subsidiary banks, may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would result in the depository institution being undercapitalized.

On January 16, 2009, we entered into a Letter Agreement with the United States Department of Treasury ( UST ) providing for the issuance of preferred stock and warrants for common stock. The Letter Agreement provides that prior to the earlier of January 16, 2012 and the date we redeem all the Series A Preferred Shares or they have been transferred to a third party by UST, we may not, without their approval, increase our quarterly dividend on common stock above \$0.06 per share.

### **Restrictions on Transactions with Affiliates**

We and our subsidiary banks are subject to Section 23A of the Federal Reserve Act. An affiliate of a bank is any company or entity that controls, is controlled by, or is under common control with the bank. In general, Section 23A imposes a limit on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties which are collateralized by the securities or obligations of the Bank or its nonbanking affiliates.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain other transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at that time for comparable transactions with or involving other non-affiliated persons.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively, the insiders ) contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution's total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

### **Privacy**

Under the Gramm-Leach-Bliley Act, financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing nonpublic personal financial information with nonaffiliated third parties except under narrow circumstances, such as the processing of transactions requested by the consumer or when the financial institution is jointly sponsoring a product or service with a nonaffiliated third party. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing to consumers. We and all of our subsidiaries have established policies and procedures to assure our compliance with all privacy provisions of the Gramm-Leach-Bliley Act.

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### **Anti-Terrorism and Money Laundering Legislation**

Our subsidiary banks are subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism of 2001 (the USA PATRIOT Act ), the Bank Secrecy Act and rules and regulations of the Office of Foreign Assets Control (the OFAC ). These statutes and related rules and regulations impose requirements and limitations on specific financial transactions and account relationships intended to guard against money laundering and terrorism financing. Our subsidiary banks have established a customer identification program pursuant to Section 326 of the USA PATRIOT Act and the Bank Secrecy Act, and otherwise have implemented policies and procedures intended to comply with the foregoing rules.

### **Proposed Legislation and Regulatory Action**

New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating and doing business in the United States. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

### **Effect of Governmental Monetary Policies**

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Board's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve Board affect the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to banks and its influence over reserve requirements to which banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

### **Item 1A. RISK FACTORS**

Our business exposes us to certain risks. Risks and uncertainties that management is not aware of or focused on may also adversely affect our business and operation. The following is a discussion of the most significant risks and uncertainties that may affect our business, financial condition and future results.

#### **Risks Related to Our Industry**

*Difficult market conditions and economic trends have adversely affected our industry and our business.*

Negative developments beginning in the latter half of 2007 in the sub-prime mortgage market and the securitization markets for such loans, together with substantial volatility in oil prices and other factors, have resulted in uncertainty in the financial markets in general and a related general economic downturn, which have continued in 2008. Dramatic declines in the housing market, with decreasing home prices and increasing delinquencies and foreclosures, have negatively impacted the credit performance of mortgage and construction loans and resulted in significant write-downs of assets by many financial institutions. In addition, the values of real estate collateral supporting many loans have declined and may continue to decline. General downward economic trends, reduced availability of commercial credit and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Concerns over the stability of the financial markets and the economy have resulted in decreased lending by financial institutions to their customers and to each other. This market turmoil and tightening of credit has led to increased commercial and consumer deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. Competition among depository institutions for deposits has increased significantly. Financial institutions have experienced decreased access to deposits or borrowings.

The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition, results of operations and stock price.

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Our ability to assess the creditworthiness of customers and to estimate the losses inherent in our credit exposure is made more complex by these difficult market and economic conditions. As a result of the foregoing factors, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations. This increased government action may increase our costs and limit our ability to pursue certain business opportunities. We also may be required to pay even higher Federal Deposit Insurance Corporation ( FDIC ) premiums than the recently increased level because financial institution failures resulting from the depressed market conditions have depleted and may continue to deplete the deposit insurance fund and reduce its ratio of reserves to insured deposits.

We do not believe these difficult conditions are likely to improve in the near future. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market and economic conditions on us, our customers and the other financial institutions in our market. As a result, we may experience increases in foreclosures, delinquencies and customer bankruptcies as well as more restricted access to funds.

***Recent legislative and regulatory initiatives to address difficult market and economic conditions may not stabilize the U.S. banking system.***

The recently enacted EESA authorizes the Treasury to purchase from financial institutions and their holding companies up to \$700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies, under a troubled asset relief program or TARP. The purpose of the TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The Treasury has allocated \$250 billion toward the TARP Capital Purchase Program. Under the TARP Capital Purchase Program, the Treasury is purchasing equity securities from participating institutions. We issued to the Treasury 50,000 Series A Preferred Shares and a Warrant for 288,129 shares of common stock pursuant to the TARP Capital Purchase Program in January 2009.

The EESA also increased federal deposit insurance on most deposit accounts from \$100,000 to \$250,000. This increase is in place until the end of 2009.

The EESA followed, and has been followed by, numerous actions by the Federal Reserve, the U.S. Congress, the Treasury, the FDIC, the SEC and others to address the current liquidity and credit crisis that has followed the sub-prime meltdown that commenced in 2007. These measures include homeowner relief that encourages loan restructuring and modification; the establishment of significant liquidity and credit facilities for financial institutions and investment banks; the lowering of the federal funds rate; emergency action against short selling practices; a temporary guaranty program for money market funds; the establishment of a commercial paper funding facility to provide back-stop liquidity to commercial paper issuers; and coordinated international efforts to address illiquidity and other weaknesses in the banking sector. The purpose of these legislative and regulatory actions is to stabilize the U.S. banking system. The EESA and the other regulatory initiatives described above may not have their desired effects. If the volatility in the markets continues and economic conditions fail to improve or worsen, our business, financial condition and results of operations could be materially and adversely affected.

***Current levels of market volatility are unprecedented.***

The capital and credit markets have been experiencing volatility and disruption for more than a year. In recent months, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers' underlying financial strength. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

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### ***Our profitability is vulnerable to interest rate fluctuations and monetary policy.***

Most of our assets and liabilities are monetary in nature, and thus subject us to significant risks from changes in interest rates. Consequently, our results of operations can be significantly affected by changes in interest rates and our ability to manage interest rate risk. Changes in market interest rates, or changes in the relationships between short-term and long-term market interest rates, or changes in the relationship between different interest rate indices can affect the interest rates charged on interest-earning assets differently than the interest paid on interest-bearing liabilities. This difference could result in an increase in interest expense relative to interest income or a decrease in interest rate spread. In addition to affecting our profitability, changes in interest rates can impact the valuation of our assets and liabilities.

As of December 31, 2008, our one-year ratio of interest-rate-sensitive assets to interest-rate-sensitive liabilities was 107.4% and our cumulative gap position was 4.1% of total earning assets, resulting in a minimum impact on earnings for various interest rate change scenarios. Floating rate loans made up 30.0% of our \$1.96 billion loan portfolio. A loan is considered fixed rate if the loan is currently at its adjustable floor or ceiling. As a result of the decline in interest rates during 2008, the Company has approximately \$226.9 million of loans that cannot be additionally priced down but could price up if rates were to return to higher levels. In addition, 64.7% of our loans receivable and 88.9% of our time deposits were scheduled to reprice within 12 months and our other rate sensitive asset and rate sensitive liabilities composition is subject to change. Significant composition changes in our rate sensitive assets or liabilities could result in a more unbalanced position and interest rate changes would have more of an impact to our earnings.

Our results of operations are also affected by the monetary policies of the Federal Reserve Board. Actions by the Federal Reserve Board involving monetary policies could have an adverse effect on our deposit levels, loan demand or business and earnings.

### ***We are subject to extensive regulation that could limit or restrict our activities and impose financial requirements or limitations on the conduct of our business, which limitations or restrictions could adversely affect our profitability.***

We are a registered bank holding company primarily regulated by the Federal Reserve Board. Our bank subsidiaries are also primarily regulated by the Federal Reserve Board, the FDIC, and the Arkansas State Bank Department.

Complying with banking industry regulations is costly and may limit our growth and restrict certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capital requirements by our regulators. Violations of various laws, even if unintentional, may result in significant fines or other penalties, including restrictions on branching or bank acquisitions. Recently, banks generally have faced increased regulatory sanctions and scrutiny, particularly under the USA PATRIOT Act and statutes that promote customer privacy or seek to prevent money laundering. As regulation of the banking industry continues to evolve, we expect the costs of compliance to continue to increase and, thus, to affect our ability to operate profitably.

### **Risks Related to Our Business**

### ***Our decisions regarding credit risk could be inaccurate and our allowance for loan losses may be inadequate, which would materially and adversely affect our business, financial condition, results of operations and future prospects.***

Management makes various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of our secured loans. We maintain an allowance for loan losses that we consider adequate to absorb future losses which may occur in our loan portfolio. In determining the size of the allowance, we analyze our loan portfolio based on our historical loss experience, volume and classification of loans, volume and trends in delinquencies and non-accruals, national and local economic conditions, and other pertinent information. As of December 31, 2008, our allowance for loan losses was approximately \$40.4 million, or 2.06% of our total loans receivable.

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If our assumptions are incorrect, our current allowance may be insufficient to cover future loan losses, and increased loan loss reserves may be needed to respond to different economic conditions or adverse developments in our loan portfolio. In addition, federal and state regulators periodically review our allowance for loan losses and may require us to increase our allowance for loan losses or recognize further loan charge-offs based on judgments different than those of our management. Any increase in our allowance for loan losses or loan charge-offs could have a negative effect on our operating results.

***Because we have a high concentration of loans secured by real estate, a further downturn in the real estate market could result in losses and materially and adversely affect our business, financial condition, results of operations and future prospects.***

A significant portion of our loan portfolio is dependent on real estate. As of December 31, 2008, approximately 82.2% of our loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. An adverse change in the economy affecting values of real estate generally or in our primary markets specifically could significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. Furthermore, it is likely that we would be required to increase our provision for loan losses. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase our allowance for loan losses, our profitability and financial condition could be adversely impacted.

Since December 31, 2007, the weakening real estate market, particularly in Florida, has and may continue to increase our level of non-performing loans. While we believe our allowance for loan losses is adequate at December 31, 2008, as additional facts become known about relevant internal and external factors that affect loan collectability and our assumptions, it may result in us making additions to the provision for loan loss during 2009. Any failure by management to closely monitor the status of the market and make the necessary changes could have a negative effect on our operating results.

***Because we have a concentration of exposure to a number of individual borrowers, a significant loss on any of those loans could materially and adversely affect our business, financial condition, results of operations, and future prospects.***

We have a concentration of exposure to a number of individual borrowers. Under applicable law, each of our bank subsidiaries is generally permitted to make loans to one borrowing relationship up to 20% of its respective capital. Historically, when our bank subsidiaries have lending relationships that exceed their individual loan to one borrower limitation, the overline, or amount in excess of the subsidiary bank's legal lending limit, is participated to our other bank subsidiaries. As a result, on a consolidated basis we may have aggregate exposure to individual or related borrowers in excess of each individual bank subsidiary's legal lending limit. As of December 31, 2008, the aggregate legal lending limit of our bank subsidiaries for secured loans was approximately \$55.2 million. Currently, our board of directors has established an in-house consolidated lending limit of \$20.0 million to any one borrowing relationship without obtaining the approval of any two of our Chairman, our President and our director Richard H. Ashley.

As of December 31, 2008, we had 35 borrowing relationships where we had a commitment to loan in excess of \$10.0 million, with the aggregate amount of those commitments totaling approximately \$542.2 million. The largest of those commitments to one borrowing relationship was \$27.4 million, which is 9.7% of our consolidated shareholders equity. Given the size of these loan relationships relative to our capital levels and earnings, a significant loss on any one of these loans could materially and adversely affect our business, financial condition, results of operations, and future prospects.

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***The unexpected loss of key officers may materially and adversely affect our business, financial condition, results of operations and future prospects.***

Our success depends significantly on our executive officers, especially John W. Allison, Ron W. Strother, Randy E. Mayor, and on the presidents of our bank subsidiaries. Our bank subsidiaries, in particular, rely heavily on their management team's relationships in their local communities to generate business. Because we do not have employment agreements or non-compete agreements with our employees, our executive officers and bank presidents are free to resign at any time and accept an employment offer from another company, including a competitor. The loss of services from a member of our current management team may materially and adversely affect our business, financial condition, results of operations and future prospects.

***Our growth and expansion strategy may not be successful and our market value and profitability may suffer.***

Growth through the acquisition of banks, *de novo* branching, and the organization of new banks represents an important component of our business strategy. Although we have no present plans to acquire any financial institution or financial services provider, any future acquisitions we might make will be accompanied by the risks commonly encountered in acquisitions. These risks include, among other things:

credit risk associated with the acquired bank's loans and investments;

difficulty of integrating operations and personnel; and

potential disruption of our ongoing business.

We expect that competition for suitable acquisition candidates may be significant. We may compete with other banks or financial service companies with similar acquisition strategies, many of which are larger and have greater financial and other resources. We cannot assure you that we will be able to successfully identify and acquire suitable acquisition targets on acceptable terms and conditions.

In addition to the acquisition of existing financial institutions, we plan to continue *de novo* branching, and we may consider the organization of new banks in new market areas. We do not, however, have any current plans to organize a new bank. *De novo* branching and any acquisition or organization of a new bank carries with it numerous risks, including the following:

the inability to obtain all required regulatory approvals;

significant costs and anticipated operating losses associated with establishing a *de novo* branch or a new bank;

the inability to secure the services of qualified senior management;

the local market may not accept the services of a new bank owned and managed by a bank holding company headquartered outside of the market area of the new bank;

the inability to obtain attractive locations within a new market at a reasonable cost; and

the additional strain on management resources and internal systems and controls.

We cannot assure that we will be successful in overcoming these risks or any other problems encountered in connection with acquisitions, *de novo* branching and the organization of new banks. Our inability to overcome these risks could have an adverse effect on our ability to achieve our business strategy and maintain our market value and profitability.

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***There may be undiscovered risks or losses associated with our acquisitions of bank subsidiaries which would have a negative impact upon our future income.***

Our growth strategy includes strategic acquisitions of bank subsidiaries. We acquired three bank subsidiaries in 2005, one in 2008, and will continue to consider strategic acquisitions, with a primary focus on Arkansas and Florida. In most cases, our acquisition of a bank includes the acquisition of all of the target bank's assets and liabilities, including its loan portfolio. There may be instances when we, under our normal operating procedures, may find after the acquisition that there may be additional losses or undisclosed liabilities with respect to the assets and liabilities of the target bank, and, with respect to its loan portfolio, that the ability of a borrower to repay a loan may have become impaired, the quality of the value of the collateral securing a loan may fall below our standards, or the allowance for loan losses may not be adequate. One or more of these factors might cause us to have additional losses or liabilities, additional loan charge-offs, or increases in allowances for loan losses, which would have a negative impact upon our future income.

***Competition from other financial institutions may adversely affect our profitability.***

The banking business is highly competitive. We experience strong competition, not only from commercial banks, savings and loan associations, and credit unions, but also from mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other financial institutions operating in or near our market areas. We compete with these institutions both in attracting deposits and in making loans.

Many of our competitors are much larger national and regional financial institutions. We may face a competitive disadvantage against them as a result of our smaller size and resources and our lack of geographic diversification.

We also compete against community banks that have strong local ties. These smaller institutions are likely to cater to the same small and mid-sized businesses that we target and to use a relationship-based approach similar to ours. In addition, our competitors may seek to gain market share by pricing below the current market rates for loans and paying higher rates for deposits. Competitive pressures can adversely affect our profitability.

***We continually encounter technological change, and we may have fewer resources than many of our competitors to continue to invest in technological improvements.***

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our clients.

As a service to our clients, our bank subsidiaries currently offer Internet banking. Use of this service involves the transmission of confidential information over public networks. We cannot be sure that advances in computer capabilities, new discoveries in the field of cryptography or other developments will not result in a compromise or breach in the commercially available encryption and authentication technology that we use to protect our clients transaction data. If we were to experience such a breach or compromise, we could suffer losses and our operations could be adversely affected.

***Our recent results do not indicate our future results, and may not provide guidance to assess the risk of an investment in our common stock.***

We are unlikely to sustain our historical rate of growth, and may not even be able to expand our business at all. Further, our recent growth may distort some of our historical financial ratios and statistics. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. If we are not able to successfully grow our business, our financial condition and results of operations could be adversely affected.



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***We may not be able to raise the additional capital we need to grow and, as a result, our ability to expand our operations could be materially impaired.***

Federal and state regulatory authorities require us and our bank subsidiaries to maintain adequate levels of capital to support our operations. While we believe that the \$50 million in capital we obtained through the sale of the Series A Preferred Shares to the Treasury in January 2009 as well as our pre-existing capital, which already exceeded the federal and state capital requirements, will be sufficient to support our current operations and anticipated expansion, factors such as faster than anticipated growth, reduced earning levels, operating losses, changes in economic conditions, revisions in regulatory requirements, or additional acquisition opportunities may lead us to seek additional capital.

Our ability to raise additional capital, if needed, will depend on our financial performance and on conditions in the capital markets at that time, which are outside our control. If we need additional capital but cannot raise it on terms acceptable to us, our ability to expand our operations could be materially impaired.

***Our directors and executive officers own a significant portion of our common stock and can exert significant control over our business and corporate affairs.***

Our directors and executive officers, as a group, beneficially own approximately 31.9% of our common stock. Consequently, if they vote their shares in concert, they can significantly influence the outcome of all matters submitted to our shareholders for approval, including the election of directors. The interests of our officers and directors may conflict with the interests of other holders of our common stock, and they may take actions affecting our company with which you disagree.

***Our accounting policies and methods impact how we report our financial condition and results of operations. Application of these policies and methods may require management to make estimates about matters that are uncertain.***

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with generally accepted accounting principles and reflect management's judgment of the most appropriate manner to report our financial condition and results of operations. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which might be reasonable under the circumstances yet might result in our reporting materially different amounts than would have been reported under a different alternative. For a description of our significant accounting policies, see Note 1 of the Notes to Consolidated Financial Statements contained in this report. These accounting policies are critical to presenting our financial condition and results of operations. They may require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions.

***Changes in accounting standards could materially impact our consolidated financial statements.***

The accounting standard setters, including the Financial Accounting Standards Board, SEC and other regulatory bodies, from time to time may change the financial accounting and reporting standards that govern the preparation of our consolidated financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results, or a cumulative charge to retained earnings.

***Our internal controls may be ineffective.***

We regularly review and update our internal controls, disclosure controls and procedures and corporate governance policies and procedures. As a result, we may incur increased costs to maintain and improve our controls and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls or procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations or financial condition.

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***A natural disaster or act of terrorism, especially one affecting our market areas, could adversely affect our business, financial condition, results of operations and future prospects.***

We are at risk of natural disaster or acts of terrorism, even if our market areas are not primarily affected. Our Florida market, in particular, is subject to risks from hurricanes, which may damage or dislocate our facilities, damage or destroy collateral, adversely affect the livelihood of borrowers or otherwise cause significant economic dislocation in areas we serve.

### **Risk Related to Owning Our Stock**

***Regulatory and contractual restrictions may limit or prevent us from paying dividends on the Series A Preferred Shares and our common stock.***

Unlike indebtedness, where principal and interest would customarily be payable on specified due dates, with respect to the Series A Preferred Shares and our common stock, dividends are payable only when, as and if authorized and declared by our board of directors and depend on, among other things, our results of operations, financial condition, debt service requirements, other cash needs and any other factors our board of directors deems relevant and, under Arkansas law, may be paid only out of lawfully available funds.

We are an entity separate and distinct from our bank subsidiaries and derive substantially all of our revenue in the form of dividends from those subsidiaries. Accordingly, we are and will be dependent upon dividends from our bank subsidiaries to pay the principal of and interest on our indebtedness, to satisfy our other cash needs and to pay dividends on the Series A Preferred Shares and our common stock. The ability of our bank subsidiaries to pay dividends is subject to their ability to earn net income and to meet certain regulatory requirements. In the event they are unable to pay dividends to us, we may not be able to pay dividends on the Series A Preferred Shares or our common stock. Also, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors.

We are also subject to certain contractual restrictions that could prohibit us from declaring or paying dividends or making liquidation payments on our common stock or the Series A Preferred Shares.

***The holders of our subordinated debentures have rights that are senior to those of our shareholders. If we defer payments of interest on our outstanding subordinated debentures or if certain defaults relating to those debentures occur, we will be prohibited from declaring or paying dividends or distributions on, and from making liquidation payments with respect to, the Series A Preferred Shares and our common stock.***

We have \$47.6 million of subordinated debentures issued in connection with trust preferred securities. Payments of the principal and interest on the trust preferred securities are unconditionally guaranteed by us. The subordinated debentures are senior to our shares of common stock and the Series A Preferred Shares. As a result, we must make payments on the subordinated debentures (and the related trust preferred securities) before any dividends can be paid on the Series A Preferred Shares and our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to the holders of the Series A Preferred Shares or our common stock. We have the right to defer distributions on the subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid to holders of our capital stock (including the Series A Preferred Shares and our common stock). If we elect to defer or if we default with respect to our obligations to make payments on these subordinated debentures, this would likely have a material adverse effect on the market value of the Series A Preferred Shares and our common stock. Moreover, without notice to or consent from the holders of the Series A Preferred Shares or our common stock, we may issue additional series of subordinated debt securities in the future with terms similar to those of our existing subordinated debt securities or enter into other financing agreements that limit our ability to purchase or to pay dividends or distributions on our capital stock, including our common stock.

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***The prices of our common stock may fluctuate significantly, and this may make it difficult for you to resell common stock when you want or at prices you find attractive.***

We cannot predict how our common stock will trade in the future. The market value of the Series A Preferred Shares and our common stock will likely continue to fluctuate in response to a number of factors including the following, most of which are beyond our control, as well as the other factors described in this Risk Factors section:

actual or anticipated variations in quarterly results of operations;

changes in financial estimates and recommendations by securities analysts;

operating and stock price performance of other companies that investors deem comparable to us;

news reports relating to trends, concerns and other issues in the financial services industry;

perceptions in the marketplace regarding us and/or our competitors;

developments related to investigations, proceedings or litigation that involve us;

dispositions, acquisitions and financings;

actions of our current stockholders, including sales of common stock by existing stockholders and our directors and executive officers; and

regulatory developments.

The market value of our common stock may also be affected by conditions affecting the financial markets in general, including price and trading fluctuations. These conditions may result in (i) volatility in the level of, and fluctuations in, the market prices of stocks generally and, in turn, our common stock and (ii) sales of substantial amounts of our common stock in the market, in each case that could be unrelated or disproportionate to changes in our operating performance. These broad market fluctuations may adversely affect the market value of our common stock.

***There may be future sales of additional common stock or preferred stock or other dilution of our equity, which may adversely affect the market price of our common stock or the Series A Preferred Shares.***

We are not restricted from issuing additional common stock or preferred stock, including any securities that are convertible into or exchangeable for, or that represent the right to receive, common stock or preferred stock or any substantially similar securities. The market value of our common stock or the Series A Preferred Shares could decline as a result of sales by us of a large number of shares of common stock or preferred stock or similar securities in the market or the perception that such sales could occur.

***Anti-takeover provisions could negatively impact our stockholders.***

Provisions in our Articles of Incorporation, Bylaws and corporate policies, Arkansas corporate law and federal regulations could delay or prevent a third party from acquiring us, despite the possible benefit to our stockholders, or otherwise adversely affect the market price of any class of our equity securities, including our common stock and the Series A Preferred Shares. These provisions include advance notice requirements for nominations for election to our board of directors and for proposing matters that stockholders may act on at stockholder meetings and a provision allowing directors to fill a vacancy in our board of directors. Our Articles of Incorporation also authorize our board of directors to issue preferred stock, and although our board of directors has not had and does not presently have any intention of issuing any preferred stock for anti-takeover purposes, preferred stock could be issued as a defensive measure in response to a takeover proposal. In addition, because we are a bank holding company, purchasers of 10% or more of our common stock may be required to obtain approvals under the Change in Bank Control Act of 1978, as amended, or the Bank Holding Company Act of 1956, as amended (and in certain cases such approvals may be required at a lesser percentage of ownership). Specifically, under regulations adopted by the Federal Reserve, any other bank holding company may be required to obtain the approval of the Federal Reserve to acquire or retain 5% or

more of our common stock and any person other than a bank holding company may be required to obtain the approval of the Federal Reserve to acquire or retain 10% or more of our common stock.

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These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock. These provisions could also discourage proxy contests and make it more difficult for holders of our common stock to elect directors other than the candidates nominated by our board of directors.

***If we are unable to redeem the Series A Preferred Shares after five years, the cost of this capital to us will increase substantially.***

If we are unable to redeem the Series A Preferred Shares prior to February 15, 2014, the cost of this capital to us will increase substantially on that date, from 5.0% per annum (approximately \$2.5 million annually) to 9.0% per annum (approximately \$4.5 million annually). Depending on our financial condition at the time, this increase in the annual dividend rate on the Series A Preferred Shares could have a material negative effect on our liquidity.

***The securities purchase agreement between us and the Treasury limits our ability to pay dividends on and repurchase our common stock.***

The securities purchase agreement between us and the Treasury provides that prior to the earlier of January 16, 2012 and the date on which all of the Series A Preferred Shares have been redeemed by us or transferred by the Treasury to third parties, we may not, without the consent of the Treasury, (a) increase the cash dividend on our common stock or (b) subject to limited exceptions, redeem, repurchase or otherwise acquire any shares of our common stock or preferred stock (other than the Series A Preferred Shares) or any trust preferred securities issued by us. In addition, we are unable to pay any dividends on our common stock unless we are current in our dividend payments on the Series A Preferred Shares. These restrictions, together with the potentially dilutive impact of the Warrant described in the next risk factor, could have a negative effect on the value of our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, as and if declared by our board of directors. Although we have historically paid cash dividends on our common stock, we are not required to do so and our board of directors could reduce or eliminate our common stock dividend in the future.

***We may be unable to, or choose not to, pay dividends on our common stock.***

Although we have paid a quarterly dividend on our common stock since the second quarter of 2003 and expect to continue this practice, we cannot assure you of our ability to continue. Our ability to pay dividends depends on the following factors, among others:

We may not have sufficient earnings since our primary source of income, the payment of dividends to us by our bank subsidiaries, is subject to federal and state laws that limit the ability of these banks to pay dividends.

Federal Reserve Board policy requires bank holding companies to pay cash dividends on common stock only out of net income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition.

Before dividends may be paid on our common stock in any year, payments must be made on our subordinated debentures and the Series A Preferred Shares as described in these Risk Factors and elsewhere in this registration statement.

Our board of directors may determine that, even though funds are available for dividend payments, retaining the funds for internal uses, such as expansion of our operations, is a better strategy.

If we fail to pay dividends, capital appreciation, if any, of our common stock may be the sole opportunity for gains on an investment in our common stock. In addition, in the event our bank subsidiaries become unable to pay dividends to us, we may not be able to service our debt, pay our other obligations or pay dividends on the Series A Preferred Shares or our common stock. Accordingly, our inability to receive dividends from our bank subsidiaries could also have a material adverse effect on our business, financial condition and results of operations and the value of your investment in our common stock.

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### ***The Series A Preferred Shares impact net income available to our common stockholders and earnings per common share, and the Warrant we issued to the Treasury may be dilutive to holders of our common stock.***

The dividends declared on the Series A Preferred Shares will reduce the net income available to common stockholders and our earnings per common share. The Series A Preferred Shares will also receive preferential treatment in the event of liquidation, dissolution or winding up of the Company. Additionally, the ownership interest of the existing holders of our common stock will be diluted to the extent the Warrant we issued to the Treasury in conjunction with the sale to the Treasury of the Series A Preferred Shares is exercised. The shares of common stock underlying the Warrant represent approximately 1.4% of the shares of our common stock outstanding as of December 31, 2008 (including the shares issuable upon exercise of the Warrant in total shares outstanding). Although the Treasury has agreed not to vote any of the shares of common stock it receives upon exercise of the Warrant, a transferee of any portion of the Warrant or of any shares of common stock acquired upon exercise of the Warrant is not bound by this restriction.

### ***The price of our common stock can be volatile.***

The price of our common stock can fluctuate widely in response to a variety of factors. Factors include actual or anticipated variations in our quarterly operating results, recommendations by securities analysts, operating and stock price performance of other companies, news reports, results of litigation and other factors, including those described in this Risk Factors section. General market fluctuations, industry factors and general economic conditions and events, such as economic slowdowns or recessions, interest rate changes and credit loss trends could also cause our common stock price to decrease regardless of our operating results. Our common stock also has a low average daily trading volume relative to many other stocks. This can lead to significant price swings even when a relatively small number of shares are being traded.

### ***Our stock trading volume may not provide adequate liquidity for investors.***

Although shares of our common stock are listed for trade on the NASDAQ Global Select Market, the average daily trading volume in the common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of a sufficient number of willing buyers and sellers of the common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the daily average trading volume of our common stock, significant sales of the common stock in a brief period of time, or the expectation of these sales, could cause a decline in the price of our common stock.

### ***Our common stock is not an insured deposit.***

Our common stock is not a bank deposit and, therefore, losses in its value are not insured by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this Risk Factors section and elsewhere in this report, and is subject to the same market forces that affect the price of common stock in any other company.

## **Item 1B. UNRESOLVED STAFF COMMENTS**

There are currently no unresolved Commission staff comments.

## **Item 2. PROPERTIES**

The Company's main office is located in a company owned 33,000 square foot building located at 719 Harkrider Street in downtown Conway, Arkansas. As of December 31, 2008 our bank subsidiaries own or lease a total of 52 branches throughout Arkansas, 9 branches in the Florida Keys and 3 branches in Southwest Florida. The Company also owns or leases other buildings that provide space for operations, mortgage lending and other general purposes. We believe that our banking and other offices are in good condition and are suitable to our needs.

**Table of Contents****Item 3. LEGAL PROCEEDINGS**

While we and our bank subsidiaries and other affiliates are from time to time parties to various legal proceedings arising in the ordinary course of their business, management believes, after consultation with legal counsel, that there are no proceedings threatened or pending against us or our bank subsidiaries or other affiliates that will, individually or in the aggregate, have a material adverse effect on our business or consolidated financial condition.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security-holders, through the solicitation of proxies or otherwise, during the fourth quarter of the fiscal year covered by this report.

**PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock trades on the Nasdaq National Market in the Global Select Market System under the symbol HOMB. The following table sets forth, for all the periods indicated, cash dividends declared, and the high and low closing bid prices for our common stock (stock dividend adjusted).

	Price per Common Share		Quarterly Dividends Per Common Share
	High	Low	
<b>2008</b>			
1st Quarter	\$20.33	\$17.81	\$ 0.046
2nd Quarter	22.45	19.41	0.051
3rd Quarter	31.23	19.63	0.060
4th Quarter	27.77	21.87	0.065
<b>2007</b>			
1st Quarter	\$23.25	\$20.16	\$ 0.023
2nd Quarter	21.89	20.06	0.032
3rd Quarter	21.37	18.30	0.037
4th Quarter	21.30	17.82	0.042

As of February 25, 2009, there were 879 shareholders of record of the Company's common stock.

Our policy is to declare regular quarterly dividends based upon our earnings, financial position, capital improvements and such other factors deemed relevant by the Board of Directors. The dividend policy is subject to change, however, and the payment of dividends is necessarily dependent upon the availability of earnings and future financial condition. In January 2009, the Company issued 50,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A totaling \$50.0 million to the United States Department of Treasury under the Capital Purchase Program of the Emergency Economic Stabilization Act of 2008. The agreement between the Company and the Treasury limits the payment of dividends on the Common Stock to a quarterly cash dividend of not more than \$0.06 per share without approval by the Treasury. This limitation will be in effect until the earlier of January 16, 2012, and the day we redeem all the Series A Preferred Shares or UST transfers them all to a third party.

There were no sales of our unregistered securities during the period covered by this report.

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We currently maintain a compensation plan, Home BancShares, Inc. 2006 Stock Option and Performance Incentive Plan, which provides for the issuance of stock-based compensation to directors, officers and other employees. This plan has been approved by the shareholders. The following table sets forth information regarding outstanding options and shares reserved for future issuance under the foregoing plan as of December 31, 2008:

<b>Plan Category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights (b)</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding shares reflected in column (a)) (c)</b>
Equity compensation plans approved by the shareholders	1,069,321	\$ 11.72	395,793
Equity compensation plans not approved by the shareholders			
	30		



**Table of Contents****Performance Graph**

Below is a graph which summarizes the cumulative return earned by the Company's stockholders since its shares of common stock were registered under Section 12 of the Exchange Act on June 22, 2006, compared with the cumulative total return on the Russell 2000 Index and SNL Bank and Thrift Index. This presentation assumes that the value of the investment in the Company's common stock and each index was \$100.00 on June 22, 2006 and that subsequent cash dividends were reinvested.

<i><b>Index</b></i>	<i><b>Period Ending</b></i>					
	<b>06/22/06</b>	<b>12/31/06</b>	<b>06/30/07</b>	<b>12/31/07</b>	<b>06/30/08</b>	<b>12/31/08</b>
Home BancShares, Inc.	100.00	133.86	125.90	117.54	126.59	164.74
Russell 2000	100.00	115.28	122.71	113.47	102.84	75.13
SNL Bank and Thrift	100.00	112.35	107.64	85.68	59.71	49.27

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**Table of Contents****Item 6. SELECTED FINANCIAL DATA.****Summary Consolidated Financial Data**

	As of or for the Years Ended December 31,				
	2008	2007	2006	2005	2004
	(Dollars and shares in thousands, except per share data(a))				
<b>Income statement data:</b>					
Total interest income	\$ 145,718	\$ 141,765	\$ 123,763	\$ 85,458	\$ 36,681
Total interest expense	59,666	73,778	60,940	36,002	11,580
Net interest income	86,052	67,987	62,823	49,456	25,101
Provision for loan losses	27,016	3,242	2,307	3,827	2,290
Net interest income after provision for loan losses	59,036	64,745	60,516	45,629	22,811
Non-interest income	22,615	25,754	19,127	15,222	13,681
Gain on sale of equity investment	6,102			465	4,410
Non-interest expense	75,717	61,535	56,478	44,935	26,131
Income before income taxes and minority interest	12,036	28,964	23,165	16,381	14,771
Provision for income taxes	1,920	8,519	7,247	4,935	5,030
Minority interest					582
Net income	\$ 10,116	\$ 20,445	\$ 15,918	\$ 11,446	\$ 9,159
<b>Per share data:</b>					
Basic earnings	\$ 0.51	\$ 1.10	\$ 0.99	\$ 0.85	\$ 1.00
Diluted earnings	0.50	1.08	0.93	0.76	0.87
Diluted cash earnings (1)	0.55	1.14	0.99	0.82	0.91
Book value per common share	14.25	13.58	12.45	10.60	9.95
Book value per share with preferred converted to common (2)	14.25	13.58	12.45	10.77	10.25
Tangible book value per common share (3) (6)	11.40	11.16	9.93	6.88	7.31
Tangible book value per share with preferred converted to common (2) (3)	11.40	11.16	9.93	7.60	8.06
Dividends Common	0.222	0.134	0.083	0.065	0.037
Average common shares outstanding	19,816	18,614	15,657	12,811	8,625
Average diluted shares outstanding	20,313	18,927	17,197	15,000	10,566
<b>Performance ratios:</b>					
Return on average assets	0.39%	0.92%	0.78%	0.69%	1.17%
Cash return on average assets (7)	0.44	0.98	0.86	0.76	1.26
Return on average shareholders' equity	3.51	8.50	8.12	7.27	8.61
Cash return on average tangible equity (3) (8)	4.88	11.06	11.46	10.16	11.54

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Net interest margin (10)	3.82	3.52	3.51	3.37	3.75
Efficiency ratio (4)	62.68	62.10	64.99	64.94	57.65
<b>Asset quality:</b>					
Nonperforming assets to total assets	1.42%	0.36%	0.23%	0.47%	1.18%
Nonperforming loans to total loans	1.53	0.20	0.32	0.69	1.73
Allowance for loan losses to nonperforming loans	135.08	903.97	574.37	291.62	182.40
Allowance for loans losses to total loans	2.06	1.83	1.84	2.01	3.16
Net (recoveries) charge-offs to average loans	1.01		0.03	0.38	0.13
		32			

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**Table of Contents****Summary Consolidated Financial Data    Continued**

	As of or for the Years Ended December 31,				
	2008	2007	2006	2005	2004
	(Dollars and shares in thousands, except per share data(a))				
<b>Balance sheet data (period end):</b>					
Total assets	\$2,580,093	\$2,291,630	\$2,190,648	\$1,911,491	\$805,186
Investment securities	355,244	430,399	531,891	530,302	190,466
Loans receivable	1,956,232	1,606,994	1,416,295	1,204,589	516,655
Allowance for loan losses	40,385	29,406	26,111	24,175	16,345
Intangible assets	56,585	45,229	46,985	48,727	22,816
Non-interest-bearing deposits	249,349	211,993	215,142	209,974	86,186
Total deposits	1,847,908	1,592,206	1,607,194	1,427,108	552,878
Subordinated debentures (trust preferred securities)	47,575	44,572	44,663	44,755	24,219
Shareholders' equity	283,044	253,056	231,419	165,857	106,610
<b>Capital ratios:</b>					
Equity to assets	10.97%	11.04%	10.56%	8.68%	13.24%
Tangible equity to tangible assets (3) (9)	8.97	9.25	8.60	6.29	10.71
Tier 1 leverage ratio (5)	10.87	11.44	11.29	9.22	13.47
Tier 1 risk-based capital ratio	12.70	13.45	14.57	12.25	17.39
Total risk-based capital ratio	13.95	14.70	15.83	13.51	17.39
Dividend payout common	43.53	12.23	8.46	7.30	3.71

(a) All per share amounts have been restated to reflect the effect of the 8% stock dividend.

(1) Diluted cash earnings per share reflect diluted earnings per share plus per share intangible amortization expense, net of the corresponding tax effect. See Management's Discussion and Analysis of Financial Condition and Results of Operations Table

20, for the non-GAAP tabular reconciliation.

- (2) Shares of Class A preferred stock and Class B preferred stock outstanding on the indicated dates are assumed to have been converted to shares of common stock.
- (3) Tangible calculations eliminate the effect of goodwill and acquisition-related intangible assets and the corresponding amortization expense on a tax-effected basis.
- (4) The efficiency ratio is calculated by dividing non-interest expense less amortization of core deposit intangibles by the sum of net interest income on a tax equivalent basis and non-interest income.
- (5) Leverage ratio is Tier 1 capital to quarterly average total assets less intangible assets and gross unrealized gains/losses on available-for-sale investment securities.

- (6) See Management's Discussion and Analysis of Financial Condition and Results of Operations Table 21, for the non-GAAP tabular reconciliation.
- (7) See Management's Discussion and Analysis of Financial Condition and Results of Operations Table 22, for the non-GAAP tabular reconciliation.
- (8) See Management's Discussion and Analysis of Financial Condition and Results of Operations Table 23, for the non-GAAP tabular reconciliation.
- (9) See Management's Discussion and Analysis of Financial Condition and Results of Operations Table 24, for the non-GAAP tabular reconciliation.
- (10) Fully taxable equivalent (assuming an income tax rate of 39.225% for 2008, 2007, 2006, 2005,

and 2004).

**Table of Contents****Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis presents our consolidated financial condition and results of operations for the years ended December 31, 2008, 2007 and 2006. This discussion should be read together with the Summary Consolidated Financial Data, our financial statements and the notes thereto, and other financial data included in this document. In addition to the historical information provided below, we have made certain estimates and forward-looking statements that involve risks and uncertainties. Our actual results could differ significantly from those anticipated in these estimates and in the forward-looking statements as a result of certain factors, including those discussed in the section of this document captioned Risk Factors, and elsewhere in this document. Unless the context requires otherwise, the terms us, we, and our refer to Home BancShares, Inc. on a consolidated basis.

**General**

We are a bank holding company headquartered in Conway, Arkansas, offering a broad array of financial services through our five wholly owned bank subsidiaries. As of December 31, 2008, we had, on a consolidated basis, total assets of \$2.58 billion, loans receivable of \$1.96 billion, total deposits of \$1.85 billion, and shareholders' equity of \$283.0 million.

We generate most of our revenue from interest on loans and investments, service charges, and mortgage banking income. Deposits are our primary source of funding. Our largest expenses are interest on these deposits and salaries and related employee benefits. We measure our performance by calculating our return on average equity, return on average assets, and net interest margin. We also measure our performance by our efficiency ratio, which is calculated by dividing non-interest expense less amortization of core deposit intangibles by the sum of net interest income on a tax equivalent basis and non-interest income.

**Key Financial Measures**

	<b>As of or for the Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Dollars in thousands, except per share data)</b>		
Total assets	\$2,580,093	\$2,291,630	\$2,190,648
Loans receivable	1,956,232	1,606,994	1,416,295
Total deposits	1,847,908	1,592,206	1,607,194
Net income	10,116	20,445	15,918
Basic earnings per share	0.51	1.10	0.99
Diluted earnings per share	0.50	1.08	0.93
Diluted cash earnings per share (1)	0.55	1.14	0.99
Net interest margin FTE	3.82%	3.52%	3.51%
Efficiency ratio	62.68	62.10	64.99
Return on average assets	0.39	0.92	0.78
Return on average equity	3.51	8.50	8.12

(1) See Table 20  
Diluted Cash  
Earnings Per  
Share for a  
reconciliation to  
GAAP for  
diluted cash  
earnings per  
share.

**2008 Overview**



Our net income decreased 50.5% to \$10.1 million for the year ended December 31, 2008, from \$20.4 million for the same period in 2007. On a diluted earnings per share basis, our net earnings decreased 53.7% to \$0.50 for the year ended December 31, 2008, as compared to \$1.08 (stock dividend adjusted) for the same period in 2007.

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The 2008 year to date decrease in earnings is primarily associated with an increase in our provision for loan losses associated with the unfavorable economic conditions, particularly in the Florida market, combined with write-downs on other real estate owned, merger expenses from our bank charter consolidation and an impairment write-off on two trust preferred investment securities. These items were mitigated by our acquisition of Centennial Bancshares, Inc., a gain on the sale of our investment in White River Bancshares, Inc. and organic growth of our bank subsidiaries.

Our return on average assets was 0.39% for the year ended December 31, 2008, compared to 0.92% for the same period in 2007. Our return on average equity was 3.51% for the year ended December 31, 2008, compared to 8.50% for the same period in 2007. The changes were primarily due to the previously discussed changes in net income for the year ended December 31, 2008, compared to the same period in 2007.

Our net interest margin, on a fully taxable equivalent basis, was 3.82% for the year ended December 31, 2008, compared to 3.52% for the same period in 2007. Our strong loan growth which was funded by run off in the investment portfolio and deposit growth in 2008, combined with our acquisition of Centennial Bancshares, Inc. and improved pricing on our deposits allowed the Company to improve net interest margin.

Our efficiency ratio (calculated by dividing non-interest expense less amortization of core deposit intangibles by the sum of net interest income on a tax equivalent basis and non-interest income) was 62.68% for the year ended December 31, 2008, compared to 62.10% for the same period in 2007. The change in our efficiency ratio is primarily due to continued improvement of our operations offset with the previously discussed changes in net income for the year ended December 31, 2008, compared to the same period in 2007.

Our total assets increased \$288.5 million, a growth of 12.6%, to \$2.58 billion as of December 31, 2008, from \$2.29 billion as of December 31, 2007. Our loan portfolio increased \$349.2 million, a growth of 21.7%, to \$1.96 billion as of December 31, 2008, from \$1.61 billion as of December 31, 2007. Shareholders' equity increased \$30.0 million, a growth of 11.9%, to \$283.0 million as of December 31, 2008, compared to \$253.1 million as of December 31, 2007. Asset and loan increases are primarily associated with our acquisition of Centennial Bancshares, Inc. and organic growth of our bank subsidiaries. During 2008, we experienced \$156.4 million of organic loan growth. The increase in stockholders' equity was primarily the result of the \$24.3 million in additional capital that was issued upon our acquisition of Centennial Bancshares, Inc. combined with the retained earnings during 2008.

As of December 31, 2008, our non-performing loans increased to \$29.9 million, or 1.53%, of total loans from \$3.3 million, or 0.20%, of total loans as of December 31, 2007. The allowance for loan losses as a percent of non-performing loans decreased to 135.08% as of December 31, 2008, compared to 904% from December 31, 2007. Unfavorable economic conditions in the Florida market increased our non-performing loans by \$17.3 million. The remaining increase in non-performing loans is associated with our Arkansas market which includes an increase of \$620,000 from our acquisition of Centennial Bancshares, Inc.

As of December 31, 2008, our non-performing assets increased to \$36.7 million, or 1.42%, of total assets from \$8.4 million, or 0.36%, of total assets as of December 31, 2007. The increase in non-performing assets is primarily the result of the \$26.6 million increase in non-performing loans combined with a \$1.7 million increase in foreclosed assets held for sale.

### **2007 Overview**

Our net income increased \$4.5 million, or 28.4%, to \$20.4 million for the year ended December 31, 2007, from \$15.9 million for the same period in 2006. Diluted earnings per share increased \$0.15, or 16.1%, to \$1.08 for the year ended December 31, 2007, from \$0.93 for 2006. The increase in earnings is primarily associated with organic growth of our bank subsidiaries.

Our return on average equity was 8.50% for the year ended December 31, 2007, compared to 8.12% for 2006. While net income for 2007 increased considerably, return on average equity only increased slightly as a result of the increase in average stockholders' equity from the net proceeds of our initial public offering in 2006 and retained earnings.

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Our return on average assets was 0.92% for the year ended December 31, 2007, compared to 0.78% for 2006. The increase was primarily due to the \$4.5 million improvement in net income for 2007 compared to 2006.

Our net interest margin on a fully tax equivalent basis was 3.52% for the year ended December 31, 2007, compared to 3.51% for 2006. During 2006, competitive pressures and a slightly inverted yield curve put pressure on our net interest margin. The current competitive pressures eased somewhat during 2007, allowing for a comparable net interest margin from December 31, 2006 to December 31, 2007 by achieving strong loan growth that was funded by both the run off in the investment portfolio and more reasonably priced interest-bearing liabilities.

Our efficiency ratio (calculated by dividing non-interest expense less amortization of core deposit intangibles by the sum of net interest income on a tax equivalent basis and non-interest income) was 62.10% for the year ended December 31, 2007, compared to 64.99% for 2006. The improvement in our efficiency ratio is primarily due to an increase in net interest income from the net proceeds of our initial public offering and continued improvement of our operations.

Our total assets increased \$101.0 million, or 4.6%, to \$2.29 billion as of December 31, 2007, compared to \$2.19 billion as of December 31, 2006. Our loan portfolio increased \$190.7 million, or 13.5%, to \$1.61 billion as of December 31, 2007, from \$1.42 billion as of December 31, 2006. Shareholders' equity increased \$21.7 million, or 9.4%, to \$253.1 million as of December 31, 2007, from \$231.4 million as of December 31, 2006. Asset and loan increases are primarily associated with organic growth of our bank subsidiaries. The increase in stockholders' equity was primarily the result of retained earnings during 2007.

As of December 31, 2007, our asset quality improved as non-performing loans declined to \$3.3 million, or 0.20%, of total loans from \$4.5 million, or 0.32%, of total loans as of the prior year-end. The allowance for loan losses as a percent of non-performing loans improved to 904.0% as of December 31, 2007, compared to 574.4% from the prior year-end.

### **Critical Accounting Policies**

*Overview.* We prepare our consolidated financial statements based on the selection of certain accounting policies, generally accepted accounting principles and customary practices in the banking industry. These policies, in certain areas, require us to make significant estimates and assumptions. Our accounting policies are described in detail in the notes to our consolidated financial statements included as part of this document.

We consider a policy critical if (i) the accounting estimate requires assumptions about matters that are highly uncertain at the time of the accounting estimate; and (ii) different estimates that could reasonably have been used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on our financial statements. Using these criteria, we believe that the accounting policies most critical to us are those associated with our lending practices, including the accounting for the allowance for loan losses, investments, intangible assets, income taxes and stock options.

*Investments.* Securities available for sale are reported at fair value with unrealized holding gains and losses reported as a separate component of shareholders' equity and other comprehensive income (loss), net of taxes. Securities that are held as available for sale are used as a part of our asset/liability management strategy. Securities that may be sold in response to interest rate changes, changes in prepayment risk, the need to increase regulatory capital, and other similar factors are classified as available for sale.

*Loans Receivable and Allowance for Loan Losses.* Substantially all of our loans receivable are reported at their outstanding principal balance adjusted for any charge-offs, as it is management's intent to hold them for the foreseeable future or until maturity or payoff. Interest income on loans is accrued over the term of the loans based on the principal balance outstanding.

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The allowance for loan losses is established through a provision for loan losses charged against income. The allowance represents an amount that, in management's judgment, will be adequate to absorb probable credit losses on identifiable loans that may become uncollectible and probable credit losses inherent in the remainder of the loan portfolio. The amounts of provisions for loan losses are based on management's analysis and evaluation of the loan portfolio for identification of problem credits, internal and external factors that may affect collectability, relevant credit exposure, particular risks inherent in different kinds of lending, current collateral values and other relevant factors.

We consider a loan to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms thereof. We apply this policy even if delays or shortfalls in payments are expected to be insignificant. All non-accrual loans and all loans that have been restructured from their original contractual terms are considered impaired loans. The aggregate amount of impaired loans is used in evaluating the adequacy of the allowance for loan losses and amount of provisions thereto. Losses on impaired loans are charged against the allowance for loan losses when in the process of collection it appears likely that losses will be realized. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When accrual of interest is discontinued, all unpaid accrued interest is reversed.

Loans are placed on non-accrual status when management believes that the borrower's financial condition, after giving consideration to economic and business conditions and collection efforts, is such that collection of interest is doubtful, or generally when loans are 90 days or more past due. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Accrued interest related to non-accrual loans is generally charged against the allowance for loan losses when accrued in prior years and reversed from interest income if accrued in the current year. Interest income on non-accrual loans may be recognized to the extent cash payments are received, although the majority of payments received are usually applied to principal. Non-accrual loans are generally returned to accrual status when principal and interest payments are less than 90 days past due, the customer has made required payments for at least six months, and we reasonably expect to collect all principal and interest.

*Intangible Assets.* Intangible assets consist of goodwill and core deposit intangibles. Goodwill represents the excess purchase price over the fair value of net assets acquired in business acquisitions. The core deposit intangible represents the excess intangible value of acquired deposit customer relationships as determined by valuation specialists. The core deposit intangibles are being amortized over 84 to 114 months on a straight-line basis. Goodwill is not amortized but rather is evaluated for impairment on at least an annual basis. We perform an annual impairment test of goodwill and core deposit intangibles as required by SFAS No. 142, *Goodwill and Other Intangible Assets*, in the fourth quarter.

*Income Taxes.* We use the liability method in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based upon the difference between the values of the assets and liabilities as reflected in the financial statements and their related tax basis using enacted tax rates in effect for the year in which the differences are expected to be recovered or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Any estimated tax exposure items identified would be considered in a tax contingency reserve. Changes in any tax contingency reserve would be based on specific development, events, or transactions.

We and our subsidiaries file consolidated tax returns. Our subsidiaries provide for income taxes on a separate return basis, and remit to us amounts determined to be currently payable.

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*Stock Options.* Prior to 2006, we elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations in accounting for employee stock options using the fair value method. Under APB 25, because the exercise price of the options equals the estimated market price of the stock on the issuance date, no compensation expense is recorded. On January 1, 2006, we adopted SFAS No. 123, *Share-Based Payment* (Revised 2004) which establishes standards for the accounting for transactions in which an entity (i) exchanges its equity instruments for goods and services, or (ii) incurs liabilities in exchange for goods and services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of the equity instruments. SFAS 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which is generally the date of the grant.

**Acquisitions and Equity Investments**

On January 1, 2008, we acquired Centennial Bancshares, Inc., an Arkansas bank holding company. Centennial Bancshares, Inc. owned Centennial Bank, located in Little Rock, Arkansas which had total assets of \$234.1 million, loans of \$192.8 million and total deposits of \$178.8 million on the date of acquisition. The consideration for the merger was \$25.4 million, which was paid approximately 4.6%, or \$1.2 million in cash and 95.4%, or \$24.3 million, in shares of our common stock. In connection with the acquisition, \$3.0 million of the purchase price, consisting of \$139,000 in cash and 140,456 shares (stock dividend adjusted) of our common stock, was placed in escrow related to possible losses from identified loans and an IRS examination. In the first quarter of 2008, the IRS examination was completed which resulted in \$1.0 million of the escrow proceeds being released. The merger further provides for an earn out based upon 2008 earnings of up to a maximum of 196,364 common shares (stock dividend adjusted) or \$4,000,000 in cash which can be paid in stock or cash at the election of the accredited shareholders. All of the conditions of this contingent consideration will be completed in the first quarter of 2009. Presently, it does not appear that the maximum will be paid. As a result of this transaction, we recorded goodwill of \$12.3 million and a core deposit intangible of \$694,000 during 2008.

In January 2005, we purchased 20% of the common stock during the formation of White River Bancshares, Inc. of Fayetteville, Arkansas for \$9.1 million. White River Bancshares owns all of the stock of Signature Bank of Arkansas, with branch locations in northwest Arkansas. In January 2006, White River Bancshares issued an additional \$15.0 million of common stock. To maintain our 20% ownership, we made an additional investment of \$3.0 million in January 2006. During April 2007, White River Bancshares acquired 100% of the stock of Brinkley Bancshares, Inc. in Brinkley, Arkansas. As a result, we made a \$2.6 million additional investment in White River Bancshares on June 29, 2007 to maintain our 20% ownership. On March 3, 2008, White River Bancshares repurchased our 20% investment in their company which resulted in a one-time gain of \$6.1 million.

In our continuing evaluation of our growth plans for the Company, we believe properly priced bank acquisitions can complement our organic growth and de novo branching growth strategies. The Company's acquisition focus will be to expand in its primary market areas of Arkansas and Florida. We are continually evaluating potential bank acquisitions to determine what is in the best interest of our Company. Our goal in making these decisions is to maximize the return to our investors.

**De Novo Branching**

We intend to continue to open new (commonly referred to de novo) branches in our current markets and in other attractive market areas if opportunities arise. During 2008, we opened two de novo branch locations. These branch locations are located in the Arkansas communities of Morrilton and Cabot. Presently, we are evaluating additional opportunities and have one firm commitment for a de novo branch in Heber Springs, Arkansas during the first part of 2009.

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**Charter Consolidation**

In July 2008, management of Home BancShares, Inc. approved the combining of all six of the Company's individually chartered banks into one charter. The six banks will adopt Centennial Bank as their common name.

In the fourth quarter of 2008, First State Bank and Marine Bank consolidated and adopted Centennial Bank as its new name. Assuming regulatory approvals are received, Community Bank and Bank of Mountain View will follow suit in the first quarter of 2009, and Twin City Bank and the original Centennial Bank will complete the process in the summer of 2009. All of the banks will, at that time, have the same name, logo and charter allowing for a more customer-friendly banking experience and seamless transactions across our entire banking network.

This decision is based in part on our continuing efforts to improve efficiency and the results of a study conducted for us by a third party. This structure will improve product and service offerings by the combined banks plus provide a greater value to customers in pricing and delivery systems across the company. We remain committed to our community banking philosophy and will continue to rely on local management and boards of directors.

**Holding Company Status**

During the second quarter of 2008, we changed from a financial holding company to a bank holding company. Since, we were not utilizing any of the additional permitted activities allowed to our financial holding company status; this will not change any of our current business practices.

**Results of Operations for the Years Ended December 31, 2008, 2007 and 2006**

The 2008 year to date decrease in earnings is primarily associated with an increase in our provision for loan losses associated with the unfavorable economic conditions, particularly in the Florida market, combined with write-downs on other real estate owned, merger expenses from our bank charter consolidation and an impairment write-off on two trust preferred investment securities. These items were mitigated from our acquisition of Centennial Bancshares, Inc., a gain on the sale of our investment in White River Bancshares, Inc. and organic growth of our bank subsidiaries.

Our net income increased \$4.5 million, or 28.4%, to \$20.4 million for the year ended December 31, 2007, from \$15.9 million for the same period in 2006. Diluted earnings per share increased \$0.15, or 16.1%, to \$1.08 for the year ended December 31, 2007, from \$0.93 for 2006. The increase in earnings is primarily associated with organic growth of our bank subsidiaries.

***Net Interest Income***

Net interest income, our principal source of earnings, is the difference between the interest income generated by earning assets and the total interest cost of the deposits and borrowings obtained to fund those assets. Factors affecting the level of net interest income include the volume of earning assets and interest-bearing liabilities, yields earned on loans and investments and rates paid on deposits and other borrowings, the level of non-performing loans and the amount of non-interest-bearing liabilities supporting earning assets. Net interest income is analyzed in the discussion and tables below on a fully taxable equivalent basis. The adjustment to convert certain income to a fully taxable equivalent basis consists of dividing tax-exempt income by one minus the combined federal and state income tax rate.

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The Federal Reserve Board sets various benchmark rates, including the Federal Funds rate, and thereby influences the general market rates of interest, including the deposit and loan rates offered by financial institutions. The Federal Funds rate, which is the cost to banks of immediately available overnight funds, began in 2006 at 4.25%. During 2006, the Federal Funds rate increased 100 basis points at a rate of 25 basis points until June 29, 2006 when it reached 5.25%. The 5.25% rate then remained constant until September 18, 2007, when the Federal Funds rate was lowered by 50 basis points to 4.75%. The Federal Funds rate decreased another 25 basis points on October 31, 2007 and December 11, 2007 returning to 4.25%. During 2008, the rate decreased by 75 basis points on January 22, 2008, 50 basis points on January 30, 2008, 75 basis points on March 18, 2008, 25 basis points on April 30, 2008 and 50 basis points to a rate of 1.50% as of October 8, 2008. The rate continued to fall 50 basis points on October 29, 2008 and 75 to 100 basis points to a low of 0.25% to 0% on December 16, 2008.

Net interest income on a fully taxable equivalent basis increased \$18.6 million, or 26.4%, to \$89.1 million for the year ended December 31, 2008, from \$70.5 million for the same period in 2007. This increase in net interest income was the result of a \$4.5 million increase in interest income combined with a \$14.1 million decrease in interest expense. The \$4.5 million increase in interest income was primarily the result of our acquisition of Centennial Bancshares, Inc. and organic growth of our bank subsidiaries offset by the repricing of our earning assets in the declining interest rate environment. The higher level of earning assets resulted in an improvement in interest income of \$25.7 million, and our earning assets repricing in the declining interest rate environment resulted in a \$21.2 million decrease in interest income for the year ended December 31, 2008. The \$14.1 million decrease in interest expense for the year ended December 31, 2008, is primarily the result of our interest bearing liabilities repricing in the declining interest rate environment offset by our acquisition of Centennial Bancshares, Inc. and organic growth of our bank subsidiaries. The repricing of our interest bearing liabilities in the declining interest rate environment resulted in a \$24.8 million decrease in interest expense for the year ended December 31, 2008. The higher level of interest-bearing liabilities resulted in additional interest expense of \$10.7 million.

Due to the rate reductions occurring late in 2007, its impact for the year was minimal. Average interest rates for 2007 reflect the higher interest rate environment that existed until September 18, 2007 when the Federal Funds rate was lowered. Net interest income on a fully taxable equivalent basis increased 8.4% to \$70.5 million for the year ended December 31, 2007, from \$65.1 million for 2006. This increase in net interest income was the result of an \$18.3 million increase in interest income offset by \$12.8 million increase in interest expense. The \$18.3 million increase in interest income was primarily the result of organic growth of our bank subsidiaries combined with the repricing of our earning assets in the higher interest rate environment. The higher level of earning assets resulted in an improvement in interest income of \$13.7 million, and our earning assets repricing in the higher interest rate environment resulted in a \$4.6 million increase in interest income during 2007. The \$12.8 million increase in interest expense for the year ended December 31, 2007, is primarily the result of organic growth of our bank subsidiaries combined with our interest bearing liabilities repricing in the higher interest rate environment. The higher level of interest-bearing liabilities resulted in additional interest expense of \$6.0 million. The repricing of our interest bearing liabilities in the higher interest rate environment resulted in a \$6.8 million increase in interest expense during 2007.

Net interest margin, on a fully taxable equivalent basis, was 3.82% for the year ended December 31, 2008 compared to 3.52% for the same periods in 2007, respectively. Our strong loan growth which was funded by run off in the investment portfolio and deposit growth in 2008, combined with our acquisition of Centennial Bancshares, Inc. and improved pricing on our deposits allowed the Company to improve net interest margin.

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Tables 1 and 2 reflect an analysis of net interest income on a fully taxable equivalent basis for the years ended December 31, 2008, 2007 and 2006, as well as changes in fully taxable equivalent net interest margin for the years 2008 compared to 2007 and 2007 compared to 2006.

**Table 1: Analysis of Net Interest Income**

	Years Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Interest income	\$ 145,718	\$ 141,765	\$ 123,763
Fully taxable equivalent adjustment	3,084	2,526	2,229
Interest income fully taxable equivalent	148,802	144,291	125,992
Interest expense	59,666	73,778	60,940
Net interest income fully taxable equivalent	\$ 89,136	\$ 70,513	\$ 65,052
Yield on earning assets fully taxable equivalent	6.37%	7.21%	6.80%
Cost of interest-bearing liabilities	2.91	4.18	3.79
Net interest spread fully taxable equivalent	3.46	3.03	3.01
Net interest margin fully taxable equivalent	3.82	3.52	3.51

**Table 2: Changes in Fully Taxable Equivalent Net Interest Margin**

	December 31,	
	2008 vs. 2007	2007 vs. 2006
	(In thousands)	
Increase in interest income due to change in earning assets	\$ 25,679	\$ 13,719
(Decrease) increase in interest income due to change in earning asset yields	(21,168)	4,580
Increase in interest expense due to change in interest-bearing liabilities	10,674	6,006
(Decrease) increase in interest expense due to change in interest rates paid on interest-bearing liabilities	(24,786)	6,832
Increase in net interest income	\$ 18,623	\$ 5,461



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Table 3 shows, for each major category of earning assets and interest-bearing liabilities, the average amount outstanding, the interest income or expense on that amount and the average rate earned or expensed for the years ended December 31, 2008, 2007 and 2006. The table also shows the average rate earned on all earning assets, the average rate expensed on all interest-bearing liabilities, the net interest spread and the net interest margin for the same periods. The analysis is presented on a fully taxable equivalent basis. Non-accrual loans were included in average loans for the purpose of calculating the rate earned on total loans.

**Table 3: Average Balance Sheets and Net Interest Income Analysis**

	Years Ended December 31,								
	2008			2007			2006		
	Average	Income /	Yield	Average	Income /	Yield	Average	Income /	Yield
	Balance	Expense	/	Balance	Expense	/	Balance	Expense	/
	(Dollars in thousands)								
ASSETS									
Earning assets									
Interest-bearing									
balances due from									
banks	\$ 5,691	\$ 133	2.34%	\$ 3,235	\$ 166	5.13%	\$ 2,939	\$ 139	4.73%
Federal funds sold	14,745	313	2.12	6,683	342	5.12	16,870	840	4.98
Investment securities									
taxable	279,152	12,610	4.52	371,893	17,003	4.57	427,696	18,879	4.41
Investment securities									
non-taxable	112,724	7,649	6.79	98,539	6,468	6.56	91,232	5,814	6.37
Loans receivable	1,922,861	128,097	6.66	1,521,881	120,312	7.91	1,314,611	100,320	7.63
Total interest-earning									
assets	2,335,173	148,802	6.37	2,002,231	144,291	7.21	1,853,348	125,992	6.80
Non-earning assets	249,767			231,114			177,170		
Total assets	\$ 2,584,940			\$ 2,233,345			\$ 2,030,518		
LIABILITIES AND SHAREHOLDERS EQUITY									
Liabilities									
Interest-bearing									
liabilities									
Interest-bearing									
transaction and									
savings deposits	\$ 684,234	\$ 10,736	1.57%	\$ 591,874	\$ 17,032	2.88%	\$ 530,219	\$ 13,179	2.49%
Time deposits	937,270	34,857	3.72	807,765	39,200	4.85	763,291	33,034	4.33
Total interest-bearing									
deposits	1,621,504	45,593	2.81	1,399,639	56,232	4.02	1,293,510	46,213	3.57
Federal funds									
purchased	7,850	182	2.32	15,538	816	5.25	13,889	689	4.96

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Securities sold under agreement to repurchase	111,398	1,522	1.37	121,751	4,746	3.90	111,635	4,420	3.96
FHLB and other borrowed funds	259,162	9,255	3.57	183,248	8,982	4.90	144,074	6,627	4.60
Subordinated debentures	47,622	3,114	6.54	44,620	3,002	6.73	44,710	2,991	6.69
Total interest-bearing liabilities	2,047,536	59,666	2.91	1,764,796	73,778	4.18	1,607,818	60,940	3.79
Non-interest bearing liabilities									
Non-interest-bearing deposits	236,009			215,212			215,075		
Other liabilities	13,568			12,781			11,611		
Total liabilities	2,297,113			1,992,789			1,834,504		
Shareholders equity	287,827			240,556			196,014		
Total liabilities and shareholders equity	\$ 2,584,940			\$ 2,233,345			\$ 2,030,518		
Net interest spread			3.46%			3.03%			3.01%
Net interest income and margin	\$ 89,136	3.82		\$ 70,513	3.52		\$ 65,052	3.51	

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Table 4 shows changes in interest income and interest expense resulting from changes in volume and changes in interest rates for the year ended December 31, 2008 compared to 2007 and 2007 compared to 2006 on a fully taxable basis. The changes in interest rate and volume have been allocated to changes in average volume and changes in average rates, in proportion to the relationship of absolute dollar amounts of the changes in rates and volume.

**Table 4: Volume/Rate Analysis**

	Years Ended December 31,					
	2008 over 2007			2007 over 2006		
	Volume	Yield /Rate	Total	Volume	Yield /Rate	Total
	(In thousands)					
Increase (decrease) in:						
Interest income:						
Interest-bearing balances due from banks	\$ 86	\$ (119)	\$ (33)	\$ 15	\$ 12	\$ 27
Federal funds sold	251	(280)	(29)	(520)	22	(498)
Investment securities taxable	(4,191)	(202)	(4,393)	(2,532)	656	(1,876)
Investment securities non-taxable	957	224	1,181	476	178	654
Loans receivable	28,576	(20,791)	7,785	16,280	3,712	19,992
Total interest income	25,679	(21,168)	4,511	13,719	4,580	18,299
Interest expense:						
Interest-bearing transaction and savings deposits	2,349	(8,645)	(6,296)	1,635	2,218	3,853
Time deposits	5,687	(10,030)	(4,343)	2,000	4,166	6,166
Federal funds purchased	(298)	(336)	(634)	85	42	127
Securities sold under agreement to repurchase	(373)	(2,851)	(3,224)	395	(69)	326
FHLB and other borrowed funds	3,111	(2,838)	273	1,897	458	2,355
Subordinated debentures	198	(86)	112	(6)	17	11
Total interest expense	10,674	(24,786)	(14,112)	6,006	6,832	12,838
Increase (decrease) in net interest income	\$ 15,005	\$ 3,618	\$ 18,623	\$ 7,713	\$ (2,252)	\$ 5,461

**Provision for Loan Losses**

Our management assesses the adequacy of the allowance for loan losses by applying the provisions of Statement of Financial Accounting Standards No. 5 and No. 114. Specific allocations are determined for loans considered to be impaired and loss factors are assigned to the remainder of the loan portfolio to determine an appropriate level in the allowance for loan losses. The allowance is increased, as necessary, by making a provision for loan losses. The specific allocations for impaired loans are assigned based on an estimated net realizable value after a thorough review of the credit relationship. The potential loss factors associated with the remainder of the loan portfolio are based on an internal net loss experience, as well as management's review of trends within the portfolio and related industries.



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Generally, commercial, commercial real estate, and residential real estate loans are assigned a level of risk at origination. Thereafter, these loans are reviewed on a regular basis. The periodic reviews generally include loan payment and collateral status, the borrowers' financial data, and key ratios such as cash flows, operating income, liquidity, and leverage. A material change in the borrower's credit analysis can result in an increase or decrease in the loan's assigned risk grade. Aggregate dollar volume by risk grade is monitored on an ongoing basis.

Our management reviews certain key loan quality indicators on a monthly basis, including current economic conditions, delinquency trends and ratios, portfolio mix changes, and other information management deems necessary. This review process provides a degree of objective measurement that is used in conjunction with periodic internal evaluations. To the extent that this review process yields differences between estimated and actual observed losses, adjustments are made to the loss factors used to determine the appropriate level of the allowance for loan losses.

The provision for loan losses represents management's determination of the amount necessary to be charged against the current period's earnings, to maintain the allowance for loan losses at a level that is considered adequate in relation to the estimated risk inherent in the loan portfolio. The provision was \$27.0 million for the year ended December 31, 2008, \$3.2 million for 2007, and \$2.3 million for 2006.

Our provision for loan losses increased \$23.8 million, or 733.3% to \$27.0 million for the year ended December 31, 2008, from \$3.2 million for 2007. The increase in the provision is primarily associated with a decline in asset quality in 2008, particularly in our Florida market combined with growth in the loan portfolio. The decrease in our asset quality is primarily related to the unfavorable economic conditions that are impacting our Florida market. The provision for loan losses in our Florida market was approximately \$21.5 million for 2008.

Our provision for loan losses increased \$935,000, or 40.5%, to \$3.2 million for the year ended December 31, 2007, from \$2.3 million for 2006. The increase in the provision is primarily associated with growth in the loan portfolio combined with the unfavorable economic conditions, particularly in the Florida market.

### ***Non-Interest Income***

Total non-interest income was \$28.7 million in 2008, compared to \$25.8 million in 2007 and \$19.1 million in 2006. Our non-interest income includes service charges on deposit accounts, other service charges and fees, trust fees, data processing fees, mortgage banking income, insurance commissions, income from title services, increases in cash value of life insurance, dividends, equity in earnings of unconsolidated affiliates and other income.

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Table 5 measures the various components of our non-interest income for the years ended December 31, 2008, 2007, and 2006, respectively, as well as changes for the years 2008 compared to 2007 and 2007 compared to 2006.

**Table 5: Non-Interest Income**

	Years Ended December 31,			2008 Change		2007 Change	
	2008	2007	2006	from 2007		from 2006	
	(Dollars in thousands)						
Service charges on deposit accounts	\$ 13,656	\$ 11,202	\$ 9,447	\$ 2,454	21.9%	\$ 1,755	18.6%
Other service charges and fees	6,564	5,470	2,642	1,094	20.0	2,828	107.0
Trust fees	73	131	671	(58)	(44.3)	(540)	(80.5)
Data processing fees	930	784	799	146	18.6	(15)	(1.9)
Mortgage lending income	2,771	1,662	1,736	1,109	66.7	(74)	(4.3)
Mortgage servicing income	853			853	100.0		
Insurance commissions	775	762	782	13	1.7	(20)	(2.6)
Income from title services	643	713	957	(70)	(9.8)	(244)	(25.5)
Increase in cash value of life insurance	2,113	2,448	304	(335)	(13.7)	2,144	705.3
Dividends from FHLB, FRB & bankers bank	828	911	659	(83)	(9.1)	252	38.2
Equity in income (loss) of unconsolidated affiliates	102	(86)	(379)	188	(218.6)	293	(77.3)
Gain on sale of equity investment	6,102			6,102	100.0		
Gain on sale of SBA loans	127	170	72	(43)	(25.3)	98	136.1
Gain (loss) on sale of premises and equipment	103	136	163	(33)	(24.3)	(27)	(16.6)
Gain (loss) on OREO, net	(2,880)	251		(3,131)	(1,247.4)	251	100.0
Gain (loss) on securities, net	(5,927)		1	(5,927)	100.0	(1)	(100.0)
Other income	1,884	1,200	1,273	684	57.0	(73)	(5.7)
Total non-interest income	\$ 28,717	\$ 25,754	\$ 19,127	\$ 2,963	11.5%	\$ 6,627	34.6%

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Non-interest income increased \$3.0 million, or 11.5%, to \$28.7 million for the year ended December 31, 2008 from \$25.8 million for the same period in 2007. The primary factors that resulted in the increase include:

Of the aggregate increase in service charges on deposit accounts, our acquisition of Centennial Bancshares, Inc. accounted for \$576,000 of the increase for the year ended December 31, 2008. The remaining increase is related to organic growth of our bank subsidiaries and an improved fee process.

Of the aggregate increase in other service charges and fees, our acquisition of Centennial Bancshares, Inc. accounted for \$136,000 of the increase for the year ended December 31, 2008. The remaining increases are a result of increased retention of interchange fees and organic growth of our bank subsidiaries.

Of the aggregate increase in mortgage lending income, our acquisition of Centennial Bancshares, Inc. accounted for \$688,000 of the increase for the year ended December 31, 2008. The remaining increase is related to organic growth of our bank subsidiaries.

The new revenue source mortgage servicing income was related to our acquisition of Centennial Bancshares, Inc. As a result of this acquisition, we now have a mortgage loan servicing portfolio of approximately \$262.0 million and purchased mortgage servicing rights of \$1.9 million.

The equity in earnings of unconsolidated affiliate is related to the 20% interest in White River Bancshares that we purchased during 2005. Because the investment in White River Bancshares is accounted for on the equity method, we recorded our share of White River Bancshares' operating earnings. White River Bancshares had been operating at a loss as a result of their status as a start up company until late in 2007. White River Bancshares repurchased our interest in their company on March 3, 2008. This resulted in a one time gain on the sale of the equity investment of \$6.1 million.

The \$2.9 million loss on OREO is primarily the result of a \$2.4 million write down on OREO related to a foreclosure on an owner occupied commercial rental center in the Florida market. Due to the unfavorable economic conditions in the Florida market, the current fair market value estimate required for this write down to be taken on the property.

During 2008, we became aware that two investment securities in our other securities category had become other than temporarily impaired. As a result of this impairment we charged off these two securities. The total of this charge-off was \$5.9 million or \$0.18 diluted earnings per share (stock dividend adjusted) for 2008. Reference the Investment Securities MD&A discussion for additional information.

The \$684,000 aggregate increase in other income is primarily the result of a fourth quarter gain of \$448,000 that is the product of our ownership of Arkansas Banker's Bank stock. The Company does not believe this gain will be of a recurring nature.

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Non-interest income increased \$6.6 million, or 34.6%, to \$25.7 million for the year ended December 31, 2007 from \$19.1 million in 2006. The primary factors that resulted in the increase from 2006 to 2007 include:

The \$1.8 million aggregate increase in service charges on deposit accounts was primarily a result of organic growth of our other bank subsidiaries' service charges and an improved fee process.

The \$2.8 million aggregate increase in other service charges and fees was primarily a result of increased retention of interchange fees, an infrequent referral fee received in the first quarter of 2007 and organic growth. More specifically, during the fourth quarter of 2006, we were able to negotiate with a new vendor the processing of interchange fees associated with our electronic banking transactions. This improved position is allowing us to retain more of the interchange fees by leveraging our in-house technology. During January 2007, we received a \$125,000 referral fee from another institution for a large loan that we elected not to originate because it was outside our normal lending activities. We do not believe referral fees of this nature will be recurring.

In the fourth quarter of 2006, we made a strategic decision to enter into an agent agreement for the management of our trust services to a non-affiliated third party. This change was caused by our aspiration to improve the overall profitability of the trust efforts. The aggregate decrease in trust fees was primarily the result of the vendor retaining a significant portion of our trust fees. The out-sourcing of the trust management resulted in an \$887,000 reduction of non-interest expense for 2007 compared to 2006. This non-interest expense reduction includes \$599,000 related to salaries and employee benefits for 2007.

Late in the third quarter of 2007, White River Bancshares moved their data processing services in house. This will result in an annual reduction of our data processing fees of approximately \$300,000.

Our community banks purchased \$35 million and \$3.5 million of additional bank owned life insurance on December 14, 2006 and April 23, 2007, respectively. The \$2.1 million aggregate increase in cash surrender value is primarily related to these new policies.

The \$252,000 increase in dividends was primarily associated with the Federal Reserve Bank (FRB) stock our bank subsidiaries bought in connection with their change to supervision of the Federal Reserve Board combined with additional stock they bought in Federal Home Loan Bank (FHLB) to increase their borrowing capacity with FHLB.

The equity in loss of unconsolidated affiliate is related to the 20% interest in White River Bancshares that we purchased during 2005. Because the investment in White River Bancshares is accounted for on the equity method, we recorded our share of White River Bancshares' operating earnings. White River Bancshares is operating at a loss as a result of their status as a start up company.

Gain on sale of premises and equipment for 2007 remained constant when compared to 2006 due to a gain in the second quarter of 2007 from the final settlement of insurance proceeds associated with the damage incurred by the storm surge during Hurricane Wilma, which struck the Florida Keys during the fourth quarter of 2005.



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Non-interest expense consists of salary and employee benefits, occupancy and equipment, data processing, and other expenses such as advertising, amortization of intangibles, electronic banking expense, FDIC and state assessment and legal and accounting fees.

Table 6 below sets forth a summary of non-interest expense for the years ended December 31, 2008, 2007, and 2006, as well as changes for the years ended 2008 compared to 2007 and 2007 compared to 2006.

**Table 6: Non-Interest Expense**

	Years Ended December 31,			2008 Change		2007 Change	
	2008	2007	2006	from 2007		from 2006	
	(Dollars in thousands)						
Salaries and employee benefits	\$ 35,566	\$ 30,496	\$ 29,313	\$ 5,070	16.6%	\$ 1,183	4.0%
Occupancy and equipment	11,053	9,459	8,712	1,594	16.9	747	8.6
Data processing expense	3,376	2,648	2,506	728	27.5	142	5.7
Other operating expenses:							
Advertising	2,644	2,691	2,383	(47)	(1.7)	308	12.9
Merger expenses	1,775			1,775	100.0		
Amortization of intangibles	1,849	1,756	1,742	93	5.3	14	0.8
Amortization of mortgage servicing rights	589			589	100.0		
Electronic banking expense	2,980	2,359	789	621	26.3	1,570	199.0
Directors' fees	991	843	774	148	17.6	69	8.9
Due from bank service charges	307	214	331	93	43.5	(117)	(35.3)
FDIC and state assessment	1,804	1,016	527	788	77.6	489	92.8
Insurance	947	901	1,030	46	5.1	(129)	(12.5)
Legal and accounting	1,384	1,206	1,025	178	14.8	181	17.7
Mortgage servicing expense	297			297	100.0		
Other professional fees	1,626	902	771	724	80.3	131	17.0
Operating supplies	959	983	940	(24)	(2.4)	43	4.6
Postage	742	663	663	79	11.9		
Telephone	901	951	975	(50)	(5.3)	(24)	(2.5)
Other expense	5,927	4,447	3,997	1,480	33.3	450	11.3
Total non-interest expense	\$ 75,717	\$ 61,535	\$ 56,478	\$ 14,182	23.0%	\$ 5,057	9.0%

Non-interest expense increased \$14.2 million, or 23.0%, to \$75.7 million for the year ended December 31, 2008, from \$61.5 million for the same period in 2007. The increase is the result of our acquisition of Centennial Bancshares, Inc. during the first quarter of 2008, the continued expansion of the Company, additional costs related to an efficiency study performed by a third party during 2008, the merger expenses associated with our charter consolidation

combined with the normal increased cost of doing business. The most significant component of the increase was \$6.8 million of additional non-interest expense from our acquisition of Centennial Bancshares, Inc.. The cost of the efficiency study was \$860,000 for 2008 and is included in other professional fees. During 2008 and 2007, we have opened two de novo branch locations in Florida and six in Arkansas.

Our charter consolidations will continue during 2009. We are anticipating Community Bank and Bank of Mountain View to consolidate in the first quarter of 2009, and Twin City Bank and the original Centennial Bank to consolidate in the summer of 2009. The costs associated with these additional consolidations could be up to approximately \$1.5 million of merger expenses in the first half of 2009.

At its April 20, 2007 meeting, our Board of Directors approved a Chairman's Retirement Plan for John Allison, our Chairman and CEO. Beginning on Mr. Allison's 65th birthday, he will receive a \$250,000 annual benefit to be paid for 10 consecutive years or until his death, whichever shall occur later. An expense of \$535,000 was accrued for 2008. An expense of \$388,000 was accrued for the year ended December 31, 2007. During April 2007, we purchased \$3.5 million of additional bank-owned life insurance to help offset a portion of the costs related to this retirement benefit.

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At its October 17, 2008 meeting, the Board of Directors of Home BancShares, Inc., pursuant to a recommendation by the Compensation Committee, granted John W. Allison, Chairman and CEO, an annual base salary of \$275,000 beginning on November 1, 2008. Also, they made him eligible for an annual discretionary cash bonus. Any cash bonus will be based upon the goals of the Company including shareholder return, earnings per share and other criteria. Mr. Allison has never received a salary prior to this time. The committee felt as a result of the leadership Mr. Allison has provided for the past 10 years, he should be compensated for his services. Mr. Allison did not receive an annual bonus for 2008.

During 2008, an internal investigation uncovered a \$2.1 million fraud by a senior officer at one of our subsidiary banks. This senior officer was terminated immediately. This fraud did not originate from the lending area but the operational area of the subsidiary bank. The fraud did not result in any losses to our customers. The Company has settled with the insurance company on this claim. As a result, we expensed \$150,000 in other expense for the insurance deductible for this issue in 2008.

Non-interest expense increased \$5.0 million, or 9.0%, to \$61.5 million for the year ended December 31, 2007, from \$56.5 million in 2006. The increase in non-interest expense is the result of the continued expansion of the Company combined with the normal increased cost of doing business. The most significant component of the increase was the \$1.6 million increase in electronic banking for 2007. The electronic banking increase was primarily the result of additional costs associated with our ability to retain more of the interchange fee income. During 2007 and 2006, we opened five de novo branch locations in Florida and six in Arkansas.

### ***Income Taxes***

The provision for income taxes decreased \$6.6 million, or 77.5%, to \$1.9 million for the year ended December 31, 2008, from \$8.5 million for 2007. The provision for income taxes increased \$1.3 million, or 17.6%, to \$8.5 million for the year ended December 31, 2007, from \$7.2 million for 2006. The effective tax rate for the years ended December 31, 2008, 2007 and 2006 were 16.0%, 29.4% and 31.3%, respectively.

The lower effective income tax rate for 2008 is primarily associated with our lower pre-tax income for the current year. During 2007, we recorded \$28.9 million of pre-tax income compared to \$12.0 million in 2008 or a reduction of \$16.9 million. The reduced pre-tax income at our marginal tax rate of 39.225% resulted in a reduction of income taxes of approximately \$6.6 million for 2008.

The lower effective income tax rate for 2007 is primarily associated with our purchase of \$3.5 million and \$35 million in additional bank-owned life insurance in the second quarter of 2007 and fourth quarter of 2006, respectively, which resulted in additional tax-free non-interest income. Also during 2007, we invested in Diamond State Ventures II, which is a venture capital fund that provides capital and assistance to small businesses in Arkansas and surrounding states throughout the South and Midwest. Our investment in Diamond State Ventures II resulted in an instant Arkansas state tax credit of one-third of our investment or \$143,000 for 2007 which lowered our current year effective tax rate by 50 basis points.

### **Financial Conditions as of and for the Years Ended December 31, 2008 and 2007**

Our total assets increased \$288.5 million, a growth of 12.6%, to \$2.58 billion as of December 31, 2008, from \$2.29 billion as of December 31, 2007. Our loan portfolio increased \$349.2 million, a growth of 21.7%, to \$1.96 billion as of December 31, 2008, from \$1.61 billion as of December 31, 2007. Shareholders' equity increased \$30.0 million, a growth of 11.9%, to \$283.0 million as of December 31, 2008, compared to \$253.1 million as of December 31, 2007. Asset and loan increases are primarily associated with our acquisition of Centennial Bancshares, Inc. and organic growth of our bank subsidiaries. During 2008, we experienced \$156.4 million of organic loan growth. The increase in stockholders' equity was primarily the result of the \$24.3 million in additional capital that was issued upon our acquisition of Centennial Bancshares, Inc. combined with the retained earnings during 2008.

**Table of Contents*****Loan Portfolio***

Our loan portfolio averaged \$1.92 billion during 2008, \$1.52 billion during 2007 and \$1.31 billion during 2006. Net loans were \$1.92 billion, \$1.58 billion and \$1.39 billion as of December 31, 2008, 2007 and 2006, respectively. The most significant components of the loan portfolio were commercial real estate, residential real estate, consumer, and commercial and industrial loans. These loans are primarily originated within our market areas of central Arkansas, north central Arkansas, southern Arkansas, southwest Florida and the Florida Keys and are generally secured by residential or commercial real estate or business or personal property within our market areas.

Certain credit markets have experienced difficult conditions and volatility during 2007 and 2008, particularly Florida. The Florida market currently is approximately 91.6% secured by real estate and 16.4% of our total loan portfolio. The markets continue to experience pressure including the well publicized sub-prime mortgage market. The Company has not or does not actively market or originate subprime mortgage loans.

Table 7 presents our period end loan balances by category as of the dates indicated.

**Table 7: Loan Portfolio**

	As of December 31,				
	2008	2007	2006	2005	2004
	(In thousands)				
Real estate:					
Commercial real estate loans:					
Non-farm/non-residential	\$ 816,603	\$ 607,638	\$ 465,306	\$ 411,839	\$ 181,995
Construction/land development	320,398	367,422	393,410	291,515	116,935
Agricultural	23,603	22,605	11,659	13,112	12,912
Residential real estate loans:					
Residential 1-4 family	391,255	259,975	229,588	221,831	86,497
Multifamily residential	56,440	45,428	37,440	34,939	17,708
Total real estate	1,608,299	1,303,068	1,137,403	973,236	416,047
Consumer	46,615	46,275	45,056	39,447	24,624
Commercial and industrial	255,153	219,062	206,559	175,396	69,345
Agricultural	23,625	20,429	13,520	8,466	6,275
Other	22,540	18,160	13,757	8,044	364
Total loans receivable	1,956,232	1,606,994	1,416,295	1,204,589	516,655
Less: Allowance for loan losses	40,385	29,406	26,111	24,175	16,345
Total loans receivable, net	\$ 1,915,847	\$ 1,577,588	\$ 1,390,184	\$ 1,180,414	\$ 500,310

**Commercial Real Estate Loans.** We originate non-farm and non-residential loans (primarily secured by commercial real estate), construction/land development loans, and agricultural loans, which are generally secured by real estate located in our market areas. Our commercial mortgage loans are generally collateralized by first liens on real estate and amortized over a 10 to 20 year period with balloon payments due at the end of one to five years. These loans are generally underwritten by addressing cash flow (debt service coverage), primary and secondary source of repayment, the financial strength of any guarantor, the strength of the tenant (if any), the borrower's liquidity and leverage, management experience, ownership structure, economic conditions and industry specific trends and collateral. Generally, we will loan up to 85% of the value of improved property, 65% of the value of raw land and 75% of the value of land to be acquired and developed. A first lien on the property and assignment of lease is required if the collateral is rental property, with second lien positions considered on a case-by-case basis.

As of December 31, 2008, commercial real estate loans totaled \$1.16 billion, or 59.3% of our loan portfolio, compared to \$997.7 million, or 62.1% of our loan portfolio, as of December 31, 2007. Our acquisition of Centennial

Bancshares, Inc. resulted in an increase of \$91.5 million of commercial real estate. The remaining increase is primarily the result of solid demand for this type of loan product which resulted in organic growth of our loan portfolio.

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*Residential Real Estate Loans.* We originate one to four family, owner occupied residential mortgage loans generally secured by property located in our primary market area. The majority of our residential mortgage loans consist of loans secured by owner occupied, single family residences. Residential real estate loans generally have a loan-to-value ratio of up to 90%. These loans are underwritten by giving consideration to the borrower's ability to pay, stability of employment or source of income, debt-to-income ratio, credit history and loan-to-value ratio.

As of December 31, 2008, we had \$447.7 million, or 22.9% of our loan portfolio, in residential real estate loans, compared to the \$305.4 million, or 19.0% of our loan portfolio, as of December 31, 2007. Our acquisition of Centennial Bancshares, Inc. resulted in an increase of \$65.4 million of residential real estate loans. The changing market conditions have given our community banks the opportunity to retain more residential real estate loans. These loans normally have maturities of less than five years.

*Consumer Loans.* Our consumer loan portfolio is composed of secured and unsecured loans originated by our banks. The performance of consumer loans will be affected by the local and regional economy as well as the rates of personal bankruptcies, job loss, divorce and other individual-specific characteristics.

As of December 31, 2008, our installment consumer loan portfolio totaled \$46.6 million, or 2.4% of our total loan portfolio, which is comparable to the \$46.3 million, or 2.9% of our loan portfolio as of December 31, 2007.

*Commercial and Industrial Loans.* Commercial and industrial loans are made for a variety of business purposes, including working capital, inventory, equipment and capital expansion. The terms for commercial loans are generally one to seven years. Commercial loan applications must be supported by current financial information on the borrower and, where appropriate, by adequate collateral. Commercial loans are generally underwritten by addressing cash flow (debt service coverage), primary and secondary sources of repayment, the financial strength of any guarantor, the borrower's liquidity and leverage, management experience, ownership structure, economic conditions and industry specific trends and collateral. The loan to value ratio depends on the type of collateral. Generally speaking, accounts receivable are financed at between 50% to 80% of accounts receivable less than 60 days past due. Inventory financing will range between 50% and 60% (with no work in process) depending on the borrower and nature of inventory. We require a first lien position for those loans.

As of December 31, 2008, commercial and industrial loans outstanding totaled \$255.2 million, or 13.0% of our loan portfolio, compared to \$219.1 million, or 13.6% of our loan portfolio, as of December 31, 2007. Our acquisition of Centennial Bancshares, Inc. resulted in an increase of \$31.5 million of commercial and industrial loans.

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Table 8 presents the distribution of the maturity of our loans as of December 31, 2008. The table also presents the portion of our loans that have fixed interest rates versus interest rates that fluctuate over the life of the loans based on changes in the interest rate environment. A loan is considered fixed rate if the loan is currently at its adjustable floor or ceiling. As a result of the decline in interest rates during 2008, the Company has approximately \$226.9 million of loans that cannot be additionally priced down but could price up if rates were to return to higher levels. These loans are shown as fixed rate in the table below.

**Table 8: Maturity of Loans**

	<b>One Year or Less</b>	<b>Over One Year Through Five Years (In thousands)</b>	<b>Over Five Years</b>	<b>Total</b>
Real estate:				
Commercial real estate loans:				
Non-farm/non-residential	\$ 187,105	\$ 457,487	\$ 172,011	\$ 816,603
Construction/land development	183,102	122,597	14,699	320,398
Agricultural	9,785	6,172	7,646	23,603
Residential real estate loans				
Residential 1-4 family	120,279	184,795	86,181	391,255
Multifamily residential	18,830	33,754	3,856	56,440
Total real estate	519,101	804,805	284,393	1,608,299
Consumer	20,440	25,359	816	46,615
Commercial and industrial	111,536	131,859	11,758	255,153
Agricultural	16,056	7,455	114	23,625
Other	3,077	16,935	2,528	22,540
Total loans receivable	\$ 670,210	\$ 986,413	\$ 299,609	\$ 1,956,232
With fixed interest rates	\$ 469,503	\$ 815,607	\$ 83,904	\$ 1,369,014
With floating interest rates	200,707	170,806	215,705	587,218
Total	\$ 670,210	\$ 986,413	\$ 299,609	\$ 1,956,232

***Non-Performing Assets***

We classify our problem loans into three categories: past due loans, special mention loans and classified loans (accruing and non-accruing).

When management determines that a loan is no longer performing, and that collection of interest appears doubtful, the loan is placed on non-accrual status. Loans that are 90 days past due are placed on non-accrual status unless they are adequately secured and there is reasonable assurance of full collection of both principal and interest. Our management closely monitors all loans that are contractually 90 days past due, treated as special mention or otherwise classified or on non-accrual status. Generally, non-accrual loans that are 120 days past due without assurance of repayment are charged off against the allowance for loan losses.

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Table 9 sets forth information with respect to our non-performing assets as of December 31, 2008, 2007, 2006, 2005, and 2004. As of these dates, we did not have any non-performing restructured loans.

**Table 9: Non-performing Assets**

	As of December 31,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Non-accrual loans	\$ 28,524	\$ 2,952	\$ 3,905	\$ 7,864	\$ 8,959
Loans past due 90 days or more (principal or interest payments)	1,374	301	641	426	2
Total non-performing loans	29,898	3,253	4,546	8,290	8,961
Other non-performing assets					
Foreclosed assets held for sale	6,763	5,083	435	758	458
Other non-performing assets	16	15	13	11	53
Total other non-performing assets	6,779	5,098	448	769	511
Total non-performing assets	\$ 36,677	\$ 8,351	\$ 4,994	\$ 9,059	\$ 9,472
Allowance for loan losses to non-performing loans	135.08%	903.97%	574.37%	291.62%	182.40%
Non-performing loans to total loans	1.53	0.20	0.32	0.69	1.73
Non-performing assets to total assets	1.42	0.36	0.23	0.47	1.18

Our non-performing loans are comprised of non-accrual loans and loans that are contractually past due 90 days. Our bank subsidiaries recognize income principally on the accrual basis of accounting. When loans are classified as non-accrual, the accrued interest is charged off and no further interest is accrued, unless the credit characteristics of the loan improves. If a loan is determined by management to be uncollectible, the portion of the loan determined to be uncollectible is then charged to the allowance for loan losses. As of December 31, 2008, we had \$16.7 million of restructured loans that are in compliance with the modified terms and are not reported as past due or non-accrual in Table 9.

Total non-performing loans were \$29.9 million as of December 31, 2008, compared to \$3.3 million as of December 31, 2007 for an increase of \$26.6 million. Non-performing loans in our Florida market totaled approximately \$22.0 million as December 31, 2008. The unfavorable economic conditions, particularly the slowdown in housing sales in the Florida market resulted in an increase in our non-performing loans by \$16.5 million during 2008. The remaining 2008 increase in non-performing loans is associated with our Arkansas market which includes an increase of \$1.3 million from our acquisition of Centennial Bancshares, Inc. The weakening real estate market has and may continue to raise our level of non-performing loans going forward. When we reported our 2007 year-end results, we provided a projection for non-performing loans to total loans in the range of 0.60% to 2.0%. This continues to be our expected range for non-performing loans to total loans. While we believe our allowance for loan losses is adequate at December 31, 2008, as additional facts become known about relevant internal and external factors that effect loan collectability and our assumptions, it may result in us making additions to the provision for loan loss during 2009.

If the non-accrual loans had been accruing interest in accordance with the original terms of their respective agreements, interest income of approximately \$1.0 million for the year ended December 31, 2008, \$270,000 in 2007, and \$450,000 in 2006 would have been recorded. Interest income recognized on the non-accrual loans for the years ended December 31, 2008, 2007 and 2006 was considered immaterial.



A loan is considered impaired when it is probable that we will not receive all amounts due according to the contracted terms of the loans. Impaired loans may include non-performing loans (loans past due 90 days or more and non-accrual loans) and certain other loans identified by management that are still performing. As of December 31, 2008, average impaired loans were \$29.4 million compared to \$11.8 million as of December 31, 2007. As of December 31, 2008, impaired loans were \$31.5 million compared to \$11.9 million as of December 31, 2007 for an increase of \$19.6 million. The unfavorable economic conditions that are impacting our Florida market accounted for \$6.3 million of the increase, while the acquisition of Centennial Bancshares, Inc., increased our impaired loans by \$9.2 million.

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The \$6.8 million in foreclosed assets held for sale is comprised of \$4.6 million of assets located in Florida with the remaining \$2.2 million of assets located in Arkansas. The Florida foreclosed assets includes one property for \$2.0 million. This foreclosure was an owner occupied commercial rental center. In 2008, we recorded a \$2.4 million write down of the property to reflect the current fair market value estimate. The property is listed for sale with a broker but is substantially vacant.

### ***Allowance for Loan Losses***

*Overview.* The allowance for loan losses is maintained at a level which our management believes is adequate to absorb all probable losses on loans in the loan portfolio. The amount of the allowance is affected by: (i) loan charge-offs, which decrease the allowance; (ii) recoveries on loans previously charged off, which increase the allowance; and (iii) the provision of possible loan losses charged to income, which increases the allowance. In determining the provision for possible loan losses, it is necessary for our management to monitor fluctuations in the allowance resulting from actual charge-offs and recoveries and to periodically review the size and composition of the loan portfolio in light of current and anticipated economic conditions. If actual losses exceed the amount of allowance for loan losses, our earnings could be adversely affected.

As we evaluate the allowance for loan losses, we categorize it as follows: (i) specific allocations; (ii) allocations for classified assets with no specific allocation; (iii) general allocations for each major loan category; and (iv) miscellaneous allocations.

*Specific Allocations.* As a general rule, if a specific allocation is warranted, it is the result of an analysis of a previously classified credit or relationship. Our evaluation process in specific allocations includes a review of appraisals or other collateral analysis. These values are compared to the remaining outstanding principal balance. If a loss is determined to be reasonably possible, the possible loss is identified as a specific allocation. If the loan is not collateral dependent, the measurement of loss is based on the expected future cash flows of the loan.

*Allocations for Classified Assets with No Specific Allocation.* We establish allocations for loans rated special mention through loss in accordance with the guidelines established by the regulatory agencies. A percentage rate is applied to each loan category to determine the level of dollar allocation.

*General Allocations.* We establish general allocations for each major loan category. This section also includes allocations to loans, which are collectively evaluated for loss such as residential real estate, commercial real estate consumer loans and commercial and industrial loans. The allocations in this section are based on a historical review of loan loss experience and past due accounts. We give consideration to trends, changes in loan mix, delinquencies, prior losses, and other related information.

*Miscellaneous Allocations.* Allowance allocations other than specific, classified, and general are included in our miscellaneous section.

*Charge-offs and Recoveries.* Total charge-offs increased to \$20.9 million for the year ended December 31, 2008, compared to \$826,000 for the same period in 2007. Total recoveries increased to \$1.5 million for the year ended December 31, 2008, compared to \$879,000 for the same period in 2007. The changes in net charge-offs are due to the unfavorable economic conditions in Florida and our proactive stance on asset quality offset by approximately a \$900,000 recovery of principal received from one borrower. Total charge-offs related to the Florida market were approximately \$16.8 million for 2008. The acquisition completed in the first quarter of 2008 had a \$1.4 million impact on net charge-offs for the year ended December 31, 2008.

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Table 10 shows the allowance for loan losses, charge-offs and recoveries as of and for the years ended December 31, 2008, 2007, 2006, 2005 and 2004.

**Table 10: Analysis of Allowance for Loan Losses**

	<b>2008</b>	<b>2007</b>	<b>As of December 31, 2006 (Dollars in thousands)</b>	<b>2005</b>	<b>2004</b>
Balance, beginning of year	\$ 29,406	\$ 26,111	\$ 24,175	\$ 16,345	\$ 14,717
Loans charged off					
Real estate:					
Commercial real estate loans:					
Non-farm/non-residential	5,743	16	322	2,448	
Construction/land development	6,661	9	125	405	5
Agricultural	863		18	15	
Residential real estate loans:					
Residential 1-4 family	6,033	349			