

HOME BANCSHARES INC

Form 10-K

March 06, 2009

**Table of Contents**

**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

Edgar Filing: HOME BANCSHARES INC - Form 10-K

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.

---

**HOME BANCSHARES, INC.**  
**FORM 10-K**  
**December 31, 2008**  
**INDEX**

	Page No.
<b><u>PART I:</u></b>	
<u>Item 1. Business</u>	3-18
<u>Item 1A. Risk Factors</u>	18-28
<u>Item 1B. Unresolved Staff Comments</u>	28
<u>Item 2. Properties</u>	28
<u>Item 3. Legal Proceedings</u>	29
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	29
<b><u>PART II:</u></b>	
<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	29-31
<u>Item 6. Selected Financial Data</u>	32-33
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation</u>	34-71
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	72-75
<u>Item 8. Consolidated Financial Statements and Supplementary Data</u>	76-119
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	119
<u>Item 9A. Controls and Procedures</u>	119
<u>Item 9B. Other Information</u>	119
<b><u>PART III:</u></b>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	120
<u>Item 11. Executive Compensation</u>	120
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	120
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	120

<u>Item 14. Principal Accounting Fees and Services</u>	120
--	-----

**PART IV:**

<u>Item 15. Exhibits, Financial Statement Schedules</u>	121
---	-----

<u>Signatures</u>	122
-------------------	-----

EX-23.1

EX-31.1

EX-31.2

EX-32.1

EX-32.2

---

**Table of Contents**

**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.



**Table of Contents**

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.



**Table of Contents**

*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

## **Table of Contents**

### **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.

**Table of Contents**

*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.

**Table of Contents**

*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.

## **Table of Contents**

*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.

**Table of Contents**

**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.

**Table of Contents**

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.





**Table of Contents**

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.

**Table of Contents**

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.

**Table of Contents**

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.

**Table of Contents**

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



## **Table of Contents**

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.

**Table of Contents**

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.

**Table of Contents**

**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.

**Table of Contents**

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.

**Table of Contents*****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.

**Table of Contents**

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.

**Table of Contents**

***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.

**Table of Contents**

***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.



**Table of Contents*****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.

**Table of Contents**

***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.

**Table of Contents**

***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.

**Table of Contents**

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.

**Table of Contents*****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.

**Table of Contents**

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>Index</i>	<i>Period Ending</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

31

**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

Edgar Filing: HOME BANCSHARES INC - Form 10-K

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

**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.

**Table of Contents**

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.

**Table of Contents**

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.

**Table of Contents**

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.

**Table of Contents**

*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.

**Table of Contents**

**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.

**Table of Contents**

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.

**Table of Contents**

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**

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Dollars in thousands)</b>		
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**

	<b>December 31,</b>	
	<b>2008 vs. 2007</b>	<b>2007 vs. 2006</b>
	<b>(In thousands)</b>	
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



**Table of Contents**

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)									
<b>ASSETS</b>										
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			
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>										
Liabilities										
Interest-bearing liabilities										
Interest-bearing transaction and savings deposits										
Time deposits	\$ 684,234	\$ 10,736	1.57%	\$ 591,874	\$ 17,032	2.88%	\$ 530,219	\$ 13,179	2.49%	
	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	

Edgar Filing: HOME BANCSHARES INC - Form 10-K

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	

**Table of Contents**

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 FHLB and other borrowed funds	(373)	(2,851)	(3,224)	395	(69)	326
Subordinated debentures	3,111	(2,838)	273	1,897	458	2,355
	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.



**Table of Contents**

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 borrower's 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.

**Table of Contents**

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)
<b>Total non-interest income</b>	<b>\$ 28,717</b>	<b>\$ 25,754</b>	<b>\$ 19,127</b>	<b>\$ 2,963</b>	<b>11.5%</b>	<b>\$ 6,627</b>	<b>34.6%</b>

**Table of Contents**

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.

**Table of Contents**

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.



**Table of Contents****Non-Interest Expense**

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.

**Table of Contents**

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.

**Table of Contents**

*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.

**Table of Contents**

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.

**Table of Contents**

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.

**Table of Contents**

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.

**Table of Contents**

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**

	As of December 31,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
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	143	515	404
Multifamily residential		6			
Total real estate	19,300	380	608	3,383	409
Consumer	442	270	243		
Commercial and industrial	1,076	176	626	758	499
Agricultural				30	786
Other	102		37	440	487
Total loans charged off	20,920	826	1,514	4,611	2,181
Recoveries of loans previously charged off					
Real estate:					
Commercial real estate loans:					
Non-farm/non-residential	1,172	423	102	294	1,057
Construction/land development	8	1	122	15	13
Agricultural		5			
Residential real estate loans:					
Residential 1-4 family	135	162	346	115	47
Multifamily residential		18	66		
Total real estate	1,315	609	636	424	1,117
Consumer	83	110	104		
Commercial and industrial	99	127	157	102	254
Agricultural					17
Other	4	33	246	324	131
Total recoveries	1,501	879	1,143	850	1,519
Net (recoveries) loans charged off	19,419	(53)	371	3,761	662
Allowance for loan losses of acquired institution	3,382			7,764	
Provision for loan losses	27,016	3,242	2,307	3,827	2,290

Edgar Filing: HOME BANCSHARES INC - Form 10-K

Balance, end of year	\$ 40,385	\$ 29,406	\$ 26,111	\$ 24,175	\$ 16,345
Net (recoveries) charge-offs to average loans	1.01%	(0.00)%	0.03%	0.38%	0.13%
Allowance for loan losses to period-end loans	2.06	1.83	1.84	2.01	3.16
Allowance for loan losses to net (recoveries) charge-offs	208	(55,483)	7,038	642	2,469
		55			

---

**Table of Contents**

*Allocated Allowance for Loan Losses.* We use a risk rating and specific reserve methodology in the calculation and allocation of our allowance for loan losses. While the allowance is allocated to various loan categories in assessing and evaluating the level of the allowance, the allowance is available to cover charge-offs incurred in all loan categories. Because a portion of our portfolio has not matured to the degree necessary to obtain reliable loss data from which to calculate estimated future losses, the unallocated portion of the allowance is an integral component of the total allowance. Although unassigned to a particular credit relationship or product segment, this portion of the allowance is vital to safeguard against the imprecision inherent in estimating credit losses.

The changes for the period ended December 31, 2008 in the allocation of the allowance for loan losses for the individual types of loans are primarily associated with the decline in asset quality, particularly in our Florida market, our acquisition of Centennial Bancshares, Inc. on January 1, 2008, net charge-offs during 2008 and normal changes in the outstanding loan portfolio for those products from December 31, 2007.

Table 11 presents the allocation of allowance for loan losses as of the dates indicated.

**Table 11: Allocation of Allowance for Loan Losses**

	As of December 31,									
	2008		2007		2006		2005		2004	
	Allowance	% of	Allowance	% of	Allowance	% of	Allowance	% of	Allowance	% of
(Dollars in thousands)	Amount	(1)	Amount	(1)	Amount	(1)	Amount	(1)	Amount	(1)
Real estate:										
Commercial real estate loans:										
Non-farm/non-residential	\$ 16,010	41.7%	\$ 11,475	37.8%	\$ 9,130	32.8%	\$ 7,202	34.1%	\$ 6,212	35.3%
Construction/land development	9,369	16.4	7,332	22.9	7,494	27.8	5,544	24.2	1,690	22.6
Agricultural	255	1.2	311	1.4	505	0.8	407	1.1	493	2.5
Residential real estate loans:										
Residential 1-4 family	6,814	20.0	3,968	16.2	3,091	16.2	3,317	18.4	2,185	16.7
Multifamily residential	880	2.9	727	2.8	909	2.6	423	2.9	156	3.4
Total real estate	33,328	82.2	23,813	81.1	21,129	80.2	16,893	80.7	10,736	80.5
Consumer	848	2.4	905	2.9	861	3.2	682	3.3	526	4.8
Commercial and industrial	4,945	13.0	3,243	13.6	3,237	14.6	4,059	14.6	2,025	13.4
Agricultural	816	1.2	599	1.3	456	1.0	505	0.7	316	1.2
Other		1.2	14	1.1	11	1.0		0.7		0.1
Unallocated	448		832		417		2,036		2,742	
Total	\$ 40,385	100.0%	\$ 29,406	100.0%	\$ 26,111	100.0%	\$ 24,175	100.0%	\$ 16,345	100.0%

(1) Percentage of loans in each category to loans receivable

**Table of Contents*****Investment Securities***

Our securities portfolio is the second largest component of earning assets and provides a significant source of revenue. Securities within the portfolio are classified as held-to-maturity, available-for-sale, or trading based on the intent and objective of the investment and the ability to hold to maturity. Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities. As of December 31, 2008 and 2007, we had no held-to-maturity or trading securities.

Securities available-for-sale are reported at fair value with unrealized holding gains and losses reported as a separate component of shareholders' equity as other comprehensive income. Securities that are held as available-for-sale are used as a part of our asset/liability management strategy. Securities classified as available for sale may be sold in response to interest rate changes, changes in prepayment risk, the need to increase regulatory capital, and other similar factors. Available-for-sale securities were \$355.2 million as of December 31, 2008, compared to \$430.4 million as of December 31, 2007. The estimated duration of our securities portfolio was 3.1 years as of December 31, 2008.

As of December 31, 2008, \$182.0 million, or 51.2%, of the available-for-sale securities were invested in mortgage-backed securities, compared to \$181.6 million, or 42.2%, of the available-for-sale securities in the prior year. To reduce our income tax burden, \$119.8 million, or 33.7%, of the available-for-sale securities portfolio as of December 31, 2008, was primarily invested in tax-exempt obligations of state and political subdivisions, compared to \$111.3 million, or 25.9%, of the available-for-sale securities as of December 31, 2007. Also, we had approximately \$50.4 million, or 14.2%, in obligations of U.S. Government-sponsored enterprises in the available-for-sale securities portfolio as of December 31, 2008, compared to \$126.3 million, or 29.3%, of the available-for-sale securities in the prior year. The Company does not have any preferred securities issued by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

Certain investment securities are valued at less than their historical cost. These declines primarily resulted from the volatility in the markets. Based on evaluation of available evidence, we believe the declines in fair value for these securities are temporary. It is our intent to hold these securities to recovery. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than temporary impairment is identified.

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. These investment securities are a pool of other financial holding companies' subordinated debentures throughout the country. As of December 31, 2008, three of these holding companies have defaulted due to their closure by the federal government and six are deferring their quarterly payments as a result of stressed capital levels. Additionally, one holding company deferring at year end has been closed in 2009 and another has stated publicly it will default on these securities. Since, the federal government has begun to seize these institutions it has resulted in our investment becoming worthless.

**Table of Contents**

Table 12 presents the carrying value and fair value of investment securities for each of the years indicated.

**Table 12: Investment Securities**

	As of December 31,							
	2008					2007		
	Amortized	Gross Unrealized	Gross Unrealized	Estimated Fair	Amortized	Gross Unrealized	Gross Unrealized	Estimated Fair
	Cost	Gains	Losses	Value	Cost	Gains	Losses	Value
	(In thousands)							
<b>Available-for-Sale</b>								
U.S. Government-sponsored enterprises	\$ 49,632	\$ 810	\$ (7)	\$ 50,435	\$ 126,898	\$ 268	\$ (872)	\$ 126,294
Mortgage-backed securities	183,808	1,673	(3,517)	181,964	184,949	179	(3,554)	181,574
State and political subdivisions	123,119	990	(4,279)	119,830	111,014	1,105	(812)	111,307
Other securities	4,238		(1,223)	3,015	11,411		(187)	11,224
Total	\$ 360,797	\$ 3,473	\$ (9,026)	\$ 355,244	\$ 434,272	\$ 1,552	\$ (5,425)	\$ 430,399

	As of December 31,			
	2006			
	Amortized	Gross Unrealized	Gross Unrealized	Estimated Fair
	Cost	Gains	Losses	Value
	(In thousands)			
<b>Available-for-Sale</b>				
U.S. Government-sponsored enterprises	\$ 199,085	\$ 79	\$ (2,927)	\$ 196,237
Mortgage-backed securities	225,747	41	(5,988)	219,800
State and political subdivisions	102,536	1,360	(496)	103,400
Other securities	12,631		(177)	12,454
Total	\$ 539,999	\$ 1,480	\$ (9,588)	\$ 531,891

**Table of Contents**

Table 13 reflects the amortized cost and estimated fair value of debt securities as of December 31, 2008, by contractual maturity and the weighted average yields (for tax-exempt obligations on a fully taxable equivalent basis) of those securities. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties.

**Table 13: Maturity Distribution of Investment Securities**

	As of December 31, 2008				Total Amortized Cost	Total Fair Value
	1 Year or Less	1 Year Through 5 Years	5 Years Through 10 Years	Over 10 Years		
<b>Available-for-Sale</b>						
U.S. Government-sponsored enterprises	\$ 33,052	\$ 9,054	\$ 5,537	\$ 1,989	\$ 49,632	\$ 50,435
Mortgage-backed securities	37,779	79,040	29,131	38,835	184,785	181,964
State and political subdivisions	24,783	68,539	17,158	12,639	123,119	119,830
Other securities	3,161	100			3,261	3,015
<b>Total</b>	<b>\$ 98,775</b>	<b>\$ 156,733</b>	<b>\$ 51,826</b>	<b>\$ 53,463</b>	<b>\$ 360,797</b>	<b>\$ 355,244</b>
Percentage of total	27.4%	43.4%	14.4%	14.8%	100.0%	
Weighted average yield	5.02%	5.05%	5.63%	5.78%	5.23%	

**Deposits**

Our deposits averaged \$1.86 billion for the year ended December 31, 2008, and \$1.61 billion for 2007. Total deposits increased \$255.7 million, or 16.1%, to \$1.85 billion as of December 31, 2008, from \$1.59 billion as of December 31, 2007. On January 1, 2008, as a result of our acquisition of Centennial Bancshares, Inc., deposits increased by \$178.8 million. Deposits are our primary source of funds. We offer a variety of products designed to attract and retain deposit customers. Those products consist of checking accounts, regular savings deposits, NOW accounts, money market accounts and certificates of deposit. Deposits are gathered from individuals, partnerships and corporations in our market areas. In addition, we obtain deposits from state and local entities and, to a lesser extent, U.S. Government and other depository institutions. Our policy also permits the acceptance of deposits. As of December 31, 2008 and 2007, brokered deposits were \$111.0 million and \$39.3 million, respectively.

The interest rates paid are competitively priced for each particular deposit product and structured to meet our funding requirements. We will continue to manage interest expense through deposit pricing and do not anticipate a significant change in total deposits unless our liquidity position changes. We believe that additional funds can be attracted and deposit growth can be accelerated through deposit pricing if we experience increased loan demand or other liquidity needs.

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. Due to the rate reductions occurring late in 2007, its impact for 2007 was minimal. As our earning assets and interest-bearing liabilities began to reprice during 2008, we experienced a more significant decline to our average rates from the lower rate environment.

**Table of Contents**

Table 14 reflects the classification of the average deposits and the average rate paid on each deposit category which is in excess of 10 percent of average total deposits, for the years ended December 31, 2008, 2007, and 2006.

**Table 14: Average Deposit Balances and Rates**

	Years Ended December 31,					
	2008		2007		2006	
	Average	Average	Average	Average	Average	Average
	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)					
		Paid		Paid		Paid
Non-interest-bearing transaction accounts	\$ 236,009	%	\$ 215,212	%	\$ 215,075	%
Interest-bearing transaction accounts	627,294	1.62	536,032	3.04	458,463	2.63
Savings deposits	56,940	0.99	55,842	1.35	71,756	1.59
Time deposits:						
\$100,000 or more	538,468	3.64	460,244	4.95	418,903	4.61
Other time deposits	398,802	3.83	347,521	4.72	344,388	3.99
Total	\$ 1,857,513	2.45%	\$ 1,614,851	3.48%	\$ 1,508,585	3.06%

Table 15 presents our maturities of large denomination time deposits as of December 31, 2008 and 2007.

**Table 15: Maturities of Large Denomination Time Deposits (\$100,000 or more)**

	As of December 31,			
	2008		2007	
	Balance	Percent	Balance	Percent
	(Dollars in thousands)			
Maturing				
Three months or less	\$ 179,599	35.9%	\$ 170,092	39.1%
Over three months to six months	118,442	23.7	90,147	20.8
Over six months to 12 months	147,415	29.4	132,472	30.4
Over 12 months	55,262	11.0	42,777	9.7
Total	\$ 500,718	100.0%	\$ 435,488	100.0%

**FHLB Borrowings**

Our FHLB borrowings were \$283.0 million as of December 31, 2008, and \$251.8 million as of December 31, 2007. The outstanding balance for December 31, 2008, includes no short-term advances and \$283.0 million of long-term advances. The outstanding balance for December 31, 2007, includes \$116.0 million of short-term advances and \$135.8 million of long-term advances. Our remaining FHLB borrowing capacity was \$191.5 million as of December 31, 2008, and \$186.6 million as of December 31, 2007. Expected maturities will differ from contractual maturities, because FHLB may have the right to call or prepay certain obligations.

**Table of Contents*****Subordinated Debentures***

Subordinated debentures, which consist of guaranteed payments on trust preferred securities, were \$47.6 million and \$44.6 million as of December 31, 2008 and 2007, respectively.

Table 16 reflects subordinated debentures as of December 31, 2008 and 2007, which consisted of guaranteed payments on trust preferred securities with the following components:

**Table 16: Subordinated Debentures**

	<b>As of December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In thousands)</b>	
Subordinated debentures, issued in 2003, due 2033, fixed at 6.40%, during the first five years and at a floating rate of 3.15% above the three-month LIBOR rate, reset quarterly, thereafter, currently callable without penalty	\$ 20,619	\$ 20,619
Subordinated debentures, issued in 2000, due 2030, fixed at 10.60%, callable beginning in 2010 with penalty ranging from 5.30% to 0.53% depending on the year of prepayment, callable in 2020 without penalty	3,243	3,333
Subordinated debentures, issued in 2003, due 2033, floating rate of 3.15% above the three-month LIBOR rate, reset quarterly, currently callable without penalty	5,155	5,155
Subordinated debentures, issued in 2005, due 2035, fixed rate of 6.81% during the first ten years and at a floating rate of 1.38% above the three-month LIBOR rate, reset quarterly, thereafter, callable in 2010 without penalty	15,465	15,465
Subordinated debentures, issued in 2006, due 2036, fixed rate of 6.75% during the first five years and at a floating rate of 1.85% above the three-month LIBOR rate, reset quarterly, thereafter, callable in 2011 without penalty	3,093	
<b>Total</b>	<b>\$ 47,575</b>	<b>\$ 44,572</b>

The trust preferred securities are tax-advantaged issues that qualify for Tier 1 capital treatment subject to certain limitations. Distributions on these securities are included in interest expense. Each of the trusts is a statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds in our subordinated debentures, the sole asset of each trust. The trust preferred securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the subordinated debentures held by the trust. We wholly own the common securities of each trust. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon our making payment on the related subordinated debentures. Our obligations under the subordinated securities and other relevant trust agreements, in aggregate, constitute a full and unconditional guarantee by us of each respective trust's obligations under the trust securities issued by each respective trust.

Presently, the funds raised from the trust preferred offerings will qualify as Tier 1 capital for regulatory purposes, subject to the applicable limit, with the balance qualifying as Tier 2 capital.

The Company holds two trust preferred securities which are currently callable without penalty based on the terms of the specific agreements. The 2009 agreement between the Company and the Treasury limits our ability to retire any of our qualifying capital. As a result, the notes previously mentioned are not currently eligible to be paid off.

***Shareholders Equity***

Stockholders' equity was \$283.0 million at December 31, 2008 compared to \$253.1 million at December 31, 2007, an increase of 11.9%. As of December 31, 2008 and 2007 our equity to asset ratio was 11.0%. Book value per common share was \$14.25 at December 31, 2008 compared to \$13.58 at December 31, 2007, a 4.9% increase. The increases in stockholders' equity and book value per share were primarily the result of our acquisition of Centennial Bancshares, Inc. and retained earnings during the prior twelve months.



**Table of Contents**

*Initial Public Offering.* We priced our initial public offering of 2.7 million shares of common stock (stock dividend adjusted) at \$16.67 per share. We received net proceeds of approximately \$40.9 million from its sale of shares after deducting sales commissions and expenses. The underwriters of the Company's initial public offering exercised and completed their option to purchase an additional 405,000 shares (stock dividend adjusted) of common stock to cover over-allotments effective July 26, 2006. We received net proceeds of approximately \$6.3 million from this sale of shares after deducting sales commissions.

*Preferred Stock Conversion.* During the third quarter of 2006, our Board of Directors authorized the redemption and conversion of the issued and outstanding shares of Home BancShares's Class A Preferred Stock and Class B Preferred Stock into Home BancShares Common Stock, effective as of August 1, 2006.

The holder's of shares of Class A Preferred Stock, received 0.789474 of Home BancShares Common Stock for each share of Class A Preferred Stock owned, plus a check for the pro rata amount of the third quarter Class A Preferred Stock dividend accrued through July 31, 2006. The Class A Preferred shareholder's did not receive fractional shares, instead they received cash at a rate of \$12.67 times the fraction of a share they otherwise would be entitled to.

The holder's of shares of Class B Preferred Stock, received three shares of Home BancShares Common Stock for each share of Class B Preferred Stock owned, plus a check for the pro rata amount of the third quarter Class B Preferred Stock dividend accrued through July 31, 2006.

*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.

This additional capital will increase our Tier 1 and Total Risk Based Capital ratios by approximately 2.2 percentage points to 14.9% and 16.2%, respectively. These ratios will continue to be significantly above the guidelines established by the bank regulatory agencies. Using a benchmark of 6.0% and 10.0%, the treasury capital will increase our excess Tier 1 and Total Risk Based Capital to approximately \$198.4 million and \$138.2 million, respectively. It will also increase the cash on hand at the parent company to \$81.4 million.

*Cash Dividends.* We declared cash dividends on our common stock of \$0.222 and \$0.134 for the years ended December 31, 2008 and 2007, respectively. We declared cash dividends on our common stock, Class A preferred stock, and Class B preferred stock of \$0.083, \$0.1458 and \$0.3325 per share, respectively, for the year ended December 31, 2006. The common per share amounts are reflective of the 8% stock dividend during 2008. The 2009 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.

*Stock Dividends.* On July 16, 2008, our Board of Directors declared an 8% stock dividend which was paid August 27, 2008 to shareholders of record as of August 13, 2008. Except for fractional shares, the holders of our common stock received 8% additional common stock on August 27, 2008. The common shareholders did not receive fractional shares; instead they received cash at a rate equal to the closing price of a share on August 28, 2008 times the fraction of a share they otherwise would have been entitled to.

All common share and common per share amounts have been restated to reflect the retroactive effect of the stock dividend. After issuance, this stock dividend lowered our total capital position by approximately \$13,000 as a result of the cash paid in lieu of fractional shares. Our financial statements reflect an increase in the number of outstanding shares of common stock, an increase in surplus and reduction of retained earnings.

**Table of Contents**

*Repurchase Program.* On January 18, 2008, we announced the adoption by our Board of Directors of a stock repurchase program. The program authorizes us to repurchase up to 1,080,000 shares (stock dividend adjusted) of our common stock. Under the repurchase program, there is no time limit for the stock repurchases, nor is there a minimum number of shares that we intend to repurchase. The repurchase program may be suspended or discontinued at any time without prior notices. The timing and amount of any repurchases will be determined by management, based on its evaluation of current market conditions and other factors. The stock repurchase program will be funded using our cash balances, which we believe are adequate to support the stock repurchase program and our normal operations. As of December 31, 2008, we have not repurchased any shares in the program. The 2009 agreement between the Company and the Treasury limits our ability to repurchase common stock.

**Liquidity and Capital Adequacy Requirements**

*Parent Company Liquidity.* The primary sources for payment of our operating expenses and dividends are current cash on hand (\$31.4 million as of December 31, 2008) and dividends received from our bank subsidiaries.

Dividend payments by our bank subsidiaries are subject to various regulatory limitations. As the result of historical special dividends paid and leveraged capital positions, the Company's subsidiary banks do not have any significant undivided profits available for payment of dividends to the Company, without prior approval of the regulatory agencies at December 31, 2008.

*Risk-Based Capital.* We, as well as our bank subsidiaries, are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and other discretionary actions by regulators that, if enforced, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classifications are also subject to qualitative judgments by the regulators as to components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes that, as of December 31, 2008 and 2007, we met all regulatory capital adequacy requirements to which we were subject.

**Table of Contents**

Table 17 presents our risk-based capital ratios as of December 31, 2008 and 2007.

**Table 17: Risk-Based Capital**

	<b>As of December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Dollars in thousands)</b>	
Tier 1 capital		
Shareholders' equity	\$ 283,044	\$ 253,056
Qualifying trust preferred securities	46,000	43,000
Goodwill and core deposit intangibles, net	(53,803)	(42,332)
Unrealized loss on available-for-sale securities	3,375	2,255
Other	189	
<b>Total Tier 1 capital</b>	<b>278,427</b>	<b>255,979</b>
Tier 2 capital		
Qualifying allowance for loan losses	27,573	23,861
<b>Total Tier 2 capital</b>	<b>27,573</b>	<b>23,861</b>
<b>Total risk-based capital</b>	<b>\$ 306,000</b>	<b>\$ 279,840</b>
Average total assets for leverage ratio	\$ 2,562,044	\$ 2,236,776
Risk weighted assets	\$ 2,193,001	\$ 1,903,364
Ratios at end of year		
Leverage ratio	10.87%	11.44%
Tier 1 risk-based capital	12.70	13.45
Total risk-based capital	13.95	14.70
Minimum guidelines		
Leverage ratio	4.00%	4.00%
Tier 1 risk-based capital	4.00	4.00
Total risk-based capital	8.00	8.00

As of the most recent notification from regulatory agencies, our bank subsidiaries were well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, our banking subsidiaries and we must maintain minimum leverage, Tier 1 risk-based capital, and total risk-based capital ratios as set forth in the table. There are no conditions or events since that notification that we believe have changed the bank subsidiaries categories.

**Table of Contents**

Table 18 presents actual capital amounts and ratios as of December 31, 2008 and 2007, for our bank subsidiaries and us.

**Table 18: Capital and Ratios**

	Actual		For Capital Adequacy Purposes (Dollars in thousands)		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2008						
Leverage ratios:						
Home BancShares	\$278,427	10.87%	\$102,457	4.00%	\$ N/A	N/A%
Centennial Bank (Formerly FSB)	89,791	8.68	41,378	4.00	51,723	5.00
Community Bank	37,957	9.33	16,273	4.00	20,341	5.00
Twin City Bank	68,810	9.53	28,881	4.00	36,102	5.00
Bank of Mountain View	16,764	9.65	6,949	4.00	8,686	5.00
Centennial Bank	23,105	8.81	10,490	4.00	13,113	5.00
Tier 1 capital ratios:						
Home BancShares	\$278,427	12.70%	\$ 87,694	4.00%	\$ N/A	N/A%
Centennial Bank (Formerly FSB)	89,791	10.02	35,845	4.00	53,767	6.00
Community Bank	37,957	11.14	13,629	4.00	20,444	6.00
Twin City Bank	68,810	10.73	25,651	4.00	38,477	6.00
Bank of Mountain View	16,764	14.99	4,473	4.00	6,710	6.00
Centennial Bank	23,105	11.01	8,394	4.00	12,591	6.00
Total risk-based capital ratios:						
Home BancShares	\$306,000	13.95%	\$175,484	8.00%	\$ N/A	N/A%
Centennial Bank (Formerly FSB)	101,071	11.28	71,682	8.00	89,602	10.00
Community Bank	42,260	12.40	27,265	8.00	34,081	10.00
Twin City Bank	76,823	11.98	51,301	8.00	64,126	10.00
Bank of Mountain View	18,115	16.19	8,951	8.00	11,189	10.00
Centennial Bank	25,758	12.27	16,794	8.00	20,993	10.00
As of December 31, 2007						
Leverage ratios:						
Home BancShares	\$255,979	11.44%	\$ 89,503	4.00%	\$ N/A	N/A%
First State Bank	54,537	9.18	23,763	4.00	29,704	5.00
Community Bank	34,189	8.90	15,366	4.00	19,207	5.00
Twin City Bank	61,178	8.87	27,589	4.00	34,486	5.00
Marine Bank	33,332	8.91	14,964	4.00	18,705	5.00
Bank of Mountain View	16,174	8.26	7,832	4.00	9,791	5.00
Tier 1 capital ratios:						
Home BancShares	\$255,979	13.45%	\$ 76,128	4.00%	\$ N/A	N/A%
First State Bank	54,537	10.29	21,200	4.00	31,800	6.00
Community Bank	34,189	11.21	12,199	4.00	18,299	6.00
Twin City Bank	61,178	10.10	24,229	4.00	36,343	6.00
Marine Bank	33,332	10.20	13,071	4.00	19,607	6.00
Bank of Mountain View	16,174	13.84	4,675	4.00	7,012	6.00
Total risk-based capital ratios:						



Edgar Filing: HOME BANCSHARES INC - Form 10-K

Home BancShares	\$279,840	14.70%	\$152,294	8.00%	\$ N/A	N/A%
First State Bank	61,188	11.54	42,418	8.00	53,023	10.00
Community Bank	38,036	12.47	24,402	8.00	30,502	10.00
Twin City Bank	68,754	11.35	48,461	8.00	60,576	10.00
Marine Bank	37,429	11.45	26,151	8.00	32,689	10.00
Bank of Mountain View	17,442	14.92	9,352	8.00	11,690	10.00
		65				

---

**Table of Contents****Off-Balance Sheet Arrangements and Contractual Obligations**

In the normal course of business, we enter into a number of financial commitments. Examples of these commitments include but are not limited to operating lease obligations, FHLB advances, lines of credit, subordinated debentures, unfunded loan commitments and letters of credit.

Commitments to extend credit and letters of credit are legally binding, conditional agreements generally having certain expiration or termination dates. These commitments generally require customers to maintain certain credit standards and are established based on management's credit assessment of the customer. The commitments may expire without being drawn upon. Therefore, the total commitment does not necessarily represent future requirements.

Table 19 presents the funding requirements of our most significant financial commitments, excluding interest, as of December 31, 2008.

**Table 19: Funding Requirements of Financial Commitments**

	Payments Due by Period				Total
	Less than One Year	One- Three Years	Three- Five Years	Greater than Five Years	
			(In thousands)		
Operating lease obligations	\$ 1,134	\$ 2,189	\$ 1,812	\$ 5,774	\$ 10,909
FHLB advances	18,584	121,132	42,145	101,114	282,975
Subordinated debentures				47,575	47,575
Loan commitments	228,904	61,960	33,991	26,367	351,222
Letters of credit	13,248	222	12	4,492	17,974

**Non-GAAP Financial Measurements**

We had \$56.6 million, \$45.2 million, and \$47.0 million total goodwill, core deposit intangibles and other intangible assets as of December 31, 2008, 2007 and 2006, respectively. Because of our level of intangible assets and related amortization expenses, management believes diluted cash earnings per share, tangible book value per share, cash return on average assets, cash return on average tangible equity and tangible equity to tangible assets are useful in evaluating our company. These calculations, which are similar to the GAAP calculation of diluted earnings per share, book value, return on average assets, return on average shareholders' equity, and equity to assets, are presented in Tables 20 through 24, respectively.

**Table 20: Diluted Cash Earnings Per Share**

	Years Ended December 31,		
	2008	2007	2006
	(In thousands, except per share data)		
GAAP net income	\$ 10,116	\$ 20,445	\$ 15,918
Intangible amortization after-tax	1,124	1,068	1,059
Cash earnings	\$ 11,240	\$ 21,513	\$ 16,977
GAAP diluted earnings per share	\$ 0.50	\$ 1.08	\$ 0.93
Intangible amortization after-tax	0.05	0.06	0.06
Diluted cash earnings per share	\$ 0.55	\$ 1.14	\$ 0.99

**Table of Contents****Table 21: Tangible Book Value Per Share**

	Years Ended December 31,		
	2008	2007	2006
	(Dollars in thousands, except per share data)		
Book value per common share: A/B	\$ 14.25	\$ 13.58	\$ 12.45
Tangible book value per common share: (A-C-D)/B	11.40	11.16	9.93
(A) Total shareholders equity	\$283,044	\$253,056	\$231,419
(B) Common shares outstanding (stock dividend adjusted)	19,860	18,630	18,582
(C) Goodwill	50,038	37,527	37,527
(D) Core deposit and other intangibles	6,547	7,702	9,458

**Table 22: Cash Return on Average Assets**

	Years Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Return on average assets: A/C	0.39%	0.92%	0.78%
Cash return on average assets: B/(C-D)	0.44	0.98	0.86
(A) Net income	\$ 10,116	\$ 20,445	\$ 15,918
(B) Cash earnings	11,240	21,513	16,977
(C) Average assets	2,584,940	2,233,345	2,030,518
(D) Average goodwill, core deposits and other intangible assets	57,394	46,102	47,870

**Table 23: Cash Return on Average Tangible Equity**

	Years Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Return on average shareholders equity: A/C	3.51%	8.50%	8.12%
Return on average tangible equity: B/(C-D)	4.88	11.06	11.46
(A) Net income	10,116	\$ 20,445	\$ 15,918
(B) Cash earnings	11,240	21,513	16,977
(C) Average shareholders equity	287,827	240,556	196,014
(D) Average goodwill, core deposits and other intangible assets	57,394	46,102	47,870

**Table of Contents****Table 24: Tangible Equity to Tangible Assets**

	Years Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Equity to assets: B/A	10.97%	11.04%	10.56%
Tangible equity to tangible assets: (B-C-D)/(A-C-D)	8.97	9.25	8.60
(A) Total assets	\$2,580,093	\$2,291,630	\$2,190,648
(B) Total shareholders equity	283,044	253,056	231,419
(C) Goodwill	50,038	37,527	37,527
(D) Core deposit and other intangibles	6,547	7,702	9,458

**Quarterly Results**

The Company reported a net loss of \$9.4 million, or \$0.46 diluted loss per share for the fourth quarter of 2008. During this quarter, the Company experienced several items that it does not consider part of its core earnings going forward. These items include a \$19.0 million increased provision for loan losses over our normal quarterly provision, \$2.4 million of write-downs on other real estate owned, \$1.8 million of merger expenses from our bank charter consolidation, a \$3.9 million impairment write-down on two trust preferred investment securities and \$448,000 of other income resulting from our ownership of Arkansas Banker's Bank stock during their fourth quarter reorganization. The combined financial impact of these items to the Company on an after-tax basis is a loss of \$16.2 million or \$0.80 diluted per share. If adjusted for these non core items the announced loss for the fourth quarter of 2008 would reflect core net income of \$6.8 million or \$0.34 diluted earnings per share compared to net income of \$5.4 million, or \$0.28 diluted earnings per share for the same period in 2007.

The increased fourth quarter provision for loan loss was primarily attributable to the increase in non-performing loans during the fourth quarter as a result of the rapidly deteriorating Florida market conditions. Non-performing loans increased from \$16.1 million in the third quarter to \$29.9 million during the fourth quarter, most of which was concentrated in Florida. The write-down on other real estate was primarily due to the declining market value of one commercial property in Florida. The write-down on trust preferred investment securities was a result of bank closures in the fourth quarter that occurred within the pool.

**Table of Contents**

Table 25 presents selected unaudited quarterly financial information for 2008 and 2007.

**Table 25: Quarterly Results**

	<b>2008 Quarter</b>				<b>Total</b>
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	
	<b>(In thousands, except per share data)</b>				
Income statement data:					
Total interest income	\$ 38,396	\$ 36,540	\$ 36,088	\$ 34,694	\$ 145,718
Total interest expense	17,565	14,799	14,233	13,069	59,666
Net interest income	20,831	21,741	21,855	21,625	86,052
Provision for loan losses	4,809	704	1,439	20,064	27,016
Net interest income after provision for loan losses	16,022	21,037	20,416	1,561	59,036
Total non-interest income	13,534	5,667	7,784	1,732	28,717
Total non-interest expense	18,683	18,497	18,478	20,059	75,717
(Loss) income before income taxes	10,873	8,207	9,722	(16,766)	12,036
Income tax (benefit) expense	3,595	2,553	3,158	(7,386)	1,920
Net (loss) income	\$ 7,278	\$ 5,654	\$ 6,564	\$ (9,380)	\$ 10,116
Per share data:					
Basic (loss) earnings	\$ 0.37	\$ 0.29	\$ 0.32	\$ (0.47)	\$ 0.51
Diluted (loss) earnings	0.36	0.28	0.32	(0.46)	0.50
Diluted cash (loss) earnings	0.37	0.29	0.34	(0.45)	0.55
	<b>2007 Quarter</b>				
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>	<b>Total</b>
	<b>(In thousands, except per share data)</b>				
Income statement data:					
Total interest income	\$ 34,184	\$ 35,144	\$ 36,381	\$ 36,056	\$ 141,765
Total interest expense	18,122	18,399	19,061	18,196	73,778
Net interest income	16,062	16,745	17,320	17,860	67,987
Provision for loan losses	820	680	547	1,195	3,242
Net interest income after provision for loan losses	15,242	16,065	16,773	16,665	64,745
Total non-interest income	6,205	6,583	6,312	6,654	25,754
Total non-interest expense	14,741	15,517	15,599	15,678	61,535
Income before income taxes	6,706	7,131	7,486	7,641	28,964
Income tax expense	1,945	2,070	2,258	2,246	8,519
Net income	\$ 4,761	\$ 5,061	\$ 5,228	\$ 5,395	\$ 20,445

Per share data:

Basic earnings	\$ 0.26	\$ 0.27	\$ 0.28	\$ 0.29	\$ 1.10
Diluted earnings	0.25	0.27	0.28	0.28	1.08
Diluted cash earnings	0.27	0.28	0.29	0.30	1.14

69

---

**Table of Contents****Adoption of Recent Accounting Pronouncements****FAS 157**

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 has been applied prospectively as of the beginning of the period.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Available for sale securities are the only material instruments valued on a recurring basis which are held by the Company at fair value. The Company does not have any Level 1 securities. Primarily all of the Company's securities are considered to be Level 2 securities. These Level 2 securities consist of U.S. government-sponsored enterprises, mortgage-backed securities plus state and political subdivisions. At the beginning of the year our Level 3 securities included the two investment securities which became worthless during the year. As a result, we wrote them down by \$5.9 million in 2008 to a value of zero. As of year end 2008, Level 3 securities were immaterial.

Impaired loans are the only material instruments valued on a non-recurring basis which are held by the Company at fair value. Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan is confirmed. Impaired loans, net of specific allowance, were \$20.6 million as of December 31, 2008. This valuation is considered Level 3, consisting of appraisals of underlying collateral and discounted cash flow analysis.

Compared to prior years, the adoption of SFAS 157 did not have a material impact on our 2008 consolidated financial statements.

**FAS 159**

Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159) became effective for the Company on January 1, 2008. FAS 159 allows companies an option to report selected financial assets and liabilities at fair value. Because we did not elect the fair value measurement provision for any of our financial assets or liabilities, the adoption of SFAS 159 did not have any impact on our 2008 consolidated financial statements. Presently, we have not determined whether we will elect the fair value measurement provisions for future transactions.

**Table of Contents****EITF 06-4 and 06-10**

Effective January 1, 2008, the Company adopted EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements and EITF 06-10, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements. As a result of the adoption of EITF 06-4, the Company recognized the effect of applying the EITF with a change in accounting principle through a cumulative-effect adjustment to retained earnings for \$276,000. Additionally, this change will result in an increase of approximately \$100,000 in annual non-interest expense as a result of the mortality cost for 2008 and beyond. The adoption of EITF 06-10 did not have any impact on our 2008 consolidated financial statements.

**Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141(revised 2007), Business Combinations, (SFAS 141(R)). SFAS 141(R), which replaces SFAS 141, Business Combinations, establishes accounting standards for all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses (the acquiree) including mergers and combinations achieved without the transfer of consideration. SFAS 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. Goodwill is measured as the excess of consideration transferred plus the fair value of any noncontrolling interest in the acquiree over the fair value of the identifiable net assets acquired. In the event that the fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any non-controlling interest (referred to as a bargain purchase), SFAS 141(R) requires the acquirer to recognize that excess in earnings as a gain attributable to the acquirer. In addition, SFAS 141(R) requires costs incurred to effect an acquisition to be recognized separately from the acquisition and requires the recognition of assets or liabilities arising from noncontractual contingencies as of the acquisition date only if it is more likely than not that they meet the definition of an asset or liability in FASB Concepts Statement No. 6, Elements of Financial Statements. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, which for us is the fiscal year beginning January 1, 2009. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it to have a material effect on the Company's financial position or results of operation.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133. SFAS No. 161 requires companies to disclose their objectives and strategies for using derivative instruments, whether or not their derivatives are designated as hedging instruments. The pronouncement requires disclosure of the fair value of derivative instruments by primary underlying risk exposures (e.g. interest rate, credit, foreign exchange rate, combination of interest rate and foreign exchange rate, or overall price). It also requires detailed disclosures about the income statement impact of derivative instruments by designation as fair-value hedges, cash-flow hedges, or hedges of the foreign-currency exposure of a net investment in a foreign operation. SFAS No. 161 requires disclosure of information that will enable financial statement users to understand the level of derivative activity entered into by the company (e.g., total number of interest-rate swaps or total notional or quantity or percentage of forecasted commodity purchases that are being hedged). The principles of SFAS No. 161 may be applied on a prospective basis and are effective for financial statements issued for fiscal years beginning after November 15, 2008. For the Company, SFAS No. 161 will be effective at the beginning of its 2009 fiscal year and will result in additional disclosures in notes to the Company's consolidated financial statements.



**Table of Contents****Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*****Liquidity and Market Risk Management***

*Liquidity Management.* Liquidity refers to the ability or the financial flexibility to manage future cash flows to meet the needs of depositors and borrowers and fund operations. Maintaining appropriate levels of liquidity allows us to have sufficient funds available for reserve requirements, customer demand for loans, withdrawal of deposit balances and maturities of deposits and other liabilities. Our primary source of liquidity at our holding company is dividends paid by our bank subsidiaries. Applicable statutes and regulations impose restrictions on the amount of dividends that may be declared by our bank subsidiaries. Further, any dividend payments are subject to the continuing ability of the bank subsidiary to maintain compliance with minimum federal regulatory capital requirements and to retain its characterization under federal regulations as a well-capitalized institution.

Each of our bank subsidiaries have potential obligations resulting from the issuance of standby letters of credit and commitments to fund future borrowings to our loan customers. Many of these obligations and commitments to fund future borrowings to our loans customers are expected to expire without being drawn upon, therefore the total commitment amounts do not necessarily represent future cash requirements affecting our liquidity position.

Liquidity needs can be met from either assets or liabilities. On the asset side, our primary sources of liquidity include cash and cash equivalents, federal funds sold, maturities of investment securities and scheduled repayments and maturities of loans. We maintain adequate levels of cash and equivalents to meet our day-to-day needs. As of December 31, 2008, our cash and cash equivalents balances were \$54.2 million, or 2.1% of total assets, compared to \$55.0 million, or 2.4% of total assets, as of December 31, 2007. Our investment securities and Fed funds sold were \$363.1 million as of December 31, 2008 and \$430.5 million as of December 31, 2007.

As of December 31, 2008, \$61.0 million, or 35.2%, of our securities portfolio, excluding mortgage-backed securities, matured within one year, and \$77.7 million, or 44.8%, excluding mortgage-backed securities, matured after one year but within five years. As of December 31, 2007, \$112.5 million, or 45.2%, of our securities portfolio, excluding mortgage-backed securities, matured within one year, and \$83.4 million, or 33.5%, excluding mortgage-backed securities, matured after one year but within five years. As of December 31, 2008 and 2007, \$187.5 million and \$210.6 million, respectively, of securities were pledged as collateral for various public fund deposits and securities sold under agreements to repurchase.

Our commercial and real estate lending activities are concentrated in loans with maturities of less than five years with both fixed and adjustable rates. As of December 31, 2008 and 2007, approximately \$1.06 billion, or 54.0%, and \$995.2 million, or 61.9%, respectively, of our loans matured within one year and/or had adjustable interest rates. 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. Additionally, we maintain loan participation agreements with other financial institutions in which we could participate out loans for additional liquidity should the need arise.

On the liability side, our principal sources of liquidity are deposits, borrowed funds, and access to capital markets. Customer deposits are our largest sources of funds. As of December 31, 2008, our total deposits were \$1.85 billion, or 71.6% of total assets, compared to \$1.59 billion, or 69.5% of total assets, as of December 31, 2007. We attract our deposits primarily from individuals, business, and municipalities located in our market areas.

We may occasionally use our Fed funds lines of credit in order to temporarily satisfy short-term liquidity needs. We have Fed funds lines with three other financial institutions pursuant to which we could have borrowed up to \$84.1 million and \$88.2 million on an unsecured basis as of December 31, 2008 and 2007, respectively. These lines may be terminated by the respective lending institutions at any time.

We also maintain lines of credit with the Federal Home Loan Bank. Our FHLB borrowings were \$283.0 million as of December 31, 2008 and \$251.8 million as of December 31, 2007. The outstanding balance for December 31, 2008, was all FHLB long-term advances. The outstanding balance for December 31, 2007, included \$116.0 million of short-term advances and \$135.8 million of FHLB long-term advances. Our FHLB borrowing capacity was \$191.5 million and \$186.6 million as of December 31, 2008 and 2007, respectively.



**Table of Contents**

We believe that we have sufficient liquidity to satisfy our current operations.

*Market Risk Management.* Our primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on a large portion of our assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which possess a short term to maturity. We do not hold market risk sensitive instruments for trading purposes.

*Asset/Liability Management.* Our management actively measures and manages interest rate risk. The asset/liability committees of the boards of directors of our holding company and bank subsidiaries are also responsible for approving our asset/liability management policies, overseeing the formulation and implementation of strategies to improve balance sheet positioning and earnings, and reviewing our interest rate sensitivity position.

One of the tools that our management uses to measure short-term interest rate risk is a net interest income simulation model. This analysis calculates the difference between net interest income forecasted using base market rates and using a rising and a falling interest rate scenario. The income simulation model includes various assumptions regarding the re-pricing relationships for each of our products. Many of our assets are floating rate loans, which are assumed to re-price immediately, and proportional to the change in market rates, depending on their contracted index. Some loans and investments include the opportunity of prepayment (embedded options), and accordingly the simulation model uses indexes to estimate these prepayments and reinvest their proceeds at current yields. Our non-term deposit products re-price more slowly, usually changing less than the change in market rates and at our discretion.

This analysis indicates the impact of changes in net interest income for the given set of rate changes and assumptions. It assumes the balance sheet remains static and that its structure does not change over the course of the year. It does not account for all factors that impact this analysis, including changes by management to mitigate the impact of interest rate changes or secondary impacts such as changes to our credit risk profile as interest rates change.

Furthermore, loan prepayment rate estimates and spread relationships change regularly. Interest rate changes create changes in actual loan prepayment rates that will differ from the market estimates incorporated in this analysis. Changes that vary significantly from the assumptions may have significant effects on our net interest income.

For the rising and falling interest rate scenarios, the base market interest rate forecast was increased and decreased over twelve months by 200 and 100 basis points, respectively. At December 31, 2008, our net interest margin exposure related to these hypothetical changes in market interest rates was within the current guidelines established by us.

Table 26 presents our sensitivity to net interest income as of December 31, 2008.

**Table 26: Sensitivity of Net Interest Income**

<b>Interest Rate Scenario</b>	<b>Percentage Change from Base</b>
Up 200 basis points	6.0%
Up 100 basis points	2.8
Down 100 basis points	(4.1)
Down 200 basis points	(10.0)

*Interest Rate Sensitivity.* Our primary business is banking and the resulting earnings, primarily net interest income, are susceptible to changes in market interest rates. It is management's goal to maximize net interest income within acceptable levels of interest rate and liquidity risks.

**Table of Contents**

A key element in the financial performance of financial institutions is the level and type of interest rate risk assumed. The single most significant measure of interest rate risk is the relationship of the repricing periods of earning assets and interest-bearing liabilities. The more closely the repricing periods are correlated, the less interest rate risk we assume. We use repricing gap and simulation modeling as the primary methods in analyzing and managing interest rate risk.

Gap analysis attempts to capture the amounts and timing of balances exposed to changes in interest rates at a given point in time. As of December 31, 2008, our gap position was relatively neutral with a one-year cumulative repricing gap of 4.1%, compared to -5.2% as of December 31, 2007. During these periods, the amount of change our asset base realizes in relation to the total change in market interest rate is approximately that of the liability base.

We have a portion of our securities portfolio invested in mortgage-backed securities. Mortgage-backed securities are included based on their assumed maturity date. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

**Table of Contents**

Table 27 presents a summary of the repricing schedule of our interest-earning assets and interest-bearing liabilities (gap) as of December 31, 2008.

**Table 27: Interest Rate Sensitivity**

	Interest Rate Sensitivity Period							Total
	0-30 Days	31-90 Days	91-180 Days	181-365 Days	1-2 Years	2-5 Years	Over 5 Years	
(Dollars in thousands)								
Earning assets								
Interest-bearing deposits due from banks	\$ 7,403	\$	\$	\$	\$	\$	\$	\$ 7,403
Federal funds sold	7,865							7,865
Investment securities	21,964	23,954	23,955	34,348	30,449	74,534	146,040	355,244
Loans receivable	736,884	95,257	166,519	266,584	358,940	321,166	10,882	1,956,232
Total earning assets	774,116	119,211	190,474	300,932	389,389	395,700	156,922	2,326,744
Interest-bearing liabilities								
Interest-bearing transaction and savings deposits	24,458	48,916	73,374	146,749	121,067	121,067	121,127	656,758
Time deposits	124,203	228,081	211,007	273,514	78,965	26,027	4	941,801
Federal funds purchased								
Securities sold under repurchase agreements	89,276				3,349	10,047	10,717	113,389
FHLB and other borrowed funds	20,278	10,260	102	13,120	97,048	111,017	31,150	282,975
Subordinated debentures	25,782	15	23	45	60		21,650	47,575
Total interest-bearing liabilities	283,997	287,272	284,506	433,428	300,489	268,158	184,648	2,042,498
Interest rate sensitivity gap	\$ 490,119	\$ (168,061)	\$ (94,032)	\$ (132,496)	\$ 88,900	\$ 127,542	\$ (27,726)	\$ 284,246
Cumulative interest rate	\$ 490,119	\$ 322,058	\$ 228,026	\$ 95,530	\$ 184,430	\$ 311,972	\$ 284,246	

sensitivity gap							
Cumulative rate							
sensitive assets							
to rate sensitive							
liabilities	272.6%	156.4%	126.6%	107.4%	111.6%	116.8%	113.9%
Cumulative gap							
as a % of total							
earning assets	21.1	13.8	9.8	4.1	7.9	13.4	12.2
				75			

---

**Table of Contents**

**Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Management's Report on Internal Control Over Financial Reporting**

The management of Home BancShares, Inc. (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of the Company's financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Accordingly, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria for effective internal control over financial reporting established in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on this assessment, management determined that the Company's internal control over financial reporting as of December 31, 2008 is effective based on the specified criteria.

BKD, LLP, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. The report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2008, is included herein.

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

Audit Committee, Board of Directors and Stockholders

Home BancShares, Inc.

Conway, Arkansas

We have audited the accompanying consolidated balance sheets of Home BancShares, Inc. as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2008. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audits included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Home BancShares, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Home BancShares, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 2, 2009, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ **BKD, LLP**

Little Rock, Arkansas

March 2, 2009



**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

Audit Committee, Board of Directors and Stockholders

Home BancShares, Inc.

Conway, Arkansas

We have audited Home BancShares, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Home BancShares, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Home BancShares, Inc. and our report dated March 2, 2009, expressed an unqualified opinion thereon.

/s/ **BKD, LLP**

Little Rock, Arkansas

March 2, 2009

**Table of Contents**

**Home BancShares, Inc.**  
**Consolidated Balance Sheets**

(In thousands, except share data)	December 31,	
	2008	2007
<b>Assets</b>		
Cash and due from banks	\$ 46,765	\$ 51,468
Interest-bearing deposits with other banks	7,403	3,553
Cash and cash equivalents	54,168	55,021
Federal funds sold	7,865	76
Investment securities available for sale	355,244	430,399
Loans receivable	1,956,232	1,606,994
Allowance for loan losses	(40,385)	(29,406)
Loans receivable, net	1,915,847	1,577,588
Bank premises and equipment, net	73,610	67,702
Foreclosed assets held for sale	6,763	5,083
Cash value of life insurance	50,201	48,093
Investments in unconsolidated affiliates	1,424	15,084
Accrued interest receivable	13,115	14,321
Deferred tax asset, net	16,267	9,163
Goodwill	50,038	37,527
Core deposit and intangibles	6,547	7,702
Mortgage servicing rights	1,891	
Other assets	27,113	23,871
<b>Total assets</b>	<b>\$ 2,580,093</b>	<b>\$ 2,291,630</b>
<b>Liabilities and Stockholders Equity</b>		
Deposits:		
Demand and non-interest bearing	\$ 249,349	\$ 211,993
Savings and interest-bearing transaction accounts	656,758	582,477
Time deposits	941,801	797,736
Total deposits	1,847,908	1,592,206
Federal funds purchased		16,407
Securities sold under agreements to repurchase	113,389	120,572
FHLB borrowed funds	282,975	251,750
Accrued interest payable and other liabilities	5,202	13,067
Subordinated debentures	47,575	44,572
<b>Total liabilities</b>	<b>2,297,049</b>	<b>2,038,574</b>
<b>Stockholders equity:</b>		
Common stock, par value \$0.01 in 2008 and 2007; shares authorized 50,000,000 in 2008 and 2007; shares issued and outstanding 19,859,582 in 2008 and 18,629,472 (stock dividend adjusted) in 2007	199	173
Capital surplus	253,581	195,649
Retained earnings	32,639	59,489

Accumulated other comprehensive loss	(3,375)	(2,255)
<b>Total stockholders equity</b>	283,044	253,056
<b>Total liabilities and stockholders equity</b>	\$ 2,580,093	\$ 2,291,630

See accompanying notes.

**Table of Contents**

**Home BancShares, Inc.**  
**Consolidated Statements of Income**

(In thousands, except per share data(1))	Year Ended December 31,		
	2008	2007	2006
<b>Interest income:</b>			
Loans	\$ 127,812	\$ 120,067	\$ 100,152
Investment securities			
Taxable	12,610	17,003	18,879
Tax-exempt	4,850	4,187	3,753
Deposits other banks	133	166	139
Federal funds sold	313	342	840
Total interest income	145,718	141,765	123,763
<b>Interest expense:</b>			
Interest on deposits	45,593	56,232	46,213
Federal funds purchased	182	816	689
FHLB and other borrowed funds	9,255	8,982	6,627
Securities sold under agreements to repurchase	1,522	4,746	4,420
Subordinated debentures	3,114	3,002	2,991
Total interest expense	59,666	73,778	60,940
<b>Net interest income</b>	86,052	67,987	62,823
Provision for loan losses	27,016	3,242	2,307
<b>Net interest income after provision for loan losses</b>	59,036	64,745	60,516
<b>Non-interest income:</b>			
Service charges on deposit accounts	13,656	11,202	9,447
Other services charges and fees	6,564	5,470	2,642
Trust fees	73	131	671
Data processing fees	930	784	799
Mortgage lending income	2,771	1,662	1,736
Mortgage servicing income	853		
Insurance commissions	775	762	782
Income from title services	643	713	957
Increase in cash value of life insurance	2,113	2,448	304
Dividends from FHLB, FRB & bankers bank	828	911	659
Equity in income (loss) of unconsolidated affiliates	102	(86)	(379)
Gain on sale of equity investment	6,102		
Gain on sale of SBA loans	127	170	72
Gain (loss) on sale of premises and equipment	103	136	163
Gain (loss) on OREO, net	(2,880)	251	
Gain (loss) on securities, net	(5,927)		1
Other income	1,884	1,200	1,273
Total non-interest income	28,717	25,754	19,127

<b>Non-interest expense:</b>			
Salaries and employee benefits	35,566	30,496	29,313
Occupancy and equipment	11,053	9,459	8,712
Data processing expense	3,376	2,648	2,506
Other operating expenses	25,722	18,932	15,947
Total non-interest expense	75,717	61,535	56,478
<b>Income before income taxes</b>	12,036	28,964	23,165
Income tax expense	1,920	8,519	7,247
<b>Net income available to all shareholders</b>	10,116	20,445	15,918
Less: Preferred stock dividends			359
<b>Income available to common shareholders</b>	\$ 10,116	\$ 20,445	\$ 15,559
<b>Basic earnings per share</b>	\$ 0.51	\$ 1.10	\$ 0.99
<b>Diluted earnings per share</b>	\$ 0.50	\$ 1.08	\$ 0.93

(1) All per share amounts have been restated to reflect the effect of the 2008 8% stock dividend.

See accompanying notes.

**Table of Contents**

**Home BancShares, Inc.**  
**Consolidated Statements of Stockholders Equity**

(In thousands, except share data (1))	Preferred Stock		Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
	A	B				(Loss)		
<b>Balances at January 1, 2006</b>	\$ 21	\$ 2	\$ 121	\$ 146,285	\$ 27,331	\$ (7,903)	\$	\$ 165,857
Comprehensive income (loss):								
Net income ..					15,918			15,918
Other comprehensive income (loss):								
Unrealized gain on investment securities available for sale, net of tax effect of \$1,926						2,994		2,994
Unconsolidated affiliates unrecognized gain on investment securities available for sale, net of taxes recorded by the unconsolidated affiliate						17		17
Comprehensive income								18,929
Conversion of 2,258,077 shares of preferred stock A to 1,782,528 shares of common stock, net of fractional shares	(21)		17	2				(2)
Conversion of 183,340 shares of preferred stock B to 550,022 shares of common stock		(2)	5	(3)				
Issuance of 3,105,000 shares of common stock from Initial Public Offering, net of offering costs of \$4,545			29	47,176				47,205
Issuance of 15,786 shares of preferred stock A from exercise of stock options					2			2
Net issuance of 735 shares of preferred stock B from exercise of stock options					8			8
Net issuance of 61,577 shares of common stock from exercise of stock options				534				534
Tax benefit from stock options exercised				211				211
Share-based compensation				380				380
Cash dividends Preferred Stock A, \$0.1350 per share					(303)			(303)
Cash dividends Preferred Stock B, \$0.3079 per share					(56)			(56)
Cash dividends Common Stock, \$0.083 per share					(1,346)			(1,346)

Edgar Filing: HOME BANCSHARES INC - Form 10-K

<b>Balances at December 31, 2006</b>	172	194,595	41,544	(4,892)	231,419
Comprehensive income (loss):					
Net income			20,445		20,445
Other comprehensive income (loss):					
Unrealized gain on investment securities available for sale, net of tax effect of \$1,639				2,541	2,541
Unconsolidated affiliates unrecognized gain on investment securities available for sale, net of taxes recorded by the unconsolidated affiliate				96	96
Comprehensive income					23,082
Net issuance of 47,937 shares of common stock from exercise of stock options	1	354			355
Tax benefit from stock options exercised		244			244
Share-based compensation		456			456
Cash dividends Common Stock, \$0.134 per share			(2,500)		(2,500)
<b>Balances at December 31, 2007</b>	173	195,649	59,489	(2,255)	253,056

See accompanying notes.

**Table of Contents**

**Home BancShares, Inc.**  
**Consolidated Statements of Stockholders' Equity**    **Continued**

(In thousands, except share data (1))	Preferred Stock		Common Stock	Capital Surplus	Retained Earnings	Accumulated	Treasury Stock	Total
	A	B				Other Comprehensive Income (Loss)		
Cumulative effect of adoption of EITF 06-4					(276)			(276)
Comprehensive income (loss):								
Net income					10,116			10,116
Other comprehensive income (loss):								
Unrealized loss on investment securities available for sale, net of tax effect of \$663						(1,212)		(1,212)
Unconsolidated affiliates unrecognized gain on investment securities available for sale, net of taxes recorded by the unconsolidated affiliate							92	92
Comprehensive income								8,996
Issuance of 1,170,506 common shares pursuant to acquisition of Centennial Bancshares, Inc			10	24,245				24,255
Net issuance of 59,604 shares of common stock from exercise of stock options			1	446				447
Disgorgement of profits				89				89
Tax benefit from stock options exercised				416				416
Share-based compensation				478				478
Cash dividends - Common Stock, \$0.222 per share					(4,404)			(4,404)
8% Stock dividend - Common Stock			15	32,258	(32,286)			(13)
<b>Balances at December 31, 2008</b>	\$	\$	\$ 199	\$ 253,581	\$ 32,639	\$ (3,375)	\$	\$ 283,044

(1) All share and per share amounts have been restated to reflect the effect of the 2008 8% stock dividend.

See accompanying notes.





**Table of Contents**

**Home BancShares, Inc.**  
**Consolidated Statements of Cash Flows**

(In thousands)	Year Ended December 31,		
	2008	2007	2006
<b>Operating Activities</b>			
Net income	\$ 10,116	\$ 20,445	\$ 15,918
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation	5,418	4,555	4,541
Amortization/Accretion	2,460	1,884	2,490
Share-based compensation	478	456	380
Tax benefits from stock options exercised	(416)	(244)	(211)
Loss (gain) on assets	8,577	(561)	(616)
Gain on sale of equity investment	(6,102)		
Provision for loan losses	27,016	3,242	2,307
Deferred income tax benefit	(4,797)	(2,467)	(1,466)
Equity in (income) loss of unconsolidated affiliates	(102)	86	379
Increase in cash value of life insurance	(2,113)	(2,448)	(304)
Originations of mortgage loans held for sale	(136,710)	(93,028)	(87,611)
Proceeds from sales of mortgage loans held for sale	137,974	90,569	88,224
Changes in assets and liabilities:			
Accrued interest receivable	2,371	(585)	(2,578)
Other assets	(1,293)	(5,455)	(7,259)
Accrued interest payable and other liabilities	(8,862)	1,802	3,216
Net cash provided by operating activities	34,015	18,251	17,410
<b>Investing Activities</b>			
Net (increase) decrease in federal funds sold	(4,999)	8,927	(1,948)
Net (increase) decrease in loans	(185,536)	(195,998)	(215,356)
Purchases of investment securities available for sale	(188,568)	(171,469)	(187,144)
Proceeds from maturities of investment securities available for sale	281,200	276,943	188,638
Proceeds from sales of investment securities available for sale			1,000
Proceeds from maturities of investment securities held to maturity			
Proceeds from sale of SBA loans	2,751	2,957	1,250
Proceeds from foreclosed assets held for sale	1,378	631	2,191
Purchases of premises and equipment, net	(7,809)	(14,782)	(9,955)
Purchase of bank owned life insurance		(3,496)	(35,000)
Acquisition of Centennial Bancshares, Inc., net funds received	1,663		
Proceeds from sale of investment in unconsolidated affiliates	19,862	(2,625)	(3,000)
Net cash used in investing activities	(80,058)	(98,912)	(259,324)

See accompanying notes.

**Table of Contents**

**Home BancShares, Inc.**  
**Consolidated Statements of Cash Flows (Continued)**

(In thousands)	Year Ended December 31,		
	2008	2007	2006
<b>Financing Activities</b>			
Net increase (decrease) in deposits	76,565	(14,988)	180,086
Net increase (decrease) in securities sold under agreements to repurchase	(7,183)	1,747	15,107
Net increase (decrease) in federal funds purchased	(16,407)	(8,863)	(19,225)
Net increase (decrease) in FHLB and other borrowed funds	(4,320)	99,982	34,714
Proceeds from issuance of subordinated debentures			
Repurchase of stock			
Proceeds from initial public offering, net			47,205
Proceeds from exercise of stock options	447	355	544
Disgorgement of profits	89		
Tax benefits from stock options exercised	416	249	211
Conversion of preferred stock A fractional shares			(2)
Dividends paid	(4,417)	(2,500)	(1,705)
 Net cash provided by financing activities	 45,190	 75,982	 256,935
 Net change in cash and cash equivalents	 (853)	 (4,679)	 15,021
Cash and cash equivalents beginning of year	55,021	59,700	44,679
 Cash and cash equivalents end of year	 54,168	 \$ 55,021	 \$ 59,700

**Table of Contents**

**Home BancShares, Inc.  
Notes to Consolidated Financial Statements**

**1. Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations***

Home BancShares, Inc. (the Company or HBI) is a bank holding company headquartered in Conway, Arkansas. The Company is primarily engaged in providing a full range of banking services to individual and corporate customers through its five wholly owned community bank subsidiaries. The bank subsidiaries have locations in central Arkansas, north central Arkansas, southern Arkansas, the Florida Keys and southwestern Florida. Recently, the Company announced plans to combine the charters of its banks into a single charter and adopt Centennial Bank as their common name. This combination is in process and is expected to be completed by the middle of 2009. The Company is subject to competition from other financial institutions. The Company also is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

***Operating Segments***

The Company is organized on a subsidiary bank-by-bank basis upon which management makes decisions regarding how to allocate resources and assess performance. Each of the subsidiary banks provides a group of similar community banking services, including such products and services as loans, time deposits, checking and savings accounts. The individual bank segments have similar operating and economic characteristics and have been reported as one aggregated operating segment.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of foreclosed assets. In connection with the determination of the allowance for loan losses and the valuation of foreclosed assets, management obtains independent appraisals for significant properties.

***Principles of Consolidation***

The consolidated financial statements include the accounts of HBI and its subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

***Reclassifications***

Various items within the accompanying financial statements for previous years have been reclassified to provide more comparative information. These reclassifications had no effect on net earnings or stockholders' equity.

***Cash and Cash Equivalents***

Cash and cash equivalents consists of cash on hand, demand deposits with banks and interest-bearing deposits with other banks.

**Table of Contents*****Investment Securities***

Interest on investment securities is recorded as income as earned. Amortization of premiums and accretion of discounts are recorded as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Gains or losses on the sale of securities are determined using the specific identification method.

Management determines the classification of securities as available for sale, held to maturity, or trading at the time of purchase based on the intent and objective of the investment and the ability to hold to maturity. Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities. The Company has no trading securities.

Securities available for sale are reported at fair value with unrealized holding gains and losses reported as a separate component of stockholders' equity and other comprehensive income (loss), net of taxes. Securities that are held as available for sale are used as a part of HBI's 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.

Securities held to maturity are reported at amortized historical cost. Securities that management has the intent and ability to hold until maturity or on a long-term basis are classified as held to maturity.

***Loans Receivable and Allowance for Loan Losses***

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for any charge-offs, deferred fees or costs on originated loans. Interest income on loans is accrued over the term of the loans based on the principal balance outstanding. Loan origination fees and direct origination costs are capitalized and recognized as adjustments to yield on the related loans.

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 existing loans that may become uncollectible and probable credit losses inherent in the remainder of the loan portfolio. The amounts of provisions to the allowance 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.

Loans considered impaired, under SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS No. 118, *Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures*, are loans for which, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company applies this policy even if delays or shortfalls in payment 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 impairment of loans is utilized 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 such 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.

**Table of Contents**

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, but 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 the Company reasonably expects to collect all principal and interest.

**Foreclosed Assets Held for Sale**

Real estate and personal properties acquired through or in lieu of loan foreclosure are to be sold and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis.

Valuations are periodically performed by management, and the real estate and personal properties are carried at fair value less cost to sell. Gains and losses from the sale of other real estate and personal properties are recorded in non-interest income, and expenses used to maintain the properties are included in non-interest expenses.

**Bank Premises and Equipment**

Bank premises and equipment are carried at cost or fair market value at the date of acquisition less accumulated depreciation. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets. Accelerated depreciation methods are used for tax purposes. Leasehold improvements are capitalized and amortized by the straight-line method over the terms of the respective leases or the estimated useful lives of the improvements whichever is shorter. The assets' estimated useful lives for book purposes are as follows:

Bank premises	15-40 years
Furniture, fixtures, and equipment	3-15 years

**Investments in Unconsolidated Affiliates**

The Company had a 20.4% and 20.1% investment in White River Bancshares, Inc. (WRBI) at December 31, 2007 and 2006, respectively. The Company's investment in WRBI at December 31, 2007 and 2006 totaled \$13.8 million and \$11.1 million, respectively. On March 3, 2008, WRBI repurchased the Company's interest in WRBI which resulted in a one-time gain of \$6.1 million. Prior to this date, the investment in WRBI was accounted for on the equity method. The Company's share of WRBI operating income included in non-interest income in 2008, 2007 and 2006 totaled \$102,000, \$86,000 and \$379,000, respectively. The Company's share of WRBI unrealized loss on investment securities available for sale at December 31, 2007 and 2006 amounted to \$92,000 and \$2,000, respectively. See the Acquisitions footnote related to the Company's acquisition of WRBI during 2005.

The Company has invested funds representing 100% ownership in five statutory trusts which issue trust preferred securities. The Company's investment in these trusts was \$1.4 million at December 31, 2008 and \$1.3 million at December 31, 2007 and 2006. Under accounting principles generally accepted in the United States of America, these trusts are not consolidated.

The summarized financial information below represents an aggregation of the Company's unconsolidated affiliates as of December 31, 2008, 2007 and 2006, and for the years then ended:

**Table of Contents**

	2008	2007 (In thousands)	2006
Assets	\$47,424	\$580,753	\$387,599
Liabilities	46,000	513,257	330,640
Equity	1,424	67,496	56,959
Net income (loss)	163	(284)	(1,822)

**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. Core deposit intangibles represent the estimated value related to customer deposit relationships in the Company's acquisitions. 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. The Company performed its annual impairment test of goodwill and core deposit intangibles during 2008, 2007 and 2006, as required by SFAS No. 142, *Goodwill and Other Intangible Assets*. The tests indicated no impairment of the Company's goodwill or core deposit intangibles.

**Mortgage Servicing Rights**

Mortgage servicing rights are purchased servicing rights acquired in HBI's acquisition of Centennial Bancshares, Inc. on January 1, 2008. As of December 31, 2008, the mortgage loan servicing portfolio of approximately \$262.0 million is being sub-serviced by a third party. The Company did not add any loans to this portfolio during 2008. These rights are amortized in proportion to and over the period of estimated servicing revenues. Impairment of mortgage servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate.

**Securities Sold Under Agreements to Repurchase**

The Company sells securities under agreements to repurchase to meet customer needs for sweep accounts. At the point funds deposited by customers become investable, those funds are used to purchase securities owned by the Company and held in its general account with the designation of Customers' Securities. A third party maintains control over the securities underlying overnight repurchase agreements. The securities involved in these transactions are generally U.S. Treasury or Federal Agency issues. Securities sold under agreements to repurchase generally mature on the banking day following that on which the investment was initially purchased and are treated as collateralized financing transactions which are recorded at the amounts at which the securities were sold plus accrued interest. Interest rates and maturity dates of the securities involved vary and are not intended to be matched with funds from customers.

**Derivative Financial Instruments**

The Company may enter into derivative contracts for the purposes of managing exposure to interest rate risk. The Company records all derivatives on the balance sheet at fair value. Historically the Company's policy has been not to invest in derivative type investments.

The Company has executed two back-to-back interest rate swap agreements associated with one borrower in the loan portfolio. Though the Company is not applying hedge accounting, the swaps are identical offsets of one another, thereby resulting in a net income impact of zero. They are being adjusted to the fair value in accordance with FASB 133. The notional amount of the loans was \$20.4 million at December 31, 2008. The impact to the 2008 financial statements was an increase of 757,000 in other assets with a corresponding increase in other liabilities.

**Table of Contents****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.

**Income Taxes**

The Company utilizes 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. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that a deferred tax asset will not be realized.

The Company and its subsidiaries file consolidated tax returns. Its subsidiaries provide for income taxes on a separate return basis, and remit to the Company amounts determined to be currently payable.

**Earnings per Share**

Basic earnings per share are computed based on the weighted average number of shares outstanding during each year. Diluted earnings per share are computed using the weighted average common shares and all potential dilutive common shares outstanding during the period. The following table sets forth the computation of basic and diluted earnings per share (EPS) for the years ended December 31 (stock dividend adjusted):

	2008	2007 (In thousands)	2006
Net income available to all shareholders	\$ 10,116	\$ 20,445	\$ 15,918
Less: Preferred stock dividends			(359)
Income available to common shareholders	\$ 10,116	\$ 20,445	\$ 15,559
Average shares outstanding	19,816	18,614	15,657
Effect of common stock options	497	313	170
Effect of preferred stock options			18
Effect of preferred stock conversions			1,352
Diluted shares outstanding	20,313	18,927	17,197
Basic earnings per share	\$ 0.51	\$ 1.10	\$ 0.99
Diluted earnings per share	\$ 0.50	\$ 1.08	\$ 0.93



**Table of Contents**

***Pension Plan***

As the result of the acquisition during December 2003 and September 2005, the Company has two noncontributory defined benefit plans covering certain employees from those acquisitions. The Company's policy is to accrue pension costs in accordance with Statement of Financial Accounting Standards No. 87, Employer's Accounting for Pensions, and to fund such pension costs in accordance with contribution guidelines established by the Employee Retirement Income Security Act of 1974, as amended. The Company uses a measurement date of January 1.

The Company's defined benefit pension plans terminated in 2007.

**2. Acquisitions**

On January 1, 2008, HBI 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 HBI 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 HBI 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, the Company recorded goodwill of \$12.3 million and a core deposit intangible of \$694,000 during 2008.

In January 2005, HBI 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 the northwest Arkansas area. In January 2006, White River Bancshares issued an additional \$15.0 million of their common stock. To maintain a 20% ownership, the Company made an additional investment in White River Bancshares 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, HBI made a \$2.6 million additional investment in White River Bancshares on June 29, 2007 to maintain its 20% ownership. On March 3, 2008, White River BancShares repurchased HBI's 20% investment in White River Bancshares resulting in a one-time gain for HBI of \$6.1 million.

**Table of Contents****3. Investment Securities**

The amortized cost and estimated fair value of investment securities were as follows:

	<b>December 31, 2008</b>			<b>Estimated Fair Value</b>
	<b>Available for Sale</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	
	<b>(In thousands)</b>			
U.S. government-sponsored enterprises	\$ 49,632	\$ 810	\$ (7)	\$ 50,435
Mortgage-backed securities	183,808	1,673	(3,517)	181,964
State and political subdivisions	123,119	990	(4,279)	119,830
Other securities	4,238		(1,223)	3,015
<b>Total</b>	<b>\$ 360,797</b>	<b>\$ 3,473</b>	<b>\$ (9,026)</b>	<b>\$ 355,244</b>

	<b>December 31, 2007</b>			<b>Estimated Fair Value</b>
	<b>Available for Sale</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	
	<b>(In thousands)</b>			
U.S. government-sponsored enterprises	\$ 126,898	\$ 268	\$ (872)	\$ 126,294
Mortgage-backed securities	184,949	179	(3,554)	181,574
State and political subdivisions	111,014	1,105	(812)	111,307
Other securities	11,411		(187)	11,224
<b>Total</b>	<b>\$ 434,272</b>	<b>\$ 1,552</b>	<b>\$ (5,425)</b>	<b>\$ 430,399</b>

Assets, principally investment securities, having a carrying value of approximately \$187.5 million and \$210.6 million at December 31, 2008 and 2007, respectively, were pledged to secure public deposits and for other purposes required or permitted by law. Also, investment securities pledged as collateral for repurchase agreements totaled approximately \$113.4 million and \$120.6 million at December 31, 2008 and 2007, respectively.

The amortized cost and estimated fair value of securities at December 31, 2008, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>Available-for-Sale</b>	
	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
	<b>(In thousands)</b>	
Due in one year or less	\$ 98,775	\$ 97,873
Due after one year through five years	156,733	154,758
Due after five years through ten years	51,826	50,379
Due after ten years	53,463	52,234

Total

\$ 360,797

\$ 355,244

**Table of Contents**

For purposes of the maturity tables, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on anticipated maturities. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal prepayments.

There were no securities classified as held to maturity at December 31, 2008 and 2007.

During the year ended December 31, 2008 and 2007, no available for sale securities were sold. During the year ended December 31, 2006, \$1.0 million in available for sale securities were sold. The gross realized gains on such sales totaled \$1,000 for the year ended December 31, 2006. The income tax expense/benefit related to net security gains and losses was 39.23% of the gross amount for and 2006.

The Company evaluates all securities quarterly to determine if any unrealized losses are deemed to be other than temporary. In completing these evaluations the Company follows the requirements of paragraph 16 of SFAS No. 115, Staff Accounting Bulletin 59 and FASB Staff Position No. 115-1. Certain investment securities are valued less than their historical cost. These declines are primarily the result of the rate for these investments yielding less than current market rates. Based on evaluation of available evidence, management believes the declines in fair value for these securities are temporary. It is management's intent to hold these securities to maturity. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary, impairment is identified.

During 2008, the Company became aware that two investment securities in the other securities category had become other than temporarily impaired. As a result of this impairment the Company 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. These investment securities are a pool of other financial holding companies' subordinated debentures throughout the country. As of December 31, 2008, three of these holding companies have defaulted due to their closure by the federal government and six are deferring their quarterly payments as a result of stressed capital levels. Additionally, one holding company deferring at year end has been closed in 2009 and another has stated publicly it will default on these securities. Since, the federal government has begun to seize these institutions it has resulted in our investment becoming worthless. No other securities were written down for other than temporarily impairment for 2008, 2007 and 2006.

For the year ended December 31, 2008, the Company had \$4.9 million in unrealized losses, which have been in continuous loss positions for more than twelve months. Included in the \$4.9 million in unrealized losses are \$2.3 million in unrealized losses, which were associated with government-sponsored securities and government-sponsored mortgage-back securities. Excluding the impairment write down during 2008, the Company's assessments indicated that the cause of the market depreciation was primarily the change in interest rates and not the issuer's financial condition, or downgrades by rating agencies. In addition, approximately 71.1% of the Company's investment portfolio matures in five years or less. As a result, the Company has the ability and intent to hold such securities until maturity.

**Table of Contents**

The following shows gross unrealized losses and estimated fair value of investment securities available for sale, aggregated by investment category and length of time that individual investment securities have been in a continuous loss position as of December 31, 2008 and 2007:

	Less Than 12 Months		December 31, 2008 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. Government-sponsored enterprises	\$ 2,385	\$ 7	\$	\$	\$ 2,385	\$ 7
Mortgage-backed securities	32,915	906	52,000	2,611	84,915	3,517
State and political subdivisions	55,162	3,091	6,605	1,188	61,767	4,279
Other securities	1,152	157	1,721	1,066	2,873	1,223
Total	\$ 91,614	\$ 4,161	\$ 60,326	\$ 4,865	\$ 151,940	\$ 9,026

	Less Than 12 Months		December 31, 2007 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. Government-sponsored enterprises	\$ 20,580	\$ 35	\$ 80,093	\$ 837	\$ 100,673	\$ 872
Mortgage-backed securities	7,906	28	142,572	3,526	150,478	3,554
State and political subdivisions	29,469	460	18,452	352	47,921	812
Other securities			2,414	187	2,414	187
Total	\$ 57,955	\$ 523	\$ 243,531	\$ 4,902	\$ 301,486	\$ 5,425

**Table of Contents****4. Loans receivable and Allowance for Loan Losses**

The various categories of loans are summarized as follows:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In thousands)</b>	
Real estate:		
Commercial real estate loans		
Non-farm/non-residential	\$ 816,603	\$ 607,638
Construction/land development	320,398	367,422
Agricultural	23,603	22,605
Residential real estate loans		
Residential 1-4 family	391,255	259,975
Multifamily residential	56,440	45,428
Total real estate	1,608,299	1,303,068
Consumer	46,615	46,275
Commercial and industrial	255,153	219,062
Agricultural	23,625	20,429
Other	22,540	18,160
Total loans receivable before allowance for loan losses	1,956,232	1,606,994
Allowance for loan losses	40,385	29,406
Total loans receivable, net	\$ 1,915,847	\$ 1,577,588

The following is a summary of activity within the allowance for loan losses:

	<b>Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(Dollars in thousands)</b>		
Balance, beginning of year	\$ 29,406	\$ 26,111	\$ 24,175
Loans charged off	(20,920)	(826)	(1,514)
Recoveries on loans previously charged off	1,501	879	1,143
Net charge-offs	(19,419)	53	(371)
Provision charged to operating expense	27,016	3,242	2,307
Allowance for loan losses of acquired institutions	3,382		
Balance, end of year	\$ 40,385	\$ 29,406	\$ 26,111

At December 31, 2008 and 2007, accruing loans delinquent 90 days or more totaled \$1.4 million and \$301,000, respectively. Non-accruing loans at December 31, 2008 and 2007 were \$28.5 million and \$3.0 million, respectively.

**Table of Contents**

Mortgage loans held for resale of approximately \$3.6 million and \$4.8 million at December 31, 2008 and 2007, respectively, are included in residential 1-4 family loans. Mortgage loans held for sale are carried at the lower of cost or fair value, determined using an aggregate basis. Gains and losses resulting from sales of mortgage loans are recognized when the respective loans are sold to investors. Gains and losses are determined by the difference between the selling price and the carrying amount of the loans sold, net of discounts collected or paid. The Company obtains forward commitments to sell mortgage loans to reduce market risk on mortgage loans in the process of origination and mortgage loans held for sale. The forward commitments acquired by the Company for mortgage loans in process of origination are not mandatory forward commitments. These commitments are structured on a best efforts basis; therefore the Company is not required to substitute another loan or to buy back the commitment if the original loan does not fund. Typically, the Company delivers the mortgage loans within a few days after the loans are funded. These commitments are derivative instruments and their fair values at December 31, 2008 and 2007 were not material.

At December 31, 2008 and 2007, impaired loans totaled \$31.5 million and \$11.9 million, respectively. As of December 31, 2008 and 2007, average impaired loans were \$29.4 million and \$11.8 million, respectively. All impaired loans had designated reserves for possible loan losses. Reserves relative to impaired loans at December 31, 2008, were \$10.9 million and \$2.6 million at December 31, 2007. Interest recognized on impaired loans during 2008 and 2007 was immaterial.

**5. Goodwill and Core Deposits and Other Intangibles**

Changes in the carrying amount and accumulated amortization of the Company's core deposits and other intangibles at December 31, 2008 and 2007, were as follows:

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
	<b>(In thousands)</b>	
<b>Goodwill</b>		
Balance, beginning of period	\$ 37,527	\$ 37,527
Acquisition of Centennial Bancshares, Inc.	12,322	
Prior Acquisition (deferred taxes)	189	
Balance, end of period	\$ 50,038	\$ 37,527
	<b>2008</b>	<b>2007</b>
	<b>(In thousands)</b>	
<b>Core Deposit and Other Intangibles</b>		
Balance, beginning of period	\$ 7,702	\$ 9,458
Acquisition of Centennial Bancshares, Inc.	694	
Amortization expense	(1,849)	(1,756)
Balance, end of year	\$ 6,547	\$ 7,702

The carrying basis and accumulated amortization of core deposits and other intangibles at December 31, 2008 and 2007 were:

	<b>December 31, 2008</b>	<b>2007</b>
	<b>(In thousands)</b>	
Gross carrying amount	\$ 14,151	\$ 13,457
Accumulated amortization	7,604	5,755

Net carrying amount		\$ 6,547	\$ 7,702
---------------------	--	----------	----------



**Table of Contents**

Core deposit and other intangible amortization for the years ended December 31, 2008, 2007 and 2006 was approximately \$1.8 million, \$1.8 million and \$1.7 million, respectively. Including all of the mergers completed, HBI's estimated amortization expense of core deposits and other intangibles for each of the years 2009 through 2013 is: 2009 \$1.8 million; 2010 \$1.8 million; 2011 \$1.1 million; 2012 \$619,000; and 2013 \$619,000.

The carrying amount of the Company's goodwill was \$50.0 million and \$37.5 million at December 31, 2008 and 2007, respectively. Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements.

**6. Deposits**

The aggregate amount of time deposits with a minimum denomination of \$100,000 was \$500.7 million and \$435.5 million at December 31, 2008 and 2007, respectively. Interest expense applicable to certificates in excess of \$100,000 totaled \$19.6 million, \$22.8 million and \$19.3 million for the years ended December 31, 2008, 2007 and 2006, respectively. As of December 31, 2008 and 2007, brokered deposits were \$111.0 million and \$39.3 million, respectively.

The following is a summary of the scheduled maturities of all time deposits at December 31, 2008 (in thousands):

One month or less	\$ 124,203
Over 1 month to 3 months	228,081
Over 3 months to 6 months	211,007
Over 6 months to 12 months	273,514
Over 12 months to 2 years	78,965
Over 2 years to 3 years	17,008
Over 3 years to 5 years	9,019
Over 5 years	4
Total time certificates of deposit	\$ 941,801

Deposits totaling approximately \$278.2 million and \$185.6 million at December 31, 2008 and 2007, respectively, were public funds obtained primarily from state and political subdivisions in the United States.

**7. FHLB Borrowed Funds**

The Company's FHLB borrowed funds were \$283.0 million and \$251.8 million at December 31, 2008 and 2007, respectively. The outstanding balance for December 31, 2008 includes no short-term advances and \$283.0 million of long-term advances. The outstanding balance for December 31, 2007 includes \$116.0 million of short-term advances and \$135.8 million of long-term advances. The long-term FHLB advances mature from the current year to 2025 with interest rates ranging from 2.020% to 5.416% and are secured by loans in the Company's loan portfolio.

Additionally, the Company had \$217.2 million and \$105.5 million at December 31, 2008 and 2007, respectively, in letters of credit under a FHLB blanket borrowing line of credit, which are used to collateralize public deposits at December 31, 2008 and 2007, respectively.

**Table of Contents**

Maturities of borrowings with original maturities exceeding one year at December 31, 2008, are as follows (in thousands):

2009	\$ 18,584
2010	86,864
2011	34,268
2012	12,071
2013	30,074
Thereafter	101,114
	\$ 282,975

**8. Subordinated Debentures**

Subordinated Debentures at December 31, 2008 and 2007 consisted of guaranteed payments on trust preferred securities with the following components:

	2008	2007
	(In thousands)	
Subordinated debentures, issued in 2003, due 2033, fixed at 6.40%, during the first five years and at a floating rate of 3.15% above the three-month LIBOR rate, reset quarterly, thereafter, currently callable without penalty	\$ 20,619	\$ 20,619
Subordinated debentures, issued in 2000, due 2030, fixed at 10.60%, callable beginning in 2010 with penalty ranging from 5.30% to 0.53% depending on the year of prepayment, callable in 2020 without penalty	3,243	3,333
Subordinated debentures, issued in 2003, due 2033, floating rate of 3.15% above the three-month LIBOR rate, reset quarterly, currently callable without penalty	5,155	5,155
Subordinated debentures, issued in 2005, due 2035, fixed rate of 6.81% during the first ten years and at a floating rate of 1.38% above the three-month LIBOR rate, reset quarterly, thereafter, callable in 2010 without penalty	15,465	15,465
Subordinated debentures, issued in 2006, due 2036, fixed rate of 6.75% during the first five years and at a floating rate of 1.85% above the three-month LIBOR rate, reset quarterly, thereafter, callable in 2011 without penalty	3,093	
Total	\$ 47,575	\$ 44,572

The trust preferred securities are tax-advantaged issues that qualify for Tier 1 capital treatment subject to certain limitations. Distributions on these securities are included in interest expense. Each of the trusts is a statutory business trust organized for the sole purpose of issuing trust securities and investing the proceeds thereof in junior subordinated debentures of the Company, the sole asset of each trust. The preferred trust securities of each trust represent preferred beneficial interests in the assets of the respective trusts and are subject to mandatory redemption upon payment of the junior subordinated debentures held by the trust. The Company wholly owns the common securities of each trust. Each trust's ability to pay amounts due on the trust preferred securities is solely dependent upon the Company making payment on the related junior subordinated debentures. The Company's obligations under the junior subordinated securities and other relevant trust agreements, in aggregate, constitute a full and unconditional guarantee by the Company of each respective trust's obligations under the trust securities issued by each respective trust.

Presently, the funds raised from the trust preferred offerings will qualify as Tier 1 capital for regulatory purposes, subject to the applicable limit, with the balance qualifying as Tier 2 capital.

The Company holds two trust preferred securities which are currently callable without penalty based on the terms of the specific agreements. The 2009 agreement between the Company and the Treasury limits our ability to retire any

of our qualifying capital. As a result, the notes previously mentioned are not currently eligible to be paid off.

**Table of Contents****9. Income Taxes**

The following is a summary of the components of the provision for income taxes:

	<b>Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>		
Current:			
Federal	\$ 5,313	\$ 9,710	\$ 7,705
State	1,215	1,271	1,008
Total current	6,528	10,981	8,713
Deferred:			
Federal	(3,511)	(2,079)	(1,226)
State	(1,097)	(383)	(240)
Total deferred	(4,608)	(2,462)	(1,466)
Provision for income taxes	\$ 1,920	\$ 8,519	\$ 7,247

The reconciliation between the statutory federal income tax rate and effective income tax rate is as follows:

	<b>Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Statutory federal income tax rate	35.00%	35.00%	35.00%
Effect of nontaxable interest income	(17.17)	(6.48)	(5.22)
Cash value of life insurance	(6.14)	(2.96)	(0.46)
State income taxes, net of federal benefit	0.64	1.99	2.15
Other	3.62	1.86	(0.19)
Effective income tax rate	15.95%	29.41%	31.28%

**Table of Contents**

The types of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts that give rise to deferred income tax assets and liabilities, and their approximate tax effects, are as follows:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In thousands)</b>	
Deferred tax assets:		
Allowance for loan losses	\$ 15,772	\$ 11,512
Deferred compensation	640	397
Stock options	514	328
Non-accrual interest income	358	562
Impairment of investment securities	2,364	39
Unrealized loss on securities	2,178	1,519
Net operating loss carryforward	119	
Other	514	628
 Gross deferred tax assets	 22,459	 14,985
Deferred tax liabilities:		
Accelerated depreciation on premises and equipment	2,519	1,997
Core deposit intangibles	2,486	2,897
Market value of cash flow hedge		4
FHLB dividends	843	681
Other	344	243
 Gross deferred tax liabilities	 6,192	 5,822
 Net deferred tax assets	 \$ 16,267	 \$ 9,163

The Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. The implementation of FIN 48 did not have any effect on the Company's financial statements.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and the states of Arkansas and Florida. With a few exceptions, the Company is no longer subject to U.S. federal and state tax examinations by tax authorities for years before 2005. The Company's Federal tax return and its state tax returns are not currently under examination.

The Company recognizes interest accrued related to unrecognized tax benefits and penalties in income tax expense. During the years ended December 31, 2008 and 2007, the Company did not recognize any interest or penalties. During the year ended December 31, 2006, the amount of interest and penalties the Company recognized were immaterial. The Company did not have any interest or penalties accrued at December 31, 2008, 2007 and 2006.

## **10. Common Stock and Stock Compensation Plans**

### ***Common Stock***

On June 22, 2006, the Company priced its initial public offering of 2.7 million shares (stock dividend adjusted) of common stock at \$16.67 per share. The total price to the public for the shares offered and sold by the Company was \$45.0 million. The amount of expenses incurred for the Company's account in connection with the offering includes approximately \$3.1 million of underwriting discounts and commissions and offering expenses of approximately \$1.0 million. The Company received net proceeds of approximately \$40.9 million from its sale of shares after deducting sales commissions and expenses.



**Table of Contents**

On July 21, 2006, the underwriters of the Company's initial public offering exercised and completed their option to purchase an additional 405,000 shares (stock dividend adjusted) of common stock to cover over-allotments effective July 26, 2006. The Company received net proceeds of approximately \$6.3 million from this sale of shares after deducting sales commissions.

On August 1, 2006, the Company redeemed and converted the issued and outstanding shares of Home BancShares's Class A Preferred Stock and Class B Preferred Stock into Home BancShares Common Stock. The conversion of the preferred stock increased the Company's outstanding common stock by approximately 2.3 million shares (stock dividend adjusted).

The holders of shares of Class A Preferred Stock, received 0.789474 of Home BancShares Common Stock for each share of Class A Preferred Stock owned, plus a check for the pro rata amount of the third quarter Class A Preferred Stock dividend accrued through July 31, 2006. The Class A Preferred shareholders did not receive fractional shares; instead they received cash at a rate of \$12.67 times the fraction of a share they otherwise would have been entitled to.

The holders of shares of Class B Preferred Stock, received three shares of Home BancShares Common Stock for each share of Class B Preferred Stock owned, plus a check for the pro rata amount of the third quarter Class B Preferred Stock dividend accrued through July 31, 2006.

On July 16, 2008, our Board of Directors declared an 8% stock dividend which was paid August 27, 2008 to shareholders of record as of August 13, 2008. Except for fractional shares, the holders of our common stock received 8% additional common stock on August 27, 2008. The common shareholders did not receive fractional shares; instead they received cash at a rate equal to the closing price of a share on August 28, 2008 times the fraction of a share they otherwise would have been entitled to.

All common share and common per share amounts have been restated to reflect the retroactive effect of the stock dividend. After issuance, this stock dividend lowered our total capital position by approximately \$13,000 as a result of the cash paid in lieu of fractional shares. Our financial statements reflect an increase in the number of outstanding shares of common stock, an increase in surplus and reduction of retained earnings.

***Stock Compensation Plans***

On March 13, 2006, the Company's board of directors adopted the 2006 Stock Option and Performance Incentive Plan. The Plan was submitted to the shareholders for approval at the 2006 annual meeting of shareholders. The purpose of the Plan is to attract and retain highly qualified officers, directors, key employees, and other persons, and to motivate those persons to improve our business results.

The Plan amends and restates various prior plans that were either adopted by the Company or companies that were acquired. Awards made under any of the prior plans will be subject to the terms and conditions of the Plan, which is designed not to impair the rights of award holders under the prior plans. The Plan goes beyond the prior plans by including new types of awards (such as unrestricted stock, performance shares, and performance and annual incentive awards) in addition to the stock options (incentive and non-qualified), stock appreciation rights, and restricted stock that could have been awarded under one or more of the prior plans. In addition, the Company's outstanding preferred stock options are also subject to the Plan.

**Table of Contents**

As of March 13, 2006, options for a total of 662,692 shares (stock dividend adjusted) of common stock outstanding under the prior plans became subject to the Plan. Also, on that date, the Company's board of directors replaced 368,280 outstanding stock appreciation rights (stock dividend adjusted) with 383,011 options (stock dividend adjusted), each with an exercise price of \$12.20 (stock dividend adjusted). During 2005, the Company had issued 368,280 stock appreciation rights (stock dividend adjusted) at \$11.73 (stock dividend adjusted) for certain executive employees throughout the Company. The appreciation rights were on a five-year cliff-vesting schedule with all appreciation rights vesting on December 31, 2009. The vesting was also subject to various financial performance goals of the Company and the subsidiary banks over the five-year period ending January 1, 2010. The options issued in replacement of the stock appreciation rights are subject to achievement of the same financial goals by the Company and the bank subsidiaries over the five-year period ending January 1, 2010.

The intrinsic value of the stock options outstanding at December 31, 2008, 2007, and 2006 was \$16.3 million, \$9.2 million and \$13.1 million, respectively. The intrinsic value of the stock options vested at December 31, 2008, 2007 and 2006 was \$10.1 million, \$6.2 million and \$8.3 million, respectively.

The intrinsic value of the stock options exercised during 2008, 2007 and 2006 was \$1.1 million, \$647,000 and \$425,000, respectively.

Total unrecognized compensation cost, net of income tax benefit, related to non-vested awards, which are expected to be recognized over the vesting periods, was \$341,000 as of December 31, 2008.

The Company has a stock option and performance incentive plan. The purpose of the plan is to attract and retain highly qualified officers, directors, key employees, and other persons, and to motivate those persons to improve our business results. This plan provides for the granting of incentive nonqualified options to purchase up to 1,620,000 (stock dividend adjusted) of common stock in the Company.

The table below summarized the transactions under the Company's stock option plans (stock dividend adjusted) at December 31, 2008, 2007 and 2006 and changes during the years then ended:

	2008		2007		2006	
	Shares	Weighted Average	Shares	Weighted Average	Shares	Weighted Average
	(000)	Exercisable Price	(000)	Exercisable Price	(000)	Exercisable Price
Outstanding, beginning of year	1,096	\$ 11.12	1,115	\$ 10.55	680	\$ 9.32
Granted	51	19.47	44	21.31	443	13.17
Converted options of preferred stock A					10	8.02
Converted options of preferred stock B					77	5.89
Forfeited	(16)	11.57	(15)	11.36	(33)	11.94
Exercised	(60)	7.49	(48)	7.40	(62)	8.70
Expired	(2)	8.02				
Outstanding, end of period	1,069	11.72	1,096	11.12	1,115	10.55
Exercisable, end of period	592	\$ 9.88	603	\$ 9.07	605	\$ 8.58



**Table of Contents**

Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006, is based on the grant date fair value. For stock option awards, the fair value is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Accordingly, while management believes that the Black-Scholes option-pricing model provides a reasonable estimate of fair value, the model does not necessarily provide the best single measure of fair value for the Company's employee stock options. The weighted-average fair value of options granted during 2008, 2007 and 2006 was \$2.62, \$4.95 and \$3.14 per share (stock dividend adjusted), respectively. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2008	2007	2006
Expected dividend yield	0.98%	0.46%	0.59%
Expected stock price volatility	3.13%	9.44%	9.23%
Risk-free interest rate	3.35%	4.65%	4.80%
	6.4	6.1	6.3
Expected life of options	years	years	years

The expected dividend yield is based on historical data. The expected volatility is based on published indexes of publicly traded bank holding companies with similar market capitalization. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of options granted is derived using the simplified method and represents the period of time that options granted are expected to be outstanding. The simplified method will continue to be used until the Company has sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term due to the limited period of time its equity shares have been publicly traded.

The following is a summary of currently outstanding and exercisable options at December 31, 2008:

Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Options Exercisable Shares (000)	Weighted-Average Exercise Price
\$ 5.69 to \$6.19	48	3.55	5.93	48	5.93
\$ 6.79 to \$8.02	174	3.73	6.86	174	6.86
\$ 8.64 to \$9.55	101	4.58	9.43	101	9.43
\$ 10.50 to \$10.81	59	6.46	10.58	59	10.58
\$ 11.73 to \$11.73	199	7.96	11.73	170	11.73
\$ 12.20 to \$12.20	337	7.20	12.20	3	12.20
\$ 18.32 to \$19.60	102	8.26	19.26	22	19.59
\$ 20.27 to \$20.48	22	8.32	20.42	4	20.41
\$ 21.55 to \$25.01	27	8.38	22.86	11	22.36
	1,069			592	

**11. Preferred Stock A and Preferred Stock A Options**

During 2003, the Company issued preferred stock A as a result of the CBB acquisition. The preferred stock A was non-voting, non-cumulative, callable and redeemable, and convertible to the Company's common stock. The preferred stock A yielded an annual non-cumulative dividend of \$0.25 to be paid quarterly if and when authorized and declared

by the Company's board of directors. Dividends had to be paid on the preferred stock A before any other class of the Company's stock.

**Table of Contents**

The Preferred Stock A was convertible at the holder's option or redeemed by the Company at its option under the following terms and conditions (common stock split adjusted):

The Preferred Stock A was convertible at the holder's option, into HBI common stock upon the earlier of the expiration of thirty months after the effective date of the merger or 180 days after the date any of the HBI common stock is registered pursuant to the Securities Act of 1933 with the Securities and Exchange Commission in connection with an initial public offering of HBI common stock. Each share of Preferred Stock A to be converted and properly surrendered to the Company pursuant to the Company's instructions for such surrender, shall be converted into 0.789474 shares of HBI Common Stock, with fractional shares of the Preferred Stock A to be converted into cash at the rate of \$12.67 times the fraction of shares held.

The Company could, at its option, redeem all of the Preferred Stock A at any time after the expiration of thirty months from the effective date of the merger or earlier if the HBI common stock becomes publicly traded and (a) the last reported trade is at least \$12.67 per share for 20 consecutive trading days or (b) if the trades are quoted on a bid and ask price basis and the mean between the bid and ask price is at least \$12.67 per share for 20 consecutive trading days.

At December 31, 2005, the Company had 26,000 preferred stock A options outstanding. The preferred stock A options became 100% exercisable at the date of the CBB acquisition and are convertible to common stock under the same terms as the outstanding preferred stock A.

On August 1, 2006, the Company redeemed and converted the issued and outstanding shares of Home BancShares Class A Preferred Stock into Home BancShares Common Stock. The holders of shares of Class A Preferred Stock, received 0.789474 of Home BancShares Common Stock for each share of Class A Preferred Stock owned, plus a check for the pro rata amount of the third quarter Class A Preferred Stock dividend accrued through July 31, 2006. The Class A Preferred shareholder's did not receive fractional shares; instead they received cash at a rate of \$12.67 times the fraction of a share they otherwise would have been entitled to. Therefore, as of December 31, 2008 and 2007, there were no preferred stock A options outstanding.

There were no transactions under the Company's preferred stock A option plan during the year ended December 31, 2008 and 2007. The table below summarizes the transactions under the Company's preferred stock A option plan at December 31, 2006 and changes during the years then ended:

	<b>2006</b>	<b>Weighted Average Exercisable Price</b>
	<b>Shares (000)</b>	
Outstanding, beginning of year	26	3.14
Converted to common stock	(11)	6.84
Exercised	(15)	0.17
Outstanding, end of period		
Exercisable, end of period		

**12. Preferred Stock B and Preferred Stock B Options**

During 2005, the Company issued preferred stock B as a result of the MBI acquisition. The Class B Preferred Stock was a non-voting, non-cumulative, callable and redeemable, convertible preferred stock. The Class B Preferred Stock yielded an annual non-cumulative dividend of \$0.57 to be paid quarterly if and when authorized and declared by HBI's board of directors, and had priority in the payment of dividends over the HBI Common Stock and any class of capital stock created after the effective date of the merger, provided that dividends had first been paid on the Class A Preferred Stock.



**Table of Contents**

The Class B Preferred Stock was redeemable by HBI at any time on the basis of three shares of HBI Common Stock for each share of Class B Preferred Stock. Holders of the Class B Preferred Stock could convert their shares of Class B Preferred Stock into shares of HBI Common Stock (three shares of HBI Common Stock for each share of Class B Preferred Stock), upon the occurrence of the earlier of July 6, 2006, or two hundred ten (210) days after the date an underwritten initial public offering of the HBI Common Stock is completed.

At December 31, 2005, the Company had 25,000 preferred stock B options outstanding. The preferred stock B options became 100% exercisable at the date of the MBI acquisition and are convertible to common stock under the same terms as the outstanding preferred stock B.

On August 1, 2006, the Company redeemed and converted the issued and outstanding shares of Home BancShares s Class B Preferred Stock into Home BancShares Common Stock. The holders of shares of Class B Preferred Stock, received three shares of Home BancShares Common Stock for each share of Class B Preferred Stock owned, plus a check for the pro rata amount of the third quarter Class B Preferred Stock dividend accrued through July 31, 2006. Therefore, as of December 31, 2008 and 2007, there were no Preferred Stock B options outstanding.

There were no transactions under the Company s preferred stock B option plan during the years ended December 31, 2008 and 2007. The table below summarizes the transactions under the Company s preferred stock B option plan at December 31, 2006 and changes during the year then ended:

	<b>2006</b>	<b>Weighted</b>
	<b>Shares</b>	<b>Average</b>
	<b>(000)</b>	<b>Exercisable</b>
		<b>Price</b>
Outstanding, beginning of year	25	19.06
Converted to common stock	(24)	19.08
Options of acquired institution		
Exercised	(1)	18.41
Outstanding, end of period		
Exercisable, end of period		

**Table of Contents****13. Non-Interest Expense**

The table below shows the components of non-interest expense for years ended December 31:

	<b>2008</b>	<b>2007</b>	<b>2006</b>
		<b>(In thousands)</b>	
Salaries and employee benefits	\$ 35,566	\$ 30,496	\$ 29,313
Occupancy and equipment	11,053	9,459	8,712
Data processing expense	3,376	2,648	2,506
Other operating expenses:			
Advertising	2,644	2,691	2,383
Merger expenses	1,775		
Amortization of intangibles	1,849	1,756	1,742
Amortization of mortgage servicing rights	589		
Electronic banking expense	2,980	2,359	789
Directors' fees	991	843	774
Due from bank service charges	307	214	331
FDIC and state assessment	1,804	1,016	527
Insurance	947	901	1,030
Legal and accounting	1,384	1,206	1,025
Mortgage servicing expense	297		
Other professional fees	1,626	902	771
Operating supplies	959	983	940
Postage	742	663	663
Telephone	901	951	975
Other expense	5,927	4,447	3,997
Total other operating expenses	25,722	18,932	15,947
Total non-interest expense	\$ 75,717	\$ 61,535	\$ 56,478

**Table of Contents****14. Employee Benefit Plans*****401(k) Plan***

The Company has a retirement savings 401(k) plan in which substantially all employees may participate. The Company matches employees' contributions based on a percentage of salary contributed by participants. The plan also allows for discretionary employer contributions. The Company's expense for the plan was \$630,000, \$423,000 and \$810,000 in 2008, 2007 and 2006, respectively, which is included in salaries and employee benefits expense.

***Chairman's Retirement Plan***

On April 20, 2007, the Company's board of directors approved a Chairman's Retirement Plan for John W. Allison, the Company's Chairman and CEO. The Chairman's Retirement Plan provides a supplemental retirement benefit of \$250,000 a year for 10 consecutive years or until Mr. Allison's death, whichever occurs later. The benefits under the plan vest based on Mr. Allison's age beginning at age 61 and fully vest when Mr. Allison reaches age 65. The benefits will also become 100% vested if, before Mr. Allison reaches the age of 65, he dies, becomes disabled, is involuntarily terminated from the Company without cause, or there is a change in control of the Company. The vested benefits will be paid in monthly installments. The benefit payments will begin on the earlier of Mr. Allison reaching age 65 or the termination of his employment with the Company for any reason other than death. If Mr. Allison dies before the benefits commence or during the 10 year guaranteed benefit period, his beneficiary will receive any remaining payments due. If he dies after the guaranteed benefit period, no further benefits will be paid. An expense of \$535,000 and \$388,000 was accrued for 2008 and 2007 for this plan, respectively.

***Stock Appreciation Rights***

On March 13, 2006, the Company's board of directors replaced 368,280 outstanding stock appreciation rights (stock dividend adjusted) with 383,011 options (stock dividend adjusted), each with an exercise price of \$12.20. During 2005, the Company had issued 368,280 stock appreciation rights (stock dividend adjusted) at \$11.73 for certain executive employees throughout the Company. The appreciation rights were on a five-year cliff-vesting schedule with all appreciation rights vesting on December 31, 2009. The vesting was also subject to various financial performance goals of the Company and the subsidiary banks over the five-year period ending January 1, 2010. The options issued in replacement of the stock appreciation rights are subject to achievement of the same financial goals by the Company and the bank subsidiaries over the five-year period ending January 1, 2010.

**Table of Contents****Pension Plan**

The following table sets forth the status of the Company's defined benefit pension plans:

	2008	December 31, 2007 (In thousands)	2006
Benefit obligation		\$	\$ 2,578
Fair value of plan assets			2,606
Funded status		\$	\$ 28
Accrued benefit cost		\$	\$ (152)
Unrecognized net (gain) or loss			(235)
Unrecognized prior service cost			
Unrecognized net obligation			
Weighted-average assumptions:			
Discount rate	%	%	5.8%
Actual return on plan assets			1.6
Expected return on plan assets			5.8
Rate of compensation increase			
Benefit cost		\$	\$ 9
Interest cost			150
Employer contributions		326	
Employee contributions			
Benefits paid		2,023	198

The assets of the plans consisted primarily of equity securities and mutual funds. The measurement date for the plans is January 1. The plans have been frozen, and there have been no new participants in the plan and no additional benefits earned. Contributions are made based upon at least the minimum amounts required to be funded under provisions of the Employee Retirement Income Security Act of 1974, with the maximum contribution not to exceed the maximum amount deductible under the Internal Revenue Code.

The long-term rate of return on assets is determined by considering the historical returns for the current mix of investments in the Company's pension plan. In addition, consideration is given to the range of expected returns for the pension plan investment mix provided by the plan's investment advisors. The Company uses the historical information to determine if there has been a significant change in the pension plan's investment return history.

The discount rate was determined by projecting cash distributions from the plan and matching them with the appropriate corporate bond yields in a yield curve regression analysis.

The Company's defined benefit pension plans terminated and settled in 2007. The plans were settled by buying paid-up annuity contracts or making lump-sum payments.

**15. Related Party Transactions**

In the ordinary course of business, loans may be made to officers and directors and their affiliated companies at substantially the same terms as comparable transactions with other borrowers. At December 31, 2008 and 2007, related party loans were approximately \$158.6 million and \$81.9 million, respectively. New loans and advances on prior commitments made to the related parties were \$129.5 million and \$66.3 million for the years ended December 31, 2008 and 2007, respectively. Repayments of loans made by the related parties were \$116.3 million and \$37.4 million for the years ended December 31, 2008 and 2007, respectively. As a result of changes in composition of the Company's related parties in 2008, the Company added \$63.4 million of related party loans.



**Table of Contents**

At December 31, 2008 and 2007, directors, officers, and other related interest parties had demand, noninterest-bearing deposits of \$21.5 million and \$37.3 million, respectively, savings and interest-bearing transaction accounts of \$1.2 million and \$400,000, respectively, and time certificates of deposit of \$9.8 million and \$9.3 million, respectively.

During 2008 and 2007, rent expense totaling \$84,000 and \$144,000, respectively, was paid to related parties.

During 2008, Centennial Bank (former First State Bank) purchased First State Plaza from a related interest party, Allison, Adcock, Rankin, LLC. The building, located in west Conway was purchased at fair market value for \$3.4 million. The land and building was appraised for \$1.1 million and \$2.3 million, respectively.

**16. Leases**

The Company leases certain premises and equipment under noncancelable operating leases which are charged to expense over the lease term as it becomes payable. The Company's leases do not have rent holidays. In addition, any rent escalations are tied to the consumer price index or contain nominal increases and are not included in the calculation of current lease expense due to the immaterial amount. At December 31, 2008, the minimum rental commitments under these noncancelable operating leases are as follows (in thousands):

2009	\$ 1,134
2010	1,105
2011	1,084
2012	1,012
2013	800
Thereafter	5,774
	\$ 10,909

**17. Concentration of Credit Risks**

The Company's primary market area is in central Arkansas, north central Arkansas, northwest Arkansas, southern Arkansas, southwest Florida and the Florida Keys (Monroe County). The Company primarily grants loans to customers located within these geographical areas unless the borrower has an established relationship with the Company.

The diversity of the Company's economic base tends to provide a stable lending environment. Although the Company has a loan portfolio that is diversified in both industry and geographic area, a substantial portion of its debtors' ability to honor their contracts is dependent upon real estate values, tourism demand and the economic conditions prevailing in its market areas.

**18. Significant Estimates and Concentrations**

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Estimates related to the allowance for loan losses and certain concentrations of credit risk are reflected in Note 4, while deposit concentrations are reflected in Note 6.

The current economic environment presents financial institutions with unprecedented circumstances and challenges which in some cases have resulted in large declines in the fair values of investments and other assets, constraints on liquidity and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans. The financial statements have been prepared using values and information currently available to the Company.

**Table of Contents**

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses, capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity.

**19. Commitments and Contingencies**

In the ordinary course of business, the Company makes various commitments and incurs certain contingent liabilities to fulfill the financing needs of their customers. These commitments and contingent liabilities include lines of credit and commitments to extend credit and issue standby letters of credit. The Company applies the same credit policies and standards as they do in the lending process when making these commitments. The collateral obtained is based on the assessed creditworthiness of the borrower.

At December 31, 2008 and 2007, commitments to extend credit of \$351.2 million and \$315.4 million, respectively, were outstanding. A percentage of these balances are participated out to other banks; therefore, the Company can call on the participating banks to fund future draws. Since some of these commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements.

Outstanding standby letters of credit are contingent commitments issued by the Company, generally to guarantee the performance of a customer in third-party borrowing arrangements. The term of the guarantee is dependent upon the credit worthiness of the borrower some of which are long-term. The maximum amount of future payments the Company could be required to make under these guarantees at December 31, 2008 and 2007, is \$18.0 million and \$15.8 million, respectively.

The Company and/or its subsidiary banks have various unrelated legal proceedings, most of which involve loan foreclosure activity pending, which, in the aggregate, are not expected to have a material adverse effect on the financial position of the Company and its subsidiaries.

**20. Financial Instruments****FAS 157**

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 has been applied prospectively as of the beginning of the period.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1**      Quoted prices in active markets for identical assets or liabilities
- Level 2**      Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3**      Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

**Table of Contents**

Available for sale securities are the only material instruments valued on a recurring basis which are held by the Company at fair value. The Company does not have any Level 1 securities. Primarily all of the Company's securities are considered to be Level 2 securities. These Level 2 securities consist of U.S. government-sponsored enterprises, mortgage-backed securities plus state and political subdivisions. At the beginning of the year our Level 3 securities included the two investment securities which became worthless during the year. As a result, we wrote them down by \$5.9 million in 2008 to a value of zero. As of year end 2008, Level 3 securities were immaterial.

Impaired loans are the only material instruments valued on a non-recurring basis which are held by the Company at fair value. Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan is confirmed. Impaired loans, net of specific allowance, were \$20.6 million as of December 31, 2008. This valuation would be considered Level 3, consisting of appraisals of underlying collateral and discounted cash flow analysis.

Compared to prior years, the adoption of SFAS 157 did not have a material impact on our 2008 consolidated financial statements.

**Fair Values of Financial Instruments**

The following methods and assumptions were used by the Company in estimating fair values of financial instruments as disclosed in these notes:

*Cash and cash equivalents and federal funds sold* For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

*Loans receivable, net* For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are assumed to approximate the carrying amounts. The fair values for fixed-rate loans are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics.

*Accrued interest receivable* The carrying amount of accrued interest receivable approximates its fair value.

*Deposits and securities sold under agreements to repurchase* The fair values of demand, savings deposits and securities sold under agreements to repurchase are, by definition, equal to the amount payable on demand and therefore approximate their carrying amounts. The fair values for time deposits are estimated using a discounted cash flow calculation that utilizes interest rates currently being offered on time deposits with similar contractual maturities.

*Federal funds purchased* The carrying amount of federal funds purchased approximates its fair value.

*Accrued interest payable* The carrying amount of accrued interest payable approximates its fair value.

*FHLB and other borrowed funds* For short-term instruments, the carrying amount is a reasonable estimate of fair value. The fair value of long-term debt is estimated based on the current rates available to the Company for debt with similar terms and remaining maturities.

*Subordinated debentures* The fair value of subordinated debentures is estimated using the rates that would be charged for subordinated debentures of similar remaining maturities.

**Table of Contents**

*Commitments to extend credit, letters of credit and lines of credit* The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date.

The following table presents the estimated fair values of the Company's financial instruments. The fair values of certain of these instruments were calculated by discounting expected cash flows, which involves significant judgments by management and uncertainties. Fair value is the estimated amount at which financial assets or liabilities could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. Because no market exists for certain of these financial instruments and because management does not intend to sell these financial instruments, the Company does not know whether the fair values shown below represent values at which the respective financial instruments could be sold individually or in the aggregate.

**Table of Contents**

	<b>December 31, 2008</b>	
	<b>Carrying</b>	<b>Fair Value</b>
	<b>Amount</b>	<b>(In thousands)</b>
<b>Financial assets:</b>		
Cash and cash equivalents	\$ 54,168	\$ 54,168
Federal funds sold	7,865	7,865
Net loans receivable, net of impaired loans	1,895,273	1,891,254
Accrued interest receivable	13,115	13,115
<b>Financial liabilities:</b>		
<b>Deposits:</b>		
Demand and non-interest bearing	\$ 249,349	\$ 249,349
Savings and interest-bearing transaction accounts	656,758	656,758
Time deposits	941,801	952,758
Federal funds purchased		
Securities sold under agreements to repurchase	113,389	113,389
FHLB and other borrowed funds	282,975	287,280
Accrued interest payable	4,888	4,888
Subordinated debentures	47,575	59,623
<b>December 31, 2007</b>		
	<b>Carrying</b>	<b>Fair Value</b>
	<b>Amount</b>	<b>(In thousands)</b>
<b>Financial assets:</b>		
Cash and cash equivalents	\$ 55,021	\$ 55,021
Federal funds sold	76	76
Investment securities available for sale	430,399	430,399
Net loans receivable	1,577,588	1,581,168
Accrued interest receivable	14,321	14,321
<b>Financial liabilities:</b>		
<b>Deposits:</b>		
Demand and non-interest bearing	\$ 211,993	\$ 211,993
Savings and interest-bearing transaction accounts	582,477	582,477
Time deposits	797,736	801,108
Federal funds purchased	16,407	16,407
Securities sold under agreements to repurchase	120,572	120,572
FHLB and other borrowed funds	251,750	253,074
Accrued interest payable	6,147	6,147
Subordinated debentures	44,572	46,485

**Table of Contents****21. Regulatory Matters**

The Company's subsidiaries are subject to a legal limitation on dividends that can be paid to the parent company without prior approval of the applicable regulatory agencies. Arkansas bank regulators have specified that the maximum dividend limit state banks may pay to the parent company without prior approval is 75% of the current year earnings plus 75% of the retained net earnings of the preceding year. Since, the Company's Arkansas bank subsidiaries are also under supervision of the Federal Reserve, they are further limited if the total of all dividends declared in any calendar year by the Bank exceeds the Bank's net profits to date for that year combined with its retained net profits for the preceding two years. As the result of leveraged capital positions, the Company's subsidiary banks do not have any significant undivided profits available for payment of dividends to the Company, without prior approval of the regulatory agencies at December 31, 2008.

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

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes that, as of December 31, 2008, the Company meets all capital adequacy requirements to which it is subject.

As of the most recent notification from regulatory agencies, the subsidiaries were well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Company and subsidiaries must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institutions categories.

**Table of Contents**

The Company's actual capital amounts and ratios along with the Company's subsidiary banks are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
As of December 31, 2008						
Leverage ratios:						
Home BancShares	\$278,427	10.87%	\$102,457	4.00%	\$ N/A	N/A%
Centennial Bank (Formerly FSB)	89,791	8.68	41,378	4.00	51,723	5.00
Community Bank	37,957	9.33	16,273	4.00	20,341	5.00
Twin City Bank	68,810	9.53	28,881	4.00	36,102	5.00
Bank of Mountain View	16,764	9.65	6,949	4.00	8,686	5.00
Centennial Bank	23,105	8.81	10,490	4.00	13,113	5.00
Tier 1 capital ratios:						
Home BancShares	\$278,427	12.70%	\$ 87,694	4.00%	\$ N/A	N/A%
Centennial Bank (Formerly FSB)	89,791	10.02	35,845	4.00	53,767	6.00
Community Bank	37,957	11.14	13,629	4.00	20,444	6.00
Twin City Bank	68,810	10.73	25,651	4.00	38,477	6.00
Bank of Mountain View	16,764	14.99	4,473	4.00	6,710	6.00
Centennial Bank	23,105	11.01	8,394	4.00	12,591	6.00
Total risk-based capital ratios:						
Home BancShares	\$306,000	13.95%	\$175,484	8.00%	\$ N/A	N/A%
Centennial Bank (Formerly FSB)	101,071	11.28	71,682	8.00	89,602	10.00
Community Bank	42,260	12.40	27,265	8.00	34,081	10.00
Twin City Bank	76,823	11.98	51,301	8.00	64,126	10.00
Bank of Mountain View	18,115	16.19	8,951	8.00	11,189	10.00
Centennial Bank	25,758	12.27	16,794	8.00	20,993	10.00
As of December 31, 2007						
Leverage ratios:						
Home BancShares	\$255,979	11.44%	\$ 89,503	4.00%	\$ N/A	N/A%
First State Bank	54,537	9.18	23,763	4.00	29,704	5.00
Community Bank	34,189	8.90	15,366	4.00	19,207	5.00
Twin City Bank	61,178	8.87	27,589	4.00	34,486	5.00
Marine Bank	33,332	8.91	14,964	4.00	18,705	5.00
Bank of Mountain View	16,174	8.26	7,832	4.00	9,791	5.00
Tier 1 capital ratios:						
Home BancShares	\$255,979	13.45%	\$ 76,128	4.00%	\$ N/A	N/A%
First State Bank	54,537	10.29	21,200	4.00	31,800	6.00
Community Bank	34,189	11.21	12,199	4.00	18,299	6.00
Twin City Bank	61,178	10.10	24,229	4.00	36,343	6.00
Marine Bank	33,332	10.20	13,071	4.00	19,607	6.00
Bank of Mountain View	16,174	13.84	4,675	4.00	7,012	6.00
Total risk-based capital ratios:						
Home BancShares	\$279,840	14.70%	\$152,294	8.00%	\$ N/A	N/A%

Edgar Filing: HOME BANCSHARES INC - Form 10-K

First State Bank	61,188,	11.54	42,418	8.00	53,023	10.00
Community Bank	38,036	12.47	24,402	8.00	30,502	10.00
Twin City Bank	68,754	11.35	48,461	8.00	60,576	10.00
Marine Bank	37,429	11.45	26,151	8.00	32,689	10.00
Bank of Mountain View	17,442	14.92	9,352	8.00	11,690	10.00

---

114



**Table of Contents****22. Additional Cash Flow Information**

In connection with the Centennial Bancshares, Inc. acquisition accounting for using the purchase method, the Company acquired approximately \$241.5 million in assets, assumed \$218.9 million in liabilities, issued \$24.3 million of equity and received net funds of \$1.7 million during 2008. The following is summary of the Company's additional cash flow information during the years ended:

	<b>2008</b>	<b>2007</b> <b>(In thousands)</b>	<b>2006</b>
Interest paid	\$61,663	\$74,500	\$58,828
Income taxes paid	14,877	9,820	7,820
Assets acquired by foreclosure	5,774	5,024	1,488

**23. Adoption of Recent Accounting Pronouncements****FAS 159**

Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159) became effective for the Company on January 1, 2008. FAS 159 allows companies an option to report selected financial assets and liabilities at fair value. Because we did not elect the fair value measurement provision for any of our financial assets or liabilities, the adoption of SFAS 159 did not have any impact on our 2008 consolidated financial statements. Presently, we have not determined whether we will elect the fair value measurement provisions for future transactions.

**EITF 06-4 and 06-10**

Effective January 1, 2008, the Company adopted EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements and EITF 06-10, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements. As a result of the adoption of EITF 06-4, the Company recognized the effect of applying the EITF with a change in accounting principle through a cumulative-effect adjustment to retained earnings for \$276,000. Additionally, this change will result in an increase of approximately \$100,000 in annual non-interest expense as a result of the mortality cost for 2008 and beyond. The adoption of EITF 06-10 did not have any impact on our 2008 consolidated financial statements.

**Table of Contents****24. Condensed Financial Information (Parent Company Only)**  
**Condensed Balance Sheets**

(In thousands)		December 31,	
		2008	2007
	<b>Assets</b>		
Cash and cash equivalents		\$ 31,420	\$ 31,413
Investment securities		100	6,334
Investments in wholly-owned subsidiaries		288,845	240,694
Investments in unconsolidated subsidiaries		1,424	15,084
Premises and equipment		478	257
Other assets		10,258	5,353
Total assets		\$ 332,525	\$ 299,135
	<b>Liabilities</b>		
Subordinated debentures		\$ 47,575	\$ 44,572
Other liabilities		1,906	1,507
Total liabilities		49,481	46,079
	<b>Stockholders Equity</b>		
Common stock		199	173
Capital surplus		253,581	195,649
Retained earnings		32,639	59,489
Accumulated other comprehensive loss		(3,375)	(2,255)
Total stockholders equity		283,044	253,056
Total liabilities and stockholders equity		\$ 332,525	\$ 299,135

**Condensed Statements of Income**

(In thousands)		Years Ended December 31,		
		2008	2007	2006
Income				
Dividends from subsidiaries		\$ 6,841	\$ 5,877	\$ 7,044
Other income		2,686	2,741	2,350
Total income		9,527	8,618	9,394
Expense		12,289	8,982	8,088
Income before income taxes and equity in undistributed net income of subsidiaries		(2,762)	(364)	1,306
Tax benefit for income taxes		3,685	2,374	2,263
Income before equity in undistributed net income of subsidiaries		923	2,010	3,569

Edgar Filing: HOME BANCSHARES INC - Form 10-K

Equity in undistributed net income of subsidiaries	9,193	18,435	12,349
<b>Net income</b>	<b>\$ 10,116</b>	<b>\$ 20,445</b>	<b>\$ 15,918</b>

**Table of Contents****Condensed Statements of Cash Flows**

<b>(In thousands)</b>	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities</b>			
Net income	\$ 10,116	\$ 20,445	\$ 15,918
Items not requiring (providing) cash Depreciation	117	14	120
Amortization	(90)	(91)	(92)
Gain on sale of equity investment	(6,102)		
Loss on investment securities	5,927		
Share-based compensation	478	456	380
Tax benefits from stock options exercised	(416)	(244)	(211)
Equity in undistributed income of subsidiaries	(9,193)	(18,435)	(12,349)
Equity in loss (income) of unconsolidated affiliates	(102)	86	379
Changes in other assets	(4,336)	(261)	(1,913)
Other liabilities	397	1,104	(236)
Net cash provided by (used in) operating activities	(3,204)	3,074	1,996
<b>Cash flows from investing activities</b>			
Purchases of premises and equipment, net	(338)	(92)	(65)
Investment in unconsolidated subsidiaries		(2,625)	(3,000)
Capital contribution to subsidiaries	(12,000)	(9,950)	(8,645)
Return of capital from subsidiaries		81	16,570
Sale of equity investment	19,862		
Purchase of Centennial Bancshares, Inc	(1,155)		
Proceeds from maturities of investment securities	307	382	284
Purchase of investment securities		(2,000)	
Net cash provided by (used in) investing activities	6,676	(14,204)	5,144
<b>Cash flows from financing activities</b>			
Net proceeds from stock issuance	447	355	47,747
Tax benefits from stock options exercised	416	249	211
Disgorgement of profits	89		
Repayment of long-term borrowings			(14,000)
Dividends paid	(4,417)	(2,500)	(1,705)
Net cash provided by (used in) financing activities	(3,465)	(1,896)	32,253
<b>Increase (decrease) in cash and cash equivalents</b>	<b>7</b>	<b>(13,026)</b>	<b>39,393</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>31,413</b>	<b>44,439</b>	<b>5,046</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 31,420</b>	<b>\$ 31,413</b>	<b>\$ 44,439</b>



**Table of Contents****25. Fourth Quarter Adjustments (Unaudited)**

The Company reported a net loss of \$9.4 million, or \$0.46 diluted loss per share, primarily due to the weakness in the real estate market, particularly Florida for the fourth quarter of 2008. During the fourth quarter the Company recorded a \$20.1 million provision for loan losses, \$2.4 million of write-downs on other real estate owned, \$1.8 million of merger expenses from our bank charter consolidation, a \$3.9 million impairment write-down on two trust preferred investment securities and \$448,000 of other income resulting from our ownership of Arkansas Bankers Bank stock during their fourth quarter reorganization.

The increased fourth quarter provision for loan loss was primarily attributable to the increase in non-performing loans during the fourth quarter as a result of the rapidly deteriorating Florida market conditions. Non-performing loans increased from \$16.1 million in the third quarter to \$29.9 million during the fourth quarter, most of which was concentrated in Florida. The write-down on other real estate was primarily due to the declining market value of one commercial property in Florida. The write-down on trust preferred investment securities was a result of bank closures in the fourth quarter that occurred within the pool.

**26. Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141(revised 2007), Business Combinations, (SFAS 141(R)). SFAS 141(R), which replaces SFAS 141, Business Combinations, establishes accounting standards for all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses (the acquiree) including mergers and combinations achieved without the transfer of consideration. SFAS 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. Goodwill is measured as the excess of consideration transferred plus the fair value of any noncontrolling interest in the acquiree over the fair value of the identifiable net assets acquired. In the event that the fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any non-controlling interest (referred to as a bargain purchase), SFAS 141(R) requires the acquirer to recognize that excess in earnings as a gain attributable to the acquirer. In addition, SFAS 141(R) requires costs incurred to effect an acquisition to be recognized separately from the acquisition and requires the recognition of assets or liabilities arising from noncontractual contingencies as of the acquisition date only if it is more likely than not that they meet the definition of an asset or liability in FASB Concepts Statement No. 6, Elements of Financial Statements. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, which for us is the fiscal year beginning January 1, 2009. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it to have a material effect on the Company's financial position or results of operation.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133. SFAS No. 161 requires companies to disclose their objectives and strategies for using derivative instruments, whether or not their derivatives are designated as hedging instruments. The pronouncement requires disclosure of the fair value of derivative instruments by primary underlying risk exposures (e.g. interest rate, credit, foreign exchange rate, combination of interest rate and foreign exchange rate, or overall price). It also requires detailed disclosures about the income statement impact of derivative instruments by designation as fair-value hedges, cash-flow hedges, or hedges of the foreign-currency exposure of a net investment in a foreign operation. SFAS No. 161 requires disclosure of information that will enable financial statement users to understand the level of derivative activity entered into by the company (e.g., total number of interest-rate swaps or total notional or quantity or percentage of forecasted commodity purchases that are being hedged). The principles of SFAS No. 161 may be applied on a prospective basis and are effective for financial statements issued for fiscal years beginning after November 15, 2008. For the Company, SFAS No. 161 will be effective at the beginning of its 2009 fiscal year and will result in additional disclosures in notes to the Company's consolidated financial statements.

Presently, the Company is not aware of any other changes from the Financial Accounting Standards Board that will have a material impact on the Company's present or future financial statements.

**Table of Contents****27. Subsequent Events****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.

**FDIC Assessments**

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.

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

No items are reportable.

**Item 9A. CONTROLS AND PROCEDURES****Evaluation of Disclosure Controls and Procedures.**

An evaluation as of the end of the period covered by this annual report was carried out under the supervision and with the participation of our management, including the Chairman and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, which are defined under SEC rules as controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Based upon that evaluation, our Chairman and Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective. As a result of this evaluation, there were no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date of evaluation.

**Item 9B. OTHER INFORMATION**

No items are reportable.

**Table of Contents**

**PART III**

**Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Incorporated herein by reference from the Company's definitive proxy statement for the Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

**Item 11. EXECUTIVE COMPENSATION**

Incorporated herein by reference from the Company's definitive proxy statement for the Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Incorporated herein by reference from the Company's definitive proxy statement for the Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Incorporated herein by reference from the Company's definitive proxy statement for the Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.

**Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Incorporated herein by reference from the Company's definitive proxy statement for the Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A.



**Table of Contents**

**PART IV**

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

The following documents are filed as part of this report:

(a) 1 and 2. Financial Statements and any Financial Statement Schedules

The financial statements and financial statement schedules listed in the accompanying index to the consolidated financial statements and financial statement schedules are filed as part of this report.

(b) Listing of Exhibits.

Exhibit

No.

23.1 Consent of BKD, LLP

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chairman and Chief Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

32.1 Certification of Chairman and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**HOME BANCSHARES, INC.**

By: /s/ John W. Allison  
John W. Allison  
Chief Executive Officer and Chairman  
of the Board of Directors

Date: February 27, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities indicated on or about February 27, 2009.

/s/ John W. Allison

John W. Allison  
Chief Executive Officer and  
Chairman of the Board of Directors  
(Principal Executive Officer)

/s/ Ron W. Strother

Ron W. Strother  
President, Chief Operating Officer  
and Director

/s/ Randy E. Mayor

Randy E. Mayor  
Chief Financial Officer and  
Treasurer (Principal Financial  
Officer and Principal Accounting  
Officer)

/s/ Robert H. Adcock, Jr.

Robert H. Adcock, Jr.  
Vice Chairman of the Board and  
Director

/s/ Richard H. Ashley

Richard H. Ashley  
Director

/s/ Dale A. Bruns

Dale A. Bruns  
Director

/s/ Richard A. Buckheim

Richard A. Buckheim  
Director

/s/ S. Gene Cauley

S. Gene Cauley  
Director

/s/ Jack E. Engelkes

Jack E. Engelkes  
Director

/s/ James G. Hinkle

James G. Hinkle  
Director

/s/ Alex R. Lieblong

Alex R. Lieblong  
Director

/s/ C. Randall Sims

C. Randall Sims  
Director

/s/ William G. Thompson

William G. Thompson  
Director