

HOME BANCSHARES INC

Form 10-Q

November 03, 2009

Table of Contents

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

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended September 30, 2009**

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)

Not Applicable

Former name, former address and former fiscal year, if changed since last report

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

Yes No

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

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: 25,683,707 shares as of October 30, 2009.

HOME BANCSHARES, INC.
FORM 10-Q
September 30, 2009
INDEX

	Page No.
<u>Part I: Financial Information</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets September 30, 2009 (Unaudited) and December 31, 2008</u>	4
<u>Consolidated Statements of Income (Unaudited) Three and nine months ended September 30, 2009 and 2008</u>	5
<u>Consolidated Statements of Stockholders Equity (Unaudited) Nine months ended September 30, 2009 and 2008</u>	6-7
<u>Consolidated Statements of Cash Flows (Unaudited) Nine months ended September 30, 2009 and 2008</u>	8
<u>Condensed Notes to Consolidated Financial Statements (Unaudited)</u>	9-29
<u>Report of Independent Registered Public Accounting Firm</u>	30
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	31-61
<u>Item 3. Quantitative and Qualitative Disclosure About Market Risk</u>	62-64
<u>Item 4. Controls and Procedures</u>	65
<u>Part II: Other Information</u>	
<u>Item 1. Legal Proceedings</u>	66
<u>Item 1A. Risk Factors</u>	66
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	66
<u>Item 3. Defaults Upon Senior Securities</u>	66
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	66
<u>Item 5. Other Information</u>	66
<u>Item 6. Exhibits</u>	66
<u>Signatures</u>	67
<u>EX-15</u>	

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, deflation 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 the Risk Factors section of our Form 10-K filed with the Securities and Exchange Commission on March 6, 2009.

Table of Contents**PART I: FINANCIAL INFORMATION****Item 1: Financial Statements****Home BancShares, Inc.
Consolidated Balance Sheets**

(In thousands, except share data)	September 30, 2009 (Unaudited)	December 31, 2008
Assets		
Cash and due from banks	\$ 39,036	\$ 46,765
Interest-bearing deposits with other banks	84,921	7,403
Cash and cash equivalents	123,957	54,168
Federal funds sold	660	7,865
Investment securities available for sale	315,269	355,244
Loans receivable	1,971,039	1,956,232
Allowance for loan losses	(41,210)	(40,385)
Loans receivable, net	1,929,829	1,915,847
Bank premises and equipment, net	70,991	73,610
Foreclosed assets held for sale	19,111	6,763
Cash value of life insurance	51,742	50,201
Investments in unconsolidated affiliates	1,424	1,424
Accrued interest receivable	12,815	13,115
Deferred tax asset, net	13,423	16,267
Goodwill	53,039	50,038
Core deposit and other intangibles	5,160	6,547
Mortgage servicing rights	1,308	1,891
Other assets	33,008	27,113
Total assets	\$ 2,631,736	\$ 2,580,093
Liabilities and Stockholders Equity		
Deposits:		
Demand and non-interest-bearing	\$ 295,755	\$ 249,349
Savings and interest-bearing transaction accounts	660,533	656,758
Time deposits	823,997	941,801
Total deposits	1,780,285	1,847,908
Federal funds purchased		
Securities sold under agreements to repurchase	63,264	113,389
FHLB borrowed funds	282,550	282,975
Accrued interest payable and other liabilities	11,594	5,202
Subordinated debentures	47,507	47,575
Total liabilities	2,185,200	2,297,049

Stockholders equity:

Preferred stock; \$0.01 par value; 5,500,000 shares authorized:

Series A fixed rate cumulative perpetual; liquidation preference of \$1,000 per share; 50,000 shares issued and outstanding at September 30, 2009; no shares issued and outstanding at December 31, 2008

49,230

Common stock, par value \$0.01; shares authorized 50,000,000; shares issued and outstanding 24,931,268 in 2009 and 19,859,582 in 2008

249

199

Capital surplus

349,429

253,581

Retained earnings

46,074

32,639

Accumulated other comprehensive income (loss)

1,554

(3,375)

Total stockholders equity

446,536

283,044

Total liabilities and stockholders equity

\$ 2,631,736

\$ 2,580,093

See Condensed Notes to Consolidated Financial Statements.

4

Table of Contents

Home BancShares, Inc.
Consolidated Statements of Income

(In thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Unaudited)			
Interest income:				
Loans	\$ 30,056	\$ 31,831	\$ 88,583	\$ 97,285
Investment securities				
Taxable	1,768	2,982	6,673	9,740
Tax-exempt	1,463	1,216	4,104	3,583
Deposits - other banks	7	35	27	127
Federal funds sold	1	24	12	289
 Total interest income	 33,295	 36,088	 99,399	 111,024
Interest expense:				
Interest on deposits	6,489	10,752	21,738	35,893
Federal funds purchased	2	79	6	168
FHLB borrowed funds	2,379	2,239	7,128	6,873
Securities sold under agreements to repurchase	126	394	361	1,349
Subordinated debentures	623	769	1,958	2,314
 Total interest expense	 9,619	 14,233	 31,191	 46,597
 Net interest income	 23,676	 21,855	 68,208	 64,427
Provision for loan losses	3,550	1,439	7,300	6,952
 Net interest income after provision for loan losses	 20,126	 20,416	 60,908	 57,475
Non-interest income:				
Service charges on deposit accounts	3,785	3,557	10,792	10,006
Other service charges and fees	1,705	1,698	5,330	5,051
Mortgage lending income	488	695	2,183	2,142
Mortgage servicing income	171	206	562	654
Insurance commissions	173	164	628	620
Income from title services	150	141	441	498
Increase in cash value of life insurance	495	544	1,546	1,642
Dividends from FHLB, FRB & bankers bank	114	194	320	702
Equity in earnings of unconsolidated affiliates				102
Gain on sale of equity investment				6,102
Gain on sale of SBA loans		26		127
Gain (loss) on sale of premises and equipment, net	(21)		(33)	(2)
Gain (loss) on OREO, net	4	(28)	(141)	(458)
Gain (loss) on securities, net			(3)	(2,067)
Other income	537	587	1,581	1,866
 Total non-interest income	 7,601	 7,784	 23,206	 26,985

Non-interest expense:				
Salaries and employee benefits	7,987	8,739	25,363	26,948
Occupancy and equipment	2,706	2,825	8,050	8,253
Data processing expense	827	815	2,478	2,434
Other operating expenses	5,556	6,099	20,775	18,023
Total non-interest expense	17,076	18,478	56,666	55,658
Income before income taxes				
Income tax expense	10,651	9,722	27,448	28,802
	3,412	3,158	8,523	9,306
Net income available to all stockholders				
Preferred stock dividends and accretion of discount on preferred stock	7,239	6,564	18,925	19,496
	670		1,906	
Net income available to common stockholders				
	\$ 6,569	\$ 6,564	\$ 17,019	\$ 19,496
Basic earnings per share				
	\$ 0.32	\$ 0.32	\$ 0.85	\$ 0.98
Diluted earnings per share				
	\$ 0.32	\$ 0.32	\$ 0.84	\$ 0.96

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

Home BancShares, Inc.
Consolidated Statements of Stockholders Equity
Nine Months Ended September 30, 2009 and 2008

	Preferred	Common	Capital	Retained	Accumulated Other Comprehensive Income (Loss)	Total
(In thousands, except share data)	Stock	Stock	Surplus	Earnings	(Loss)	Total
Balance at January 1, 2008	\$	\$ 173	\$ 195,649	\$ 59,489	\$ (2,255)	\$ 253,056
Cumulative effect of adoption of FASB ASC 715-60				(276)		(276)
Comprehensive income (loss):						
Net income				19,496		19,496
Other comprehensive income (loss):						
Unrealized loss on investment securities available for sale, net of tax effect of (\$1,907)					(3,142)	(3,142)
Unconsolidated affiliates unrecognized loss on investment securities available for sale, net of taxes recorded by the unconsolidated affiliate					92	92
Comprehensive income						16,446
Issuance of 1,170,506 common shares pursuant to acquisition of Centennial Bancshares, Inc.		10	24,245			24,255
Net issuance of 23,381 shares of common stock from exercise of stock options				196		196
Tax benefit from stock options exercised				134		134
Share-based compensation				354		354
Cash dividends Common Stock, \$0.157 per share				(3,113)		(3,113)
8% Stock dividend Common Stock		15	32,258	(32,286)		(13)
Balances at September 30, 2008 (unaudited)		198	252,836	43,310	(5,305)	291,039
Comprehensive income (loss):						
Net loss				(9,380)		(9,380)
Other comprehensive income (loss):						
Unrealized gain on investment securities available for sale, net of tax effect of \$2,570					1,930	1,930
Comprehensive loss						(7,450)

Edgar Filing: HOME BANCSHARES INC - Form 10-Q

Net issuance of 36,223 shares of common stock from exercise of stock options	1	250			251
Disgorgement of profits		89			89
Tax benefit from stock options exercised		282			282
Share-based compensation		124			124
Cash dividends - Common Stock, \$0.065 per share			(1,291)		(1,291)
Balances at December 31, 2008	199	253,581	32,639	(3,375)	283,044
See Condensed Notes to Consolidated Financial Statements.					
	6				

Table of Contents

Home BancShares, Inc.
Consolidated Statements of Stockholders Equity Continued
Nine Months Ended September 30, 2009 and 2008

	Preferred	Common	Capital	Retained	Accumulated Other Comprehensive Income (Loss)	Total
(In thousands, except share data)	Stock	Stock	Surplus	Earnings	(Loss)	Total
Comprehensive income (loss):						
Net income				18,925		18,925
Other comprehensive income (loss):						
Unrealized gain on investment securities available for sale, net of tax effect of \$3,181					4,929	4,929
Comprehensive income						23,854
Issuance of 4,950,000 shares of common stock from public stock offering, net of offering costs of \$4,933.		49	93,275			93,324
Issuance of 50,000 shares of preferred stock and common stock warrant	49,094		906			50,000
Accretion of discount on preferred stock	136			(136)		
Net issuance of 115,286 shares of common stock from exercise of stock options		1	1,295			1,296
Tax benefit from stock options exercised			367			367
Share-based compensation			5			5
Cash dividend Preferred Stock - 5%				(1,770)		(1,770)
Cash dividends Common Stock, \$0.180 per share				(3,584)		(3,584)
Balances at September 30, 2009 (unaudited)	\$ 49,230	\$ 249	\$ 349,429	\$ 46,074	\$ 1,554	\$ 446,536

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

Home BancShares, Inc.
Consolidated Statements of Cash Flows

(In thousands)	Period Ended September 30,	
	2009	2008
	(Unaudited)	
Operating Activities		
Net income	\$ 18,925	\$ 19,496
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	3,926	4,093
Amortization/accretion	2,242	1,873
Share-based compensation	5	354
Tax benefits from stock options exercised	(367)	(134)
Loss on assets	177	2,400
Gain on sale of equity investment		(6,102)
Provision for loan losses	7,300	6,952
Deferred income tax benefit	(337)	(1,816)
Equity in income of unconsolidated affiliates		(102)
Increase in cash value of life insurance	(1,546)	(1,642)
Originations of mortgage loans held for sale	(149,501)	(106,723)
Proceeds from sales of mortgage loans held for sale	149,590	105,351
Changes in assets and liabilities:		
Accrued interest receivable	300	1,682
Other assets	(5,791)	(4,107)
Accrued interest payable and other liabilities	6,759	(1,996)
Net cash provided by operating activities	31,682	19,579
Investing Activities		
Net (increase) decrease in federal funds sold	7,205	(25,481)
Net (increase) decrease in loans	(38,549)	(178,195)
Purchases of investment securities available for sale	(59,293)	(156,508)
Proceeds from maturities of investment securities available for sale	84,063	223,506
Proceeds from sale of investment securities available for sale	22,972	
Proceeds from sale of SBA loans		2,751
Proceeds from foreclosed assets held for sale	4,689	826
Purchases of premises and equipment, net	(1,340)	(3,479)
Acquisition of Centennial Bancshares, Inc., net of funds received	(3,100)	1,663
Proceeds from sale of investment in unconsolidated affiliate		19,862
Net cash provided by (used in) investing activities	16,647	(115,055)
Financing Activities		
Net increase (decrease) in deposits	(67,623)	141,728
Net increase (decrease) in securities sold under agreements to repurchase	(50,125)	(12,222)
Net increase (decrease) in federal funds purchased		(16,407)
Net increase (decrease) in FHLB and other borrowed funds	(425)	(9,113)

Edgar Filing: HOME BANCSHARES INC - Form 10-Q

Proceeds from exercise of stock options	1,296	196
Proceeds from issuance of preferred stock and common stock warrant	50,000	
Proceeds from issuance of common stock	93,324	
Tax benefits from stock options exercised	367	134
Dividends paid on preferred stock	(1,770)	
Dividends paid on common stock	(3,584)	(3,126)
Net cash provided by financing activities	21,460	101,190
Net change in cash and cash equivalents	69,789	5,714
Cash and cash equivalents beginning of year	54,168	55,021
Cash and cash equivalents end of period	\$ 123,957	\$ 60,735

See Condensed Notes to Consolidated Financial Statements.

8

Table of Contents

Home BancShares, Inc.
Condensed Notes to Consolidated Financial Statements
(Unaudited)

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 wholly owned community bank subsidiary Centennial Bank (the Bank). During 2009, the Company completed the combination of its former bank charters into a single charter, adopting Centennial Bank as the common name. The Bank has locations in central Arkansas, north central Arkansas, southern Arkansas, the Florida Keys and southwestern Florida. 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.

A summary of the significant accounting policies of the Company follows:

Operating Segments

Community banking is the Company's only operating segment. No revenues are derived from foreign countries and no single external customer comprises more than 10% of the Company's revenues.

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.

Investments in Unconsolidated Affiliates

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 September 30, 2009 and December 31, 2008. Under accounting principles generally accepted in the United States of America, these trusts are not consolidated.

Table of Contents

The summarized financial information below represents an aggregation of the Company's unconsolidated affiliates as of September 30, 2009 and 2008, and for the three-month and nine-month periods then ended:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Assets	\$47,424	\$47,424	\$47,424	\$47,424
Liabilities	46,000	46,000	46,000	46,000
Equity	1,424	1,424	1,424	1,424
Net income				163

Interim financial information

The accompanying unaudited consolidated financial statements as of September 30, 2009 and 2008 have been prepared in condensed format, and therefore do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The information furnished in these interim statements reflects all adjustments, which are, in the opinion of management, necessary for a fair statement of the results for each respective period presented. Such adjustments are of a normal recurring nature. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter or for the full year. The interim financial information should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2008 Form 10-K, filed with the Securities and Exchange Commission.

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. Prior year per share amounts have been adjusted for the stock dividend which occurred in August of 2008. The following table sets forth the computation of basic and diluted earnings per common share (EPS) for the three-month and nine-month periods ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Net income available to common stockholders	\$ 6,569	\$ 6,564	\$ 17,019	\$ 19,496
Average shares outstanding	20,480	19,814	20,079	19,808
Effect of potential share issuance for acquisition earn out		195		195
Effect of common stock options	223	314	240	306
Diluted shares outstanding	20,703	20,323	20,319	20,309
Basic earnings per common share	\$ 0.32	\$ 0.32	\$ 0.85	\$ 0.98
Diluted earnings per common share	\$ 0.32	\$ 0.32	\$ 0.84	\$ 0.96

Table of Contents**2. Acquisitions**

On January 1, 2008, the Company 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 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. In addition to the consideration given at the time of the merger, the merger agreement provided for additional contingent consideration to Centennial's stockholders of up to a maximum of \$4 million, which could be paid in cash or our common stock at the election of the former Centennial accredited stockholders, based upon the 2008 earnings performance. The final contingent consideration was computed and agreed upon in the amount of \$3.1 million on March 11, 2009. The Company paid this amount to the former Centennial stockholders on a pro rata basis on March 12, 2009. All of the former Centennial stockholders elected to receive the contingent consideration in cash. As a result of this transaction, the Company recorded total goodwill of \$15.4 million and a core deposit intangible of \$694,000.

3. Investment Securities

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

	September 30, 2009			Estimated Fair Value
	Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	
(In thousands)				
U.S. government-sponsored enterprises	\$ 30,532	\$ 215	\$ (9)	\$ 30,738
Mortgage-backed securities	129,589	2,959	(1,683)	130,865
State and political subdivisions	146,751	3,343	(941)	149,153
Other securities	5,840		(1,327)	4,513
Total	\$ 312,712	\$ 6,517	\$ (3,960)	\$ 315,269

	December 31, 2008			Estimated Fair Value
	Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	
(In thousands)				
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
Total	\$ 360,797	\$ 3,473	\$ (9,026)	\$ 355,244

Assets, principally investment securities, having a carrying value of approximately \$192.9 million and \$187.5 million at September 30, 2009 and December 31, 2008, 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 \$63.3 million and \$113.4 million at September 30, 2009 and December 31, 2008, respectively.

Table of Contents

During the three-month period ended September 30, 2009, no available for sale securities were sold. During the nine-month period ended September 30, 2009, \$23.0 million in available for sale securities were sold. The gross realized gains and losses on these sales totaled \$890,000 and \$893,000, respectively. The income tax expense/benefit related to net security gains and losses was 39.225% of the gross amounts.

During the three-month and nine-month period ended September 30, 2008 no available for sale securities were sold.

The amortized cost and estimated fair value of securities at September 30, 2009, 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.

	Available-for-Sale	
	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	\$ 128,931	\$ 129,050
Due after one year through five years	131,821	133,707
Due after five years through ten years	30,660	31,463
Due after ten years	21,300	21,049
Total	\$ 312,712	\$ 315,269

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.

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 FASB ASC 320, *Investments Debt and Equity Securities*. 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. The Company does not intend to sell or believe it will be required to sell these investments before recovery of their amortized cost bases, which may be 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.

No securities were deemed by management to have other-than-temporary impairment for the nine month periods ended September 30, 2009, besides securities for which impairment was taken in prior periods. During the second quarter of 2008, the Company became aware that one of its investment securities in the other securities category had become other than temporarily impaired. As a result of this impairment, the security was written-down by \$2.1 million or \$0.06 diluted earnings per share for the second quarter of 2008. In the last half of 2008, it became known that this security as well as another investment security in the other securities category had become worthless. The total charge-off on these securities totaled \$3.8 million or \$0.12 diluted earnings per share for the second half of 2008. These investment securities were a pool of other financial holding companies' subordinated debentures throughout the country. These investments were deemed worthless as a result of the current banking crisis. Several of the financial holding companies in these pools defaulted due to their closure by the federal government. Additionally, several other financial holding companies in these pools began deferring their quarterly payments as a result of stressed capital levels. These were the only two securities of this type owned by the Company.

Table of Contents

For the period ended September 30, 2009, the Company had \$3.8 million in unrealized losses, which have been in continuous loss positions for more than twelve months. Included in the \$3.8 million in unrealized losses are \$2.8 million in unrealized losses, which were associated with government-sponsored securities and government-sponsored mortgage-back securities. Excluding impairment write downs taken in prior periods, 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 83.3% 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.

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 the periods ended September 30, 2009 and December 31, 2008:

	Less Than 12 Months		September 30, 2009 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In thousands)			
U.S. Government-sponsored enterprises	\$ 5,011	\$ 9	\$	\$	\$ 5,011	\$ 9
Mortgage-backed securities	14,376	185	7,300	1,498	21,676	1,683
State and political subdivisions			19,514	941	19,514	941
Other securities			1,586	1,327	1,586	1,327
Total	\$ 19,387	\$ 194	\$ 28,400	\$ 3,766	\$ 47,787	\$ 3,960
			(In thousands)			
			December 31, 2008 12 Months or More		Total	
	Less Than 12 Months Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
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

Table of Contents**4: Loans Receivable and Allowance for Loan Losses**

The various categories of loans are summarized as follows:

	September 30, 2009	December 31, 2008
	(In thousands)	
Real estate:		
Commercial real estate loans		
Non-farm/non-residential	\$ 812,195	\$ 816,603
Construction/land development	353,645	320,398
Agricultural	36,675	23,603
Residential real estate loans		
Residential 1-4 family	394,626	391,255
Multifamily residential	63,025	56,440
Total real estate	1,660,166	1,608,299
Consumer	40,288	46,615
Commercial and industrial	220,511	255,153
Agricultural	21,126	23,625
Other	28,948	22,540
Total loans receivable before allowance for loan losses	1,971,039	1,956,232
Less: Allowance for loan losses	41,210	40,385
Total loans receivable, net	\$ 1,929,829	\$ 1,915,847

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

	2009	2008
	(In thousands)	
Balance, beginning of year	\$ 40,385	\$ 29,406
Additions		
Provision charged to expense	7,300	6,952
Allowance for loan loss of Centennial Bancshares, Inc.		3,382
Net loans charged off		
Losses charged to allowance, net of recoveries of \$1,355 and \$1,411 for the first nine months of 2009 and 2008, respectively	6,475	3,368
Balance, September 30	\$ 41,210	36,372
Additions		
Provision charged to expense		20,064
Net loans charged off		
Losses charged to allowance, net of recoveries of \$90 for the last three months of 2008		16,051

Balance, end of year \$ 40,385

At September 30, 2009 and December 31, 2008, accruing loans delinquent 90 days or more totaled \$2.1 million and \$1.4 million, respectively. Non-accruing loans at September 30, 2009 and December 31, 2008 were \$32.6 million and \$28.5 million, respectively.

Table of Contents

The Company did not sell any of the guaranteed portions of SBA loans during 2009. During the three-month and nine-month periods ended September 30, 2008, the Company sold \$821,000 and \$2.6 million of the guaranteed portion of certain SBA loans, which resulted in a gain of \$26,000 and 127,000, respectively.

Mortgage loans held for sale of approximately \$6.3 million and \$6.4 million at September 30, 2009 and December 31, 2008, 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.

At September 30, 2009 and December 31, 2008, impaired loans totaled \$45.6 million and \$31.5 million, respectively. As of September 30, 2009 and 2008, average impaired loans were \$40.1 million and \$28.8 million, respectively. All impaired loans had designated reserves for possible loan losses. Reserves relative to impaired loans were \$15.9 million and \$10.9 million at September 30, 2009 and December 31, 2008, respectively. Interest recognized on impaired loans during the nine months ended September 30, 2009 and 2008 was approximately \$2.0 million and \$1.7 million, respectively.

5: Goodwill and Core Deposits and Other Intangibles

Changes in the carrying amount and accumulated amortization of the Company's goodwill and core deposits and other intangibles for the nine-month period ended September 30, 2009 and for the year ended December 31, 2008, were as follows:

	September 30, 2009	December 31, 2008
	(In thousands)	
Goodwill		
Balance, beginning of period	\$ 50,038	\$ 37,527
Acquisition of Centennial Bancshares, Inc.	3,100	12,322
Prior Acquisition (deferred taxes)		189
Charter consolidation	(99)	
Balance, end of period	\$ 53,039	\$ 50,038
	2009	2008
	(In thousands)	
Core Deposit and Other Intangibles		
Balance, beginning of period	\$ 6,547	\$ 7,702
Acquisition of Centennial Bancshares, Inc.		694
Amortization expense	(1,387)	(1,387)
Balance, September 30	\$ 5,160	7,009
Amortization expense		(462)
Balance, end of year		\$ 6,547

The carrying basis and accumulated amortization of core deposits and other intangibles at September 30, 2009 and December 31, 2008 were:

	September 30, 2009	December 31, 2008
	(In thousands)	
Gross carrying amount	\$ 14,151	\$ 14,151

Accumulated amortization	8,991	7,604
Net carrying amount	\$ 5,160	\$ 6,547

Table of Contents

Core deposit and other intangible amortization was approximately \$462,000 for each of the three-months ended September 30, 2009 and 2008. Core deposit and other intangible amortization was approximately \$1.4 million for each of the nine-months ended September 30, 2009 and 2008. 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.

Goodwill is tested annually for impairment during the fourth quarter. 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 \$470.9 million and \$500.7 million at September 30, 2009 and December 31, 2008, respectively. Interest expense applicable to certificates in excess of \$100,000 totaled \$3.2 million and \$4.4 million for the three months ended September 30, 2009 and 2008, respectively. Interest expense applicable to certificates in excess of \$100,000 totaled \$10.2 million and \$15.1 million for the nine months ended September 30, 2009 and 2008, respectively. As of September 30, 2009 and December 31, 2008, brokered deposits were \$76.2 million and \$111.0 million, respectively.

Deposits totaling approximately \$188.0 million and \$278.2 million at September 30, 2009 and December 31, 2008, respectively, were public funds obtained primarily from state and political subdivisions in the United States.

7: Securities Sold Under Agreements to Repurchase

From time to time, primarily as a short-term financing arrangement for investment or liquidity purposes, the Company has entered into repurchase agreements with certain business customers. This involves the selling of one or more of the securities in the Company's investment portfolio and by entering into an agreement to repurchase that same security at an agreed upon later date. A rate of interest is paid by the Company for the subject period of time. At September 30, 2009 and December 31, 2008, securities sold under agreements to repurchase totaled \$63.3 million and \$113.4 million, respectively.

8: FHLB Borrowed Funds

The Company's FHLB borrowed funds were \$282.6 million and \$283.0 million at September 30, 2009 and December 31, 2008, respectively. The outstanding balance for September 30, 2009 includes \$10.0 million of short-term advances and \$272.6 million of long-term advances. All of the outstanding balance for December 31, 2008 are long-term advances. The FHLB advances mature from the current year to 2025 with fixed interest rates ranging from 2.020% to 5.185% and are secured by loans and investments securities. As of September 30, 2009, the Company has one floating short-term rate advance with a rate of 0.200%. Expected maturities will differ from contractual maturities, because FHLB may have the right to call or prepay certain obligations.

Table of Contents**9: Subordinated Debentures**

Subordinated Debentures at September 30, 2009 and December 31, 2008 consisted of guaranteed payments on trust preferred securities with the following components:

	September 30, 2009	December 31, 2008
	(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 in 2010 with a penalty ranging from 5.30% to 0.53% depending on the year of prepayment, callable in 2020 without penalty	3,175	3,243
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	3,093
Total subordinated debt	\$ 47,507	\$ 47,575

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 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**10: Income Taxes**

The following is a summary of the components of the provision for income taxes for the three-month and nine-month periods ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Current:				
Federal	\$ 3,619	\$ 3,116	\$ 7,495	\$ 9,290
State	675	552	1,365	1,643
Total current	4,294	3,668	8,860	10,933
Deferred:				
Federal	(736)	(407)	(282)	(1,337)
State	(146)	(103)	(55)	(290)
Total deferred	(882)	(510)	(337)	(1,627)
Provision for income taxes	\$ 3,412	\$ 3,158	\$ 8,523	\$ 9,306

The reconciliation between the statutory federal income tax rate and effective income tax rate is as follows for the three-month and nine-month periods ended September 30:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Statutory federal income tax rate	35.00%	35.00%	35.00%	35.00%
Effect of nontaxable interest income	(5.20)	(5.26)	(5.55)	(4.54)
Cash value of life insurance	(1.63)	(1.95)	(1.97)	(2.00)
State income taxes, net of federal benefit	3.23	3.00	3.10	3.06
Other	0.63	1.69	0.47	0.79
Effective income tax rate	32.03%	32.48%	31.05%	32.31%

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:

	September 30, 2009	December 31, 2008
	(In thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 16,070	\$ 15,772
Deferred compensation	860	640
Stock options	429	514
Non-accrual interest income	989	358
Impairment of investment securities	39	2,364
Real estate owned	945	
Unrealized loss on securities		2,178
Net operating loss carryforward		119
Other	614	514
Gross deferred tax assets	19,946	22,459
Deferred tax liabilities:		
Accelerated depreciation on premises and equipment	2,331	2,519
Unrealized gain on securities	1,003	
Core deposit intangibles	1,993	2,486
FHLB dividends	848	843
Other	348	344
Gross deferred tax liabilities	6,523	6,192
Net deferred tax assets	\$ 13,423	\$ 16,267

11: Common Stock and Stock Compensation Plans

In September 2009, the Company raised common equity through an underwritten public offering by issuing 4,950,000 shares of common stock at \$19.85. The net proceeds of the offering after deducting underwriting discounts and commissions and offering expenses were \$93.3 million. In October 2009, the underwriter's of our stock offering exercised and completed their option to purchase an additional 742,500 shares of common stock at \$19.85 to cover over-allotments. The net proceeds of the exercise of the over-allotment option after deducting underwriting discounts and commissions were \$14.0 million. The total net proceeds of the offering after deducting underwriting discounts and commissions and offering expenses were \$107.3 million.

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. As a result of the recent public stock offering, the number of shares of common stock underlying the ten-year warrant held by the Treasury, will be reduced by half to 144,064 shares of our common stock at an exercise price of \$26.03 per share.

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.

Table of Contents

On July 16, 2008, our Board of Directors declared an 8% stock dividend which was paid August 27, 2008 to stockholders 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 stockholders 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 share and per share amounts occurring before August 27, 2008 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.

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 of common stock in the Company.

Total unrecognized compensation cost, net of income tax benefit, related to non-vested awards, which are expected to be recognized over the vesting periods, is approximately \$126,000 as of September 30, 2009. The intrinsic value of the stock options outstanding and stock options vested at September 30, 2009 was \$9.2 million and \$6.2 million, respectively. The intrinsic value of the stock options exercised during the three-month and nine-month periods ended September 30, 2009 was approximately \$1.1 million and \$531,000, respectively.

The table below summarized the transactions under the Company's stock option plans at September 30, 2009 and December 31, 2008 and changes during the nine-month period and year then ended, respectively:

	For the Nine Months Ended September 30, 2009		For the Year Ended December 31, 2008	
	Shares	Weighted Average Exercisable Price	Shares	Weighted Average Exercisable Price
	(000)	Price	(000)	Price
Outstanding, beginning of year	1,069	\$11.72	1,096	\$11.12
Granted			51	19.47
Forfeited/Expired	(74)	14.64	(18)	11.18
Exercised	(115)	11.24	(60)	7.49
Outstanding, end of period	880	11.54	1,069	11.72
Exercisable, end of period	538	\$10.36	592	\$ 9.88

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. There were no options granted during the nine-months ended September 30, 2009. The weighted-average fair value of options granted during the year-ended December 31, 2008, was \$2.62. 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:

	For the Nine Months Ended September 30, 2009	For the Year Ended December 31, 2008
Expected dividend yield	Not applicable	0.98%
Expected stock price volatility	Not applicable	3.13%
Risk-free interest rate	Not applicable	3.35%
Expected life of options	Not applicable	6.4 years

The following is a summary of currently outstanding and exercisable options at September 30, 2009:

	Options Outstanding			Options Exercisable		
	Options Outstanding Shares (000)	Weighted- Average Remaining Contractual Life (in years)	Weighted- Average Exercise Price	Options Exercisable Shares (000)	Weighted- Average Exercise Price	
Exercise Prices						
\$ 5.69 to \$6.19	9	1.69	\$ 5.81	9	\$ 5.81	
\$ 6.79 to \$7.71	174	2.98	6.85	174	6.85	
\$ 8.64 to \$9.55	89	3.93	9.41	88	9.41	
\$10.50 to \$10.81	47	5.81	10.59	47	10.59	
\$11.73 to \$11.73	173	7.30	11.73	170	11.73	
\$12.20 to \$12.20	288	6.46	12.20	3	12.20	
\$18.32 to \$19.60	56	7.95	19.03	18	19.18	
\$20.35 to \$20.48	17	7.60	20.43	7	20.43	
\$22.36 to \$25.01	27	7.63	22.86	22	22.36	
	880			538		

During the third quarter of 2009, the Company granted 6,400 shares of restricted common stock to its President and Chief Operating Officer. The restricted shares will vest 25% annually over four years beginning on the first anniversary of the grant. These restricted shares are also limited by the 2009 agreement between the Company and the Treasury. This agreement has additional provisions concerning the transferability of the shares and the continuation of performing substantial services for the Company.

Table of Contents**12. Non-Interest Expense**

The table below shows the components of non-interest expense for three and nine months ended September 30, 2009 and 2008:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Salaries and employee benefits	\$ 7,987	\$ 8,739	\$ 25,363	\$ 26,948
Occupancy and equipment	2,706	2,825	8,050	8,253
Data processing expense	827	815	2,478	2,434
Other operating expenses:				
Advertising	567	670	2,023	1,975
Merger expenses	2		1,640	
Amortization of intangibles	462	462	1,387	1,387
Amortization of mortgage servicing rights	218	148	583	442
Electronic banking expense	686	740	2,438	2,315
Directors' fees	239	254	760	716
Due from bank service charges	104	73	311	217
FDIC and state assessment	913	524	3,827	1,325
Insurance	278	244	846	707
Legal and accounting	74	382	877	978
Mortgage servicing expense	75	59	225	220
Other professional fees	278	184	787	1,461
Operating supplies	217	234	622	723
Postage	163	189	512	557
Telephone	164	238	523	702
Other expense	1,116	1,698	3,414	4,298
Total other operating expenses	5,556	6,099	20,775	18,023
Total non-interest expense	\$ 17,076	\$ 18,478	\$ 56,666	\$ 55,658

13: 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.

Table of Contents

14: 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.

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 and capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity.

15: 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 September 30, 2009 and December 31, 2008, commitments to extend credit of \$336.4 million and \$351.2 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 September 30, 2009 and December 31, 2008, is \$17.4 million and \$18.0 million, respectively.

The Company and/or its subsidiary bank 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.

Table of Contents**16: Regulatory Matters**

The Bank is 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 Bank is 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. During the first six months of 2009, the Company did not request any dividends from its banking subsidiary. In the third quarter of 2009, the Company received a dividend of \$2.1 million from its banking subsidiary. As a result of the additional common equity raised through an underwritten public offering during September 2009, the Company does not anticipate requesting dividends from its banking subsidiary during the fourth quarter of 2009.

The Federal Reserve Board's risk-based capital guidelines include the definitions for (1) a well-capitalized institution, (2) an adequately-capitalized institution, and (3) and undercapitalized institution. The criteria for a well-capitalized institution are: a 5% Tier 1 leverage capital ratio, a 6% Tier 1 risk-based capital ratio, and a 10% total risk-based capital ratio. As of September 30, 2009, the Bank met the capital standards for a well-capitalized institution. The Company's Tier 1 leverage capital ratio, Tier 1 risk-based capital ratio, and total risk-based capital ratio were 17.29%, 19.58%, and 20.84%, respectively, as of September 30, 2009.

17: 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. On March 11, 2009, the Company settled the contingent consideration for \$3.1 million which was paid to the Centennial stockholders in cash. The following is summary of the Company's additional cash flow information during the three and nine months ended:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
	(In thousands)			
Interest paid	\$10,804	\$14,977	\$32,614	\$48,351
Income taxes paid	4,600	2,127	10,000	12,877
Assets acquired by foreclosure	4,784	4,265	17,178	5,429

Table of Contents**18: Financial Instruments**

Effective January 1, 2008, the Company adopted FASB ASC 820, *Fair Value Measurements and Disclosures*. FASB ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FASB ASC 820 has been applied prospectively as of the beginning of the period.

FASB ASC 820 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. FASB ASC 820 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 2008, our Level 3 securities included 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 and September 30, 2009, Level 3 securities were immaterial.

Impaired loans that are collateral dependent are the only material financial assets 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 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 \$29.6 million and \$20.6 million as of September 30, 2009 and December 31, 2008, respectively. This valuation would be considered Level 3, consisting of appraisals of underlying collateral.

Foreclosed assets held for sale are the only material non-financial assets valued on a non-recurring basis which are held by the Company at fair value, less estimated costs to sell. At foreclosure, if the fair value, less estimated costs to sell, of the real estate acquired is less than the Company's recorded investment in the related loan, a write-down is recognized through a charge to the allowance for loan losses. Additionally, valuations are periodically performed by management and any subsequent reduction in value is recognized by a charge to income. The fair value of foreclosed assets held for sale is estimated using Level 2 inputs based on observable market data. As of September 30, 2009 and December 31, 2008, the fair value of foreclosed assets held for sale, less estimated costs to sell was \$19.1 million and \$6.8 million, respectively.

Table of Contents**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.

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

	September 30, 2009	
	Carrying	Fair Value
	Amount	(In thousands)
Financial assets:		
Cash and cash equivalents	\$ 123,957	\$ 123,957
Federal funds sold	660	660
Net loans receivable, net of impaired loans	1,900,183	1,898,296
Accrued interest receivable	12,815	12,815
Financial liabilities:		
Deposits:		
Demand and non-interest bearing	\$ 295,755	\$ 295,755
Savings and interest-bearing transaction accounts	660,533	660,533
Time deposits	823,997	829,954
Federal funds purchased		
Securities sold under agreements to repurchase	63,264	63,264
FHLB and other borrowed funds	282,550	287,618
Accrued interest payable	3,298	3,298
Subordinated debentures	47,507	62,629
	December 31, 2008	
	Carrying	Fair Value
	Amount	(In thousands)
Financial assets:		
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
Financial liabilities:		
Deposits:		
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

Table of Contents**19: Recently Issued Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board (FASB) issued FASB ASC 805, *Business Combinations*, which established principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The adoption of this standard did not have a material effect on the Company's results of operations or financial position.

In March 2008, the FASB issued FASB ASC 815, *Derivatives and Hedging*. FASB ASC 815 requires qualitative disclosure about objectives and strategies for using derivative and hedging instruments, quantitative disclosures about fair value amounts of the instruments and gains and losses on such instruments, as well as disclosures about credit-risk features in derivative agreements. The adoption of this standard did not have a material effect on the Company's results of operations or financial position.

On April 9, 2009, the FASB finalized three FASB Staff Positions (FSPs) regarding the accounting treatment for investments including mortgage-backed securities. These FSPs changed the method for determining if an other-than-temporary impairment (OTTI) exists and the amount of OTTI to be recorded through an entity's income statement. The changes brought about by the FSPs provide greater clarity and reflect a more accurate representation of the credit and noncredit components of an OTTI event. The three FSPs are as follows:

FASB ASC 820-10-65-4, *Fair Value Measurements and Disclosures* provides guidelines for making fair value measurements that determine fair value when the volume and level of activity for assets or liabilities have significantly decreased and identify transactions that are not orderly.

FASB ASC 320-10-65, *Investments – Debt and Equity Securities* provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities.

FASB ASC 825-10-65, *Financial Instruments* enhances consistency in financial reporting by increasing the frequency of fair value disclosures.

The adoption of these did not have a material effect on the Company's results of operations or financial position.

In May 2009, FASB issued FASB ASC 855, *Subsequent Events* with the objective to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. FASB ASC 855 sets forth: (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. FASB ASC 855 is effective for interim and annual financial periods ending after June 15, 2009. The adoption of FASB ASC 855 on June 30, 2009, did not have an impact on the Company's consolidated financial statements.

Table of Contents

In June 2009, FASB issued FASB ASC 860, *Transfers and Servicing*. The objective of FASB ASC 860 is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. FASB ASC 860 shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it have a material effect on the Company's financial position or results of operation.

In June 2009, FASB issued FASB ASC 810, *Consolidation*. The objective of FASB ASC 810 is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. FASB ASC 810 shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it have a material effect on the Company's financial position or results of operation.

20. Subsequent Events

Subsequent events have been evaluated through November 3, 2009, which is the date the financial statements were issued.

Table of Contents

Report of Independent Registered Public Accounting Firm

Audit Committee, Board of Directors and Stockholders

Home BancShares, Inc.

Conway, Arkansas

We have reviewed the accompanying condensed consolidated balance sheet of Home BancShares, Inc. as of September 30, 2009 and the related condensed consolidated statements of income for the three-month and nine-month periods ended September 30, 2009 and 2008 and statements of stockholders' equity and cash flows for the nine-month periods ended September 30, 2009 and 2008. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2008 and the related consolidated statements of income, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 2, 2009, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2008 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ BKD, LLP

Little Rock, Arkansas

November 3, 2009

Table of Contents**Item 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with our Form 10-K, filed with the Securities and Exchange Commission on March 6, 2009, which includes the audited financial statements for the year ended December 31, 2008. *Unless the context requires otherwise, the terms "Company", "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 wholly owned bank subsidiary. As of September 30, 2009, we had, on a consolidated basis, total assets of \$2.63 billion, loans receivable of \$1.97 billion, total deposits of \$1.78 billion, and stockholders' equity of \$446.5 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 common 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

	As of or for the Three Months Ended September 30,		As of or for the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in thousands, except per share data)			
Total assets	\$2,631,736	\$2,650,590	\$2,631,736	\$2,650,590
Loans receivable	1,971,039	1,967,923	1,971,039	1,967,923
Total deposits	1,780,285	1,913,071	1,780,285	1,913,071
Net income	7,239	6,564	18,925	19,496
Net income available to common stockholders	6,569	6,564	17,019	19,496
Basic earnings per common share	0.32	0.32	0.85	0.98
Diluted earnings per common share	0.32	0.32	0.84	0.96
Diluted cash earnings per common share (1)	0.33	0.34	0.88	1.00
Annualized net interest margin FTE	4.26%	3.82%	4.09%	3.83%
Efficiency ratio	51.44	59.25	58.67	57.95
Annualized return on average assets	1.12	1.00	0.98	1.01
Annualized return on average common equity	8.46	9.02	7.69	9.09

(1) See Table 16
Diluted Cash
Earnings Per
Common Share
for a
reconciliation to
GAAP for
diluted cash
earnings per
common share.

Table of Contents**Overview*****Results of Operations for Three Months Ended September 30, 2009 and 2008***

Our net income increased 10.3% to \$7.2 million for the three-month period ended September 30, 2009, from \$6.6 million for the same period in 2008. On a diluted earnings per share basis, our earnings were \$0.32 for the three-month periods ended September 30, 2009 and 2008. The \$675,000 increase in net income is primarily associated with a 44 basis point increase in net interest margin, reduced salaries and employee benefits, an improvement in service charges on deposits and reduced accounting fees offset by the higher provision for loan losses, recurring FDIC and state assessment fees and lower mortgage lending income.

Our annualized return on average assets was 1.12% for the three months ended September 30, 2009, compared to 1.00% for the same period in 2008. Our annualized return on average common equity was 8.46% for the three months ended September 30, 2009, compared to 9.02% for the same period in 2008, respectively. The improvements in annualized return on average assets were primarily due to the previously discussed changes in earnings for the three months ended September 30, 2009, compared to the same period in 2008. The decline in the annualized return on average common equity was a result of the additional common equity offset by the improvements in net income.

Our annualized net interest margin, on a fully taxable equivalent basis, was 4.26% for the three months ended September 30, 2009, compared to 3.82% for the same period in 2008. Our ability to improve pricing on our deposits and hold down the decline of interest rates on loans allowed the Company to expand net interest margin by 44 basis points.

Our efficiency ratio was 51.44% for the three months ended September 30, 2009, compared to 59.25% for the same period in 2008. This positive progress was primarily due to our ability to raise net interest margin and the continued improvement of our overall operations.

Results of Operations for Nine Months Ended September 30, 2009 and 2008

Our net income decreased 2.9% to \$18.9 million for the nine-month period ended September 30, 2009, from \$19.5 million for the same period in 2008. On a diluted earnings per share basis, our net earnings decreased 12.5% to \$0.84 for the nine-month period ended September 30, 2009, as compared to \$0.96 for the same period in 2008.

During the first nine months of 2009, we incurred merger expenses related to the consolidation of our charters and a special assessment from the FDIC. Excluding the \$1.7 million after tax or \$0.08 diluted earnings per share negative impact of these two non-core items, core net income and core diluted earnings per common share for the nine-month period ended September 30, 2009 were \$20.6 million and \$0.92, respectively.

During the first nine months of 2008, we sold our investment in White River Bancshares, conducted an efficiency study and incurred an investment security impairment. Excluding the \$2.0 million after tax or \$0.10 diluted earnings per share positive combined impact of these three non-core items, core net income and core diluted earnings per common share for the nine-month period ended September 30, 2008 were \$17.5 million and \$0.86, respectively.

The \$3.1 increase in core earnings is primarily associated with a 26 basis point increase in net interest margin, reduced salaries and employee benefits and improving fees in non-interest income offset by the higher provision for loan losses and the recurring increase in FDIC and state assessment fees.

Our annualized return on average assets was 0.98% for the nine months ended September 30, 2009, compared to 1.01% for the same period in 2008. Our annualized return on average common equity was 7.69% for the nine months ended September 30, 2009, compared to 9.09% for the same period in 2008.

Table of Contents

Excluding the after tax \$1.7 million of non-core expenses in 2009 and the after tax \$2.0 million of combined net non-core earnings in 2008, our core return on average assets would have been 1.03% and 0.91% for the nine months ended September 30, 2009 and 2008, respectively. While our core return on average common equity would have been 8.15% and 8.16% for the nine months ended September 30, 2009 and 2008, respectively. The improvements in annualized return on average assets were primarily due to the previously discussed changes in earnings for the three months ended September 30, 2009, compared to the same period in 2008. The decline in the annualized return on average common equity was a result of the additional common equity offset by the improvements in net income.

Our annualized net interest margin, on a fully taxable equivalent basis, was 4.09% for the nine months ended September 30, 2009, compared to 3.83% for the same period in 2008, respectively. Our ability to improve pricing on our deposits and hold down the decline of interest rates on loans allowed the Company to expand net interest margin.

Our efficiency ratio was 58.67% for the nine months ended September 30, 2009, compared to 57.95% for the same period in 2008. Excluding the after tax \$1.7 million of non-core expenses in 2009 and the after tax \$2.0 million of combined net non-core earnings in 2008, our core efficiency ratio would have been 55.61% and 59.30% for the nine months ended September 30, 2009 and 2008, respectively. This positive progress was primarily due to our ability to raise net interest margin and the continued improvement of our overall operations.

Financial Condition as of and for the Period Ended September 30, 2009 and December 31, 2008

Our total assets as of September 30, 2009 increased \$51.6 million, an annualized growth of 2.7%, to \$2.63 billion from the \$2.58 billion reported as of December 31, 2008. Our loan portfolio increased slightly by \$14.8 million, an annualized growth of 1.0%, to \$1.97 billion as of September 30, 2009, from \$1.96 billion as of December 31, 2008. Stockholders' equity increased \$163.5 million to \$446.5 million as of September 30, 2009, compared to \$283.0 million as of December 31, 2008. The increase in stockholders' equity is primarily associated with the issuance of \$50.0 million of preferred stock to the United States Department of Treasury and the net issuance of \$93.3 million or 4,950,000 shares of common stock resulting from our recent common stock offering combined with retained earnings for the first nine months of 2009. Excluding the issuance of the \$50.0 million of preferred stock and the net issuance of the \$93.3 million of common stock, the annualized growth in stockholders' equity for the first nine months of 2009 was 9.5%.

As of September 30, 2009, our non-performing loans increased to \$34.7 million, or 1.76%, of total loans from \$29.9 million, or 1.53%, of total loans as of December 31, 2008. The allowance for loan losses as a percent of non-performing loans decreased to 119% as of September 30, 2009, compared to 135% as of December 31, 2008. The increase in non-performing loans is primarily the result of the continued unfavorable economic conditions, particularly in Florida the market. Non-performing loans in Florida were \$24.2 million at September 30, 2009 compared to \$17.3 million as of December 31, 2008.

As of September 30, 2009, our non-performing assets increased to \$53.9 million, or 2.05%, of total assets from \$36.7 million, or 1.42%, of total assets as of December 31, 2008. The increase in non-performing assets is primarily the result of the continued unfavorable economic conditions, particularly in the Florida market. Non-performing assets in Florida were \$36.7 million at September 30, 2009 compared to \$22.0 million as of December 31, 2008.

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 in Note 1 of the audited consolidated financial statements included in our Form 10-K, filed with the Securities and Exchange Commission.

Table of Contents

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 stockholders' equity and other comprehensive income (loss). 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, except for mortgage loans held for sale. Interest income on loans is accrued over the term of the loans based on the principal balance outstanding.

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. 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 FASB ASC 350, *Intangibles - Goodwill and Other* in the fourth quarter.

Table of Contents

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.

Stock Options. In accordance with FASB ASC 718, *Compensation - Stock Compensation* and FASB ASC 505-50, *Equity-Based Payments to Non-Employees*, the fair value of each option award is estimated on the date of grant. The Company recognizes compensation expense for the grant-date fair value of the option award over the vesting period of the award.

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 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. In addition to the consideration given at the time of the merger, the merger agreement provided for additional contingent consideration to Centennial's stockholders of up to a maximum of \$4 million, which could be paid in cash or our common stock at the election of the former Centennial accredited stockholders, based upon the 2008 earnings performance. The final contingent consideration was computed and agreed upon in the amount of \$3.1 million on March 11, 2009. We paid this amount to the former Centennial stockholders on a pro rata basis on March 12, 2009. All of the former Centennial stockholders elected to receive the contingent consideration in cash. As a result of this transaction, we recorded total goodwill of \$15.4 million and a core deposit intangible of \$694,000.

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. In the near term, our principal acquisition focus will be to expand our presence in Arkansas and other nearby markets, and in Florida, through pursuing FDIC-assisted acquisition opportunities. 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.

Branches

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 2009, we opened a branch location in the Arkansas community of Heber Springs. Presently, we are evaluating additional opportunities but have no firm commitments for any additional de novo branch locations.

As a result of the evaluation process for cost saving opportunities under the efficiency study, three existing Arkansas branches were closed during the second quarter of 2009. The locations closed were located in New Edinburg, Kingsland and one of our two Heights neighborhood locations in Little Rock.

Table of Contents

Charter Consolidation

We have recently combined the charters of our subsidiary banks into a single charter and adopted Centennial Bank as the common name. In the fourth quarter of 2008, First State Bank and Marine Bank consolidated and adopted Centennial Bank as its new name. Community Bank and Bank of Mountain View were completed in the first quarter of 2009, and Twin City Bank and the original Centennial Bank finished the process in June of 2009.

All of our banks now have the same name, logo and charter, allowing for a more customer-friendly banking experience and seamless transactions across our entire banking network. We remain committed, however, to our community banking philosophy and will continue to rely on local community bank boards and management built around experienced bankers with strong local relationships.

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 Three Months Ended September 30, 2009 and 2008

Our net income increased 10.3% to \$7.2 million for the three-month period ended September 30, 2009, from \$6.6 million for the same period in 2008. On a diluted earnings per share basis, our earnings were \$0.32 for the three-month periods ended September 30, 2009 and 2008. The \$675,000 increase in net income is primarily associated with a 44 basis point increase in net interest margin, reduced salaries and employee benefits, an improvement in service charges on deposits and reduced accounting fees offset by the higher provision for loan losses, recurring FDIC and state assessment fees and lower mortgage lending income.

For Nine Months Ended September 30, 2009 and 2008

Our net income decreased 2.9% to \$18.9 million for the nine-month period ended September 30, 2009, from \$19.5 million for the same period in 2008. On a diluted earnings per share basis, our net earnings decreased 12.5% to \$0.84 for the nine-month period ended September 30, 2009, as compared to \$0.96 for the same period in 2008.

During the first nine months of 2009, we incurred merger expenses related to the consolidation of our charters and a special assessment from the FDIC. Excluding the \$1.7 million after tax or \$0.08 diluted earnings per share negative impact of these two non-core items, core net income and core diluted earnings per common share for the nine-month period ended September 30, 2009 were \$20.6 million and \$0.92, respectively.

During the first nine months of 2008, we sold our investment in White River Bancshares, conducted an efficiency study and incurred an investment security impairment. Excluding the \$2.0 million after tax or \$0.10 diluted earnings per share positive combined impact of these three non-core items, core net income and core diluted earnings per common share for the nine-month period ended September 30, 2008 were \$17.5 million and \$0.86, respectively.

The \$3.1 increase in core earnings is primarily associated with, a 26 basis point increase in net interest margin, reduced salaries and employee benefits and improving fees in non-interest income offset by the higher provision for loan losses and the recurring increase in FDIC and state assessment fees.

Table of Contents***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.

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 2008 at 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 \$2.1 million, or 9.2%, to \$24.7 million for the three-month period ended September 30, 2009, from \$22.6 million for the same period in 2008. This increase in net interest income was the result of a \$2.5 million decrease in interest income combined with a \$4.6 million decrease in interest expense. The \$2.5 million decrease in interest income was primarily the result of the repricing of our earning assets in the declining interest rate environment combined with the lower level of earning assets. The repricing of our earning assets in the declining interest rate environment resulted in a \$2.2 million decrease in interest income while the lower level of earning assets resulted in a decrease in interest income of \$306,000, for the three-month period ended September 30, 2009. The \$4.6 million decrease in interest expense for the three-month period ended September 30, 2009, is primarily the result of our interest bearing liabilities repricing in the declining interest rate environment combined with a reduction in our interest bearing liabilities. The repricing of our interest bearing liabilities in the declining interest rate environment resulted in a \$3.9 million decrease in interest expense. The reduction of our interest bearing liabilities resulted in lower interest expense of \$760,000.

Net interest income on a fully taxable equivalent basis increased \$4.4 million, or 6.5%, to \$71.0 million for the nine-month period ended September 30, 2009, from \$66.7 million for the same period in 2008. This increase in net interest income was the result of an \$11.0 million decrease in interest income combined with a \$15.4 million decrease in interest expense. The \$11.0 million decrease in interest income was primarily the result of the repricing of our earning assets in the declining interest rate environment offset by a higher level of earning assets. The repricing of our earning assets in the declining interest rate environment resulted in a \$12.5 million decrease in interest income while the higher level of earning assets resulted in an increase in interest income of \$1.5 million, for the nine-month period ended September 30, 2009. The \$15.4 million decrease in interest expense for the nine-month period ended September 30, 2009, is primarily the result of our interest bearing liabilities repricing in the declining interest rate environment combined with a reduction in our interest bearing liabilities. The repricing of our interest bearing liabilities in the declining interest rate environment resulted in a \$14.0 million decrease in interest expense. The reduction of our interest bearing liabilities resulted in lower interest expense of \$1.3 million.

Net interest margin, on a fully taxable equivalent basis, was 4.26% and 4.09% for the three and nine months ended September 30, 2009 compared to 3.82% and 3.83% for the same periods in 2008, respectively. Our ability to improve pricing on our deposits and hold the decline of interest rates on loans to a minimum allowed the Company to expand 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 three-month and nine-month periods ended September 30, 2009 and 2008, as well as changes in fully taxable equivalent net interest margin for the three-month and nine-month periods ended September 30, 2009, compared to the same periods in 2008.

Table 1: Analysis of Net Interest Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in thousands)			
Interest income	\$ 33,295	\$ 36,088	\$ 99,399	\$ 111,024
Fully taxable equivalent adjustment	1,023	768	2,811	2,236
Interest income fully taxable equivalent	34,318	36,856	102,210	113,260
Interest expense	9,619	14,233	31,191	46,597
Net interest income fully taxable equivalent	\$ 24,699	\$ 22,623	\$ 71,019	\$ 66,663
Yield on earning assets fully taxable equivalent	5.92%	6.22%	5.89%	6.51%
Cost of interest-bearing liabilities	2.00	2.75	2.14	3.06
Net interest spread fully taxable equivalent	3.92	3.47	3.75	3.45
Net interest margin fully taxable equivalent	4.26	3.82	4.09	3.83

Table 2: Changes in Fully Taxable Equivalent Net Interest Margin

	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009 vs. 2008
	(In thousands)	
Increase (decrease) in interest income due to change in earning assets	\$ (306)	\$ 1,464
Increase (decrease) in interest income due to change in earning asset yields	(2,232)	(12,514)
(Increase) decrease in interest expense due to change in interest-bearing liabilities	760	1,371
(Increase) decrease in interest expense due to change in interest rates paid on interest-bearing liabilities	3,854	14,035
Increase (decrease) in net interest income	\$ 2,076	\$ 4,356

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 three-month and nine-month periods ended September 30, 2009 and 2008. 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

	Three Months Ended September 30,					
	2009			2008		
	Average	Income	Yield	Average	Income	Yield
	Balance	/	/	Balance	/	/
	(Dollars in thousands)					
ASSETS						
Earnings assets						
Interest-bearing balances due from banks	\$ 5,860	\$ 7	0.47%	\$ 6,882	\$ 35	2.02%
Federal funds sold	2,056	1	0.19	5,196	24	1.84
Investment securities taxable	173,940	1,768	4.03	266,400	2,982	4.45
Investment securities non-taxable	137,653	2,343	6.75	113,222	1,925	6.76
Loans receivable	1,979,967	30,199	6.05	1,964,267	31,890	6.46
Total interest-earning assets	2,299,476	34,318	5.92	2,355,967	36,856	6.22
Non-earning assets	271,871			247,510		
Total assets	\$ 2,571,347			\$ 2,603,477		
LIABILITIES AND STOCKHOLDERS EQUITY						
Liabilities						
Interest-bearing liabilities						
Savings and interest-bearing transaction accounts	\$ 663,387	\$ 1,138	0.68%	\$ 690,564	\$ 2,651	1.53%
Time deposits	843,286	5,351	2.52	940,558	8,101	3.43
Total interest-bearing deposits	1,506,673	6,489	1.71	1,631,122	10,752	2.62
Federal funds purchased	2,847	2	0.28	16,044	79	1.96
Securities sold under agreement to repurchase	63,989	126	0.78	111,829	394	1.40
FHLB borrowed funds	288,406	2,379	3.27	254,230	2,239	3.50
Subordinated debentures	47,520	623	5.20	47,611	769	6.43
Total interest-bearing liabilities	1,909,435	9,619	2.00	2,060,836	14,233	2.75
Non-interest bearing liabilities						
Non-interest bearing deposits	290,435			242,155		
Other liabilities	14,371			10,961		
Total liabilities	2,214,241			2,313,952		
Stockholders equity	357,106			289,525		

Edgar Filing: HOME BANCSHARES INC - Form 10-Q

Total liabilities and stockholders equity	\$ 2,571,347		\$ 2,603,477	
Net interest spread		3.92%		3.47%
Net interest income and margin	\$ 24,699	4.26%	\$ 22,623	3.82%

39

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

	Nine Months Ended September 30,					
	2009			2008		
	Average Balance	Income / Expense	Yield / Rate	Average Balance	Income / Expense	Yield / Rate
	(Dollars in thousands)					
ASSETS						
Earnings assets						
Interest-bearing balances due from banks	\$ 6,762	\$ 27	0.53%	\$ 5,795	\$ 127	2.93%
Federal funds sold	9,095	12	0.18	15,640	289	2.47
Investment securities taxable	202,333	6,673	4.41	289,059	9,740	4.50
Investment securities non-taxable	127,333	6,553	6.88	111,206	5,645	6.78
Loans receivable	1,975,626	88,945	6.02	1,903,891	97,459	6.84
Total interest-earning assets	2,321,149	102,210	5.89	2,325,591	113,260	6.51
Non-earning assets	265,375			248,976		
Total assets	\$ 2,586,524			\$ 2,574,567		
LIABILITIES AND STOCKHOLDERS EQUITY						
Liabilities						
Interest-bearing liabilities						
Savings and interest-bearing transaction accounts	\$ 668,227	\$ 3,599	0.72%	\$ 679,667	\$ 8,822	1.73%
Time deposits	876,304	18,139	2.77	927,573	27,071	3.90
Total interest-bearing deposits	1,544,531	21,738	1.88	1,607,240	35,893	2.98
Federal funds purchased	3,910	6	0.21	8,700	168	2.58
Securities sold under agreement to repurchase	73,509	361	0.66	112,612	1,349	1.60
FHLB borrowed funds	282,356	7,128	3.38	257,786	6,873	3.56
Subordinated debentures	47,543	1,958	5.51	47,634	2,314	6.49
Total interest-bearing liabilities	1,951,849	31,191	2.14	2,033,972	46,597	3.06
Non-interest bearing liabilities						
Non-interest bearing deposits	280,317			240,449		
Other liabilities	11,816			13,527		
Total liabilities	2,243,982			2,287,948		
Stockholders equity	342,542			286,619		
Total liabilities and stockholders equity	\$ 2,586,524			\$ 2,574,567		
Net interest spread			3.75%			3.45%
Net interest income and margin		\$ 71,019	4.09%		\$ 66,663	3.83%

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 three-month and nine-month periods ended September 30, 2009 compared to the same periods in 2008, 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

	Three Months Ended September 30, 2009 over 2008			Nine Months Ended September 30, 2009 over 2008		
	Volume	Yield/Rate	Total	Volume	Yield/Rate	Total
	(In thousands)					
Increase (decrease) in:						
Interest income:						
Interest-bearing balances due from banks	\$ (4)	\$ (24)	\$ (28)	\$ 18	\$ (118)	\$ (100)
Federal funds sold	(10)	(13)	(23)	(86)	(191)	(277)
Investment securities taxable	(960)	(254)	(1,214)	(2,864)	(203)	(3,067)
Investment securities non-taxable	415	3	418	829	79	908
Loans receivable	253	(1,944)	(1,691)	3,567	(12,081)	(8,514)
Total interest income	(306)	(2,232)	(2,538)	1,464	(12,514)	(11,050)
Interest expense:						
Interest-bearing transaction and savings deposits	(100)	(1,413)	(1,513)	(146)	(5,077)	(5,223)
Time deposits	(776)	(1,974)	(2,750)	(1,427)	(7,505)	(8,932)
Federal funds purchased	(38)	(39)	(77)	(60)	(102)	(162)
Securities sold under agreement to repurchase	(133)	(135)	(268)	(366)	(622)	(988)
FHLB borrowed funds	288	(148)	140	633	(378)	255
Subordinated debentures	(1)	(145)	(146)	(5)	(351)	(356)
Total interest expense	(760)	(3,854)	(4,614)	(1,371)	(14,035)	(15,406)
Increase (decrease) in net interest income	\$ 454	\$ 1,622	\$ 2,076	\$ 2,835	\$ 1,521	\$ 4,356

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.

During these tough economic times, the Company continues to follow our historical conservative procedures for lending and evaluating the provision and allowance for loan losses. We have not and do not participate in higher risk lending such as subprime. Our practice continues to be primarily traditional real estate lending with strong loan-to-value ratios. While there have been declines in our collateral value, particularly Florida, these declines have been addressed in our assessment of the adequacy of the allowance for loan losses.

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 borrowers' financial data, and key ratios such as cash flows, operating income, liquidity, and leverage. A material change in the borrower's credit analysis can result in an increase or decrease in the loan's assigned risk grade. Aggregate dollar volume by risk grade is monitored on an ongoing basis.

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

During the first quarter of 2008, we began to experience a decline in our asset quality, particularly in the Florida market. In 2008, non-performing loans started the year at \$3.3 million but ended the third quarter at \$16.1 million and ended the year with a balance of \$29.9 million. As of September 30, 2009, non-performing loans are \$34.7 million.

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. Our provision for loan losses increased \$2.1 million, or 146.7%, to \$3.5 million for the three-month period ended September 30, 2009, from \$1.4 million for the same period in 2008. Our provision for loan losses increased \$348,000, or 5.0%, to \$7.3 million for the nine-month period ended September 30, 2009, from \$7.0 million for the same period in 2008. The provision for loan losses in our Florida market was approximately \$2.7 million and \$5.6 million for the three and nine months ended September 30, 2009, respectively. The deterioration of the loan portfolio during this time required us to make these provisions to the allowance for loan loss to provide for charge-offs and problem credits.

Non-Interest Income

Total non-interest income was \$7.6 million for the three-month period ended September 30, 2009 compared to \$7.8 million for the same period in 2008. Total non-interest income was \$23.2 million for the nine-month period ended September 30, 2009 compared to \$27.0 million for the same period in 2008. Our recurring non-interest income includes service charges on deposit accounts, other service charges and fees, mortgage lending, mortgage servicing, insurance, title fees, increase in cash value of life insurance and dividends.

Table of Contents

Table 5 measures the various components of our non-interest income for the three-month and nine-month periods ended September 30, 2009 and 2008, respectively, as well as changes for the three-month and nine-month periods ended September 30, 2009 compared to the same periods in 2008.

Table 5: Non-Interest Income

	Three Months Ended September 30,		2009 Change		Nine Months Ended September 30,		2009 Change	
	2009	2008	from 2008		2009	2008	from 2008	
(Dollars in thousands)								
Service charges on deposit accounts	\$ 3,785	\$ 3,557	\$ 228	6.4%	\$ 10,792	\$ 10,006	\$ 786	7.9%
Other service charges and fees	1,705	1,698	7	0.4	5,330	5,051	279	5.5
Mortgage lending income	488	695	(207)	(29.8)	2,183	2,142	41	1.9
Mortgage servicing income	171	206	(35)	(17.0)	562	654	(92)	(14.1)
Insurance commissions	173	164	9	5.5	628	620	8	1.3
Income from title services	150	141	9	6.4	441	498	(57)	(11.4)
Increase in cash value of life insurance	495	544	(49)	(9.0)	1,546	1,642	(96)	(5.8)
Dividends from FHLB, FRB & bankers bank	114	194	(80)	(41.2)	320	702	(382)	(54.4)
Equity in income of unconsolidated affiliates				0.0		102	(102)	(100.0)
Gain on sale of equity investment				0.0		6,102	(6,102)	(100.0)
Gain on sale of SBA loans		26	(26)	(100.0)		127	(127)	(100.0)
Gain (loss) on sale of premises and equipment, net	(21)		(21)	100.0	(33)	(2)	(31)	1,550.0
Gain (loss) on OREO, net	4	(28)	32	(114.3)	(141)	(458)	317	(69.2)
Gain (loss) on securities, net				0.0	(3)	(2,067)	2,064	(99.9)
Other income	537	587	(50)	(8.5)	1,581	1,866	(285)	(15.3)
Total non-interest income	\$ 7,601	\$ 7,784	\$ (183)	(2.4)%	\$ 23,206	\$ 26,985	\$ (3,779)	(14.0)%

Non-interest income decreased \$183,000, or 2.4%, to \$7.6 million for the three-month period ended September 30, 2009 from \$7.8 million for the same period in 2008. The primary factors that resulted in this decrease are the declines

in mortgage lending income and lower dividend yields offset by an improved fee process for service charges on deposit accounts.

Non-interest income decreased \$3.8 million, or 14.0%, to \$23.2 million for the nine-month period ended September 30, 2009 from \$27.0 million for the same period in 2008. Excluding the \$2.1 million impairment loss on securities and the income from our investment in White River Bancshares during 2008, we experienced an increase in core non-interest income of \$358,000 or 1.6% for 2009. The primary factors that resulted in this increase are an improved fee process for our service charges and reduced losses on OREO offset by lower dividend yields.

We have a mortgage loan servicing portfolio of approximately \$218.4 million and purchased mortgage servicing rights of \$1.3 million. We are currently exploring opportunities to increase our mortgage servicing portfolio. If a properly priced mortgage servicing portfolio becomes available, we would be interested in investing an additional \$7.5 million in mortgage servicing rights.

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, amortization of mortgage servicing rights, electronic banking expense, FDIC and state assessment, mortgage servicing and legal and accounting fees.

Table of Contents

Table 6 below sets forth a summary of non-interest expense for the three-month and nine-month periods ended September 30, 2009 and 2008, as well as changes for the three-month and nine-month periods ended September 30, 2009 compared to the same periods in 2008.

Table 6: Non-Interest Expense

	Three Months Ended		2009 Change		Nine Months Ended		2009 Change	
	September 30, 2009	2008	from 2008		September 30, 2009	2008	from 2008	
	(Dollars in thousands)							
Salaries and employee benefits	\$ 7,987	\$ 8,739	\$ (752)	(8.6)%	\$ 25,363	\$ 26,948	\$ (1,585)	(5.9)%
Occupancy and equipment	2,706	2,825	(119)	(4.2)	8,050	8,253	(203)	(2.5)
Data processing expense	827	815	12	1.5	2,478	2,434	44	1.8
Other operating expenses:								
Advertising	567	670	(103)	(15.4)	2,023	1,975	48	2.4
Merger expenses	2		2	100.0	1,640		1,640	100.0
Amortization of intangibles	462	462		0.0	1,387	1,387		0.0
Amortization of mortgage servicing rights	218	148	70	47.3	583	442	141	31.9
Electronic banking expense	686	740	(54)	(7.3)	2,438	2,315	123	5.3
Directors fees	239	254	(15)	(5.9)	760	716	44	6.1
Due from bank service charges	104	73	31	42.5	311	217	94	43.3
FDIC and state assessment	913	524	389	74.2	3,827	1,325	2,502	188.8
Insurance	278	244	34	13.9	846	707	139	19.7
Legal and accounting	74	382	(308)	(80.6)	877	978	(101)	(10.3)
Mortgage servicing expense	75	59	16	27.1	225	220	5	2.3
Other professional fees	278	184	94	51.1	787	1,461	(674)	(46.1)
Operating supplies	217	234	(17)	(7.3)	622	723	(101)	(14.0)
Postage	163	189	(26)	(13.8)	512	557	(45)	(8.1)
Telephone	164	238	(74)	(31.1)	523	702	(179)	(25.5)
Other expense	1,116	1,698	(582)	(34.3)	3,414	4,298	(884)	(20.6)
Total non-interest expense	\$ 17,076	\$ 18,478	\$ (1,402)	(7.6)%	\$ 56,666	\$ 55,658	\$ 1,008	1.8%

Non-interest expense decreased \$1.4 million, or 7.6%, to \$17.1 million for the three-month period ended September 30, 2009, from \$18.5 million for the same period in 2008. This decrease is the result of our on-going

implementation of the efficiency study and recently completed charter consolidation, particularly in the reduced personnel costs offset by the recurring FDIC and state assessment fees and the normal increase in cost of doing business.

Non-interest expense increased \$1.0 million, or 1.8%, to \$56.7 million for the nine-month period ended September 30, 2009, from \$55.7 million for the same period in 2008. During the nine months ended September 30, 2009, we incurred \$1.6 million of merger expenses and a \$1.2 million for the special assessment from the FDIC. During the nine months ended September 30, 2008, we conducted an efficiency study for \$860,000. Excluding these non-core items, core non-interest expense was \$53.9 million for the nine months ended September 30, 2009 compared to \$54.8 million for the same period in 2008. This decrease is the result of our on-going implementation of the efficiency study and recently completed charter consolidation, particularly in the reduced personnel costs offset by the recurring FDIC and state assessment fees and the normal increase in cost of doing business.

The Board of Directors of the FDIC have increased insured institutions' normal recurring assessment and imposed a special assessment. These increased assessment fees are in response to the current banking crisis in the United States.

The efficiency study is expected to be fully implemented in the fourth quarter of 2009.

Table of Contents***Income Taxes***

The provision for income taxes increased \$254,000, or 8.0%, to \$3.4 million for the three-month period ended September 30, 2009, from \$3.2 million as of September 30, 2008. The provision for income taxes decreased \$783,000, or 8.4%, to \$8.5 million for the nine-month period ended September 30, 2009, from \$9.3 million as of September 30, 2008. The effective income tax rate was 32.0% and 31.1% for the three-month and nine-month periods ended September 30, 2009, compared to 32.5% and 32.3% for the same periods in 2008, respectively. The primary cause of this decrease is the result of our increase in non-taxable investments.

Financial Condition as of and for the Period Ended September 30, 2009 and December 31, 2008

Our total assets as of September 30, 2009 increased \$51.6 million, an annualized growth of 2.7%, to \$2.63 billion from the \$2.58 billion reported as of December 31, 2008. Our loan portfolio increased slightly by \$14.8 million, an annualized growth of 1.0%, to \$1.97 billion as of September 30, 2009, from \$1.96 billion as of December 31, 2008. Stockholders' equity increased \$163.5 million to \$446.5 million as of September 30, 2009, compared to \$283.0 million as of December 31, 2008. The increase in stockholders' equity is primarily associated with the issuance of \$50.0 million of preferred stock to the United States Department of Treasury and the net issuance of \$93.3 million or 4,950,000 shares of common stock resulting from our recent common stock offering combined with retained earnings for the first nine months of 2009. Excluding the issuance of the \$50.0 million of preferred stock and the net issuance of the \$93.3 million of common stock, the annualized growth in stockholders' equity for the first nine months of 2009 was 9.5%.

Loan Portfolio

Our loan portfolio averaged \$1.98 billion during both the three-month and nine-month periods ended September 30, 2009. Loans were \$1.97 billion as of September 30, 2009, compared to \$1.96 billion as of December 31, 2008, a modest annualized increase of 1.0%. The slow down in loan growth from our historical expansion rates was not unexpected. Our customers have grown more cautious in this weakening economy.

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, northwest 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 2008 and 2009, particularly Florida. The Florida market currently is approximately 92.2% secured by real estate and 16.1% of our loan portfolio.

Table of Contents

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

Table 7: Loan Portfolio

	As of September 30, 2009	As of December 31, 2008
	(In thousands)	
Real estate:		
Commercial real estate loans:		
Non-farm/non-residential	\$ 812,195	\$ 816,603
Construction/land development	353,645	320,398
Agricultural	36,675	23,603
Residential real estate loans:		
Residential 1-4 family	394,626	391,255
Multifamily residential	63,025	56,440
Total real estate	1,660,166	1,608,299
Consumer	40,288	46,615
Commercial and industrial	220,511	255,153
Agricultural	21,126	23,625
Other	28,948	22,540
Total loans receivable before allowance for loan losses	1,971,039	1,956,232
Less: Allowance for loan losses	41,210	40,385
Total loans receivable, net	\$ 1,929,829	\$ 1,915,847

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 September 30, 2009, commercial real estate loans totaled \$1.20 billion, or 61.0% of our loan portfolio, which is comparable to \$1.16 billion, or 59.3% of our loan portfolio, as of December 31, 2008. Florida commercial real estate loans are approximately 9.8% of our loan portfolio.

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 September 30, 2009, residential real estate loans totaled \$457.7 million, or 23.2% of our loan portfolio, which is comparable to \$447.7 million, or 22.9% of our loan portfolio, as of December 31, 2008. Florida residential real estate loans are approximately 5.0% of our loan portfolio.

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.

Table of Contents

As of September 30, 2009, our installment consumer loan portfolio totaled \$40.3 million, or 2.0% of our total loan portfolio, compared to the \$46.6 million, or 2.4% of our loan portfolio as of December 31, 2008. This decrease is associated with normal payoffs and pay downs combined with flat loan demand.

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 September 30, 2009, commercial and industrial loans outstanding totaled \$220.5 million, or 11.2% of our loan portfolio, compared to \$255.2 million, or 13.0% of our loan portfolio, as of December 31, 2008. This decrease is associated with normal payoffs and pay downs combined with flat loan demand.

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 8 sets forth information with respect to our non-performing assets as of September 30, 2009 and December 31, 2008. As of these dates, all non-performing restructured loans are included in non-accrual loans.

Table 8: Non-performing Assets

	As of September 30, 2009	As of December 31, 2008
	(Dollars in thousands)	
Non-accrual loans	\$ 32,585	\$ 28,524
Loans past due 90 days or more (principal or interest payments)	2,089	1,374
Total non-performing loans	34,674	29,898
Other non-performing assets		
Foreclosed assets held for sale	19,111	6,763
Other non-performing assets	128	16
Total other non-performing assets	19,239	6,779
Total non-performing assets	\$ 53,913	\$ 36,677
Allowance for loan losses to non-performing loans	118.85%	135.08%

Edgar Filing: HOME BANCSHARES INC - Form 10-Q

Non-performing loans to total loans		1.76	1.53
Non-performing assets to total assets		2.05	1.42
	47		

Table of Contents

Our non-performing loans are comprised of non-accrual loans and loans that are contractually past due 90 days. Our bank subsidiary recognizes 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.

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 September 30, 2009, 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.

As of September 30, 2009, we had \$36.4 million of restructured loans that are in compliance with the modified terms and are not reported as past due or non-accrual in Table 8. Of the \$36.4 million in restructured loans, \$2.6 million are also reported as impaired loans. Most of these credits are where borrowers have continued to pay as agreed but negotiated a lower interest rate due to general economic pressures rather than credit specific pressure. Our Florida market contains \$30.4 million of these restructured loans.

Total foreclosed assets held for sale were \$19.1 million as of September 30, 2009, compared to \$6.8 million as of December 31, 2008 for an increase of \$12.3 million. The increase is primarily the result of foreclosure on two Florida housing developments in the Keys. Each of the two housing developments has vacant lots and one completed model home. The foreclosed assets held for sale are comprised of \$12.5 million of assets located in Florida with the remaining \$6.6 million of assets located in Arkansas. The Florida foreclosed assets include a substantially vacant owner occupied commercial rental center in the Keys plus the two Florida housing developments. The properties are currently listed for sale with a broker.

Total non-performing loans were \$34.7 million as of September 30, 2009, compared to \$29.9 million as of December 31, 2008 for an increase of \$4.8 million. The increase in non-performing loans is primarily from our Florida market. Non-performing loans are \$24.2 million in the Florida market.

If the non-accrual loans had been accruing interest in accordance with the original terms of their respective agreements, interest income of approximately \$477,000 and \$222,000 for the three-month periods ended September 30, 2009 and 2008, respectively, and \$1.4 million and \$474,000 for the nine-month periods ended September 30, 2009 and 2008, respectively, would have been recorded. The interest income recognized on the non-accrual loans for the three-month period ended September 30, 2009 and 2008 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 September 30, 2009, average impaired loans were \$40.1 million compared to \$28.8 million as of September 30, 2008. As of September 30, 2009, impaired loans were \$45.6 million compared to \$31.5 million as of December 31, 2008 for an increase of \$14.1 million. The unfavorable economic conditions that are impacting our Florida market accounted for \$7.6 million of the increase. As of September 30, 2009, our Florida market accounted for \$16.8 million of the impaired loans.

Non-performing loans and impaired loans are defined differently. Some loans may be included in both categories.

Table of Contents***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 \$4.5 million for the three months ended September 30, 2009, compared to \$1.7 million for the same period in 2008. Total charge-offs increased to \$7.8 million for the nine months ended September 30, 2009, compared to \$4.8 million for the same period in 2008. Total recoveries increased to \$347,000 for the three months ended September 30, 2009, compared to \$43,000 for the same period in 2008. Total recoveries were approximately \$1.4 million for the nine-months ended September 30, 2009 and 2008. The changes in net charge-offs are due to the unfavorable economic conditions in Florida and our proactive stance on asset quality.

Table of Contents

Table 9 shows the allowance for loan losses, charge-offs and recoveries as of and for the three-month and nine-month periods ended September 30, 2009 and 2008.

Table 9: Analysis of Allowance for Loan Losses

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in thousands)			
Balance, beginning of period	\$ 41,804	\$ 36,563	\$40,385	\$29,406
Loans charged off				
Real estate:				
Commercial real estate loans:				
Non-farm/non-residential	1,773	33	2,759	49
Construction/land development	241	747	881	1,389
Agricultural		14		14
Residential real estate loans:				
Residential 1-4 family	1,632	635	2,307	2,166
Multifamily residential				
Total real estate	3,646	1,429	5,947	3,618
Consumer	396	105	1,136	271
Commercial and industrial	441	66	732	817
Agricultural				
Other	8	73	15	73
Total loans charged off	4,491	1,673	7,830	4,779
Recoveries of loans previously charged off				
Real estate:				

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 September 30, 2009 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, net charge-offs during 2009 and normal changes in the outstanding loan portfolio for those products from December 31, 2008.

Table 10 presents the allocation of allowance for loan losses as of September 30, 2009 and December 31, 2008.

Table 10: Allocation of Allowance for Loan Losses

	As of September 30, 2009		As of December 31, 2008	
	Allowance Amount	% of loans(1) (Dollars in thousands)	Allowance Amount	% of loans(1)
Real estate:				
Commercial real estate loans:				
Non-farm/non-residential	\$ 13,506	41.2%	\$ 16,010	41.7%
Construction/land development	9,152	17.9	9,369	16.4
Agricultural	292	1.9	255	1.2
Residential real estate loans:				
Residential 1-4 family	10,375	20.0	6,814	20.0
Multifamily residential	515	3.2	880	2.9
Total real estate	33,840	84.2		